THE STAGES OF SCANDAL AND THE ROLES OF GENERAL COUNSEL

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This Essay examines the roles of a general counsel, as the corporation's chief legal officer, in responding to scandals when they happen and in developing and enforcing internal preventive practices prior to the occurrence of any particular scandal. The Essay differentiates between scandals and crises more generally, emphasizing the integral connection between scandal and jeopardy to reputation and tracing the interrelationships between a corporation's reputation and that of its general counsel. The Essay argues that risks associated with scandal may strengthen general counsel's power within the senior management team, in particular in general counsel's relationship with the corporation's CEO. Although general counsel's position as a member of the senior management team may imperil counsel's ability to bring detached judgment to bear, counsel's position within the corporation is a critical component of effectiveness in anticipating and addressing scandals.

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INTRODUCTION

Not all organizational crises, even ones with wide-reaching consequences, constitute scandals. Unlike crises or adverse events more generally, scandals embroil identifiable actors who are (or should be) held responsible for the consequences of their actions. A scandal is triggered by conduct that offends generally shared moral sensibilities and that becomes the focus of sustained and general attention. For an organization as for an individual, the long-term taint in the wake of scandal may overwhelm its immediate consequences, whether financial, legal, or otherwise. Separately, crises that have many distinct causes are difficult to untangle into discrete lines of responsibility traceable to culpable individual actors.[1] Reflecting on the near-collapse of the world financial system in 2008, Bear Stearns's last CEO—his own firm a memorable casualty—detailed a number of macroeconomic developments that preceded the crisis while acknowledging that "greed was a factor in all this, too."[2] In the end, "these things do occur with some regularity, and we haven't ever figured out how to stop the next one from happening."[3] To be sure, distinctly identifiable scandals may occur in the midst of a larger crisis.

The underlying conduct that makes an incident a scandal often violates the law.[4] Examples, some ongoing, of scandals centered on illegal or arguably illegal conduct are numerous and include: News Corp. and the hacking of cell phone records by employees of the now-defunct *News of the World*, plus payoffs to police officers for phone-

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1. For a recent example, see Jesse Eisinger, *The S.E.C.'s Meek Approach to Combating Securities Fraud*, N.Y. TIMES, Oct. 27, 2011, at B5 (identifying multiple factors that explain why to date "[n]o major investment banker has been brought up on criminal charges stemming from the financial crisis," the SEC has taken a risk-adverse pattern in civil complaints and enforcement proceedings, and "private litigation has failed" to take up slack in enforcement). On private-party litigation stemming from the 2008 financial crisis, Eisinger identifies the status of many putative victims as a factor: "large financial institutions and money managers . . .do not want to sue because it could reveal their own compromised behavior. Or they would be revealing to customers that they had simply been taken by other, smarter bankers." *Id.*

2. WILLIAM D. COHAN, HOUSE OF CARDS: A TALE OF HUBRIS AND WRETCHED EXCESS ON WALL STREET 448–49 (2009) (internal quotation marks omitted). In the same vein, "everybody tries to look at what happened in the previous six months to find somebody or something to blame it on. But, in truth, it was a team effort. . .. Government. Rating agencies. Wall Street. Commercial banks. Regulators. Investors." *Id.* at 450 (internal quotation marks omitted).

3. *Id.* at 449–50 (internal quotation marks omitted).

4. Ongoing investigations in the wake of the 2008 financial crisis may yet result in criminal indictments of specific individuals who worked on behalf of specific financial firms. *See* Jeff Madrick & Frank Partnoy, *Should Some Bankers Be Prosecuted?*, N.Y. REV. BOOKS, Nov. 10, 2011, at 23.

related information not otherwise available;[5] Siemens and a widespread bribery scheme;[6] UBS and $2.3 billion in unauthorized trades by a rogue employee;[7] high-tech companies and backdated stock options;[8] and Hewlett-Packard's use of pretexting to investigate its own board.[9] All were preceded by the prior decade's financial accounting scandals at Enron, WorldCom, and HealthSouth. Some scandals involved lawyers whose conduct was legally culpable or otherwise problematic.[10]

Scandals are also distinctive from crises because reputation is central to a scandal's impact. The damage inflicted by a well-publicized scandal may impugn the reputations of the individuals and organizations involved and carry long-lasting consequences for them. Relatedly, individuals and organizations that wish to avoid damage to reputation may avoid engaging in conduct that may generate a scandal, resulting in a constraint on behavior that turns on the anticipated impact of a scandal. And attempts to mitigate adverse impacts on reputation or their duration often shape how organizations respond in the midst and aftermath of a scandal, once the underlying incident has come to light.

This Essay focuses on the roles of a general counsel, as a corporation's chief legal officer, in responding to scandals when they occur and in developing and enforcing internal preventative practices prior to the occurrence of any particular scandal. The Essay's analysis and concrete examples concern publicly held corporations, in part because their visibility and significance are more likely to attract the degree of sustained media scrutiny that sparks general public interest. Prior scholarship explores at length the nature and sources of ambiguities inherent in the general counsel's position.[11] In connection with a corporation's vulnerability to scandal, a general counsel's position within a corporation's senior echelons may afford deep insights into its weaknesses and furnish leverage to address them. However, the general counsel's position may also imply tensions between the value of professional detachment and counsel's natural empathy with other members of the senior management team. Additionally, as a member of that team, the general counsel's working definition of independent

5. *See infra* text accompanying notes 96-101.

6. *See infra* text accompanying notes 112-115.

7. *See infra* text accompanying notes 118-123.

8. *See infra* text accompanying notes 33-37.

9. *See infra* text accompanying notes 54-57.

10. Deborah L. Rhode, *Moral Counseling*, 75 FORDHAM L. REV. 1317, 1320 (2006) ("Lawyers have been implicated in almost all of the major health, safety, and financial scandals of recent decades.").

11. *See, e.g.*, Deborah A. DeMott, *The Discrete Roles of General Counsel*, 74 FORDHAM L. REV. 955 (2005); Sung Hui Kim, *Gatekeepers Inside Out*, 21 GEO. J. LEGAL ETHICS 411 (2008).

professional judgment may be shaded by a managerialist view that de-emphasizes compliance with legal and ethical norms or dulls their distinctiveness among the constraints or risk-relevant factors applicable to a corporation, stressing instead "the importance of protecting the client" from regulatory oversight and business competition.[12] In Robert Rosen's account, a general counsel's power can only be exercised "at the executive level, in the presence of the [Vice Presidents]," the other "functional specialists" who serve on the senior management team.[13] Gaps may follow in corporate accountability when compliance with the law gives way to patterns of organizational redesign that emphasize "adding value" to the corporation in the measurable short term.[14]

However, as Professor Rosen acknowledges, scandal may prompt a sharp correction in course toward greater centralization and control,[15] which would facilitate a renewed emphasis on legal and regulatory compliance and the distinctiveness of general counsel's role. In prospective terms, the magnitude of damage—including but not limited to adverse legal consequences—that may follow a scandal could enable general counsel to engage the attention of other members of the senior management team, plus underline the distinctiveness of legal compliance, the consequences of non-compliance, and the centrality of counsel's professional insights. Thus, the illegality that underpins many scandals should strengthen general counsel's hand, in part because it implicates counsel's technical facility with the content of the law and its application. Once a scandal emerges, moreover, the functions served by general counsel can be crucial in defining the scandal's often-cathartic consequences. At that point, general counsel's capacity to persuade the CEO and other members of senior management may reach an apogee.

To make its points more crisply, the Essay differentiates among the stages of a scandal to demonstrate that each implicates different dimensions of a general counsel's responsibilities to a corporate client, as well as the inevitable tensions implicit in a general counsel's position. The Essay thus sketches some of the specifics of scandals that are relevant to a general counsel's functions and authority. Part I begins by exploring and defining the distinctiveness of scandal in contrast to organizational crises, errors, and risks more generally. Part I also

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12. David B. Wilkins, *Team of Rivals? Toward a New Model of the Corporate Attorney/Client Relationship*, *in* 62 CURRENT LEGAL PROBLEMS 2009, at 478, 533 (Colm O'Cinneide ed. 2010).

13. Robert Eli Rosen, *"We're All Consultants Now": How Change in Client Organizational Strategies Influences Change in the Organization of Corporate Legal Services*, 44 ARIZ. L. REV. 637, 666 (2002).

14. *Id.* at 681.

15. *Id.*

examines the definition and operation of reputation. Like scandal, the meaning and operation of reputation are both intuitive and complex, as is the insight that concern for reputation may operate as a constraint on potentially scandalous behavior. Moreover, the nature of reputation may vary as between individuals (including a general counsel and other lawyers) and organizations, like a corporate client. Prior scholarship that explores the significance of reputation to lawyers' work differentiates "reputational" from "nonreputational" lawyers, placing in one category an outside lawyer who renders opinions on the legality of transactions and, in a separate "nonreputational" category, inside counsel.[16] However useful in some contexts, this categorization slights the complexity of reputational issues that bear upon the roles of general counsel. Part II examines the stages of scandal; although these may overlap, the Essay demonstrates the analytic value of differentiating among a prelude or incipient stage, followed by a distinct stage once a potentially scandalous incident is known to have occurred, and then a postlude stage of learning and planning for the future. Part III concludes with a few implications for a general counsel's sources of authority and effectiveness within a large corporation. These include the reciprocal relationships between counsel's personal reputation as a professional, the corporation's reputation and management structure, and the agility required for success in general counsel's position.

I. DEFINING SCANDAL

A. Crises and the Vocabulary of Crisis Management and Risk Management

Many scandals fall within a subset of events that constitute organizational crises but have additional characteristic elements. An organizational crisis can be defined as "a low-probability, high-impact event that threatens the viability of the organization and is characterized by ambiguity of cause, effect, and means of resolution, as well as by a belief that decisions must be made swiftly."[17] Any definition of crisis implies that the event carries an "element of surprise."[18] In the scholarship of crisis management, a crisis—like many scandals—represents a threat to "core values or life-sustaining systems" and

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16. Karl S. Okamoto, *Reputation and the Value of Lawyers*, 74 OR. L. REV. 15, 28 (1995).

17. Christine M. Pearson & Judith A. Clair, *Reframing Crisis Management*, 23 ACAD. MGMT. REV. 59, 60 (1998).

18. John F. Preble, *Integrating the Crisis Management Perspective into the Strategic Management Process*, 34 J. MGMT. STUD. 769, 777 (1997).

requires urgent responses under conditions of uncertainty.[19] Natural disasters,[20] political upheaval, bank panics and other financial crises, and massive technological failures may all precipitate crises for corporations and other organizations when unlikely risks materialize. Within the realm of financial crises, some are susceptible to strict quantitative definitions while defining others requires more qualitative judgments.[21]

Discussions of crisis management, like those of risk management, often use a flattened vocabulary that does not fully encompass all potential consequences or their causes. The managerialist orientation of crisis management, for example, focusing as it does on implications for organizational policy and operations, tends to omit symbolic perspectives on crises—their meaning within frameworks that legitimate a given order—with the consequence that decision-makers may interpret the significance of events within an unduly anemic framework.[22] Relatedly, the vocabulary of enterprise risk management assumes that risks—"potential events that may affect the entity"—may be identified and then managed within the entity's overall tolerance or appetite for risk relative to a reasonable assurance of achieving its objectives.[23] Enterprise risk management incorporates corporate governance as a mechanism of managing behavioral risks with financial and technical

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19. Arjen Boin, *Editor's Introduction* to I CRISIS MANAGEMENT xvii (Arjen Boin ed. 2008).

20. *Id.*

21. CARMEN M. REINHART & KENNETH S. ROGOFF, THIS TIME IS DIFFERENT: EIGHT CENTURIES OF FINANCIAL FOLLY 4 (2009). In the first category Reinhart and Rogoff place inflation crises; currency crashes and debasement through reduction in the metallic content of coins or a new currency that supersedes an older depreciated currency; and bursts in asset price bubbles. *Id.* at 4–8. Requiring more qualitative evaluation are banking crises, external debt crises involving an outright default on sovereign debt, and domestic public debt crises. *Id.* at 8–14. For events within this latter category, endpoints for a crisis can be difficult to establish. *Id.* at 14.

22. For a fuller elaboration, see Paul 't Hart, *Symbols, Rituals and Power: The Lost Dimensions of Crisis Management*, 1 J. CONTINGENCIES & CRISIS MGMT. 36 (1993), *reprinted* in 3 CRISIS MANAGEMENT, *supra* note 19, at 84. Hart's initial illustration is the refusal of an official state funeral by the surviving families of Aldo Moro and anti-Mafia Judge Borsellino; the families ascribed responsibility to the state when Prime Minister Moro was killed by his captors and Judge Borsellino was assassinated. Each refusal was "a symbolic act of anger, despair and defiance" that underscored the larger implications of the government's failures. *Id.* at 84. Each refusal also called into question an official interpretation of the incident that focused on short-term and event-based concerns as opposed to broader implications for governmental effectiveness and legitimacy. *Id.* at 100.

23. Michelle M. Harner, *Ignoring the Writing on the Wall: The Role of Enterprise Risk Management in the Economic Crisis*, 5 J. BUS. & TECH. L. 45, 46 (2010) (quoting COMM. OF SPONSORING ORGS. OF THE TREADWAY COMM'N, ENTERPRISE RISK MANAGEMENT—INTEGRATED FRAMEWORK: EXECUTIVE SUMMARY 2 (2004)).

risk management.[24] Implicit is commensurability across risk categories, regardless of differences among them.[25] To the extent the law is treated as simply a source of "risk" that may for this purpose be homogenized with risks stemming from other sources, it is incorporated within a risk-management framework as another constraint on conduct, "not norms that express views of right conduct or desirable states of the world."[26] Situated within a corporate client, a lawyer (including the general counsel) might be captivated by this neutral vocabulary; if the lawyer's role is framed by members of management, counsel could be accorded a significant role in corporate compliance while the decision of whether to comply with the law could nonetheless be treated as "the ultimate risk management decision"[27] within overall managerial responsibility for risk management.

Compliance with the law fits poorly within this vocabulary. For one thing, as Stephen Bainbridge notes, business risk management, inevitably intertwined as it is with risk taking, differs in significant degree from questions of legal compliance.[28] Failures on either score can lead to financial loss, but although an effective risk management program "can prevent risks from materializing and perhaps limit the impact of those that do," a good legal compliance program additionally can limit the consequences of incidents of non-compliance by mitigating penalties.[29] More generally, compliance with the law is a less complex question (at least in many cases) than the complexity of managing business risks. Whether or not to comply is a binary, yes-or-no, either-

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24. *Id.*

25. Commensurability across categories is also implicit in management literature premised on identifying and managing threats to a corporation's ongoing ability to create value. Work by lawyers could be characterized as "an indispensible aid to manage these ongoing threats, which often involve a legal component," which does not necessarily differentiate among degrees or types of legal matters. Omari Scott Simmons & James D. Dinnage, *Innkeepers: A Unifying Theory of the In-House Counsel Role*, 41 SETON HALL L. REV. 77, 83 (2011) ("[F]ailure to comply with a federal regulation, a poorly written supply contract, or a mishandled product lawsuit, all constitute a threat to corporate value.").

26. Robert W. Gordon, *A New Role for Lawyers?: The Corporate Counselor after Enron*, 35 CONN. L. REV. 1185, 1192 (2003).

27. Kim, *supra* note 11, at 439. In Professor Kim's assessment, "[f]or inside counsel to challenge management's commands or self-professed authority to make such decisions would be perceived as a violation of inside counsel's role commitments and an embarrassing disruption of a well-defined social script." *Id.*

28. Stephen M. Bainbridge, Caremark *and Enterprise Risk Management*, 34 J. CORP. L. 967, 981 (2009).

29. *Id.* at 982 (discussing an example of downward adjustments to fines under federal sentencing guidelines when a firm has appropriate compliance program in place or voluntarily discloses a violation).

or question,[30] even when determining what the law requires in particular circumstances requires a nuanced inquiry. Thus, failure to comply with the law[31]—particularly a considered failure to comply—has a stark quality of disregard of generally applicable social norms that can transform what might have been an incident, or under some circumstances a crisis, into a scandal.

B. Scandals and Their Narrative Arcs

A distinctive quality of scandals is their use as vehicles for the expression of public outrage. To be sure, crises and disasters also serve as focal points for expression of widely shared sentiments, but tones of outrage and moral disapproval are distinctive to scandals. What transforms an underlying incident into a scandal is its transmission to the public as news through media technologies. The incident becomes a story, narrativized into an account of moral irresponsibility on the part of identifiable actors.[32] As an incident or pattern of incidents becomes a scandal, official law enforcement may respond in ways that track the intensity of media scrutiny.

Consider in this light the phenomenon of stock-option backdating, often referred to as a "scandal."[33] Backdating is problematic in several respects. To back date the grant date of a stock option to an earlier date on which the stock traded at a lower price than the option's exercise price is often inconsistent with the terms on which a corporation's shareholders approved the stock option plan. More generally, by assuring grantees that the option is in the money when granted, the practice of back dating seems inconsistent with furnishing forward-looking incentives to grantees, likely the premise on which the shareholders approved the option plan and the directors approved a particular set of grants. Backdating, which often carries adverse tax and accounting implications, may stem from management's lack of candor with the corporation's directors when they approve option grants. Academic research initially identified the possibility that some corporations engaged in backdating; as the practice immediately

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30. *Id.* at 988.

31. Inaction by a board of directors aware of a sustained pattern of major regulatory violations is an example. *Id.* at 987.

32. James Lull & Stephen Hinerman, *The Search for Scandal*, *in* MEDIA SCANDALS: MORALITY AND DESIRE IN THE POPULAR CULTURE MARKETPLACE 1, 7 (James Lull & Stephen Hinerman eds., 1997).

33. *See, e.g.*, D.M. Osborne, *Stock Option Scandals Take down a Record Number of GCs*, CORP. COUNS. (Dec. 7, 2006), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1165413316556 (reporting that in one year, twelve general counsels stepped down and "the casualty list will only grow").

"resonate[d] as yet another example of executive greed and deception," it had what it needed to "generat[e] substantial populist outrage" once it became a front-page story in the *Wall Street Journal* that identified individual corporations as suspected culprits, followed by other stories in the business and general press.[34] In turn followed investigations by the SEC, which are the focus of a recent study by Stephen Choi and his co-authors. Relative to other SEC investigations of accounting-related conduct over the same period, the backdating investigations had consequences that diminished as the scandal wore on, implying that over the cycle of investigations smaller errors became the focus with smaller consequences.[35]

More generally, in the assessment of Professor Choi and his co-authors, the SEC's enforcement priorities "respond[] to the salience of financial wrongdoing"; media coverage is a plausible proxy for salience[36] because it likely reflects popular opinion as well as the interest of members of Congress who determine the level at which the SEC is funded.[37] Additionally, this scandal's duration and immediate consequences turned on the ongoing salience of the scandal's narrative, itself shaped by the intensity and breadth of media coverage. In contrast, the occurrence of crises, their duration, and their consequences are more independent of ongoing media engagement. That is, scandal necessarily requires an audience which, as the backdating episodes illustrate, may include law-enforcement agencies. As discussed in Part II.C, this dimension of scandal implicates general counsel in an agent's role on behalf of the corporation, communicating (or managing communications) on the corporation's behalf with external audiences.

C. Reputations: Individuals and Organizations

Scandals by their nature often impugn the reputations of those involved, including lawyers. For example, over the potentially long shelf life of a law school text of case studies on professional responsibility, it is not a positive for a lawyer's reputation to be

34. Stephen J. Choi et al., *Scandal Enforcement at the SEC: Salience and the Arc of the Option Backdating Investigations* 2 (New York Univ. Sch. of Law, Law & Econ. Research Paper No. 11-20, 2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1876725.

35. *Id.* at 29.

36. *Id.* at 35.

37. *Id.* at 4.

featured as a contributor to a corporate scandal.[38] Reputation itself is an intuitive and somewhat indeterminate concept. For example, one might ask, "reputation for what?"[39] Reputation might be limited to one issue or, in the case of a lawyer, one dimension of conduct; or reputation's reach might be broader[40] when untrustworthiness or unreliability in one connection signals a broader problem. Another basic question about reputation is "whose reputation?" Reputation necessarily seems closely personalized or tightly associated with its subject, whether an individual or an organization, and not transferrable to others. For an organization, perhaps selling or licensing a product's brand or a trade name might count as a transfer of reputation, but not, one suspects, necessarily so. In particular, organizations like law firms that furnish expert services dependent on the trustworthiness of individual actors might have a valuable "brand" in the firm's name[41] but not one comparable in transferability to a well-established brand name for a physically consumable good, such as a trademarked name associated with a soft drink made according to a secret formula. That's not to deny the

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38. Many examples appear in MICHAEL C. ROSS, ETHICS & INTEGRITY IN LAW & BUSINESS: AVOIDING "CLUB FED" (2011). Early in the book the author asks law students: "What can be learned from the media reports of ethical scandals in business and the involvement in them by lawyers?" *Id.* at 2. Although the book does not name the lawyers involved, it includes ample citations to published accounts through which a reader who wishes could identify lawyers by name. *See, e.g.*, *id.* at 17 & n.18. (reporting incidents in which general counsel lacked license to practice law in the corporation's headquarters state or in any state); *id.* at 43 & n.2 (pretexting by chairman and general counsel of "[a] well-known Silicon Valley high-tech company . . .to investigate leaks from the company's board of directors"); *id.* at 111 & n.10 (general counsel of biotech company sells shares in company on day he learns of fatal adverse reaction by patient to company's new drug, having earlier placed sell order and then instructing broker to proceed with sale once informed of the reaction); *id.* at 112 & n.13 (general counsel of semiconductor manufacturer trades on non-public information via information swapping-arrangement with neighbor, an employee of a computer hardware company).

39. For an incisive treatment of reputation as an explanation for compliance with international law, see Rachel Brewster, *Unpacking the State's Reputation*, 50 HARV. INT'L L.J. 231 (2009). In particular, if a state's reputation for compliance is issue-specific or specific to particular treaty partners, reputation by itself may not create much of an incentive for states to comply with international law. *Id.* at 259–62. Additionally, only reputation that is transferrable would translate from one area to another and thereby create issue-independent incentives for compliance. *Id.* at 261–62.

40. *See id.* at 262–66.

41. Thus, perhaps the reputation associated with a law firm depends for its durability on more than continuity over time of the name under which the firm operates. *Cf.* Okamoto, *supra* note 16, at 16 (commenting on prototype of business lawyers involved in acquisition transactions "working at an organization whose very name carries prestige in its community").

attractiveness of discussing, in an "as-if" way, lawyers' "brands" but to suggest that the relevant qualities of reputation are different.

Reputation operates differently depending on whether its subject is an organization or an individual. For an organizational subject like a corporation, reputational consequences may be more limited or issue-focused, and events that impugn reputation may diminish in significance with the departure of identified individuals who bear responsibility for the underlying conduct.[42] Thus, for an organization associated with a scandal,[43] it is easy to understand the attractiveness of an identifiable culprit with whose exit the organization's reputation may be recast. When the individual identified as a culprit is not culpable, or not especially culpable relative to other causes, blame has been personalized on to a scapegoat.[44] In contrast, for an individual once tainted by scandal, redemption may be possible but likely not through this route. On the other hand, the post-scandal circumstances of general (and other inside) counsel tainted by fraud or serious ethics violations warrant empirical study. If discipline by a state bar committee is unlikely, a post-scandal future in the legal profession remains a possibility, at least theoretically.[45]

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42. Brewster, *supra* note 39, at 256–57 (noting that "[s]tates are not static" because the composition of governments can and does change, with the consequence that acts of a prior government that resulted in loss of reputation are not necessarily predictive of conduct of the new government).

43. As discussed later at greater length, scandal and its consequences may attach to an organization in a more salient fashion or in a different way than the scandal's association with identifiable human actors. *See infra* text accompanying notes 54–65. This calls into question the assertion in some scholarship that scandals necessarily require identified human culprits. *See* LULL & HINERMAN, *supra* note 32, at 4 ("[T]he scandal differs in some ways substantively and discursively from the moral panic in that *scandals must be traceable to real persons who are held responsible for their actions.*").

44. For a discussion of scapegoating in connection with disasters, see Thomas E. Drabeck & Enrico L. Quarantelli, *Scapegoats, Villains, and Disasters*, TRANSACTION, no. 4, 1967 at 12, *reprinted in* 3 CRISIS MANAGEMENT, *supra* note 19, at 146. The authors associate the personalization of fault to less culpable individuals with distracting attention from "structural flaws," which in the context of the article means a range of authority structures and regulatory deficiencies that were substantial causal factors in disasters. Some scholars associate the attribution of blame following a disaster with unconscious feelings of guilt, which produces scapegoating and other irrational behaviors. *Id.* at 147–48. Other scholars find the primary motive to be a desire to assure that such a disaster does not happen again, in which persons are blamed when natural causes are insufficient. *Id.* at 148–49.

45. *See* Sue Reisinger, *Punished, Debarred—But Still Members of the Bar*, CORP. COUNS. (Nov. 14, 2011), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202532237528 (reporting three cases of general counsel, discharged from employment, who remain members of the bar; one was convicted of a federal criminal misdemeanor, one found guilty of ethics violations by a state utility

Additionally, when the individual in question is a professional like a general counsel or other lawyer, reputation operates across a broader scope than is true for an organization, for which reputation may be more closely associated with particular issues or activities. Relatedly, the duration over time of a professional's reputation may be more evanescent because of its greater vulnerability.[46] Likewise, reputation may be more crucial to a professional because it is so integral to the professional's work. Scholars who examine the ability of lawyers and other professionals to serve as gatekeepers that furnish credible monitoring and sanctioning of clients' compliance with the law treat reputation as an asset belonging to the professional, one that stems from a track record accumulated over time.[47] To explain how law firms might have jeopardized their reputational capital in the accounting-related scandals of the late-twentieth century, John Coffee identifies the multiple guises in which a firm may promote itself: "[t]o the corporate general counsel, it is the tough, relentless advocate, the hard-driving negotiator and the skillful planner who is able to exploit whatever loopholes the law offers. To investors and the public generally, it is the wise statesman with an impeccable reputation for integrity . . .."[48] Thus, as applicable to any single actor, reputation has chameleon-like qualities that may vary with the audience.

Finally, the meaning and operation of reputation are more complex (and interesting) than many accounts suggest. For a general counsel, in contrast to external counsel, individual reputation as a professional is closely linked to that of the client. On the one hand, this close tie often

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commission, and one lost his right to practice before the SEC as part of a settlement resolving charges of financial reporting fraud). The article also reports that officials of state bars in Texas and Indiana cannot recall any instance of bar discipline in their states against a general counsel. *Id.* Indeed, in-house lawyers from one scandal-doomed organization may later appear in senior positions at another. For example, the head of compliance at Refco, a broker that failed in a massive accounting fraud, later became the Senior Vice President for legal matters and head of compliance at MF Global, a collapsed financial firm unable to locate $1.2 billion in customer funds, according to its bankruptcy trustee. *See* Francine McKenna, *Lax Law Enforcement Means MF Global Mistakes Will Be Repeated*, BANK THINK (Nov. 11, 2011), http://www.americanbanker.com/law-law-enforcement-means-mf-global-mistakes-will-be-repeated-1044009-1.html.

46. On reputation's "fleeting" or "evanescent" qualities, see Christopher T. Hines, *Reputation as Ethical Consideration* 3 n.4 (draft), *available at* http://ssrn.com/abstract=1940007) (noting that legal practitioners have "long understood this momentary aspect of one's professional reputation").

47. JOHN C. COFFEE JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 325–26 (2006); Hines, *supra* note 46, at 45 & nn.270–71.

48. COFFEE, *supra* note 47, at 326. Professor Coffee notes that for some purposes, "it may be necessary to insist that a law firm choose a single role that it is to play for a corporate client." *Id.*

underlies the conclusion that inside counsel is ill-suited to play a gatekeeping role for many reasons, including economic dependency on one client;[49] on the other hand, because a general counsel's professional reputation and that of the corporation are so closely tied, a general counsel might well build her own reputation through effective interventions to establish and maintain the corporation's reputation for conduct and qualities that are salient to the law.[50] Of relevance in this connection is the phenomenon of turnover among general counsel. As of 2005, general counsel turnover among S&P 500 firms was about double that for CEOs; in 2005, twenty-nine percent of general counsel departed their firms, in contrast to fifteen percent of CEOs.[51] The inter-firm mobility of general counsel implies that their positions are consistent with developing individual professional reputations that are transportable to other firms. This calls into question the view that a general counsel's position disables her from establishing a professional reputation that is transferable to another employer.[52]

D. The Sticky Aftermath of Scandal

Although some scandals constitute or are part of crises that threaten a corporation's continued viability, every scandal does not necessarily constitute a crisis, at least a crisis with such high stakes. The stakes for many corporations implicated in the scandalous backdating of stock options were not so grave.[53] However, a sequence

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49. Kim, *supra* note 11, at 414 (arguing that conventional portrayal of "gatekeeping efficacy of inside and outside counsel is caricatured and exaggerated").

50. Okamoto, *supra* note 16, at 28–29 n.33. Professor Okamoto recounts the reaction of the Chief Legal Officer of a large public corporation to his hypothesis that lawyers who work inside a corporation are "nonreputational lawyers." *Id.* The Chief Legal Officer's corporation offered securities for public sale with prospectuses listing him, not an external counsel, as the source of the opinion in the prospectus on the legality of the offering. *Id.* And beyond this transactional specific, the Chief Legal Officer insisted that "corporate counsel can be instrumental in establishing and maintaining [a] reputation" that obviates the need to obtain an opinion from external counsel. *Id.* at 29 n.33.

51. *See* Wilkins, *supra* note 12, at 510.

52. *See* COFFEE, *supra* note 47, at 195.

53. The resolution of backdating incidents at Apple Computer is a leading example of relatively mild consequences. *See, e.g.*, Peter Burrows, *Byte of the Apple: A Nice Tidy End to the Options Backdating Scandal*, BLOOMBERG BUSINESSWEEK (Aug. 14, 2008), http://www.businessweek.com/technology/ByteOfTheApple/blog/archives/2008/08/a_nice_tidy_end.html (reporting settlement by former general counsel of Apple Computer of backdating charges brought by SEC and characterizing it as a victory for Apple investors because it obviated the possibility of testimony by Apple's CEO, Steve Jobs, who although exonerated in investigation conducted by Apple's board, returned to the company at the time back dating commenced). To Steve Jobs's

of scandals, each without large or immediately evident financial consequences, may call into question a corporation's culture or reputation in wide-reaching ways. Sequential scandals associated with Hewlett-Packard (HP) are instructive on this score. In 2006, its Chief Compliance Officer (a lawyer), who reported to HP's general counsel, authorized the security department's use of false pretenses to investigate suspected board-level leaking, an investigative practice termed "pretexting." The investigation was triggered by an expression of concern about leaking by HP's Chairman to its general counsel. When the investigative tactics came to light, they were condemned as outrageous, illegal, and highly rash.[54] Congressional hearings followed, as did federal felony charges for an investigator (to which he pled guilty) and state felony charges, ultimately reduced to misdemeanors, against HP's Chairman (ultimately dismissed by the court), the Chief Compliance Officer, and two investigators.[55] Additionally, the Chairman, the general counsel, and the Chief Compliance Officer lost their jobs.

In Miriam Baer's thoughtful account, the legal analysis undertaken by the Chief Compliance Officer was superficial; although more searching inquiry might have concluded that pretexting was outside the scope of federal and state prohibitions, he "*should* have recognized that the risk of criminal, civil, and professional liability (not to mention the potential effect on HP's reputation) was rapidly shifting" with greater public and official concern about pretexting.[56] More generally, those responsible at HP seemed oblivious to the prospect that, when used by a private-sector corporation for its own ends, deceptive investigative tactics would seem abusive and less likely to be tolerable

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biographer, the climate within the corporation for which he was responsible "made it hard for someone like" Apple's general counsel to go against his wishes, which in this connection required the creation of phony board minutes to show that the board had approved a huge grant of stock options to Mr. Jobs on a date chosen because Apple's price on that date was around $18 in contrast to $20 on the later grant date. WALTER ISAACSON, STEVE JOBS 449–51 (2011). Also implicated in the scandal was Apple's CFO (also a board member) who was cited by the SEC for negligence in the paperwork associated with another set of option grants. *Id.* at 450–51. This led to the CFO's resignation and his perception that he had been made a scapegoat. *Id.* at 451. On the organizational function of scapegoats in the context of scandal, see *supra* text accompanying notes 43-44.

54. Miriam Hechler Baer, *Corporate Policing and Corporate Governance: What Can We Learn from Hewlett-Packard's Pretexting Scandal?*, 77 U. CIN. L. REV. 523, 524–25 (2008).

55. *Id.* at 531–32.

56. *Id.* at 533.

than deception practiced by public law enforcement agencies.[57] Another scandal followed for HP in 2010 when its CEO Mark Hurd—relatively new in the job during the pretexting scandal—was forced to resign in a split board vote after an investigation of an allegation of sexual harassment proved that allegation unfounded but surfaced inaccurate expense reports, purportedly submitted by Mr. Hurd to conceal the relationship.[58]

These incidents illustrate that a corporation itself may acquire a reputation via association with scandal that is in some ways independent of the foibles of identifiable individuals and that survives once the corporation has jettisoned them. Additionally, the consequences of such a reputation may not operate in synch with the reaction of financial markets. Throughout the pretexting scandal, HP thrived financially, with its stock reaching its highest price in six years.[59] Nonetheless, the company's successive scandals are now case studies in materials for law[60] and business[61] students, framed as exemplars of problematic conduct. A case study for business students continues HP's saga, through a successor CEO in office for a brief eleven-month term who was fired by the board following the CEO's announcement that the company would make major business changes and a subsequent twenty percent decline in HP's stock price.[62] Thereafter the board named one of its own members as CEO without either forming a search committee or naming an interim CEO. Commenting on the appointment, HP's Executive Chairman said in a conference call to investors: "If we thought there was a better choice outside, we would have conducted the

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57. *See id.* at 571–73. The same obliviousness may have dulled the insights of those responsible at News Corp. once they learned of the information-gathering tactics deployed at *The News of the World*. *See infra* text accompanying notes 96-101.

58. *See* David F. Larcker & Brian Tayan, *Leadership Challenges at Hewlett-Packard: Through the Looking Glass*, *in* CLOSER LOOK SERIES, at 1, 5 (Rock Ctr. for Corporate Governance, Ser. No. CGRP-21, Oct. 11, 2011), *available at* http://ssrn.com/abstract=1941849.

59. James Stewart, *The Kona Files*, NEW YORKER, Feb. 19, 2007, *available at* http://www.newyorker.com/reporting/2007/02/19/070219fa_ct_stewart.

60. ROSS, *supra* note 38, at 43–44 (pretexting scandal); *id.* at 76–77 (CEO forced to resign following investigation of sexual harassment claim and revelation of "relatively small amount of expense reimbursement from the company"). The latter incident, headed "The Boss Has Trouble," asks the student reader to place herself in the role of the corporation's general counsel, adding that shortly after his resignation the CEO went to work for a principal competitor, as did Mark Hurd. *Id.* at 77; *see also* Simmons & Dinnage, *supra* note 25, at 125 (noting that "reputation and brand equity," as other species of business risk, "may outweigh legal risks").

61. Larcker & Tayan, *supra* note 58.

62. *Id.* at 6

search."[63] That is, distinct from HP's financial results and even the reaction of financial markets, HP's reputation in the wake of successive scandals and fumbling would stymie the prospect of hiring a new CEO with suitable credentials from outside the company. Consistent with the distinction drawn above between individual and organizational reputations, the Executive Chairman attempted to sever HP from individuals with starring roles in prior scandals, saying "[t]his is not the board that was around for pretexing. This is not the board that fired Mark Hurd. This is not the board that did everything you want to write about. . ..."[64]

Thus, in some situations a scandal's aftermath may prove sticky for an organization even once it jettisons specific individuals closely associated with the scandal. This stickiness is consistent with the general recognition that, although immeasurable, a corporation's reputation constitutes a valuable and fragile asset.[65] Senior management's awareness of this fact should strengthen the hand of general counsel, whose own reputation, as discussed above, is so closely linked to that of the corporation.

II. THE STAGES OF A SCANDAL

A. In General: A Confession by a Rogue Trader Morphed into a Major Scandal

For the reasons just explored, conduct within a corporation that may become the object of scandal should be of special concern to the corporation's general counsel; once an incident becomes known, the management of its aftermath may itself create a scandal when the underlying incident might not have done so. Indeed, an inadequate response may enable subsequent conduct that leads to materially worse consequences for the corporation and for general counsel as an individual professional. An initial example frames this Essay's subsequent exploration of more specifics of general counsel's roles at each stage.

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63. *Id.* (internal quotation marks omitted).

64. *Id.* (quoting Final Transcript: Hewlett-Packard Names Meg Whitman President and Chief Executive Officer Conference Call 6, Sept. 22, 2011, *available at* http://h30261.www3.hp.com/phoenix.zhtml?p=iroleventDetails&c=71087&eventID=4204723).

65. Michele DeStefano Beardslee, *Advocacy in the Court of Public Opinion, Installment One: Broadening the Role of Corporate Attorneys*, 22 GEO. J. LEGAL ETHICS 1259, 1262 (2009) (suggesting a corporation's reputation is perhaps "its 'largest uninsured asset'" (quoting David S. Margulies, *Media Relations for Litigation*, *in* 1 ASS'N OF TRIAL LAWYERS OF AM. CONVENTION MATERIALS (2005))).

In 1991, the head of the government securities trading desk at Salomon Brothers Inc. confessed to his immediate superior that he had submitted a false bid in an auction for U.S. Treasury securities held two months before.[66] The report appears to have been precipitated by the trader's receipt of a letter from the U.S. Treasury sent to a Salomon client (and copied to the trader) on whose purported behalf the trader had submitted an unauthorized bid; he did so with the objective of outwitting a limit imposed by Treasury on the maximum available for any one bidder. To be sure, 1991 may seem a long time ago in some respects, but the subsequent occurrence of large-scale incidents of rogue trading assures the ongoing salience of the Salomon Brothers saga.[67] The trader's immediate superior admonished him and asked if he had engaged in similar conduct, which the trader denied having done. The superior next met with the corporation's President and its Chief Legal Officer and reported his conversation with the errant trader to them. The Chief Legal Officer advised that the trader's misconduct was a serious matter (indeed it constituted a federal crime)[68] and that its

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66. *In re Gutfreund*, Exchange Act Release No. 34-31554, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,067 (Dec. 3, 1992). All the facts that follow were drawn from this source.

67. More recent examples include Société Général, *see* Nicola Clark, *Ex-Trader in France Gets 3 Years*, N.Y. TIMES, Oct. 6, 2010, at B1 (discussing that after a €4.9 billion trading loss the trader was convicted of breach of trust, forgery, and unauthorized use of bank's computers), and UBS, *see* Victoria Howley & Emma Thomasson, *UBS $2 billion Rogue Trade Suspect Held in London*, REUTERS (Sept. 15, 2011), http://www.reuters.com/article/2011/09/us-ubs-idUSTRE87E15I20110915 (discussing that after a $2 billion loss caused by London-based trader of Swiss bank the trader was arrested on suspicion of fraud). The consequences of the UBS scandal may range more widely than the firm itself if the incident makes tougher industry-wide regulations more likely, in particular through bans on proprietary trading by banks. *See* Emma Thomasson & Edward Taylor, *Special Report: How a Rogue Trader Crashed UBS*, REUTERS (Sept. 26, 2011), http://www.reuters.com/article/2011/09/26/us-ubs-idUSTRE78L7IB20110926. On the phenomenon of rogue traders more generally, see Kimberly D. Krawiec, *Accounting for Greed: Unraveling the "Rogue Trader" Mystery*, 79 OR. L. REV. 301 (2000); Kimberly D. Krawiec, *The Return of the Rogue*, 51 ARIZ. L. REV. 127, 128–33 (2009) (further explaining rogue traders).

68. The SEC filed a complaint against the trader, alleging violations of the antifraud and recordkeeping provisions of the Securities Exchange Act. *SEC v. Mozer*, Litigation Release No. 13918, 55 SEC Docket 2170 (Dec. 29, 1993). The trader was also indicted by a federal grand jury and pled guilty to two counts of making false statements about the illegal bids. *See Briefly: Securities*, L.A. TIMES (Oct. 2, 1993), http://articles.latimes.com/1993-10-02/business/fi-41357_1_paul-mozer. A shareholder derivative suit settled prior to trial for $40 million, one of the largest case recoveries in a derivative action. *See* Declaration of Jeff S. Westerman in Support of Plaintiff's Motion for Attorneys' Fees and Expenses and Service Award to Plaintiff at 17, *Milgram v. Chase Bank, USA* , No. CV 10-00336 GW (PJWX (C.D. Cal. Nov. 22, 2011), *available at* https://www.milgramsettlement.com/pdf/Westerman%20Decl%20ISO%20Mtn%20for%20Attys%20Fees,%20Expenses,%20Svc%20Award%20to%20

occurrence should be reported to the government. At a later meeting that included the corporation's Chairman, the Chief Legal Officer stated he believed the submission of the false bid constituted a criminal act and that, although Salomon probably had no legal duty to report its commission, in reality the corporation "had no choice but to report the matter to the government," either to the Treasury Department or the Federal Reserve Bank of New York.[69]

Although all four participants believed that a decision had been made at the meeting that the President or the Chairman would make the report, neither did so, despite urging from the Chief Legal Officer. The rogue trader was not disciplined nor were limitations placed on his activities, such as intensified supervision. Following his disclosure to management, the trader submitted two more unauthorized bids in auctions of Treasury securities. Rumors began to circulate in the market of an attempt to "squeeze" the market in connection with the latter auction, prompting officials of the Treasury to meet with Salomon's Chairman and President. Salomon eventually engaged an outside law firm to investigate, which led to the revelation of the trader's unauthorized bids, plus a prior episode that preceded the incident reported to the trader's immediate superior.

Severe consequences followed for Salomon, including criminal charges against the trader, a civil suit brought by the SEC against the firm, shareholder litigation, and SEC administrative proceedings against the firm, its Chairman and its President, and the trader's immediate superior. Although the chief legal officer was not named as a respondent in the SEC's administrative proceeding, the SEC's ruling discussed his conduct in detail and noted that "he has represented that he does not intend to be employed in the securities industry in the future."[70] Salomon paid $290 million in fines and penalties to settle claims arising from the false bidding matter.[71] Finally, Salomon's business was placed in jeopardy by a government threat to disqualify it from bidding at Treasury auctions, a threat countered by senior management's resignation and a nine-month period in which Warren

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Pltf.pdf; *see also Weiner v. Gutfreund (In re Salomon, Inc. S'holders Derivative Litig.)*, 68 F.3d 554, 555–56 (2d Cir. 1995) (affirming district court's holding that claims against defendants stemming from involvement in firm's violations of federal securities laws would not be referred to arbitration under rules of New York Stock Exchange but would be tried in district court). In connection with this shareholders' derivative suit, I prepared an expert report in anticipation of testimony at trial.

69. *Gutfreund*, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 83,601.

70. *Id.* at 83,608 n.23.

71. *See* Gretchen Morgenson, *Was Someone Squeezing Treasuries?*, N.Y. TIMES, Aug. 7, 2005, at 1.

Buffett, chairman of Salomon's largest shareholder, ran the firm.[72] In 1997, Salomon was acquired by Travelers Group (later Citicorp).[73]

This entire episode can be subdivided into distinct albeit somewhat overlapping stages, each with implications for the responsibilities of the corporation's Chief Legal Officer. In the first stage, the prelude to the eventual scandal, the adequacy of the corporation's compliance processes is clearly open to question, especially in light of the fact that the Chief Compliance Officer reported to the Chief Legal Officer. As it happens, Salomon's processes enabled the rogue trader to conceal the submission of false bids by creating fictitious trade tickets "selling" the unauthorized purchases to the relevant customer accounts and then back again to Salomon, all "to create the appearance that the customers had received the securities awarded in response to the unauthorized bids and had sold those securities to Salomon."[74] To conceal the fictional trades used to conceal the unauthorized purchases, the trader also directed the clerk who created the trading records to prevent confirmations from being sent to the customers.

When the trader confessed to his superior, his transgression was not yet a scandal. What made it so was the firm's response. As the SEC emphasizes, the firm's Chief Legal Officer then had knowledge of "serious misconduct involving a senior official of a brokerage firm."[75] He failed to take appropriate steps to address the misconduct, including directing an investigation or instituting measures to prevent a reoccurrence of the misconduct, and in any event would have a duty to verify the implementation of such measures. Although the Chief Legal Officer was not a direct supervisor of the trader at the time he learned of the bid, and thus was not in a position comparable to those of the

72. *See Warren Buffett and the Salomon Saga*, DEALBOOK (Sept. 24, 2008), http://dealbook.nytimes.com/2008/09/24/warren-buffett-and-the-salomon-saga/. Mr. Buffett, in a letter to shareholders of his Berkshire Hathaway holding company, characterized this period as "'far from fun.'" *Id.* (quoting Letter from Warren E. Buffet, Chairman, to the shareholders of Berkshire Hathaway, Inc. (Mar. 1, 1993), *available at* http://www.berkshirehathaway.com/letters/1992.html). Mr. Buffett credits Salomon's lead lawyer on government matters (Ron Olson): "[He was] key to our success in getting through this trouble. . .. If we were to resolve our problems in a coordinated and prompt manner, we needed a lawyer with exceptional legal, business and human skills. Ron had them all." Letter from Warren E. Buffet, *supra*.

73. The acquisition was effected through a merger between Salomon and Smith Barney, a wholly-owned subsidiary of Travelers Group, forming Salomon Smith Barney. In 1998, Travelers and Citicorp merged to form Citigroup, Inc. *See Salomon Brothers*, CITI, http://www.citigroup.com/citi/corporate/history/salomon.htm (select "> 1990 – 1997" in center of page; then "> 1998") (last visited Feb. 12, 2012).

74. *Gutfreund*, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 83,599.

75. *Id.* at 83,609.

Chairman, the President, and the trader's immediate superior,[76] the Chief Legal Officer in the circumstances became a "supervisor" for regulatory purposes with the responsibility to take appropriate action to respond to the trader's reported misconduct.[77] Remaining a bystander to fumbling by others does not fulfill this duty, either in this specific regulatory context or more generally when an affirmative response is required. Additionally, for Salomon, failure at this stage of events then led to the scandal that ensued once the trader, again, submitted unauthorized bids. The consequences for the firm intensified when Salomon's senior management did not do as they had agreed and voluntarily report the incident to which the trader had confessed to the government, which led to major adverse consequences for the firm.

Thus, each stage of this narrative calls into question the effectiveness of the corporation's chief legal officer. The trader's ability to submit false bids seems—at least in the bright light of hindsight—to imply deficiencies in Salomon's internal controls and compliance systems. Once the trader confessed an incident of serious misconduct, his reinstallation in the same position with the same scope of unilateral authority implies heedlessness to the risk that he might again submit a false bid or engage in other illegal conduct enabled by ongoing loose controls. Failing to investigate at this point, either by using internal resources or engaging external counsel for the purpose, left open the possibility (which turned out to be true) that the trader's prior misconduct was not confined to one incident. And the incident itself did not spark any inquiry into the adequacy of the firm's compliance and control systems and personnel themselves. In particular, a complex organization may always tempt an actor to "test [his or her] luck against the existing controls";[78] the Salomon trader,

76. They learned, through the trader's confession, "that a high level employee of the firm with significant trading discretion had engaged in extremely serious misconduct." *Id.* at 83,606. As a consequence, they had a duty to investigate and, although they could seek guidance from counsel, the duty constituted "an affirmative obligation to undertake an appropriate inquiry." *Id.* Moreover, pending the outcome of the investigation, they had a duty to place the trader under increased supervision and to limit his activities appropriately. *Id.* These duties stem from multiple interpretations of the SEC's authority under the Securities Exchange Act to impose sanctions for inadequate supervision on individuals associated with a broker-dealer and on the firm itself when it "has failed reasonably to supervise . . .with a view to preventing violations [of federal securities laws], another person who commits such a violation, if such person is subject to his supervision." 15 U.S.C. § 78u-2(a)(4) (2006).

77. *Gutfreund*, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 83,609.

78. Catherine Dunn, *UBS's $2 Billion 'Rogue Trader' Exposes Risk Management Failures*, CORP. COUNS. (Sept. 16, 2011), http://www.law.com/jsp.cc/.jsp?id=120251491938 (quoting Professor Jerry Markham on separation of functions as essential to internal risk control).

additionally, confessed to testing his ability to evade a governmentally imposed constraint through illegal means.

B. Precursors to Scandal

It is self-evident that an organization does not become implicated in scandals when its employees and other agents comply with applicable law and do not test the boundaries of either the law or generally accepted norms of behavior applicable to their work.[79] As illustrated above, some firms operate in a legal and regulatory context that itself imposes specific duties to supervise employees to assure compliance with the law and to respond appropriately to indications of wrongdoing.[80] Within the broader ambit of general corporate law, the well-known opinion in *In re Caremark International Inc. Derivative Litigation*[81] imposes on directors a duty to assure themselves that "information and reporting systems exist in the organization that are reasonably designed to provide senior management and the board itself timely, accurate information sufficient to allow management and the board . . .to reach informed judgments concerning both the corporation's compliance with law and its business performance."[82] Within the corporation's senior management, the efficacy of compliance systems seems securely within a general counsel's province of expertise, whether or not compliance functions and personnel are entirely situated within the corporation's legal function.

A recent empirical study highlights the centrality of compliance-related functions to the role of a contemporary general counsel. Tanina Rostain contextualizes this development in an era of "influx of law into the corporation," in which corporations had ample incentives to create codes of behavior, engage in compliance training, and institute controls and procedures to insure compliance with the law.[83] Professor Rostain conducted a small pilot study of general counsels of Fortune 100 firms who "articulated a robust account of their jurisdiction over questions of legal risk."[84] Most reported directly to the CEO, thereby formalizing

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79. *See* Geoffrey C. Hazard, Jr., *Ethical Dilemmas of Corporate Counsel*, 46 EMORY L.J. 1011, 1021 (1997) ("[E]arly interception . . .is much easier than cleaning up a mess after the fact.").

80. *See, e.g.*, *In re Wedbush Secs., Inc.*, 48 SEC 963, 967 (1988) (imperative that those in authority in large organizations "exercise particular vigilance when indications of irregularity reach their attention").

81. 698 A.2d 959 (Del. Ch. 1996).

82. *Id.* at 970.

83. Tanina Rostain, *General Counsel in the Age of Compliance: Preliminary Findings and New Research Questions*, 21 GEO. J. LEGAL ETHICS 465, 468 (2008).

84. *Id.* at 473.

their authority, and most were confident in their ability to interdict conduct that posed significant legal risks.[85] Although most respondents saw themselves as members of the corporation's business team, they also understood themselves to occupy a distinctly defined gatekeeping role of preventing serious wrongdoing.[86] They drew on their legal expertise as their base of influence within the corporation, in particular their ability to distinguish among legal risks, ranging from conduct that is clearly illegal to the merely questionable.[87] General counsel deployed multiple techniques to influence behavior, including "reputational and ethical considerations . . ., proposing different, less risky ways to structure transactions, or leaving the issue to management to decide after providing a full discussion of the risks involved."[88]

To be sure, assuming that the respondents' self-reporting is accurate, it is possible that selection effects are at work because most general counsels who participated in the study worked for traditional companies without any track record of legal problems or significant risk taking.[89] Nonetheless, Professor Rostain's study lends empirical confirmation to the general insight that sources within a company itself are better able to assure its integrity than outside monitors.[90] Her respondents' authority, grounded in their technical legal expertise, stemmed from the centrality of compliance matters to their work. As suggested above, their professional reputations would turn, not just on their individual probity and skills, but also on the efficacy of the corporation's compliance systems, which in turn would enhance the corporation's reputation for law-abiding and ethical conduct. Moreover, one component in the era of law's internalization into the corporation—the 2002 enactment of the Sarbanes-Oxley ("SOX") legislation—had the effect of generating dialog within the respondents' corporations about the responsibilities of directors and controls throughout the business. By requiring greater attention to internal controls and auditing, SOX engaged boards of directors and senior management in discussions that enhanced their awareness of their responsibilities and arguably induced

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85. *Id.* at 474.

86. *Id.* at 475.

87. *Id.* at 478.

88. *Id.*

89. *Id.* at 474.

90. *See* Kim, *supra* note 11, at 460–63. Professor Kim quotes the former general counsel of General Electric: "If we want companies to fuse high performance with high integrity, the place to begin—and to be most effective—is inside the company itself. Outside regulators and gatekeepers can never be as potent and preventative as internal governance on the front lines from the CEO on down." *Id.* at 412 (quoting Ben W. Heineman, Jr., *Caught in the Middle*, CORP. COUNS., Apr. 2007, at 84, 89) (internal quotation marks omitted).

greater aversion to taking legally aggressive positions.[91] Crucial to these discussions was general counsel—often serving as secretary of the board and thus present at board meetings—whose position was further empowered by SOX and its threat of criminal sanctions.

C. Management in the Midst

Additional dimensions of general counsel's role become salient with knowledge that an incident of problematic conduct has occurred. These dimensions have both internal and external points of focus. As the experience of Salomon Bros. illustrates, a situation may warrant a full investigation to determine its extent and severity; it may also warrant a review of the design and operation of relevant reporting and control systems. It may also be necessary, as a practical if not legal matter, to report the incident's occurrence outside the corporation to governmental authorities. Relatedly, the incident may bear on the accuracy of the corporation's public statements that are material to investors.

Foregoing or truncating an adequate investigation into allegations of wrongdoing has additional perils, not present in the saga of Salomon Bros., in particular the risk that the allegations will prove unfounded or that, eager to distance itself from identified culprits, the corporation may jettison the wrong personnel, which itself may provoke a scandal. Earlier this year, for example, in response to a tip that three senior managers were stealing intellectual property concerning its planned electric car, Renault investigated and fired the three managers while its CEO appeared on television to announce that evidence supported the firings.[92] Two months and further investigation later, the tipster was unveiled as a fraud, the managers were exonerated, the CEO apologized (again on television), the company reassigned the officer who oversaw the investigation, the head of the legal department was fired,[93] and a Renault security official was arrested "and charged with fraud in connection with payments [the company] made through him as part of its internal inquiry."[94] Additionally, the company's internal investigation reportedly annoyed France's domestic intelligence agency

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91. Rostain, *supra* note 83, at 487–88.

92. John Bussey, *Some CEO Survival Lessons from the Scandal at Renault*, WALL ST. J. (Apr. 22, 2011), http://online.wsj.com/article/SB10001434052748707889404562769.html.

93. *Id.*

94. John Gapper, *Learning the Lessons of the Renault Affair*, FT.COM (Mar. 16, 2011, 7:57 PM), http://www.ft.com/cms/s/0/db8c05fc-5004-11e0-9ad1-00144feab49a.html#axzz1mZC0hDed.

because France owns fifteen percent of Renault but the company's internal investigation did not liaise with the agency, which opened its own investigation.[95]

More notoriously, the ongoing travails of News Corp. illustrate the perils of dealing with potentially scandalous incidents in ways that seem after the fact only to have worsened its situation in the longer term. As is now well-known, when incidents of illegal phone hacking at *The News of the World* came to light, no comprehensive investigation was undertaken, and a senior executive of News Corp. approved a confidential £700,000 settlement in the first lawsuit filed against the company.[96] Had the case proceeded in court, evidence would have contradicted earlier parliamentary testimony by News Corp. executives that hacking was isolated to one rogue reporter who covered the royal family.[97] As it happens, News Corp.'s long-time general counsel had resigned about a month before the scandal broke, which occurred when it became evident that the subjects of hacking included a young murder victim, in addition to the assumed celebrity targets.[98] Thereafter responsibility for conducting an internal investigation was lodged with an independent director on the company's board, who engaged several prominent lawyers and law firms to assist.[99] To date the scandal has led to the loss of News Corp.'s opportunity to acquire all the remaining shares in BSkyB and has called into question whether its Chairman, Rupert Murdoch, could be succeeded by his son James, the degree of whose awareness of the incidents underlying the scandal is in

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95. Hugh Schofield, *Renault Spy Scandal Risks Denting Carmaker's Reputation*, BBC NEWS (Mar. 15, 2011), http://bbc.co.uk/news/world-europe-12732421.

96. Don Van Natta Jr. et al., *Tabloid Hack Attack on Royals, and Beyond*, N.Y. TIMES, Sept 1, 2010, http://www.nytimes.com/2010/09/05/magazine/05hacking-t.html?_r=1&pagewanted=print. Indeed, the company reportedly paid "hefty sums" to other hacking victims who threatened suit, on condition of silence. *See* Jo Becker & Ravi Somaiya, *Murdoch Aides Long Obscured Scandal's Scale*, N.Y. TIMES, July 19, 2010, at A1.

97. *See* Don Van Natta Jr. & Jo Becker, *Murdoch, 'Surprised and Shocked,' Is Likely to Face More Questions*, N.Y. TIMES, July 20, 2011, at A11.

98. *See* Russell Adams & Jessica E. Vascellaro, *Murdoch Selects His Team Carefully*, WALL ST. J., July 19, 2011, at B5 (reporting that departure of general counsel followed the transfer of more legal responsibilities to a new executive (Joel Klein), formerly a Justice Department lawyer and chancellor of New York City's public school system, seen as "an encroachment on the turf" of general counsel).

99. *See, e.g.*, Jeremy W. Peters et al., *Murdoch's Unlikely Ally*, N.Y. TIMES, July 24, 2011, at A1 (reporting retention of Williams & Connolly); Jeremy W. Peters, *For Murdoch, a Board Meeting with Friendly Faces*, N.Y. TIMES, Aug. 10, 2011, at B1 (reporting retention of "some of the biggest names in white collar criminal defense" by the director in charge of the internal investigation at News Corp.).

question.[100] Crisis management experts fault the company for its initial failure to understand—or its decision to ignore—the potential magnitude of the problem when evidence of wrongdoing continued to emerge.[101] And likely News Corp.'s prominence as an owner of media properties, some of which specialized in the revelation of scandals and salacious behavior more generally, heightened its vulnerability to its own scandal.

How prominent a role general counsel should play in interactions with audiences external to the corporation—especially news media—is an inescapable question. Acting as the corporation's agent in dealing with third parties is integral to general counsel's role, in particular in relationships with external counsel.[102] Although traditionally law and public relations were understood to be separate disciplines,[103] the engagement more recently of general counsels in managing public relations functions and acting as the corporation's public spokesperson suggests heightened appreciation of the importance of the metaphorical court of public opinion.[104] Moreover, as discussed above, law enforcement agencies and regulatory bodies like the SEC may find media attention salient to determining enforcement priorities.[105] One recent empirical study finds law and public relations to be "intertwined," with general counsel actively engaged, typically behind the scenes, in managing the media fallout of potentially scandalous events.[106] Counsel might draft press releases, develop talking points (for others to deliver), and deal with implications for filings with the SEC.[107] Managing in this setting is often an iterative process with public relations professionals that is not free from tensions: as one study respondent characterized the dynamic: "'in a high stakes legal matter, PR wants to put the best spin on it and I would say this is not

100. *See* David Carr, *Scandal Splinters a Family's Business*, N.Y. TIMES, July 25, 2011, at B1 (reporting assessment of unidentified family friend that "'Rupert may end up having to make a choice between his son and the company, which is fairly biblical'").

101. *See* John Bussey, *The Missteps in Managing News Corp.'s Hacking Crisis*, WALL ST. J., July 21, 2011, at B1.

102. DeMott, *supra* note 11, at 970–72.

103. Beardslee, *supra* note 65, at 1261.

104. *Id.* at 1264 (characterizing as an "emerging trend" the practice of "general counsels acting as legal PR managers for legal issues facing large publicly traded corporations").

105. *See supra* text accompanying notes 34–37.

106. *See* Beardslee, *supra* note 65, at 1296.

107. *Id.* at 1280.

something you could spin. You have to call just the facts and no spins.'"[108]

This development enhances general counsel's role as the corporation's agent, encompassing as it does non-legal audiences for less technical messages about the corporation's conduct. It also brings temptations to "spin," to over- or under-state to try to mitigate the adverse impact on the corporation, even when counsel serves not as a direct spokesperson but an author of a script behind the scenes. At stake is not just counsel's credibility to external audiences, but the base of counsel's authority for audiences internal to the corporation. That is, excesses as an outward-looking agent in the guise of public relations manager may undermine counsel's gravitas as an internal force for compliance with the law.

D. Scandal as Catharsis and Its Lessons

For some corporations, the experience of scandal results in an attempt to transform the organization into one that warrants a reputation for compliance with the law. Overcoming the taint of scandal may require appointing a new general counsel with both a broadly defined mandate and a prior reputation from which to derive credibility.[109] A recent instance is the response of Siemens in the wake of a widespread bribery scandal, which ultimately led to the company's payment of a $1.6 billion fine in addition to an internal inquiry and restructurings with an estimated cost of over $1 billion.[110] At Siemens, bribery around the globe was an organized activity; one midlevel executive in a subsidiary that sold telecommunications equipment oversaw an annual bribery budget of $40 to $50 million.[111] When Germany (Siemens' home jurisdiction) joined an international convention banning foreign bribery in 1999, Siemens responded with an internal "'paper program'" that was designedly ineffectual to staunch the outflow of funds paid as bribes.[112] All began to collapse once international law enforcement

108. *Id.* at 1286 (quoting an interview with the general counsel of a pharmaceutical company).

109. *See* DeMott, *supra* note 11, at 973–74 (recounting Morgan Stanley's replacement of a long-time general counsel with a prominent lawyer (a former regulator) to improve the company's legal reputation in the wake of litigation losses and issues involving investment analysts tainted by conflicts of interest).

110. Siri Schubert & T. Christian Miller, *At Siemens, Bribery Was Just a Line Item*, N.Y. TIMES (Dec. 20, 2008), http://www.nytimes.com/2008/12/21/business/worldbusiness/21siemnens.html?pagewanted=all.

111. *Id.*

112. *Id.*

investigated, culminating in arrests in Germany in 2006 and investigations in the United States soon thereafter.

Siemens hired a new general counsel (from General Electric) in 2007 into a corporate culture that led many employees to believe that "bribes were not only acceptable but also implicitly encouraged."[113] His appointment, an integral part of the company's settlement of charges under the Foreign Corrupt Practices Act, came with an expectation of ongoing and aggressive monitoring to be implemented within and funded by Siemens itself.[114] In addition to redrafting internal rules, conducting extensive retraining exercises for employees, and instituting whistleblowing mechanisms, Siemens increased the size of its internal compliance staff from 86 in 2006 to slightly fewer than 500 and included experienced law-enforcement personnel in the compliance cohort.[115] At the head is the new general counsel, who acknowledges that evidence of new bribery could always come to light but is confident that the days of systematic corruption are over.[116] That he came to Siemens from General Electric—an acknowledged pioneer in effective anti-bribery techniques in the context of global operations—both underscores his own reputation and stakes it to future developments at Siemens.

To be sure, systemic change in the context of a large and complex corporation can prove elusive. The Swiss bank UBS, mentioned earlier in connection with a recent $2 billion loss caused by a rogue trader in its London office,[117] suggests a cautionary tale. Severely affected by the financial crisis that began to unfold in 2007, UBS entered 2008 with "significant legacy risk positions" on which it incurred major losses.[118] The bank "identified significant weaknesses in its risk management" practices and internal controls and, following the crisis, revamped them to strengthen its board's responsibilities, adopted an integrated approach to risk control, and increased its emphasis on reporting.[119]

The revelation of a major rogue trading incident in September 2011 led to the resignation of UBS's CEO, characterized as "an admission that the bank's latest scandal has effectively undone all his

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113. Carter Dougherty, *The Sheriff at Siemens, at Work under the Justice Dept.'s Watchful Eye*, N.Y. TIMES (Oct. 6, 2008), http://www.nytimes.com/2008/10/07/business/07siemens.html?pagewanted=all.

114. *See id.*

115. *Id.*

116. *Id.*

117. *See supra* note 66.

118. Harner, *supra* note 23, at 50 (citing UBS AG, Annual Report (Form 20-F), at 120 (Mar. 11, 2009)).

119. *Id.* (citing UBS AG, Annual Report (Form 20-F), at 120 (Mar. 11, 2009)).

efforts over the past two years to lobby against tougher bank regulations."[120] The scandal also calls into question the efficacy of UBS's internal controls on proprietary trading. Reportedly, senior managers were "'flabbergasted'" to discover that the rogue equity trader at the London desk that dealt with Exchange Traded Funds (ETFs) had engaged in fake hedging transactions, concealing them by false entries into UBS's systems of counterparties known to the trader not to require confirmation prior to the settlement date, thereby tricking the system into believing the fake hedges represented real transactions.[121] The failure of UBS managers adequately to confirm the trades with the purported counterparties breached the bank's internal rules.[122] Further complications in the wake of the incident stem from lack of clarity whether Swiss or U.K. regulators have responsibility for UBS's London unit.[123] That is, the bank's elaborate multi-jurisdictional structure added a layer of complexity that may have facilitated the rogue trader's ability to evade detection. Thus, measures taken in the aftermath of one scandal may not prevent another.

More generally, a scandal may furnish an occasion to redefine the general counsel's role toward closer focus on compliance and, proactively, toward anticipating and defusing risk.[124] Refocusing the general counsel's role—and appointing a general counsel with a credible background in a regulatory or law-enforcement agency—is a mechanism through which scandal may have a cathartic effect. In turn, a refocused role for general counsel may require hiring a new counsel with credentials, background, and reputation that are consistent with the refocused role.

III. IMPLICATIONS FOR GENERAL COUNSEL

The incidents and developments recounted in this Essay bear on larger questions about the position of general counsel and, in particular, the nature and sources of general counsel's authority within the corporation and within the senior management team. In an era in which the design and effectiveness of internal compliance functions loom

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120. Thomasson & Taylor, *supra* note 67.

121. *Id.*

122. Deborah Ball, *New UBS Leader Ousts Risk Chief*, WALL ST. J., Dec. 2, 2011, at C1. UBS's new CEO ousted its Chief Risk Officer who, although not held directly responsible for the scandal, was assessed to be not "the right person for the job." *Id.*

123. Dunn, *supra* note 78.

124. *See* David B. Wilkins, *Is the In-house Counsel Movement Going Global? Assessing the Role of Internal Counsel in Emerging Economies*, 2012 WIS. L. REV. 251 (noting shifts over time in priorities of general counsel).

large, as does the threat of scandal as a significant sanction for non-compliant behavior, general counsel's authority may be strengthened. In broad terms, this could be seen as a further example of the remarkable adaptability of the legal profession in the United States to changed circumstances. These circumstances include clients' demand for legal services, which general counsel, as a member of the senior management team, has a role in shaping and channeling.

In his account of the legal history of the United States, Lawrence Friedman characterizes lawyers as "The Nimble Profession."[125] Agility and alertness, the sharp-witted traits that constitute nimbleness, enable general counsel to adapt and respond to the internalization of mechanisms of legal compliance and to the heightened salience of scandal and relationships with external non-legal audiences in a media-saturated era. General counsel's authority as a member of senior management depends, as noted above, both on counsel's membership in the corporation's cohort at the top of its managerial hierarchy, as well as on counsel's credibility as a holder of specialized expertise, arguably grounded in technique and knowledge that are distinctive and separable from skills in business management per se.[126] Only the "nimble" and strong-willed succeed in a position grounded in two potentially inconsistent sources of authority, which are proximity to senior management and the capacity to exercise judgment as a professional in a detached manner.

Scandal may also open space for persuasion in general counsel's relationship with other members of senior management, in particular, the CEO. The jeopardy to reputation posed by a scandal and how it is managed, along with the potentially more concrete jeopardy to the CEO's ongoing position in the corporation, may create a more alert and receptive audience for general counsel's advice. Scandal, that is, undergirds general counsel's capacity to serve, not precisely as a "gatekeeper" comparable to a financial auditor, but as a "persuasive counselor" who "go[es] further than simply describing the law and suggesting ways to comply with it. . .. [but] [i]nstead . . .affirmatively, proactively, and courageously tr[ies] to persuade their client," as represented by the CEO, to comply with the law and, beyond literal

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125. LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 483 (3d ed. 2005). In another work, Professor Friedman notes that contemporary lawyers "overwhelmingly . . .manage business affairs." LAWRENCE M. FRIEDMAN, LAW IN AMERICA: A SHORT HISTORY 168 (2002). The jumbo economy of the United States "floats on a sea of lawyers." *Id.*

126. For a full explication of this point, albeit one based on a case study of lawyers who work in a distinctive context (documenting derivatives transactions), see ANNELISE RILES, COLLATERAL KNOWLEDGE: LEGAL REASONING IN THE GLOBAL FINANCIAL MARKETS 228–32 (2011).

compliance, to act to minimize jeopardy to the corporation.[127] Essential to this role is a capacity for prediction beyond the immediate specifics, that is, to "see around the corners" using many angles of vision.[128] And, as discussed at length in connection with Salomon Bros. and its rogue trading incident, remaining a bystander to fumbling by other members of senior management is unlikely to be an adequate response.

This Essay also suggests that nature and operation of reputation in this context are more complex than may often be assumed. General counsel's professional reputation is, of course, personal to that lawyer but also linked to dimensions of the corporation's reputation. And perhaps reputation may operate in reciprocal fashion: a high-reputation incoming general counsel serves as a credible signal of change at a scandal-ridden or otherwise troubled corporation, while a general counsel's success in restoring or enhancing the corporation's reputation also enhances counsel's personal professional reputation. Moreover, an incoming general counsel in some sense stakes his or her personal reputation to that of the corporation going forward, placing it in potential jeopardy, which may contribute to the credibility of the signal. Lateral mobility among general counsel suggests that, although their reputation is linked to that of the corporations they serve, it may be transferable to successive corporate employers.

Finally, it is evident that a corporation's reputation, like its "culture" more generally, is not solely the work of general counsel. Other members of senior management also play significant roles in defining a corporation's culture, including its orientation toward compliance with the law and regulation.[129] Choosing to serve as a general counsel in a particular environment—or to continue to serve once more fully informed—also implicates counsel's reputation. One component of an organization that determines its "culture" is the definition of authority among senior persona within the organization, in particular, the relationship between a corporation's general counsel and its CEO. As noted above, the emergence of a scandal may enhance the general counsel's capacity for persuasion. The formal relationship between the CEO and the general counsel, in particular whether the

127. E. Norman Veasey & Christine T. Di Guglielmo, *The Tensions, Stresses, and Professional Responsibilities of the Lawyer for the Corporation*, BUS. LAW., Nov. 2006, at 1, 30.

128. *See* Simmons & Dinnage, *supra* note 25, at 83 ("Prudent corporate managers cannot wait until . . .threats materialize; they require a type of consistent and strategic guidance that in-house counsel are uniquely positioned to provide.").

129. *See, e.g.*, ISAACSON, *supra* note 53, at 451 (Apple's CEO, "[c]ontemptuous of rules and regulations . . .created a climate that made it hard for someone like [Apple's general counsel] to buck his wishes" and facilitated backdating of stock options).

general counsel reports to the CEO, is also relevant. Although recent data report a direct reporting relationship in most large corporations,[130] in financial services firms, the percentage of general counsel who report directly to the CEO is much lower.[131] This may imply "a less important position in the corporate hierarchy,"[132] consistent with a historical pattern, at least within investment banking, that assigned lower status and pay levels to personnel charged with compliance in contrast to bankers and traders.[133] Thus, formal allocations of power and rights of audience (like direct reporting lines) are relevant to the likelihood of effective service by general counsel, in addition to general counsel's personal qualities.

Although scandal is an unlikely vantage point from which to assess ongoing developments in the position of general counsel, it is nonetheless revealing. To be sure, most corporations, like most people, do not become the object of sustained media scrutiny and public outrage. The vantage point of scandal illustrates distinctions among the functions served by a general counsel, the distinctive sources of counsel's power within the corporation, and the factors that enhance or undermine counsel's effectiveness.

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130. Wilkins, *supra* note 124, at 284 n.144 (citing John C. Coates et al., *Hiring Teams, Firms, and Lawyers: Evidence of the Evolving Relationships in the Corporate Legal Market*, 36 J.L. & SOC. INQUIRY 999, 1008 (2011) (reporting that general counsel reports directly to CEO in ninety-four percent of the S&P 500 companies that were sampled)).

131. *Id.* (citing Coates et al., *supra* note 130, at 1008 (reporting that general counsel reports directly to CEO in sixty percent of financial services firms)).

132. *Id.*

133. GILLIAN TETT, FOOL'S GOLD: THE INSIDE STORY OF J.P. MORGAN AND HOW WALL ST. GREED CORRUPTED ITS BOLD DREAM AND CREATED A FINANCIAL CATASTROPHE 114–15 (2010). Casual references to the relatively lowly status of lawyers, at least in some financial services firms, are also of anecdotal support. For example, an account of A.I.G.'s Financial Product Unit, which focuses on management within the unit that absorbed risks associated with subprime mortgage debt, notes in passing that the unit's employees "got rich. Exactly how rich is hard to say, but there are plenty of hints. One is that a company lawyer—a mere lawyer!—took home a $25 million bonus . . .." Michael Lewis, *The Man Who Crashed the World*, VANITY FAIR, Aug. 2009, *available at* http://www.asensio.com/vf.pdf.