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In House Counsel Ethics

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RULE 5.2: RESPONSIBILITIES OF A SUBORDINATE LAWYER

(a) A lawyer is bound by these Rules notwithstanding that the lawyer acted at the direction of another person.

(b) A subordinate lawyer does **not** violate these Rules if that lawyer acts in accordance with a supervisory lawyer's reasonable resolution of an arguable question of professional duty.

RULE 1.6: CONFIDENTIALITY OF INFORMATION

(a) A lawyer **shall not** knowingly reveal confidential information, as defined in this Rule, or use such information to the disadvantage of a client or for the advantage of the lawyer or a third person, unless:

(1) the client gives informed consent;

(2) the disclosure is impliedly authorized to advance the best interests of the client and is either reasonable under the circumstances or customary in the professional community.

"Confidential information" consists of information gained during or relating to the representation of a client, whatever its source, that is (a) protected by the attorney-client privilege, (b) likely to be embarrassing or detrimental to the client if disclosed, or (c) information that the client has requested be kept confidential. "Confidential information" does not ordinarily include (i) a lawyer's legal knowledge or legal research or (ii) information that is generally known in the local community or in the trade, field or profession to which the information relates.

RULE 1.13: ORGANIZATION AS CLIENT

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action or intends to act or **refuses to act in a matter related to the representation that (i) is a violation of a legal obligation to the organization or a violation of law that reasonably might be imputed to the organization, and (ii) is likely to result in substantial injury to the organization**, then the lawyer **shall proceed as is reasonably necessary** in the best interest of the organization. In determining how to proceed, the lawyer shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the lawyer's representation, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters and any other relevant considerations. Any measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization. **Such measures may include, among others:**

(3) referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law.

(c) **If, despite the lawyer's efforts** in accordance with paragraph (b), **the highest authority that can act on behalf of the organization** insists upon action, or a **refusal to act, that is clearly in violation of law and is likely to result in a substantial injury to the organization, the lawyer may reveal confidential information** only if permitted by Rule 1.6, **and may resign** in accordance with Rule 1.16.

RULE 1.2: SCOPE OF REPRESENTATION AND ALLOCATION OF AUTHORITY BETWEEN CLIENT AND LAWYER

(d) A lawyer **shall not** counsel a client to engage, or assist a client, in conduct that the lawyer knows is illegal or fraudulent, except that the lawyer may discuss the legal consequences of any proposed course of conduct with a client.

RULE 1.6: CONFIDENTIALITY OF INFORMATION

(b) A lawyer **may** reveal or use confidential information to the extent that the lawyer reasonably believes necessary:

(1) to prevent reasonably certain death or substantial bodily harm

RULE 1.16: DECLINING OR TERMINATING REPRESENTATION

(b) a lawyer **shall** withdraw from the representation of a client when:

(1) the lawyer knows or reasonably should know that the representation will result in a violation of these Rules or of law.

(c) a lawyer **may** withdraw from representing a client when:

(2) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;

(4) the client insists upon taking action with which the lawyer has a fundamental disagreement.

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Challenging Road Awaits GM's New Top Lawyer

Share us on: By **Melissa Maleske**

Law360, New York (February 20, 2015, 4:01 PM ET) -- When General Motors Co.'s newly named general counsel Craig Glidden takes the wheel March 1, his ultimate goal will be overhauling fundamental legal department policies and procedures that experts say were deeply flawed under outgoing GC Michael Millikin.

GM said Thursday that Glidden, most recently the GC at LyondellBasell Industries N.V., will replace the embattled Millikin, who is retiring in July from the company in the aftermath of the automaker's faulty ignition switch crisis, which allegedly brewed within the company for nearly a decade and led to multiple deaths.

"This is going to be taught as a case study in cultural failure of the first order, and tragically so," says Ben Heineman, the former longtime general counsel of General Electric Co. "At the center of this cultural failure was the legal department, and at the center of the legal department was the general counsel."

An internal investigation of GM's handling of the ignition switch crisis pointed to crucial deficiencies both **in the legal department** and throughout the company, highlighting the repeated failures by employees to elevate the ignition reports to the attention of upper management.

The investigation led GM to fire six in-house lawyers, including North American general counsel

Michael Robinson. Millikin, GM's general counsel since 2009, escaped the ax but has spent the last year under fire, pressed by recalls, U.S. Senate panels and **litigation**.

Millikin's exit was long overdue and his legal department's failures were emblematic of "a horrible bureaucratic culture" that saturated GM as a whole, says Heineman, who is now a senior fellow at Harvard Law School and Harvard's Kennedy School of Government. In his view, Millikin's **ignorance of the ignition issues** is no excuse; rather, it indicates significant and intrinsic failures as a general counsel.

"It's the kind of thing that gives general counsel and lawyers a bad name," Heineman says. "It was a complete failure to have systems and processes that would surface these issues in a much more timely way so they could be addressed."

In a May 2014 **report on the ignition switch investigation** prepared by Jenner & Block LLP Chairman Anton Valukas, he points to systemic failures inside GM to establish clear reporting processes and lines. It tells of an investigation into safety anomalies related to ignition malfunctions that GM lawyers opened and then left unresolved two-and-a-half years without elevating to upper management.

The report makes 10 recommendations aimed at the role of GM lawyers. The recommendations seem obvious, Heineman says, things that should have already been in place, particularly at a company that makes products that can lead to death.

The report advises, for example, putting in writing that in-house counsel should report observed violations of law or company policy and providing specific guidance on when issues should be elevated to the general counsel.

Glidden should seize the opportunity to help GM come out of the ignition scandal stronger and with best practices in place to address future problems, says Thomas Campbell, who leads the crisis management practice at Pillsbury Winthrop Shaw Pittman LLP, and his experience taking the legal helm at LyondellBasell during a bankruptcy should serve him well at GM.

"The very best time to overhaul a system that has historical problems is immediately in the aftermath of the crisis," Campbell says. "Bureaucracies like GM become very rigid, and during a crisis the basic structures of the company are shaken. People are willing to change in a way they never would have been able to."

Campbell says a good 20 percent of a general counsel's success or failure is tied to his or her ability to manage a crisis. And Glidden is likely to face another crisis at GM, he says, because we live in a media-driven world of extreme volatility in which the "predictable cycle of crisis" has been condensed to a crisis occurring every five years or so, whereas in the past a company might expect one to arise every 20 or 30 years.

So now's the time for Glidden to learn from GM's past mistakes and put bedrock and emergency systems in place.

In addition, Glidden will have a small window after arriving at GM to do some significant due diligence and uncover any ticking time bombs, Campbell says, which could be a flaw in an investigation, a set of bad facts that hasn't yet come to light or latent defects in GM's crisis management or litigation defense strategy. Glidden would have to take any serious issues to the management team and plan for a solution, he says.

“You have a limited time to bring problems to the fore or you take ownership of those problems,” Campbell says. “Either you have to identify them as being your predecessor’s issues or, if you’re silent, those issues become your issues and you’re associated with them.”

Glidden should also take a look at his employees, Campbell says, to ensure his best and brightest don’t depart for smoother waters. Companies dealing with major crises tend to go through a reaction process almost parallel to human grieving, he says, starting with anger, denial and bargaining.

“I think GM is still in the malaise stage,” he says. “I have watched other companies in that stage. A company has to help its own people see their future with the company.”

Glidden will have the benefit of a clean slate as he comes into GM. Crisis management guru Eric Dezenhall, who runs crisis communications firm Dezenhall Resources Ltd., says it’s better to be the second crisis management team than the first, which will usually be deemed a failure.

New leaders walking into a crisis should define success, set expectations and then knuckle down, because crisis management is a long game, he says.

“Most companies under fire do survive crises, but not to the degree that they want and not with the speed that they want,” Dezenhall says. “Your goal should not be to win awards for good crisis management because it's the job of analysts to declare crises to have been botched. If you've been able to get back to business over time with your enterprise intact, you've won.”

--Editing by Jeremy Barker and Kelly Duncan.

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ORGANIZATIONAL CULTURE

Ethical Breakdowns

by Max H. Bazerman and Ann E. Tenbrunsel

FROM THE APRIL 2011 ISSUE

The vast majority of managers mean to run ethical organizations, yet corporate corruption is widespread. Part of the problem, of course, is that some leaders are out-and-out crooks, and they direct the malfeasance from the top. But that is rare. Much more often, we believe, employees bend or break ethics rules because those in charge are blind to unethical behavior and may even unknowingly encourage it.

Consider an infamous case that, when it broke, had all the earmarks of conscious top-down corruption. The Ford Pinto, a compact car produced during the 1970s, became notorious for its tendency in rear-end collisions to leak fuel and explode into flames. More than two dozen people were killed or injured in Pinto fires before the company issued a recall to correct the problem. Scrutiny of the decision process behind the model's launch revealed that under intense competition from Volkswagen and other small-car manufacturers, Ford had rushed the Pinto into production. Engineers had discovered the potential danger of ruptured fuel tanks in preproduction crash tests, but the assembly line was ready to go, and the company's leaders decided to proceed. Many saw the decision as evidence of the callousness, greed, and mendacity of Ford's leaders—in short, their deep unethicality.

But looking at their decision through a modern lens—one that takes into account a growing understanding of how cognitive biases distort ethical decision making—we come to a different conclusion. We suspect that few if any of the executives involved in the Pinto decision

believed that they were making an unethical choice. Why? Apparently because they thought of it as purely a business decision rather than an ethical one.

Taking an approach heralded as rational in most business school curricula, they conducted a formal cost-benefit analysis—putting dollar amounts on a redesign, potential lawsuits, and even lives—and determined that it would be cheaper to pay off lawsuits than to make the repair. That methodical process colored how they viewed and made their choice. The moral dimension was not part of the equation. Such "ethical fading," a phenomenon first described by Ann Tenbrunsel and her colleague David Messick, takes ethics out of consideration and even increases unconscious unethical behavior.

What about Lee Iacocca, then a Ford executive VP who was closely involved in the Pinto launch? When the potentially dangerous design flaw was first discovered, did anyone tell him? "Hell no," said one high company official who worked on the Pinto, according to a 1977 article in *Mother Jones*. "That person would have been fired. Safety wasn't a popular subject around Ford in those days. With Lee it was taboo. Whenever a problem was raised that meant a delay on the Pinto, Lee would chomp on his cigar, look out the window and say 'Read the product objectives and get back to work.'"

FOCUS ON FAILURE

My life has been nothing but a failure, and all that's left for me to do is to destroy my paintings before I disappear."

CLAUDE MONET
PAINTER

We don't believe that either Iacocca or the executives in charge of the Pinto were consciously unethical or that they intentionally sanctioned unethical behavior by people further down the chain of command. The decades since the Pinto case have allowed us to dissect Ford's decision-making process and apply the latest behavioral ethics theory to it. We believe that the patterns evident there continue to recur in organizations. A host of psychological and organizational factors diverted the Ford executives' attention from the ethical dimensions of the problem, and executives today are swayed by similar forces. However, few grasp how their own cognitive biases and the incentive systems they create can conspire to negatively skew behavior and obscure it from view. Only by understanding these influences can leaders create the ethical organizations they aspire to run.

Five Barriers to an Ethical Organization

Even the best-intentioned executives are often unaware of their own or their employees' unethical behavior. Here are some of the reasons—and what to do about them.

	ILL-CONCEIVED GOALS	MOTIVATED BLINDNESS	INDIRECT BLINDNESS	THE SLIPPERY SLOPE	OVERVALUING OUTCOMES
DESCRIPTION	We set goals and incentives to promote a desired behavior, but they encourage a negative one.	We overlook the unethical behavior of others when it's in our interest to remain ignorant.	We hold others less accountable for unethical behavior when it's carried out through third parties.	We are less able to see others' unethical behavior when it develops gradually.	We give a pass to unethical behavior if the outcome is good.
EXAMPLE	The pressure to maximize billable hours in accounting, consulting, and law firms leads to unconscious padding.	Baseball officials failed to notice they'd created conditions that encouraged steroid use.	A drug company deflects attention from a price increase by selling rights to another company, which imposes the increase.	Auditors may be more likely to accept a client firm's questionable financial statements if infractions have accrued over time.	A researcher whose fraudulent clinical trial saves lives is considered more ethical than one whose fraudulent trial leads to deaths.
REMEDIES	Brainstorm unintended consequences when devising goals and incentives. Consider alternative goals that may be more important to reward.	Root out conflicts of interest. Simply being aware of them doesn't necessarily reduce their negative effect on decision making.	When handing off or outsourcing work, ask whether the assignment might invite unethical behavior and take ownership of the implications.	Be alert for even trivial ethical infractions and address them immediately. Investigate whether a change in behavior has occurred.	Examine both "good" and "bad" decisions for their ethical implications. Reward solid decision processes, not just good outcomes.

Click here for a larger image of the graphic.

Ill-Conceived Goals

In our teaching we often deal with sales executives. By far the most common problem they report is that their sales forces maximize sales rather than profits. We ask them what incentives they give their salespeople, and they confess to actually rewarding sales rather than profits. The lesson is clear: When employees behave in undesirable ways, it's a good idea to look at what you're encouraging them to do. Consider what happened at Sears, Roebuck in the 1990s, when management gave automotive mechanics a sales goal of $147 an hour—presumably to increase the speed of repairs. Rather than work faster, however, employees met the goal by overcharging for their services and "repairing" things that weren't broken.

It’s a good idea to look at what you’re encouraging employees to do. A sales goal of $147 an hour led auto mechanics to “repair” things that weren’t broken.

Sears is certainly not unique. The pressure at accounting, consulting, and law firms to maximize billable hours creates similarly perverse incentives. Employees engage in unnecessary and expensive projects and creative bookkeeping to reach their goals. Many law firms, increasingly aware that goals are driving some unethical billing practices, have made billing more transparent to encourage honest reporting. Of course, this requires a detailed allotment of time spent, so some firms have assigned codes to hundreds of specific activities. What is the effect? Deciding where in a multitude of categories an activity falls and assigning a precise number of minutes to it involves some guesswork—which becomes a component of the billable hour. Research shows that as the uncertainty involved in completing a task increases, the guesswork becomes more unconsciously self-serving. Even without an intention to pad hours, overbilling is the outcome. A system designed to promote ethical behavior backfires.

Let’s look at another case in which a well-intentioned goal led to unethical behavior, this time helping to drive the recent financial crisis. At the heart of the problem was President Bill Clinton’s desire to increase homeownership. In 2008 the *BusinessWeek*editor Peter Coy wrote:

Add President Clinton to the long list of people who deserve a share of the blame for the housing bubble and bust. A recently re-exposed document shows that his administration went to ridiculous lengths to increase the national homeownership rate. It promoted paper-thin down payments and pushed for ways to get lenders to give mortgage loans to first-time buyers with shaky financing and incomes. It’s clear now that the erosion of lending standards pushed prices up by increasing demand, and later led to waves of defaults by people who never should have bought a home in the first place.

The Sears executives seeking to boost repair rates, the partners devising billing policies at law firms, and the Clinton administration officials intending to increase homeownership never meant to inspire unethical behavior. But by failing to consider the effects of the goals and reward systems they created, they did.

Part of the managerial challenge is that employees and organizations require goals in order to excel. Indeed, among the best-replicated results in research on managerial behavior is that providing specific, moderately difficult goals is more effective than vague exhortations to “do your best.” But research also shows that rewarding employees for achieving narrow goals such as exact production quantities may encourage them to neglect other areas, take undesirable “ends justify the means” risks, or—most important from our perspective—engage in more unethical behavior than they would otherwise.

Leaders setting goals should take the perspective of those whose behavior they are trying to influence and think through their potential responses. This will help head off unintended consequences and prevent employees from overlooking alternative goals, such as honest reporting, that are just as important to reward if not more so. When leaders fail to meet this responsibility, they can be viewed as not only promoting unethical behavior but blindly engaging in it themselves.

Motivated Blindness

It’s well documented that people see what they want to see and easily miss contradictory information when it’s in their interest to remain ignorant—a psychological phenomenon known as motivated blindness. This bias applies dramatically with respect to unethical behavior. At Ford the senior-most executives involved in the decision to rush the flawed Pinto into production not only seemed unable to clearly see the ethical dimensions of their own decision but failed to recognize the unethical behavior of the subordinates who implemented it.

Let's return to the 2008 financial collapse, in which motivated blindness contributed to some bad decision making. The "independent" credit rating agencies that famously gave AAA ratings to collateralized mortgage securities of demonstrably low quality helped build a house of cards that ultimately came crashing down, driving a wave of foreclosures that pushed thousands of people out of their homes. Why did the agencies vouch for those risky securities?

Part of the answer lies in powerful conflicts of interest that helped blind them to their own unethical behavior and that of the companies they rated. The agencies' purpose is to provide stakeholders with an objective determination of the creditworthiness of financial institutions and the debt instruments they sell. The largest agencies, Standard & Poor's, Moody's, and Fitch, were—and still are—paid by the companies they rate. These agencies made their profits by staying in the good graces of rated companies, not by providing the most accurate assessments of them, and the agency that was perceived to have the laxest rating standards had the best shot at winning new clients. Furthermore, the agencies provide consulting services to the same firms whose securities they rate.

Research reveals that motivated blindness can be just as pernicious in other domains. It suggests, for instance, that a hiring manager is less likely to notice ethical infractions by a new employee than are people who have no need to justify the hire—particularly when the infractions help the employee's performance. (We've personally heard many executives describe this phenomenon.) The manager may either not see the behavior at all or quickly explain away any hint of a problem.

Consider the world of sports. In 2007 Barry Bonds, an outfielder for the San Francisco Giants, surpassed Hank Aaron to become the all-time leader in career home runs—perhaps the most coveted status in Major League Baseball. (Bonds racked up 762 versus Aaron's 755.) Although it was well known that the use of performance-enhancing drugs was common in baseball, the Giants' management, the players' union, and other interested MLB groups failed to fully investigate the rapid changes in Bonds's physical appearance, enhanced strength, and dramatically increased power at the plate. Today Bonds stands accused of illegally using

steroids and lying to a grand jury about it; his perjury trial is set for this spring. If steroid use did help bring the home runs that swelled ballpark attendance and profits, those with a stake in Bonds's performance had a powerful motivation to look the other way: They all stood to benefit financially.

It does little good to simply note that conflicts of interest exist in an organization. A decade of research shows that awareness of them doesn't necessarily reduce their untoward impact on decision making. Nor will integrity alone prevent them from spurring unethical behavior, because honest people can suffer from motivated blindness. Executives should be mindful that conflicts of interest are often not readily visible and should work to remove them from the organization entirely, looking particularly at existing incentive systems.

Indirect Blindness

In August 2005 Merck sold off two cancer drugs, Mustargen and Cosmegen, to Ovation, a smaller pharmaceutical firm. The drugs were used by fewer than 5,000 patients and generated annual sales of only about $1 million, so there appeared to be a clear logic to divesting them. But after selling the rights to manufacture and market the drugs to Ovation, Merck continued to make Mustargen and Cosmegen on a contract basis. If small-market drugs weren't worth the effort, why did Merck keep producing them?

Soon after the deal was completed, Ovation raised Mustargen's wholesale price by about 1,000% and Cosmegen's even more. (In fact, Ovation had a history of buying and raising the prices on small-market drugs from large firms that would have had public-relations problems with conspicuous price increases.) Why didn't Merck retain ownership and raise the prices itself? We don't know for sure, but we assume that the company preferred a headline like "Merck Sells Two Products to Ovation" to one like "Merck Increases Cancer Drug Prices by 1,000%."

We are not concerned here with whether pharmaceutical companies are entitled to gigantic profit margins. Rather, we want to know why managers and consumers tend not to hold people and organizations accountable for unethical behavior carried out through third

parties, even when the intent is clear. Assuming that Merck knew a tenfold price increase on a cancer drug would attract negative publicity, we believe most people would agree that using an intermediary to hide the increase was unethical. At the same time, we believe that the strategy worked because people have a cognitive bias that blinds them to the unethicality of outsourcing dirty work.

Consider an experiment devised by Max Bazerman and his colleagues that shows how such indirectness colors our perception of unethical behavior. The study participants read a story, inspired by the Merck case, that began this way: "A major pharmaceutical company, X, had a cancer drug that was minimally profitable. The fixed costs were high and the market was limited. But the patients who used the drug really needed it. The pharmaceutical was making the drug for $2.50/pill (all costs included), and was only selling it for $3/pill."

Then a subgroup of study participants was asked to assess the ethicality of "A: The major pharmaceutical firm raised the price of the drug from $3/pill to $9/pill," and another subgroup was asked to assess the ethicality of "B: The major pharmaceutical X sold the rights to a smaller pharmaceutical. In order to recoup costs, company Y increased the price of the drug to $15/pill."

Participants who read version A, in which company X itself raised the price, judged the company more harshly than did those who read version B, even though the patients in that version ended up paying more. We asked a third subgroup to read both versions and judge which scenario was more unethical. Those people saw company X's behavior as less ethical in version B than in version A. Further experiments using different stories from inside and outside business revealed the same general pattern: Participants judging on the basis of just one scenario rated actors more harshly when they carried out an ethically questionable action themselves (directly) than when they used an intermediary (indirectly). But participants who compared a direct and an indirect action based their assessment on the outcome.

These experiments suggest that we are instinctively more lenient in our judgment of a person or an organization when an unethical action has been delegated to a third party—particularly when we have incomplete information about the effects of the outsourcing. But the results also reveal that when we're presented with complete information and reflect on it, we can overcome such "indirect blindness" and see unethical actions—and actors—for what they are.

Managers routinely delegate unethical behaviors to others, and not always consciously. They may tell subordinates, or agents such as lawyers and accountants, to "do whatever it takes" to achieve some goal, all but inviting questionable tactics. For example, many organizations outsource production to countries with lower costs, often by hiring another company to do the manufacturing. But the offshore manufacturer frequently has lower labor, environmental, and safety standards.

> Managers routinely delegate unethical behaviors to others, and not always consciously.

When an executive hands off work to anyone else, it is that executive's responsibility to take ownership of the assignment's ethical implications and be alert to the indirect blindness that can obscure unethical behavior. Executives should ask, "When other people or organizations do work for me, am I creating an environment that increases the likelihood of unethical actions?"

The Slippery Slope

You've probably heard that if you place a frog in a pot of boiling water, the frog will jump out. But if you put it in a pot of warm water and raise the temperature gradually, the frog will not react to the slow change and will cook to death. Neither scenario is correct, but they make a fine analogy for our failure to notice the gradual erosion of others' ethical standards. If we

find minor infractions acceptable, research suggests, we are likely to accept increasingly major infractions as long as each violation is only incrementally more serious than the preceding one.

Bazerman and the Harvard Business School professor Francesca Gino explored this in an experiment in which the participants—"auditors"—were asked to decide whether to approve guesses provided by "estimators" of the amount of money in jars. The auditors could earn a percentage of a jar's contents each time they approved an estimator's guess—and thus had an incentive to approve high estimates—but if they were caught approving an exaggerated estimate, they'd be fined $5. Over the course of 16 rounds, the estimates rose to suspiciously high levels either incrementally or abruptly; all of them finished at the same high level. The researchers found that auditors were twice as likely to approve the high final estimates if they'd been arrived at through small incremental increases. The slippery-slope change blinded them to the estimators' dishonesty.

Now imagine an accountant who is in charge of auditing a large company. For many years the client's financial statements are clean. In the first of two scenarios, the company then commits some clear transgressions in its financial statements, even breaking the law in certain areas. In the second scenario, the auditor notices that the company stretched but did not appear to break the law in a few areas. The next year the company's accounting is worse and includes a minor violation of federal accounting standards. By the third year the violation has become more severe. In the fourth year the client commits the same clear transgressions as in the first scenario.

The auditors-and-estimators experiment, along with numerous similar ones by other researchers, suggest that the accountant above would be more likely to reject the financial statements in the first scenario. Bazerman and colleagues explored this effect in depth in "Why Good Accountants Do Bad Audits" (HBR November 2002).

To avoid the slow emergence of unethical behavior, managers should be on heightened alert for even trivial-seeming infractions and address them immediately. They should investigate whether there has been a change in behavior over time. And if something seems amiss, they should consider inviting a colleague to take a look at all the relevant data and evidence together—in effect creating an "abrupt" experience, and therefore a clearer analysis, of the ethics infraction.

Overvaluing Outcomes

Many managers are guilty of rewarding results rather than high-quality decisions. An employee may make a poor decision that turns out well and be rewarded for it, or a good decision that turns out poorly and be punished. Rewarding unethical decisions because they have good outcomes is a recipe for disaster over the long term.

> Rewarding unethical decisions because they have good outcomes is a recipe for disaster over the long term.

The Harvard psychologist Fiery Cushman and his colleagues tell the story of two quick-tempered brothers, Jon and Mark, neither of whom has a criminal record. A man insults their family. Jon wants to kill the guy: He pulls out and fires a gun but misses, and the target is unharmed. Matt wants only to scare the man but accidentally shoots and kills him. In the United States and many other countries, Matt can expect a far more serious penalty than Jon. It is clear that laws often punish bad outcomes more aggressively than bad intentions.

Bazerman's research with Francesca Gino and Don Moore, of Carnegie Mellon University, highlights people's inclination to judge actions on the basis of whether harm follows rather than on their actual ethicality. We presented the following stories to two groups of participants.

Both stories begin: “A pharmaceutical researcher defines a clear protocol for determining whether or not to include clinical patients as data points in a study. He is running short of time to collect sufficient data points for his study within an important budgetary cycle in his firm.”

Story A continues: “As the deadline approaches, he notices that four subjects were withdrawn from the analysis due to technicalities. He believes that the data in fact are appropriate to use, and when he adds those data points, the results move from not quite statistically significant to significant. He adds these data points, and soon the drug goes to market. This drug is later withdrawn from the market after it kills six patients and injures hundreds of others.”

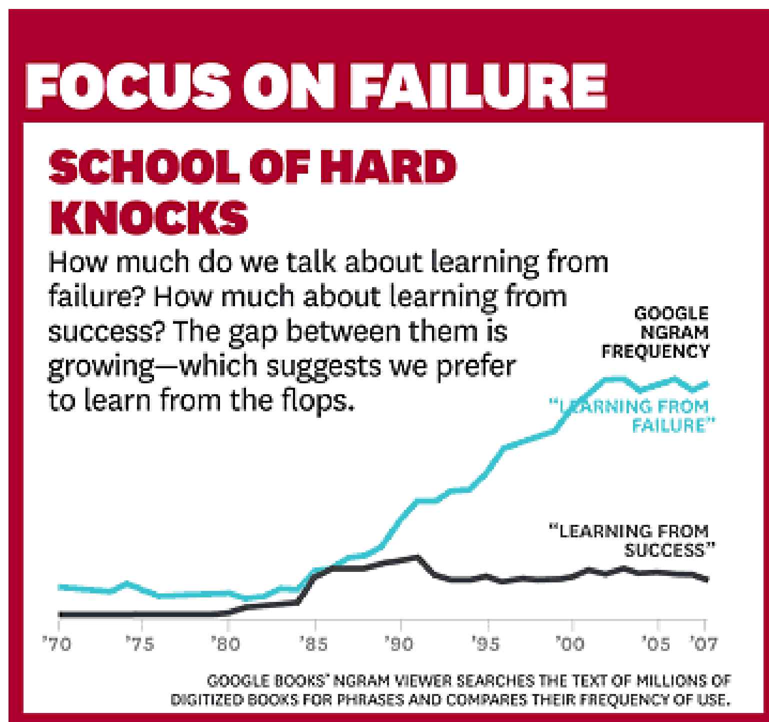
Story B continues: “He believes that the product is safe and effective. As the deadline approaches, he notices that if he had four more data points for how subjects are likely to behave, the analysis would be significant. He makes up these data points, and soon the drug goes to market. This drug is a profitable and effective drug, and years later shows no significant side effects.”

After participants read one or the other story, we asked them, “How unethical do you view the researcher to be?” Those who read story A were much more critical of the researcher than were those who read story B, and felt that he should be punished more harshly. Yet as we see it, the researcher’s behavior was more unethical in story B than in story A. And that is how other study participants saw it when we removed the last sentence—the outcome—from each story.

Managers can make the same kind of judgment mistake, overlooking unethical behaviors when outcomes are good and unconsciously helping to undermine the ethicality of their organizations. They should beware this bias, examine the behaviors that drive good outcomes, and reward quality decisions, not just results.

The Managerial Challenge

Companies are putting a great deal of energy into efforts to improve their ethicality—installing codes of ethics, ethics training, compliance programs, and in-house watchdogs. Initiatives like these don't come cheap. A recent survey of 217 large companies indicated that for every billion dollars of revenue, a company spends, on average, $1 million on compliance initiatives. If these efforts worked, one might argue that the money—a drop in the bucket for many organizations—was well spent. But that's a big if. Despite all the time and money that have gone toward these efforts, and all the laws and regulations that have been enacted, observed unethical behavior is on the rise.



This is disappointing but unsurprising. Even the best-intentioned ethics programs will fail if they don't take into account the biases that can blind us to unethical behavior, whether ours or that of others. What can you do to head off rather than exacerbate unethical behavior in your organization? Avoid "forcing" ethics through surveillance and sanctioning systems. Instead ensure that managers and employees are aware of the biases that can lead to unethical behavior. (This simple step might have headed off the disastrous decisions Ford managers made—and employees obeyed—in the Pinto case.) And encourage your staff to ask this important question when considering various options: "What ethical implications might arise from this decision?"

Above all, be aware as a leader of your own blind spots, which may permit, or even encourage, the unethical behaviors you are trying to extinguish.

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The New York Times

How G.M.'s Lawyers Failed in Their Duties

By Peter J. Henning

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In the aftermath of the savings and loan scandal, Judge Stanley Sporkin asked how a once-prominent financial institution could engage in a pattern of misconduct. "Where were the professionals when these clearly improper transactions were being consummated?" he asked.

For General Motors, the negligence and incompetence that resulted in at least 13 deaths and multiple injuries from a faulty ignition switch is equally troubling. Numerous lawyers were on the scene, but none took responsibility for making sure their client did not continue to keep defective cars on the road.

A report issued by Anton R. Valukas describes the failures over a decade in which G.M.'s lawyers were squarely at the center of the ineptitude. They were participants in numerous meetings that produced little tangible action to address a serious problem. The New York Times reported that the role of the lawyers, at least three of whom have been fired, will be a focus of congressional hearings on the company's failure to recall its vehicles.

One of the first rules of the legal profession is that "a lawyer shall provide competent representation to a client." How could so many lawyers fail in this regard?

The report's description of G.M.'s culture is particularly telling in how it seems to have infected the company's lawyers. Mary T. Barra, the chief executive, described the "G.M. nod," which, according to the report, happens "when everyone nods in agreement to a proposed plan of action, but then leaves the room and does little."

As just one example of the many delays that occurred with the acquiescence of the lawyers, a committee of G.M. lawyers agreed in January 2011 to settle a lawsuit

over an accident in which an “anomaly” with the ignition switch occurred. A senior lawyer directed that another meeting take place to look into issues with other vehicles experiencing that problem, but it did not occur until July 2011.

The report notes that no one could “explain why six months passed before the meeting took place, but the delay again highlights the lack of urgency in addressing the issue.”

It was not just a lack of urgency that led to G.M.’s failure to deal with the issue. In 2012, a newly hired lawyer asked why a recall had not been issued for vehicles that had problems related to airbags not deploying in an accident, which was directly traceable to the faulty ignition switch. The response was that other lawyers “were resigned to the fact that engineering was acting slowly,” which led him to conclude that “this is how it works. We raise it with engineering and they decide.”

The report described this as the “G.M. salute,” which is “a crossing of the arms and pointing outward towards others, indicating that the responsibility belongs to someone else, not me.”

But that is the antithesis of a lawyer’s responsibility in representing a client. Unlike others who work for a company, corporate counsel would prevent violations rather than giving in to the wishes of management. In a recent speech, Kara M. Stein, a commissioner of the Securities and Exchange Commission, stressed the importance of having lawyers act as gatekeepers to “disrupt or prevent misconduct.”

The rules of the profession requires lawyers to “report up” when they become aware of misconduct “that is likely to result in substantial injury to the organization.” In-house lawyers have a particularly difficult task under this requirement because the client is also their sole source of income, so ensuring that the company does not suffer from internal misconduct can conflict with a desire to protect one’s job.

Blowing the whistle on their own bosses, or demanding action when it can put a career at risk, can be nearly impossible when lawyers are caught up in a hidebound culture that enshrines not taking responsibility for decisions.

It is not clear whether any of G.M.'s lawyers even recognized there was an issue with how they were representing the company. Nor is it clear that they considered whether they needed to take action to protect it from greater harm.

The company's lawyers appear to have viewed their obligation to only deal with the incidents immediately demanding their attention, thereby failing to notice the pattern of problems. Each piece of litigation was evaluated solely on the question of how much the company might have to pay, without any regard to the broader issue of whether there was a systemic failure in one of its products.

Thus, cases were settled without any urgency to assess whether G.M. had a more extensive problem, despite warnings from outside counsel that there was a risk of punitive damages that could have cost the company millions of dollars more.

Even when the corporate lawyers received the "bombshell" information in April 2013 that the engineer responsible for the ignition switch had ordered a change in the part years earlier, they quickly settled the case but did little else. Thus, it was almost another year before G.M. issued the recall.

The G.M. legal staff even received a report from a Wisconsin state trooper in 2007 outlining the defect in its vehicles, but it sat unseen in the files until 2014.

The settlements were kept secret, a standard legal practice that effectively suppressed information that might have helped identify a pattern of accidents traceable to a particular type of defect. Even the fact that a defect in its vehicles caused deaths was never brought to the attention of the company's general counsel, according to the Valukas report. G.M. also did not tell federal regulators about the defect in a timely manner, drawing a $35 million penalty, the maximum allowed.

The failure to take the long view, to step back from the particulars of a lawsuit to ask harder questions about whether there was a pattern, was the ultimate failure by G.M.'s lawyers. And that's at the heart of what a lawyer should do in representing a corporate client, to ensure that it does not continue to engage in conduct that puts it at increasing risk.

Yet there are few remedies available to pursue G.M.'s lawyers for failing to protect their client's interests. Criminal law prohibits perjury and obstruction of

justice, but there is no evidence in the report that any lawyer purposely hid information or encouraged a witness to lie. Secret settlements can keep information from becoming publicly available, but there is nothing illegal about that practice.

The legal ethics rules require a lawyer to represent a client competently, but that provision is rarely enforced though the disciplinary process. Instead, it is the client who pursues a claim for malpractice based on the lawyer's failures.

But it is unlikely that G.M. can hold its lawyers responsible for the harm it suffered because proving that any particular decision, or failure to act, led to the damage it has suffered would be difficult. The lawyers could even rely on the "G.M. salute" if they were sued to argue that the inaction of others caused at least as much damage as any incompetence on their part.

In the end, G.M. did about the only thing it could do when it fired a few of its lawyers. Unfortunately, that is small consolation to the victims of accidents caused by a defective product that stayed on the road far too long.

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Shades of Enron: the Legal Ethics Implications of the General Motors Scandal

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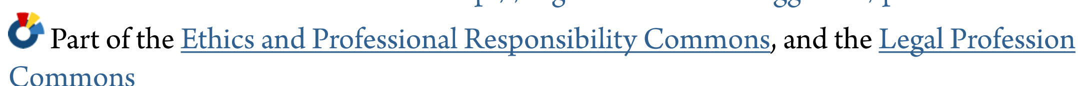

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Legal Ethics Forum

June 09, 2014

Professor Michele Benedetto Neitz - "Shades of Enron: the Legal Ethics Implications of the General Motors Scandal"

[This is a guest post by Michele Benedetto Neitz on one of the more important topics of the year: the role of lawyers in the GM matter. JJS]

Here we go again. "Where were the Lawyers?" is becoming a predicable refrain in response to any wide-ranging corporate scandal. General Motors is battling a rising deluge of lawsuits, investigations, and government fines in the wake of its February 2014 recall of millions of cars for a safety defect. The defect, a faulty ignition switch, is allegedly responsible for 13 fatalities and hundreds of injuries.

The sorrow of the tragic loss of life in this case is now joined by growing public anger about a cover-up at the company to avoid liability for the defect. GM's engineers and managers may have known of the problem as early as 2004, and GM's in-house lawyers apparently knew about the defect in 2013 or earlier. The facts are still developing in this story, and the release of an internal investigation report last week directed by Anton Valukas answered significant questions. The actions of GM's lawyers clearly raise significant legal ethics ramifications.

The Michigan State Bar, legal ethicists, and in-house counsel should take note of potential violations of the following rules.

1. Perjury

GM is defending multiple high-profile lawsuits related to the defect. One Georgia case, brought by the family of crash victim Brooke Melton, included depositions of GM engineers to identify the precise nature of the defective switch. During his deposition testimony in the Melton case, GM engineer Raymond DeGiorgio testified that he had never approved any modifications to the design switch. Documents later revealed that Mr. DeGiorgio had in fact personally signed off on the changes to the switch in 2006.

GM's lawyers, from the law firm King & Spaulding, may or may not have known about Mr. DeGiorgio's apparently perjurious testimony during the deposition. The Valukas internal investigation revealed that soon after the deposition, the K&S lawyers told GM "This case needs to be settled." If they did know about perjurious testimony, Georgia Rule 3.3 (a)(3), like the ABA and Michigan Rules, would have required them to refuse to offer the testimony. After the deposition, lawyers who learned that the testimony was false should have followed remedial measures, including reporting the testimony to the court if necessary. Although the Melton family's case was settled one day before a GM executive was scheduled to testify, the Melton family's lawyer is now petitioning to reopen the case in light of Mr. DeGiorgio's perjurious testimony.

2. Reporting up the Ladder and Confidentiality

When did the lawyers know about the defect? The answer is still unclear, with observers noting that GM's lawyers have had a pattern of settling cases related to the defect before GM executives could be deposed. An amended class action complaint filed on Wednesday argued that it is "inconceivable" that GM's lawyers did not know about the defect before the company's 2009 bankruptcy. The Valukas internal investigation report disclosed that outside counsel warned GM in July 2013 that a "compelling" case could be made for knowledge of the defect as early as 2005, but "no GM lawyer apprised the General Counsel." CEO Mary Barra stated that she did not know about the defect on Chevrolet, Pontiac and Saturn vehicles until January 20, 2014, and the board learned immediately after she did. GM was fined $35 million in May for failing to comply with a federal law requiring automakers to report any safety defect within five days.

GM lawyers' apparent knowledge about the defect, which was directly responsible for fatal injuries, triggered at least two ethical rules. First, any corporate counsel with knowledge of a violation of law that would harm the lawyers' organization must report up the ladder under Michigan Rule 1.13 If a GM lawyer reported this to GC Michael Milliken, and his response was inadequate, the lawyer should have gone to the CEO and ultimately (if necessary) the board of directors. If there was still no progress, Rule 1.13 would have permitted GM's lawyers to report the defect outside of the company.

An exception to the general attorney-client confidentiality rule also applies here. Under Michigan Rule 1.6(b)(3), GM's lawyers could have revealed confidences and secrets to the extent reasonably necessary to rectify the consequences of GM's illegal actions in the furtherance of which the lawyer's services have been used. Indeed, the outcome of the GM scandal is the type of result this exception was arguably designed to prevent. Even in California, where the only exception to confidentiality is the prevention of a criminal act likely to cause death or substantial bodily harm, the GM lawyers would have been permitted to break confidentiality and reveal information that might have saved lives.

Congress, are you listening? Since GM is a public company, the Sarbanes-Oxley Act would also apply. Under SOX, lawyers should have gone up the chain of command and would have been allowed to report outside the company. We can expect the GM case to serve as a useful case study the next time Congress considers mandating outside reporting under SOX.

3. Conflict of Interest

As the cover-up scandal reached a crescendo, GM hired Anton Valukas to co-direct an internal investigation with GM Michael Milliken. Valukas is chairman of Jenner & Block, a firm serving as current outside counsel for GM. Lawyers from King & Spaulding, a firm that has represented GM in cases since the 1970s, assisted with the investigation.

GM released the detailed report last week, and its stark assessment of GM's failures caused numerous GM employees to be fired. Even so, the existing relationship between the firms and GM raised questions about whether this internal investigation was credibly independent. As Professor Monroe Freedman noted, "A reasonable person might question whether the firm wants to curry favor with GM, so it can maintain a good relationship or obtain future work." The report cleared the top officers, including the CEO and General Counsel, of any wrongdoing. Senator Richard Blumenthal called the report "the best money can buy," noting that it "absolves upper management, denies deliberate wrongdoing, and dismisses corporate responsibility." Whether an actual conflict exists, the appearance of a conflict is overwhelming and caused more bad press for General Motors.

The parallels to the Enron case are obvious: Corporate officials are lying about the company's actions. In-house attorneys are staying mute about corporate wrongdoing. A law firm with a potential conflict of interest is conducting an internal investigation. With these resemblances, General Motors' shareholders should hope the end result is not an Enron-style collapse. At least the Michigan Bar examiners will have an easy PR fact pattern for July's bar exam.

Posted by John Steele at 04:59 AM | Permalink

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Society of Corporate Compliance and Ethics

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The Chief Compliance Officer vs the General Counsel: Friend or foe?

By José A. Tabuena

Editor's Note: Mr. Tabuena is with the Center for Corporate Governance at Deloitte & Touche USA LLP and has previously served as a compliance officer and in-house counsel. He is a member of the Advisory Board for Compliance & Ethics.

Both the chief compliance officer (CCO) and the general counsel (GC) or chief legal officer perform crucial and related compliance functions for their organization, whether it is a public, private, or not-for-profit entity. There are still a fair number of companies where the GC also serves as the compliance officer. While this dual function is generally more prevalent in smaller companies, it is not uncommon in larger organizations.[1]

Is there a real distinction between the two roles? Can an individual serve effectively as both general counsel and compliance officer simultaneously? What safeguards, if any, are needed if one does serve in a dual role? And where the two positions co-exist, how can they work together to help achieve the goals of the compliance program?

Both officers face challenges and tensions between the functions of the CCO and those of the GC. Both have compliance responsibilities, but they each have distinctive roles that can result in potentially conflicting professional obligations. Various reporting models and relationships exist between the two, and some considerations and approaches can be used to ensure that appropriate checks and balances are in place.

"We both acknowledge it's a very close call and agree to disagree," say the General Counsel (GC) and Chief Compliance Officer (CCO) at a management meeting. In this instance, the CCO believes that a proposed contractual arrangement with a physician group poses some regulatory risk and potentially may run afoul of certain laws. The GC sides with executive management who are convinced that the deal is sound and has minimal likelihood of wrongdoing.

But what if the CCO is so sure of his position that he feels obligated to take the issue to the Board? Should the GC be concerned that her judgment would be subject to close scrutiny and could possibly be considered a violation of professional rules of conduct?

Increase the tension even further. What if the deal proceeds and a subsequent internal audit review results in adverse compliance findings? Beyond the question of a violation of law arising from the arrangement, can there also be divergence in opinion as to whether disclosure to the government is now required?

Because insights can be gleaned from experiences in health care, this discussion will refer to developments from the life sciences and health care sectors. Many health care compliance officers have gained stature and senior status in their organizations as a result of the intensive regulatory scrutiny faced in the industry.

Some Historical Context

The role of the CCO is relatively new in the annals of organizational management, especially compared with the GC who has a long history of serving a company as its consigliore or chief legal advisor. The dual role held by a single individual appears to be less common in health care,[2] which should not be surprising, given the pronouncements by government officials and regulatory authorities with oversight over health care industry sectors. The Office of Inspector General (OIG) compliance guidance and the U.S. Sentencing Guidelines for Organizations (the "Federal Sentencing Guidelines") make clear the role of the CCO in operating the compliance program and reporting to the board. When the OIG Compliance Program Guidance (CPG) first came out in 1998, it became apparent that health care authorities were of the view that a CCO should not be subordinate to a GC or a chief financial officer (CFO), because:

> Free standing compliance functions help to ensure independent and objective legal reviews and financial analyses of the institute's compliance efforts and activities. By separating the compliance function from the key management positions of general counsel or chief hospital financial officer (where the size and structure of the hospital makes this a feasible option), a system of checks and balances is established to more effectively achieve the goals of the compliance program.[3]

This OIG point of view was followed in subsequent CPGs issued for the various health care and pharmaceutical industry sectors. It was then reaffirmed in their 2005 Supplemental Guidance for Hospitals, where (in discussing the need to perform a regular review of the compliance program) the OIG noted, among other things, the following factor to consider:

- Is the relationship between the compliance function and the general counsel function appropriate to achieve the purpose of each?[4]

The concern by the government with how the GC should oversee and interface with the compliance function was also made abundantly clear following a now infamous quote by U.S. Senator Charles Grassley in a letter to Tenet Healthcare Corporation:

> Apparently, neither Tenet (nor its General Counsel) saw any conflict in her wearing two hats as Tenet's General Counsel and Chief Compliance Officer…It doesn't take a pig farmer from Iowa to smell the stench of conflict in that arrangement.[5]

This sharp delineation between the compliance and legal roles, however, is not universal. For instance, the American Bar Association Task Force on Corporate Responsibility (ABA Task Force) focused solely on the role of the chief legal officer in an organization's corporate governance program and did not address the separate role and responsibilities of the compliance officer.[6]

In response to Enron and other corporate scandals, the ABA appointed the Task Force to "examine systemic issues relating to corporate responsibility arising out of the unexpected and traumatic bankruptcy of Enron and other Enron-like situations which have shaken confidence in the effectiveness of the governance and disclosure systems applicable to public companies in the United States."[7] The work of the Task Force overlapped with Sarbanes-Oxley and was done with consideration of its provisions. The work thus addressed the importance of engaging internal and external counsel in corporate governance and legal compliance matters that were raised by Section 307 of Sarbanes-Oxley. As noted by the OIG and the American Health Lawyers Association (AHLA) in a joint publication, the ABA Task Force recommended that:

> The general counsel of a public corporation should have primary responsibility for assuring the implementation of an effective legal compliance system under the oversight of the board of directors.[8]

So, on the one hand, the Federal Sentencing Guidelines, the OIG, and Senator Grassley state that the CCO has a distinct compliance role that should be separate and independent from the legal function, while on the other, as set forth in Sarbanes-Oxley and by the ABA, it is the GC who is responsible for "legal" compliance.

Can these different perspectives be reconciled?[9] Conceptual issues can be explored surrounding the role of a compliance program, its administration by the CCO, and the interface with the GC, along with the potential barriers and conflicts imposed

by recent updates to the professional standards and duties of each respective position. To appreciate the organizational dynamics, it is helpful to first understand how the role of the compliance officer differs from that of the GC.

Defining the Role of Compliance

A useful starting point is clarity on how an organization itself defines the role and scope of the compliance program, and thereby, the duties of the CCO who is tasked with the day-to-day operations of the program. In many respects, the position is unique and relatively new to the modern organization. Most people can articulate what a lawyer or auditor does for a living, but the average employee may have difficulty defining "compliance."

In its strictest sense, both the compliance officer and GC have responsibility for the organization's compliance with laws, regulations, and other applicable rules and standards. The divergence is how they function to achieve this objective and the corresponding impact on their respective professional duties.

The GC generally provides legal advice on how the organization can comply with applicable laws while attaining its business objectives.[10] It is this "legal advice" that is subject to licensure, regulation, and professional standards.

The CCO, by contrast, is a management function which incorporates legal considerations while influencing processes and practices of the organization.[11] One well-known commentator describes the distinction as follows:

> Being general counsel and being CCO are very different things. A lawyer, ethically, has a duty to give sound legal advice and to represent the client's interests "zealously." The compliance officer's mission is substantially different: it is to do whatever it takes to prevent and detect misconduct…While the lawyer may give legal advice, the compliance professional translates that advice into management action. While the lawyer must focus on what will result in success in legal battles, the compliance professional wants to prevent the very mistakes that result in legal battles…

Given this description, it is clear the functions are complementary, but not the same. Compliance is a management, not a legal function."[12] Another way to view the distinction is that legal assists in defining and establishing the appropriate company standards, while compliance supports in implementing and monitoring those processes that ensure the established standards are being met.

A compliance program can be viewed as a management tool relied upon by the Board to manage the operations of the company in a manner consistent with relevant rules and the organization's own values and goals. Compliance relies heavily on legal expertise (and vice versa) but also involves management know-how in training, human resource matters, communications, auditing, and internal controls.

By creating and implementing the compliance program composed of the elements detailed in the Federal Sentencing Guidelines, the compliance officer is responsible for coordinating applicable policies and procedures, the code of conduct, employee training on ethics and compliance, oversight of internal reporting mechanisms (e.g., the helpline/hotline), coordinating compliance audits, investigations, and corrective action plans.

The compliance officer may also have an internal audit role. If resources are shared with the internal audit function, both the CCO and the chief audit executive (CAE) may report directly to the Board and deal with allegations of misconduct of very high senior officials. As observed by a noted authority, "the most powerful people in the corporation—CEO's, CFO's and even general counsels—may perpetrate the "most dangerous business offenses…you cannot expect someone to 'police up.' That is, you cannot expect a human being to tell a direct boss that she is wrong, when the boss is fully committed to a course of action (and ready to fire anyone who gets in the way)."[13]

As a result, the trend is for the CCO to be a senior level position with commensurate access to senior management and the Board, with sufficient budget and critical protections (e.g., termination of the compliance officer requires approval by the Board). Ultimately, the role of CCO involves more than just support for following the rules. Laws and standards have always existed, but given the volume of legal mandates and the regulatory incentives to comply, what has evolved is a distinct cross-disciplinary systems approach with considerable rigor in application, implemention, and management of a program. Apart from internal investigations and the addressing of misconduct, these compliance program processes are generally not within the purview of in-house counsel.

Moreover, the tendency to view compliance as another legal topic sometimes results in the underestimation of the

management skills and organizational change required to effectuate a compliance program. This is often seen in the early stages of the program where there may be over-emphasis on rule analysis and legalistic policy development.[14] Consider the advice to compliance professionals from a leading authority in Australia:

> To reach its full potential, the profession's value must stem not from its role as a valuable, but resented policeman, but to an indispensable aid to running good businesses well. It will require both education of the market—employers and regulators—and personal growth. For individuals, my advice is look at your personal skill bank. Can you own the room? Do you have courage of conviction? Do you have great communication skills—particularly active listening? Can you change language, tone, and pitch to suit the audience? Can you read people? These skills and attributes will differentiate you from those who just know the rules and how to apply them. Lastly, do you really know the business—its drivers for cost, income and growth; its systems, processes, and culture? If you can say yes to all of these, you will inexorably move, if you have not already, from policeman to strategic ally.[15]

Only in recent history have organizations learned by trial-and-error to go beyond the advisory model of compliance as influenced by its legal heritage, to one that is about checks and balances, and of driving and influencing change on a wide spectrum of regulatory and ethical issues.

An effective compliance program enables objective sources of monitoring and advice through information, analyses, and recommendations that are free from undue influence and constraints. Having appropriate checks and balances in compliance reporting to ensure proper oversight is necessary regardless of who has formal responsibility for the program. The potential for disagreement between the compliance and corporate counsel is a real risk that an organization needs to address.

Compliance Reporting Models: Developing a Complementary Set of Responsibilities

The board committee overseeing the compliance function, and the entire board itself, should understand how these two roles interface as they both support the directors by ensuring that they receive accurate and candid advice. Ultimately "[i]t is the Board's responsibility to reconcile these potentially conflicting views into a complementary set of responsibilities and reporting relationships."[16]

Essentially there are three models for structuring the relationship between the compliance and legal functions in an organization:

- The CCO and the GC are one and the same;
- The CCO reports to the GC; and
- The CCO does not report to and is independent from the GC[17]

There are pros and cons for each reporting structure and each presents different considerations on how to manage compliance issues.

Dual roles: one person, two hats

The recently amended Federal Sentencing Guidelines provide more exacting requirements for the staffing of a compliance and ethics program, but they also recognize that the small and mid-size organization often do not have the resources to create an entirely new officer-level position to manage the program. The Federal Sentencing Guidelines recognize this practicality by offering an endorsement for utilizing existing officers rather than creating a new CCO position.[18] And when a new role is not created, often the compliance responsibility is assigned to the GC.

The dual role is not limited to smaller companies. As noted earlier, a fair percentage of surveyed organizations have a CG who has the additional role of COO.[19] Clearly, the size and sophistication of the legal staff is relevant and impacts the structure and nature of the organizational interactions on legal and compliance matters.

There are obvious advantages to a dual role, especially for the resource-strapped organization. Most compliance (and ethical) issues have legal ramifications and combining the positions can promote operational efficiency. Attorneys provide guidance on how laws impact business operations, and compliance personnel incorporate that advice into the ethical practices of the organization. Arguably, the compliance role is an inherently legal one.

An additional benefit is that legal privileges and discovery protections readily apply and can be more easily managed when the CCO is also the GC. Further, there can be the advantage of authority and influence with the perception that, if the GC is involved, the matter must be significant. Conversely, government regulators are concerned that the professional role of the GC can serve as a shield to limit government access to information.

As compliance professionals in health care are well aware, the government clearly takes the view that unification of the positions creates an untenable conflict. Still, it is not universally accepted, even within health care, that the GC should never function as the CCO. Others have commented that an individual can serve both roles, although care must be exercised to ensure that an individual "clearly differentiates his or her actions as general counsel from those as compliance officer."[20] The difficulty here, as with other situations involving multiple hats, is that the degree of care applied to keep the roles distinct is dependent, to an extent, on the individual wearing the hats. Moreover, there is often the hurdle of finding the two complementary skill sets in a single person.

Assuming it is better to have a formal compliance program with a designated compliance officer than to not have one at all, and given the reality that the compliance role may be held by the GC, what steps can an organization take to allay the concerns expressed by the OIG? The resource guide developed by the OIG and the AHLA provides recommendations that can help ensure that the objectives of the compliance program (and not just the legal department) are met. The recommended considerations[21] include the following:

- Adopting a process where the GC may recuse himself or herself from a compliance investigation, as well as other alternative processes if the matter involves the conduct or judgment of the GC;
- Periodic board initiated third-part audits or assessments of the compliance program; and
- Authorizing the Board and Audit Committee to retain outside counsel or other experts with respect to selected matters under Board-approved criteria.

Another consideration to ensure a compliance system with appropriate checks and balances is to have substantial involvement by a management-level compliance committee. In some organizations, compliance is functionally operated by committee—multiple individuals sharing a single hat—with the GC receiving support and coordination from managers, such as the chief financial officer, human resource leader, chief audit executive, and key business unit leaders.

With small nonprofits whose legal department may consist of the GC as the sole in-house attorney, there may be no better alternative. For many smaller companies, it may make the most sense if the compliance officer is also the GC, because there is sufficient overlap in their roles.

Keep in mind that no matter what the tone is at the top, the risk remains that a particular individual in a dual role will have a limited perspective. In other words, when one is acting in the primary capacity as counsel for the organization, there may be an inherent bias to filter or censor (consciously or unconsciously) critical information that should be reported to the Board. An active compliance committee and the measures noted above can mitigate such risk while providing added credibility and buy-in support for compliance program activities.

Two Functions: Separate but Unequal

Where the CCO is a separate individual but reports to the GC, additional challenges emerge. Again, the OIG has expressed concern about compliance programs where the CCO is subordinate to the GC. Having one function report to the other can solve some checks-and-balances problems, and commentators point to the operational efficiencies attendant such a structure, especially when the GC is senior to and more experienced than the CCO.[22] Overall, the GC and the CCO must work closely together and a direct reporting relation can make operational sense. Additionally, the added resource enables the CCO to focus on compliance operational responsibilities, which can be relief to an overburdened GC.

As with the dual roles, the down-side of this reporting structure is that it can be overly dependent on the individuals in the two positions. CCOs who report to more seasoned and higher-level GCs can face undue pressure if they disagree with their bosses. The tension is obvious and more pronounced when one is not on equal footing and is dependent on another for their livelihood.

As observed previously, "the most powerful people in a corporation…may perpetrate the most dangerous business offenses..."[23] By structuring the compliance program in a way that makes the primary compliance monitor beholden to another superior in the C-suite can be a risky proposition, especially if it is a particular GC who has undeniable clout and when the CCO is viewed as ineffectual.

The OIG and AHLA convey the following recommendations[24] that can attenuate this risk:

- Provide alternative reporting mechanisms that formally provide the CCO direct reporting to another member of senior management as deemed necessary by the CCO;
- Establish procedures to have someone other than the GC authorize the

CCO to conduct compliance investigations, including the right to hire outside counsel; and

- Require periodic direct reports from the CCO to the Board, balanced by the GC's consultation, so that both may report to and advise the Board, consistent with their responsibilities.

For a new compliance function, it may be appropriate for the compliance officer to initially be part of the legal department and administratively report to the GC. At this stage, the newly minted CCO can benefit from the experience, resources, influence, and exposure that the GC can provide to support the compliance program. With additional reporting considerations that provide a level of independence for the CCO, this subordinate structure may work very well for some organizations.

As an additional safeguard, the company can protect the compliance officer from an unusually powerful GC (or other senior executive), by requiring Board approval before a CCO can be terminated.[25] This is in line with protections afforded to CAEs who face similar challenges of maintaining independence and objectivity when dealing with the highest levels in the organization.

As the compliance function evolves and develops it own resources, an assessment of this initial reporting structure should be undertaken. Depending on the size and complexity of the organization, it may ultimately be advantageous for the compliance function to be wholly independent and separate from legal.

Two Separate Complementary Functions

If an organization has sufficient resources to establish a comprehensive compliance program, ideally it should be freestanding to minimize the negative consequences that may arise if the GC and CCO roles have conflicting professional obligations. The clear trend, especially in health care, is for the compliance officer to occupy a senior-level position with commensurate protections, budget, support, and access. If the CCO and GC are essentially given equal stature, there can be enhanced oversight by the Board, because it is more likely to receive balanced and unvarnished information.

When a compliance officer has such senior-appropriate protections, the likelihood is improved for the appropriate reporting up (or out) that may be more difficult for in-house counsel. It is ironic that the term "oversight" is a suitable double entendre in this situation, meaning either to oversee or to have overlooked or missed something important. A Board in ensuring appropriate oversight should assure itself that its CCO is able to provide objective information, analyses, and recommendations. Having a compliance officer who is independent from the GC provides the surest checks and balances in the compliance reporting process.

Considerations still need to be kept in mind when the CCO is independent from the GC. Even the role of the compliance officer needs to be counterbalanced against unchecked zeal in rooting out noncompliance and unethical conduct. Recommendations from the OIG and AHLA[26] include the following:

- Have the GC involved in an advisory capacity in core compliance processes such as: 1) program risk assessments; 2) policies; 3) help-lines and investigations; 4) corrective action to address violations; and 5) reports on compliance processes;
- Include the GC in routine reviews of compliance matters being reported by the CCO—of course, excluding matters in which the GC is the subject of the report; and
- Requiring notice and consultation with the GC when the CCO has independent authority to retain outside counsel and consultants.

An effective CCO will be expected to have the experience and judgment to exercise authority and discretion in an appropriate fashion. A CCO will need to know when an issue needs the direct involvement of the GC and/or outside counsel, for instance, when the application of legal privileges needs careful consideration. When handling compliance audits, help-line calls, and internal investigations, the CCO will undoubtedly need the full support and close coordination of the legal function.

Conflicting Professional Obligations?

Relationship tensions are likely to arise in the handling of a potential legal violation. If a compliance officer has a reputation for integrity within the organization, employees may be more willing to raise and divulge sensitive issues to the compliance department. Company attorneys may not benefit from the same degree of openness, because they are typically viewed as representing the organization and not the individual employees. The CCO is often perceived as more of an ombudsman to the employee.

However, corporate counsel are well situated to become aware of instances involving "material violations," because they are often involved in directing internal investigations (to preserve legal privileges) or providing advice on legal

consequences. For publicly traded U.S. companies, attorneys who appear before the SEC (whether in-house or external counsel), are now required to escalate certain types of violations.

Under Sarbanes Oxley § 307 and SEC Rule 205, material violations of law should be directed to the chief legal officer, who is then responsible for developing an appropriate response. This is the genesis of the duty of in-house counsel to report evidence of a material violation committed by a corporate officer "up the ladder."[27] If the GC or CEO does not respond appropriately, then the counsel must report the evidence to the board of directors.[28] Similarly, the ABA report provides recommendations for attorneys to report potential problems of legal non-compliance.[29]

Therefore, more explicitly than before, a major compliance function of the GC and the in-house attorneys is to bring issues of wrongdoing to the attention of appropriate authorities within the organization. Yet the new professional standards raise difficult questions about the extent to which counsel must disclose information and risk breaching the attorney-client privilege.

Conceivably, in-house counsel may find themselves at odds and in conflict with the company's CCO. As noted, the CCO as ombudsman typically has sensitive information that may require him or her to report at the Board level without executive knowledge. Ideally, the CCO and GC should work closely and trust each other on complicated matters that require difficult judgment calls. But if there is an outright disagreement, how can the competing obligations be handled, especially if the alleged material violation is a close call? This concern was already problematic before Sarbanes-Oxley and the amended ABA rules, when the attorney-client privilege was perceived as preventing the obligation of reporting up[30] or out.

It is useful to evaluate the dilemma in the context of the applicable professional obligations and standards of professional conduct. In stark contrast to the licensed attorney who may become disbarred, the compliance officer lacks a similar professional and disciplinary body that could restrict his or her livelihood.[31] Further, no specific laws or regulations currently provide guidance on professional conduct issues for compliance professionals, comparable to what exists for attorneys.

Reporting Structures

- Enhancing system of checks and balances to meet objectives of the compliance & ethics program. All structures benefit with participation by an active *management compliance committee*.

Model	Considerations for Mitigating Structural Risks
One Person, Two Hats (Dual role)	• Process for GC recusal during a compliance investigation • Alternative processes for investigating and reviewing matters involving the GC • Periodic Board initiated 3rd-party assessments of the compliance program • Allowing Board / Audit Committee to retain outside counsel and experts
Separate but Unequal	• Alternative mechanisms that provide the CCO direct reporting to another member of senior management • Procedures to have someone other than the GC authorize the CCO to conduct investigations, including retention of outside counsel and experts • Require periodic direct reports from the CCO to the Board
Separate and Complementary	• Having the GC involved in core compliance processes such as: 1) risk assessments; 2) policy development; 3) internal investigations; and 4) devising remedial measures to address violations of law • Include the GC in routine review of compliance matters • Requiring consultation with the GC when the CCO has authority to retain outside counsel and consultants

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The closest the compliance profession has to a code of professional conduct in the United States[32] is the Code of Ethics for Health Care Compliance Professionals adopted by the Health Care Compliance Association (HCCA) in 1999. Although an accepted code of ethics can help elevate the status of a profession and strengthen the field,[33] the HCCA currently lacks an enforcement body and doesn't require a licensing credential before one can work the field (though the association does have a professional certification in health care compliance). For a code to have credibility, it usually has to be more than a vague set of aspirational statements. A code should provide guidance for the professional to address difficult situations.

The HCCA Code of Ethics is considered effective, because it provides guidance on dealing with difficult compliance dilemmas.[34] For example, the HCCA Code describes the compliance professional's obligations to the public as "beyond [that of] other professionals" due to the responsibility of preventing misconduct. The Code goes on to describe the significant steps for considering resignation and reporting a matter to public officials.[35]

If there is a disagreement between the CCO, GC, and/or management on a specific compliance matter, a conflict ensues due to differing reporting obligations, especially when the compliance officer feels compelled to "go public." The imposition of reporting obligations on in-house counsel raises some challenging issues. Practical steps for the GC and CCO to resolve differences of opinion and to secure consensus need to be carefully considered, and this is a currently developing area of corporate governance and compliance.

The Compliance Officer and Counsel as Whistleblower

Apart from the consequences that counsel or a CCO may face from their professional affiliation or licensing body, reporting out or whistleblowing can be a career limiting event. As a practical matter, Sarbanes-Oxley can be viewed as creating a conflict between an attorney's duty of confidentiality to the client and his or her own personal interest in avoiding discipline or indictment.

In-house attorneys, and not just the high ranking GC, should be concerned with the risks for not reporting up. Recently the government has been bypassing the GC—and indicting lower ranking in-house counsel—for alleged involvement in corporate fraud.[36]

But are company lawyers and compliance professionals protected if they do opt to speak out in good conscience and after exhausting internal options? A variety of federal statutes provide protections against retaliation for private sector employees who make good faith reports of an employer's conduct that violates criminal or civil laws. Most states also have some form of laws that protect employees from retaliation. And Section 806 of Sarbanes-Oxley provides protection for employees of publicly traded companies.

Here there may also be divergence on the impact on counsel versus the compliance professional. Presumably, compliance officers would be covered by Section 806 if they faced retaliation for providing information to the government on certain types of misconduct. In reality, a CCO does not face the same professional restrictions of protecting "privileged" and confidential information as counsel does.

Attorneys would appear to be protected under Sarbanes-Oxley, though how much protection that affords remains to be seen. The issue for lawyers is whether whistleblower laws permit a claim against a former employer despite laws and ethics rules that permit an employer to discharge a lawyer for almost any reason. And if former counsel were to bring a claim, can the lawyer use privileged information in proving such a case? At the moment, there is considerable variability in how these issues are addressed.

Overall, these issues present no small challenges for both the CCO and the GC. Especially for counsel, there is a balance between the traditional duties of client loyalty and the emerging expectation that counsel will act to influence compliant behavior and report as needed. This perceived conflict between professional duties and public expectations supports the need to separate the roles of the GC and the CCO in large complex organizations.

Conclusion

In difficult situations, a CCO's perspective about a controversial transaction or event would obviously be unnoticed, if that person was also serving as the GC who happened to agree with executive management. As company counsel, the GC is likely to be more focused on supporting the organization's business objectives while staying within the bounds of the law, and less likely concerned with shaping the ethical practices of the organization.

Without an authoritative compliance officer there would be less effective and unconstrained monitoring. The potential

for receiving prudent advice contrary to the determined business plans of management, as supported by a similarly inclined GC, declines. Certain unique business and professional responsibilities need a system of checks and balances that are more difficult to achieve by locating all responsibilities, perspectives, and knowledge within one person or even one function. We're just now starting to see a rash of implicated GCs and other in-house attorneys in major allegations of misconduct (e.g., Medicaid fraud, backdating of stock options, the use of pretexting to obtain personal data, etc.).

In providing legal analysis and advice on how the organization can comply with applicable laws, the GC has a certain vantage point for guiding an entity toward attaining business objectives. In comparison, the CCO is first a manager of a corporation's actions—in implementing a compliance plan, with legal considerations as a backdrop. He or she must do whatever it takes to prevent and detect misconduct.

As seen in health care, strict regulatory requirements and a unique operational environment require close coordination and cooperation between the legal and compliance functions. The key to a successful partnership is a clear understanding of each other's role and the mutual dependencies of each. In the final analysis, a Board needs to be confident that, through the structure of its compliance system, it is receiving a sufficient body of information to exercise its oversight role to prevent corporate governance failures. On balance, a compliance program must correspond to the organization's own structure and business imperatives. In more and more organizations, a robust compliance and ethics program with a high-level CCO is proving necessary. ■

1. See Corpedia and the Association of Corporate Counsel Compliance Program and Risk Assessment Survey of 2005, p.10, where 61% of surveyed companies have a CCO with 48% of those having the dual role of general counsel; see also Corpedia and The Conference Board 2006 Compliance Program and Risk Assessment Benchmarking Survey, p.10, where 38% of the CCOs were reported to also be the general counsel.
2. Health Care Compliance Association Eighth Annual Survey: 2006 Profile of Health Care Compliance Officers, pp.17, 30, where 13% of CCOs are also the general counsel/attorney.
3. Department of Health and Human Services, OIG Compliance Program Guidance for Hospitals, Federal Register, Vol. 63, No. 35, Feb. 23, 1998, 8987, at 8993, f.n. 35.
4. OIG Supplemental Compliance Program Guidance for Hospitals, Federal Register, Vol. 70, No. 19, Jan. 31, 2005, 4858, at 4874.
5. Grassley Investigates Tenet Healthcare's Use of Federal Tax Dollars, Sept. 8, 2003, Press Release providing text of his letter to Tenet Healthcare Corporation.
6. It didn't help that Sarbanes-Oxley failed to formally acknowledge the role of compliance programs and professionals despite the long-standing existence of the U.S. Sentencing Guidelines for Organizations (see comments of attorney Joe Murphy in Tabuena, J., Meet Joseph Murphy, Compliance & Ethics, March 2006, pp. 28-29).
7. Cheek III, J.H., et al., Report of the American Bar Association, Task Force on Corporate Responsibility, 2003.
8. Id. at 32.
9. See U.S. Department of Health and Human Services OIG and AHLA, An Integrated Approach to Corporate Compliance: A Resource for Health Care Organization Boards of Directors, July 1, 2004. The OIG/AHLA resource describes three models of the relationship between corporate counsel and the compliance officer, including steps to mitigate perceived negative consequences from combining the two roles.
10. Demetriou, A.J., et al., Compliance Roles for Counsel to Corporations, American Health Lawyers Association Topical Insight Series, July 2005, p. 13. Similar to the OIG/AHLA resource, supra note 9, this publication provides discussion on the relationship of in-house counsel to compliance officers.
11. Id. at 13.
12. Quote of Joseph Murphy from Tabuena, J., Compliance & Ethics, supra note 6 at 28.
13. Id.
14. This is not to denigrate the legal professional, because the compliance function needs access to good attorneys and their advice. However, the skills required for an effective lawyer do not necessarily translate into those required for a competent compliance officer. 15 Tabuena,J., Meet Mike Lotzof, Compliance & Ethics, June 2006.
15. Tabuena, J., Meet Mike Lotzof, Compliance & Ethics, June 2006. Mr. Lotzof is formerly the Chief Executive officer of the Australasian Compliance Institute which has established an accreditation program with three levels of certification for compliance professionals.
16. Supra, note 9 at 6.
17. Supra, note 10 at 12.
18. Federal Sentencing Guidelines, 8B2.1, Application Note 2(c)(iii), providing that using available personnel rather than employing a separate staff or organization to carry out compliance and ethics activities is an acceptable alternative for the small organization.
19. Supra, note 1.
20. See comments of respected healthcare attorney Gary Eiland in Snell, R., Gary Eiland Discusses the Relationship of Compliance with Other Departments, Journal of Health Care Compliance, July-August 2004, at 38. Mr. Eiland opines that the OIG is more concerned with whether such duality would limit access to information and documents if an investigation were to ensue.
21. See note 9, supra, An Integrated Approach to Corporate Compliance: A Resource for Health Care Organization Boards of Directors at 8.
22. See note 20, supra. Mr. Eiland observes that often the general counsel is the more senior and experienced of the two officers but nevertheless, "the compliance officer should have dual reporting lines in order to report directly to the chief executive officer and board compliance committee, as appropriate".
23. Supra, note 6 at 28.
24. See Note 1, supra, An Integrated Approach to Corporate Compliance: A Resource for Health Care Organization Boards of Directors at 8.
25. See Murphy, J., Questions to Ask About an In-House and Ethics Job Offer, ethikos and Corporate Conduct Quarterly, November/December 2004, at 9.
26. See note 9, supra, at 8.
27. 17 C.F.R. § 205.2(i), 2003 (17 C.F.R. Part 205 contains the rules promulgated by the SEC in response to Section 307 of the Sarbanes-Oxley Act.
28. For a detailed analysis of the impact of the Sarbanes-Oxley standards of professional conduct on in-house attorneys, see Noordhash, K., Sarbanes-Oxley Act and In-House Counsel: Suggestions for Viable Compliance, Georgetown Journal of Legal Ethics, Summer 2005.
29. ABA Model Rules of Professional Conduct, Rule 1.13. While the focus of the ABA Task Force was on public companies, many of its recommendations as well as the amendments to Model Rule 1.13, apply to non-profit and privately-held corporations.
30. The traditional rule did not impose sanctions, as Sarbanes-Oxley now does, on an attorney who chose not to report up the ladder, so long as nothing was done to further or abet the illegal conduct.
31. While a CCO may be a licensed attorney or Certified Public Accountant, they are usually not functioning in a professional capacity in which the designation is held (i.e., a compliance officer is not dispensing legal or accounting advice).
32. For the compliance professional certifications in Australia, one of the mandatory requirements is adherence to the Australasian Compliance Institute ("ACI") Code of Ethics. The ACI has an ethics committee which hears issues and a defined hearing and appeals process.
33. Murphy, J., Ethics for Ethicists? A Code for Ethics and Compliance Professionals, 17 ethikos 8, March/April 2004.
34. Tabuena, J., Meet Joseph Murphy, Compliance & Ethics, supra note 1 at 25.
35. HCCA Code of Ethics for Health Care Compliance Professionals, R1.4.
36. Reisinger, S., Aiming Lower, Corporate Counsel, April 1, 2006.

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