Achieving the Advice Advantage

Managers Must Partner with Lawyers for Business Success

Excerpted from

Winning Legally:
How to Use the Law to Create Value, Marshal Resources, and Manage Risk

By

Constance E. Bagley

Harvard Business Press
Boston, Massachusetts

ISBN-13: 978-1-4221-8164-5
8165BC

Copyright 2008 Harvard Business School Publishing Corporation
All rights reserved
Printed in the United States of America

This chapter was originally published as chapter 9 of *Winning Legally: How to Use the Law to Create Value, Marshal Resources, and Manage Risk*, copyright 2005 Harvard Business School Publishing Corporation.

No part of this publication may be reproduced, stored in or introduced into a retrieval system, or transmitted, in any form, or by any means (electronic, mechanical, photocopying, recording, or otherwise), without the prior permission of the publisher. Requests for permission should be directed to permissions@hbsp.harvard.edu, or mailed to Permissions, Harvard Business School Publishing, 60 Harvard Way, Boston, Massachusetts 02163.

You can purchase Harvard Business Press books at booksellers worldwide. You can order Harvard Business Press books and book chapters online at www.HBSPress.org, or by calling 888-500-1016 or, outside the U.S. and Canada, 617-783-7410.

9

Achieving the Advice Advantage

WHAT DO YOU HAVE when you have a lawyer up to her head in sand? Not enough sand.

Managers often express frustration that lawyers are too expensive and not practical enough about what it takes to compete effectively in today's global marketplace. Popular stereotypes of lawyers include "overhead," "Dr. No," "internal cop," "keep us out of trouble," and "get us out of trouble!"[1] In a survey by the Case Western Reserve University Law School, business leaders associated the word *lawyer* with "authoritative," "conservative," "arrogant," "intimidating," and "know-it-all."[2] It needn't be this way.

Ideally, managers and their counsel work together as a team to identify the business and legal risks and opportunities associated with a particular transaction or activity. When managers and lawyers effectively tap each other's areas of professional expertise, the available attractive options increase dramatically.

For example, experienced intellectual property lawyers can help firms protect the trade secrets that create competitive advantage, build valuable brands, and exploit (either internally or through licensing) proprietary technology or original works of authorship. Skilled corporate attorneys can help structure acquisitions or dispositions of assets to achieve the most favorable after-tax return while reducing the downside risk.[3] Yet the plethora of lawyer jokes reflects just how hard it is to forge a strategic alliance between lawyers and their clients.

This final chapter shows managers how to collaborate more effectively with their lawyers to craft the best overall strategy and tactics for achieving core business objectives while minimizing legal risks and costs. It urges managers to bring in the lawyers early in the process of deciding what action to take. Drawing on research from the field of information technology, it suggests ways managers can better integrate legal considerations into the formation and execution of business strategy and create relationships of trust and mutual respect with counsel. The chapter discusses the role of a general counsel and offers guidelines for using attorney-client privilege to protect confidential communications. It concludes by explaining the importance of working with lawyers who view themselves as true counselors and not mere hired guns.

Treat Your Lawyer as a Partner, Not a Necessary Evil

To question existing assumptions and break away from old habits, both lawyers and managers must be creative. As a first step, they should be proactive. Legally astute managers bring in counsel early in the decision-making cycle; they do not wait until the last minute to fight a fire that has already started or to bless a deal that has already been struck. For counsel, being invited to participate in the decision-making or the deal-making stage means something far different than serving as a rubber stamp or a "No man."

While in private practice, I was surprised at the number of times my clients told me that a change in structure that I proposed to dramatically reduce the legal risk would, with some tweaking, make little difference in the business outcome. If my clients had been reluctant to bring me in early, I would have been far less effective. By helping me better understand their business and strategic goals and by listening to my legal concerns, my clients enabled us to tap each other's areas of professional expertise. Working together, we crafted strategies and solutions that were superior to what either of us would have devised acting alone.

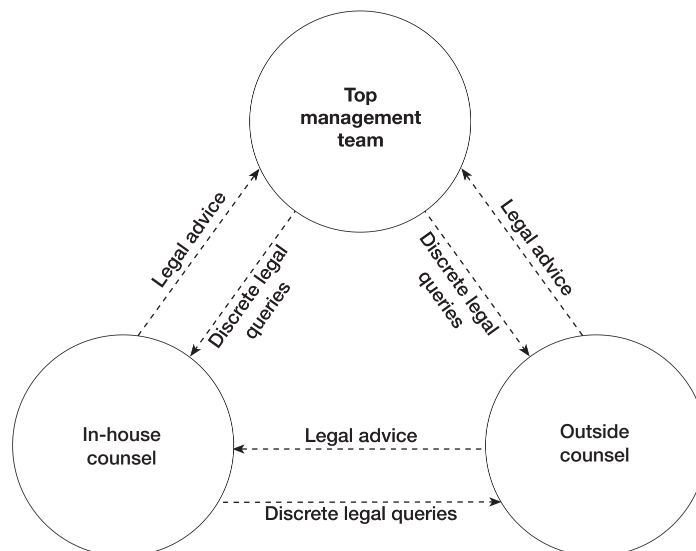
Unfortunately, counsel-manager communication often takes the form of reaction-counteraction. Despite their limited legal expertise,

managers are often reluctant to ask their attorneys too broad a question for fear that they might receive an answer that would preclude their doing what they really want to do. So instead, the client frames a very technical question to the attorney, and the attorney frames an equally technical answer, without inquiring why the question is being asked or considering the broader business context within which it is being raised. This conventional approach is depicted in figure 9-1.

Consider the board of directors of Enron, who asked Enron's long-time outside counsel Vinson & Elkins whether the board needed to take any action in response to an employee memo claiming accounting irregularities. The board expressly told Vinson & Elkins not to "second guess" Andersen's accounting treatment. Vinson & Elkins duly responded to this very narrow inquiry by acknowledging that the accounting treatment was "creative and aggressive" and that there was a "serious risk of adverse publicity and litigation"

FIGURE 9-1

Conventional approach



due to the “bad cosmetics” of certain transactions, but they concluded that no further investigation was needed.[4]

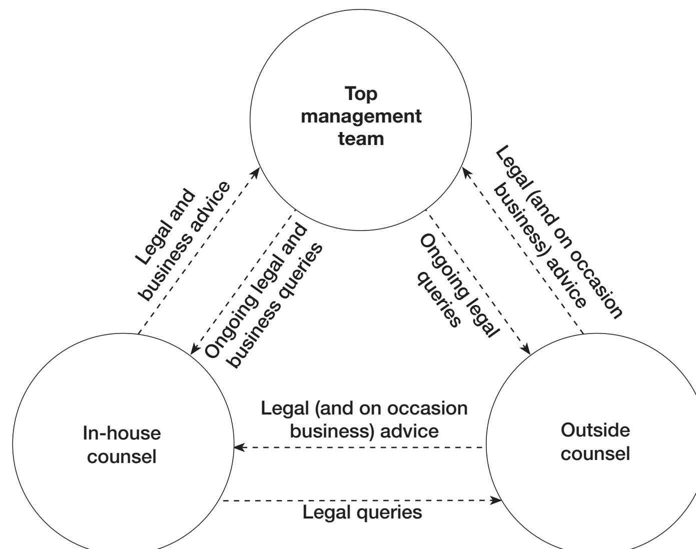
It is hard to understand how a lawyer can render meaningful advice about a claim of accounting fraud without considering whether the claim has any merit. Indeed, the special board committee that investigated Enron’s accounting debacle faulted Vinson & Elkins for its failure to look at the whole picture.

Legally astute managers call on their lawyers to play a more active role in formulating the corporation’s strategy as a whole instead of just being technical consultants brought in when the firm is confronted with a legal problem.[5] This approach is depicted in figure 9-2.

Marshall Clinard and Peter Yeager go so far as to assert, “Business corporations do not have legal problems. They have business problems where legal considerations may be more or less important, depending on the specific circumstances.”[6] Clinard and Yeager focused on preventing the value destruction that results from non-

FIGURE 9-2

Legally astute approach



compliance, but their reasoning applies equally to the upside, where managers can create and capture value.[7]

Of course, counsel has to earn management's respect by learning enough about the company's business and strategy to make a creative contribution in the joint problem-solving exercise. Legal advice should be business oriented. It should help managers address business opportunities and threats in ways that are legally permissible,[8] effective, and efficient.[9]

David Andrews, former senior vice president for legal affairs at PepsiCo, stresses to his lawyers the importance of "getting close" to the client—the business units.[10] To further this objective, he instituted the PepsiCo Legal Academy in 2003. PepsiCo's top lawyers met with Indra K. Nooyi, the company's president and chief financial officer, as well as its auditors and others, to discuss the company's strategy, financial performance, and accounting controls. Nooyi encouraged PepsiCo's lawyers to bring both their legal expertise and their business judgment to bear when working with managers, saying, "We can't afford this separation of church and state."[11] She urged the lawyers to speak up if a manager proposed a deal that did not make good business sense to the lawyer instead of just focusing on preparing the perfect legal documentation for a flawed deal.

The goal should be to create what Kim Clark and Steven Wheelwright call "heavyweight teams,"[12] comprising managers and their counsel. Instead of just representing their functional group, members of heavyweight teams act as general managers with responsibility for the success of the entire project. This requires team members to become actively involved in the work of members from other functional areas.

On a heavyweight product development team, for example, members from engineering, production, marketing, sales, and legal take joint responsibility for designing and selling an innovative and differentiated product while also complying with applicable law and avoiding product liability risk. The legal strategy becomes part of the business strategy when top management calls on every team member to consider the business and legal opportunities and risks associated with various designs, methods of production, marketing plans, and sales activities.

To ensure that the top management team receives objective legal advice about the legality of the business strategy crafted by the heavyweight team, it may be appropriate for certain in-house and outside lawyers to be kept separate from the management team designing the strategy. This important monitoring function is akin to that performed by internal and external auditors and requires a degree of independence.

Like Information Technology, Law Is Not a Black Box Best Left to the Experts

In many ways, this book's mantra of integrating legal considerations into business strategy and decision making parallels what is now regarded as best practice for managing information technology (IT) in many industries.[13] Early on, companies tended to view information technology as a black box.[14] IT issues were shuffled off to the IT department or outsourced with a "you take care of it" attitude.

Information technology executives spent the majority of their careers within the IT function. Few were likely to be involved in strategic planning and control. On the other hand, general managers were not expected to understand the technology, and CEOs and other senior executives were not expected to become personally involved in IT decisions. Top managers felt uncomfortable making hard choices about IT yet found that they were not realizing much business value from the high-priced technology they installed.

Today, experts agree that IT is too important to business success to be handled in a vacuum. Research by Lynda M. Applegate and Joyce J. Elam reveals that today the IT function is more closely integrated with general corporate management.[15] IT executives are often external hires with significant experience managing a non-IT function. They are expected to gain experience in business strategy, management, and operations so that they can bring a broad business perspective to the position. An increasing number of IT executives report directly to the CEO and are members of the senior management team or sit on the strategic policy committee.

Jeanne Ross and Peter Weill concluded in a recent study that senior managers in high-performing companies take a leadership role in key IT decisions.[16] Although IT executives should make decisions about IT management, Ross and Weill recommend that they should not be left to make choices (whether by default or by design) that determine the impact of IT on a company's business strategy. Indeed, Mark D. Lutchen, former global CIO of Pricewaterhouse-Coopers, argues that a firm will not reap the expected benefits from technology unless the "CEO and his or her executive leadership team . . . have a conceptual understanding of how technology can support business growth."[17]

So too should the CEO and other senior managers exercise leadership over the business consequences of legal decisions and the legal consequences of business decisions. But it should be *informed* leadership that takes the middle road between complete abdication of responsibility for any legal issues to the legal department, on the one hand, and infrequent consultation with the lawyers on the other.

The CEO and the general counsel can both take valuable lessons from the Applegate and Elam study of the IT function. First, the barriers of overspecialization must come down. Senior managers must learn more about the legal function, and the general counsel and other members of the legal team must learn more about the business function. Second, synergy must be cultivated—it won't grow or happen on its own. Taking the perspective of the other person (or at the very least, learning more about the thought process behind legal or business decision making) can help build a mutually complementary understanding that combines the best expertise from both the legal and the business sides. A general counsel who can articulate "hybrid" business-legal solutions is extremely valuable.

Third, any general counsel who really wants to have an influence on corporate decision making has to earn a place at the table in policy making or strategic planning committees. Hank Barnette, general counsel and then CEO of Bethlehem Steel, attended executive education courses at the Harvard Business School to hone his general management skills. Fourth, the general counsel must educate

and groom the legal staff to play a more integrated role with company management.

The decision whether to outsource the IT function also yields insights for companies as they choose between hiring in-house counsel or retaining an outside firm as needed. Outsourcing the IT functions to an outside service provider used to be a popular cost-saving option for many companies. Ross and Weill discovered, however, that many outsourcing arrangements eventually became unsatisfactory as a company's needs changed. Service providers with standard offerings and detailed contracts were not flexible enough to meet changing requirements.

Ross and Weill make the point that outsourcing a function means outsourcing responsibility for critical decisions related to that function. Companies often opted to outsource IT because management was unhappy with their in-house staff, yet the dissatisfaction was often the result of senior management's own lack of involvement.[18] Today firms are more likely to keep their main IT capabilities in-house and also engage in "selective outsourcing" when special skills and expertise may be required for particular problems.

Like internal IT staff, in-house lawyers have intimate knowledge of the company and its policies and objectives, as well as accumulated wisdom in dealing with particular kinds of corporate problems. In-house lawyers are able to participate in strategy and business planning and can often establish a better relationship with top managers. This internal competence can be complemented as needed by an outside law firm's expertise and breadth of experience with many different corporate clients and regulators.[19]

Experienced inside counsel can usually judge when something can and should be done in-house and when it should be farmed out. For example, firms often retain outside counsel to handle peak-time overflow work, litigation, and specialty matters, such as international tax, in which in-house counsel lack the requisite expertise. Regulatory law, antitrust compliance, and intellectual property matters often require collaboration between inside and outside counsel.

Stephen Friedman and Evan Stewart recommend that companies move to a "project team" model, whereby projects are staffed by both

inside and outside lawyers, chosen for their experience and ability (even if costly).[20] Typically, when a new project arises inside a company, the first question asked is "Should this project be done by inside or outside counsel?" Friedman and Stewart argue that this question leads to inefficiencies. They would instead ask, "Who is the best person to be responsible for this project?" and "Who should be on the team?"

Thus a project manager (from the company or the outside law firm) directs the team composed of in-house and external counsel. This arrangement could challenge the traditional organizations of both the legal department and the outside law firm, but it works well for people like PepsiCo's associate general counsel, Rob Cox. Cox uses this approach when PepsiCo does a major acquisition. He selects a partner from one of the company's preferred law firms to work with him and his staff to negotiate and close the deal.

The Critical Role of General Counsel

Smaller businesses often cannot afford in-house legal staff, and even some very large corporations elect to retain outside counsel for all their legal work. Regardless of whether a company relies on inside or outside counsel or some combination thereof, every company should have one lawyer who acts as a general counsel with overall responsibility for the legal function. If a company has no in-house general counsel but instead uses a variety of lawyers within one outside law firm, there should be a single partner in the law firm managers can contact to determine which lawyer in the firm would be best suited to handle the matter at hand.

The role of general counsel is more relevant than ever. Indeed, a December 2004 article in *BusinessWeek* titled "A Compelling Case for Lawyer-CEOs" cited the elevation of Charles O. Prince III to head Citigroup and Michael G. Cherkasky to head scandal-ridden Marsh & McLennan as evidence that the number of lawyer-CEOs is only likely to grow.[21] Although *BusinessWeek* is probably correct that the JD degree is unlikely to replace the MBA as the credential of choice for CEOs anytime soon,[22] there has probably never been a time when

legal considerations have played such a key role in strategy formulation and execution.

Corporations are facing global, multijurisdictional regulations and challenges, and they are risking large penalties and damage to reputation for noncompliance. Lawyers must teach clients compliance and policy requirements plus practical tactics to keep out of trouble. General counsel must keep abreast of legal trends, pending legislation, and competitive opportunities and risks so that they can step in proactively to shape results, avoid other companies' mistakes, and prevent crises.

Laura Stein, senior vice president and general counsel of Heinz, believes that in-house lawyers develop best relations with senior management by building trust and providing proactive advice.[23] She sees her job as increasing shareholder value.[24] To do so, she interacts frequently with senior management over strategy, growth, risk protection, budget, planning, and operations.

In its *Corporate Executive's Guide to the Role of General Counsel*,[25] the American Corporate Counsel Association (ACCA) identified four goals for the general counsel. First, the general counsel must be aware of the big corporate picture and understand the wider, cumulative, and aggregate risk consequences for the company of individual management decisions. Second, the general counsel should maintain a separate corporationwide information flow that counterbalances the "filtered" information flow upward to the CEO and board of directors. A separate information flow enables the general counsel to serve as a senior adviser capable of giving the most senior levels of the company a clear picture of what is going on.

Third, the general counsel must be viewed as a person who helps guide the chief executive to do the right and wise thing, a role far more broadly defined than ensuring minimum compliance with applicable laws and regulations. To ensure that he received frank and candid advice, Texaco CEO James Kinnear selected a general counsel whose career objective was to be the very best general counsel possible, not the next CEO.[26]

Fourth, the general counsel should adopt a risk assessment approach. There is often no clear right answer, so the challenge is to

know enough about what might happen to chart a course that stands the best chance of protecting the company's interests.

General counsel can help the company manage risk with the following actions:

- Identifying and assessing risks
- Counseling senior management and the board
- Managing the actual provision of legal services for the company
- Controlling costs associated with those risks and services
- Performing an internal regulatory function

Furthermore, the general counsel is instrumental in implementing the disclosure and reporting controls required by the Sarbanes-Oxley Act. The CEO and CFO must certify the adequacy of these controls, and they should work with the general counsel to design them, to monitor their adequacy, and to make any necessary refinements or changes.

In the ACCA's 2001 survey of CEOs and other senior managers at 149 companies, the respondents characterized the four most important roles of in-house general counsel:

- Educator regarding legal issues (61 percent)
- Ethics advisor (60 percent)
- Compliance officer (52 percent)
- Sounding board or confidante for the CEO (51 percent)[27]

Only 37 percent of respondents valued in-house counsel as a member of the strategic planning team, only 23 percent as a risk manager, and only 16 percent as a mediator or conflict resolution expert. There is clearly room for improvement.

The ACCA survey identified trustworthiness, confidentiality, and providing accurate, timely, and focused feedback as the most desirable qualities for counsel.[28] Respondents rated as critically important counsel's understanding of company business and his or her ability to focus on prevention and compliance.

The ACCA recommends that the in-house general counsel be free to focus on how to achieve the best legal results, whether via hiring experienced professionals or retaining the best outside counsel. According to the ACCA, if the in-house general counsel is responsible for the costs and results of litigation (including the total amount of settlements and money damage awards) and of transaction-oriented work, then the company should be indifferent to particular legal costs, as long as the overall cost of a project is as low as is practical.

I disagree. If, as I believe is true, every legal dispute is a business problem requiring a business solution, then the lawyers should not be the ultimate decision makers when it comes to deciding whether to settle a case and on what terms.

Similarly, although the general counsel (like the technical IT experts deciding how to staff a project) is usually in the best position to decide when to retain outside counsel and to select the best lawyer for the job, it is important for the general managers involved to have a say in the matter. This is especially critical when negotiating transactions where the style and experience of the outside counsel can seriously affect the likelihood of striking an advantageous deal and creating an enduring relationship. Even in the event of litigation, the responsible manager should ask about the proposed litigator's approach to litigation ("take no prisoners" or try to find a win-win solution to settle the dispute) and ask whether the lawyer has relevant experience dealing with disputes of this kind in this industry.

Involving the managers who will be deciding the business issues in the selection of counsel reinforces the notion that the lawyers and the managers are expected to work as a team. It also makes it clear that outside counsel's real client is the manager, not the general counsel. Certainly the general counsel should be kept informed and consulted when appropriate, but there should be a clear line of communication between the managers with decision-making authority and the lawyers (regardless of whether they are inside or outside of the company).

Managers should require the general counsel to create a realistic budgeting structure for outside work so that the lawyers and managers can make intelligent judgments about what the project or liti-

gation is worth and should cost. For example, the Monsanto legal department requires a budget plan for legal matters expected to exceed $20,000, detailing the scope and sequence of the contracted work and the milestones to be met for each phase of the representation.[29] The budget must also stipulate billing deadlines to satisfy Monsanto's forecasting requirements and to assist the finance department with monthly accrual information. Some extra-contract supplemental costs are allowed, but they require company authorization before reimbursement. The Monsanto legal department has not resorted to using outside auditors to review billing charges, but they have challenged excessive billing or poor performance on occasion.

Most law firms bill Monsanto by the hour, although some offer flat fee or hybrid arrangements (monthly retainer plus discounted hourly fees) as well. Monsanto also negotiates volume discounts, but these sometimes lead to problems of accessibility and responsiveness. To facilitate mutual understanding and to build a strong relationship, Monsanto stresses the need for regular, clear, and open communication with the outside firm.

In allocating legal costs to the various business units, top management should ensure that they do not deter managers from seeking legal advice when they need it. Rather than viewing legal expenses as a cost, companies might be better served to view it as an investment in a valuable dynamic capability that can be a source of competitive advantage.

Centralize or Decentralize Legal Resources?

Another issue is whether a company should have a central law department or distribute the in-house lawyers among their corporate clients, such as by business unit. Considerations of consistency, efficiency, cost, and evaluation must play a part in this decision. For example, in a company with homogeneous products and plans, a centralized legal department might make most sense, whereas decentralization may be preferable in a large, multibusiness company. However, it is important to ensure that decentralized groups of lawyers do not become captives of their business groups or pursue

legal strategies at odds with the legal and business strategies of the firm as a whole. Thus, it is often prudent to centralize regulatory functions, such as antitrust, environmental, and securities law compliance, at the firm's executive headquarters and for the board of directors to appoint a chief compliance officer who reports directly to the audit committee of the board.

The ACCA recommends that the general counsel have ultimate authority to evaluate and set up the compensation for the in-house lawyers in either scenario. This seems appropriate as long as the general counsel seeks feedback from the manager-clients about the quality, timeliness, and cost of the legal services provided.

Keeping Communications Confidential: The Attorney-Client Privilege

Since the sixteenth century, the *attorney-client privilege* has promoted justice by protecting confidential communications between clients and their attorneys. Clients are more likely to make a full and frank disclosure of the truth to an attorney if they know that the attorney cannot be compelled to pass the information on to other parties. Lawyers, in turn, are better able to advise and represent their clients if the client honestly discloses the complete facts.

Although many business people believe that they understand which communications are privileged, a survey by Paul Rice of a sample of *Fortune* 100 corporations revealed serious gaps in managers' knowledge of the requirements for maintaining the privilege. Of those surveyed, 72 percent knew that only communications between an attorney and client that relate to legal advice are protected by the attorney-client privilege. But only 58 percent knew that the communications had to be confidential or that confidentiality had to be maintained by limiting distribution to those with a "need to know."[30] Rice found that officers and directors were generally no better informed about the privilege than other employees even though officers and directors have far greater access to confidential communications.[31] To remedy the knowledge gap, managers should understand and apply the following considerations.

Who Is the Client?

The attorney-client privilege belongs to the client alone. The attorney has an obligation to alert the client to the existence of the privilege and, if necessary, to invoke it on the client's behalf. The client can, however, waive the privilege over the attorney's objection if the client so desires.

Because the attorney-client privilege belongs only to the client, it becomes critically important to identify who exactly is the client. This is not an issue when an individual hires a lawyer to give legal advice on a personal matter, but it becomes more problematic when a company hires an attorney.

The general counsel and other in-house lawyers as well as the outside counsel retained by the company represent the *company*, not the managers who may have hired them. Among the Rice survey respondents, more than half the officers and directors erroneously believed that the general counsel represents them personally when they discuss matters relating to their corporate responsibilities.[32]

Because the company is the client, no employee or director (not even the CEO) may invoke the privilege on his or her own behalf. Whatever an employee divulges cannot be kept secret from the executive officers of the company or the board of directors. The board has the ultimate authority to decide whether to assert the attorney-client privilege on behalf of the corporation or to disclose the communication to a prosecutor, court, or other third party.

Companies often seek to defend a criminal or other charge by claiming that the wrong was committed by a "rogue" employee. As a result, individual employees who confessed their role in the wrongdoing often find themselves offered up as sacrifices to take heat off the company.

Management should make it clear to every employee and director that, unless otherwise specified in a written engagement letter, any lawyer hired by the company or serving in the in-house legal department represents the company, not any one individual. As a result, anything divulged by an employee or director can be disclosed to a prosecutor or other third party and used in a court of law.

Which Communications Are Privileged?

Several conditions must be satisfied for communications to be protected by the privilege. First, the communication must be kept confidential. If the client relays the information to others or makes the communication in the presence of others not protected by the privilege, then the communication is not privileged.

All privileged documents should be marked "attorney-client privilege" both to restrict their circulation to those with a "need to know" and to ensure that they are not inadvertently produced in response to a discovery request. A manager should never forward an e-mail or letter from counsel to anyone else without first confirming with counsel that the document can be shared with that person without losing the privilege. Sometimes, it is best for managers to meet face-to-face with counsel or to chat over the telephone and not reduce the conversation to writing to avoid indiscreet disclosure of sensitive discussions.

Consider the following example of how *not* to document legal advice. A partner at Cravath, Swaine and Moore had explained to a client whose business was being seriously affected by price-cutters the difference between refusing to do business with a price-cutter (a legal choice) and entering into agreements with customers not to cut prices (illegal minimum resale price maintenance). When the Federal Trade Commission investigated the client for resale price maintenance, one of the first documents found in the files of the sales manager was a memorandum to his district managers, stating, "Cravath says we can refuse to sell to price-cutters, but can't make agreements to maintain prices. Accordingly, whenever you put a price-cutter back on our list [based] on his agreement not to cut prices, do not send a copy of the agreement to the home office."[33]

Second, the attorney to whom the communication is made must be a practicing attorney at the time of the communication, and the person making the communication must be a current or prospective client seeking legal advice. The attorney-client privilege extends to communications with both in-house and outside counsel as long as the communication occurs while the attorney is acting in a legal

capacity. However, if a client is conversing with an attorney about nonlegal matters (such as business strategy), the conversation is not protected.

Throughout this book I have urged counsel to link legal strategy with business strategy. When it comes to attorney-client privilege, however, the lawyers must maintain a clear distinction between their legal services and their role as a business advisor. This can be particularly difficult and dangerous when a lawyer serves as both general counsel and a board member, because it is often not clear whether the attorney is giving business or legal advice. As a result, it is generally not prudent for the general counsel to serve as a member of the board of directors.

Third, the attorney-client privilege does not protect client communications that are made to further a crime or other illegal act. If an executive were to ask an attorney about the best way to embezzle money without getting caught, the conversation would not be privileged.

In July 1997, the Florida Court of Appeals rejected the tobacco companies' claim of attorney-client privilege for eight confidential documents, including attorneys' notes from in-house meetings on legal strategy.[34] The court concluded that because the documents contained evidence that tobacco attorneys participated in an industrywide conspiracy to defraud the public about the danger of smoking, they came within the exception for communications to further commission of fraud or a crime. Disclosure of these documents was pivotal to the successful lawsuits that resulted in the tobacco companies paying more than $200 billion to settle charges of engaging in a conspiracy to mislead the public about the hazards of smoking.

Protecting Corporate Communications

A corporation (or other business entity) can communicate with an attorney only through its officers, directors, or employees. The attorney-client privilege protects the communications of any company employee with counsel as long as the subject matter of the communication relates to the employee's duties and the communication is made at the direction of a corporate superior.[35] Thus, communications

between a corporation's attorneys and any of its employees, not just a small, upper-level group, can be protected under the attorney-client privilege as long as the communications pass the subject matter test.

It is not clear whether the attorney-client privilege applies to communications with former employees. There is also an issue of what exactly constitutes a voluntary waiver of the attorney-client privilege by a corporation. Finally, there is still uncertainty about the protection the privilege gives corporations in suits brought against them by their own shareholders.

The corporation's storage and dissemination policies regarding privileged communications should be distributed in writing and explained to all employees. Over half the respondents in Rice's survey were unaware of any corporate policies on the creation, storage, and distribution of privileged communications, 70 percent did not know that the policies were in writing, and a remarkable 90 percent expressed the view that corporate policies were not adequately communicated. Further, almost half of the people surveyed did not think it necessary either to segregate privileged documents or to clearly label them with "attorney-client privilege" to alert potential readers to their confidential nature.

Guidelines for Retaining the Privilege

Experts have offered several suggestions for keeping communications between a corporate employee and counsel within the scope of the attorney-client privilege.[36] First, a communication between an attorney and a corporation is protected when the client is seeking or receiving only legal advice, not business advice. Thus, corporations should usually request legal advice in writing and assign communication with the attorney to a specific employee who has responsibility over the subject matter at issue.

Second, corporations should make sure that senior management directs all communications between employees and corporate counsel and that the employees know they must keep all communications confidential.

Third, corporate employees should deal directly with counsel (not through intermediaries) and maintain separate confidential files and documentation. Communications with counsel must not be shared with anyone outside the corporation or even with other corporate employees unless the subject matter relates to the employee's duties and the communication is shared at the direction of a corporate superior.

Fourth, when a corporation gives a government agency access to its communications or files, the corporation should negotiate a written agreement of confidentiality with the agency or an agreement that the agency will not take physical possession of the documents. The corporation should also investigate the possibility of statutory protection in this situation.

Internal Investigations and Waiver of the Attorney-Client Privilege

If a corporation wants to avoid prosecution for the misdeeds of its employees, it must offer full cooperation in the investigation and prosecution of the individuals involved in the alleged wrongdoing. The U.S. Justice Department has taken the position that cooperation often includes waiving attorney-client privilege for any internal investigations by counsel retained to determine whether wrongdoing has occurred or to identify the individuals involved.

This controversial policy requires top management and counsel to make what can feel like a Hobson's choice. On the one hand, they open the corporation to criminal prosecution if they do not agree to waive attorney-client privilege. On the other hand, if they waive the privilege in hopes of avoiding corporate prosecution, they take the risk that the information thus revealed could lead to a broader corporate indictment.

Arthur Andersen's corporate demise occurred in just such a situation: after Andersen agreed to waive attorney-client privilege in hopes of avoiding a firmwide indictment in the Enron affair, the company released masses of documents to the government. Among these was

the "smoking gun" e-mail in which Andersen lawyer Nancy Temple reminded the Enron audit team to honor Andersen's document retention policies—which helped seal Andersen's conviction for obstruction of justice.

Select a Counselor, Not a Hired Gun

Managers are best served by lawyers who provide judicious and informed advice that helps leverage lawful business opportunities into activities that increase realizable value while managing risk. Sometimes that means saying no. So when selecting counsel, legally astute managers consider not only technical expertise but also the reputation the lawyer has for pushing back when the client has proposed a course of action that the lawyer considers unwise.

Elihu Root, a former U.S. secretary of war, secretary of state, and U.S. senator, remarked, "About half the practice of a decent lawyer consists in telling would-be clients that they are damned fools and should stop."[37] As professionals and officers of the court, lawyers are expected to exercise independent judgment and not sell their conscience as well as their services to the client who pays them.[38]

The American Bar Association's *Model Rules of Professional Conduct*, adopted in whole or in part by most states, require a lawyer to "exercise independent professional judgment and render candid advice."[39] When advising a client, "a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation."[40] The ABA goes on to explain that a client is entitled to "straightforward advice expressing the lawyer's honest assessment" even when it "involves unpleasant facts and alternatives that a client may be disinclined to confront."[41] Although a lawyer "endeavors to sustain the client's morale and may put advice in as acceptable a form as honesty permits," a lawyer "should not be deterred from giving candid advice by the prospect that the advice will be unpalatable to the client."[42]

Purely "technical legal advice" can sometimes be inadequate. Instead, the ABA calls it "proper for a lawyer to refer to relevant moral and ethical considerations" because these considerations

"impinge upon most legal systems and may decisively influence how the law will be applied."[43] The ABA states that a lawyer may accept at face value an express or implicit request for purely technical advice from a client experienced in legal matters, but in my experience clients are rarely best served by such advice.

Consider how Columbia/HCA Healthcare's managers and lawyers responded when Columbia/HCA discovered a $14 million Medicare reimbursement error in its favor. Instead of reporting the error, Columbia/HCA executives sought and obtained a legal opinion that it was not required to disclose the error to the Department of Health and Human Services. They also established a "reserve" of $500,000 per year to repay any money the government might later decide that Columbia/HCA owed.[44] It turned out that the lawyers got it wrong. Columbia/HCA's failure to report the error led to the first criminal indictments against the company's managers for Medicare fraud.

I don't know how Columbia/HCA's lawyers couched their advice, whether they framed their opinion in terms of legal technicalities or some broader principle. Given that Columbia/HCA used the opinion as an excuse for not reporting the error, I suspect it was the former. Perhaps the management team was intent on keeping the error secret regardless of its lawyers' advice.

What I do know is that a client is less likely to push the limits of the law and to engage in unethical conduct if its lawyers go beyond the technicalities of the rules and engage the client in a meaningful dialogue about the ethics of the client's plan and the probable effect on their reputation and their relationships with key constituencies.

A lawyer shouldn't say "no" without first collaborating with the responsible manager to determine both what the objective should be and whether there is a legal way to achieve it, however. Thus, the general counsel of Heinz stated that she never expects a lawyer to approve a transaction that does not meet the requirements imposed by law, but she does want outside counsel to be more "creative and innovative."

Contrast the advice the lawyers gave Enron and Columbia/HCA Healthcare with the collaborative process that created Citigroup, as

described in the opening paragraphs of this book. As general counsel at the time, Chuck Prince did not suggest that Chairman Sandy Weill violate the letter or the spirit of the law. Instead, the two worked to change the law while preparing a backup plan to put into place if their lobbying efforts failed.

The Importance of Winning Legally

In his next job as Citigroup's CEO, Chuck Prince faced continuing challenges as he attempted to teach the whole sprawling global organization the importance of winning legally. Perhaps if Citigroup's managers and lawyers had worked together more effectively at the cutting edge of competition and innovation, they could have avoided the analyst scandals, the questionable deals for Enron and WorldCom, the predatory mortgage lending practices, and other mistakes of the late 1990s. Certainly Chuck Prince (and Citigroup shareholders) would have preferred to save the roughly $10 billion the group paid in fines and damages to put "the entire era behind us."[45]

But is the struggle ever really over? In September 2004, the financial authorities in Japan shut down Citigroup's lucrative private banking business there, citing "severe legal violations" and "extremely inappropriate transactions" that could indicate a pattern of money laundering. The Japanese government also announced that it would revoke Citibank's private banking license as of September 2005.[46] Six officers left their jobs in the immediate wake of the announcement, out of 238,000 highly capable employees in a worldwide organization that consistently wins awards for being the best and most admired company in its industry.

Citigroup announced in early 2005 that it had taken a $244 million after-tax charge against earnings related to the closing of Japan Private Bank and had set up a $131 million after-tax reserve related to the resolution of a Securities and Exchange Commission investigation of its transfer agent business.[47] Prince characterized the legal and regulatory charges recorded in 2004 as "significant disappointments" and assured investors that "resolving open legal and regulatory issues is a key management priority." Chuck Prince still has

work to do—and so does every other CEO, senior executive, manager, and corporate counsel who cares about building an enduring organization that can maximize strategic value while minimizing legal and business risk.

Winning legally requires leadership, persistence, and vigilance, but it is an attainable goal. By studying the game plan and heeding the play-by-play advice contained in this book, managers increase their odds of fielding a winning team.

Notes

Chapter 9

1. Stephen J. Friedman and C. Evan Stewart (eds.), *Corporate Executive's Guide to the Role of the General Counsel* (Chicago, IL: American Corporate Counsel Association, 2000). According to Ben Heineman, General Electric's senior vice-president, law and public affairs, "Nowdays every firm should have its own in-house lawyer-statesman" who supplies practical wisdom and not just technical mastery, understands long-term effects, and evinces a deep concern for the public interest as well as for the private good of the firm. *Economist*, 20 March 2004.

2. Milo Geyelin, "More Law Schools Are Teaching Students Value of Assuming Clients' Point of View," *Wall Street Journal*, 17 September 1991, B1.

3. Ronald J. Gilson, "Value Creation by Business Lawyers: Legal Skills and Asset Pricing," *Yale Law Journal* 94 (1984): 239–311.

4. Richard A. Oppel Jr. and Kurt Eichewald, "Arthur Andersen Fires an Executive for Enron Orders," *New York Times*, 16 January 2002, A6.

5. Marshall B. Clinard and Peter C. Yeager, *Corporate Crime* (New York: Free Press, 1980), 20

6. Ibid.

7. Ibid.

8. Ibid., 18.

9. "Effective" is used here to refer to the aspect of strategy implementation that focuses on doing the right things. "Efficient" refers to doing things right. Mike H. Ryan, Carl L. Swanson, and Rogene A. Buchholz, *Corporate Strategy, Public Policy and the Fortune 500: How America's Major Corporations Influence Government* (Oxford and New York: Blackwell, 1987), 18.

10. David Andrews, interview with the author, Purchase, New York, 30 October 2005.

11. Indra K. Nooyi, interview with the author, Purchase, New York, 30 October 2005.

12. Kim B. Clark and Steven C. Wheelwright, "Organizing and Leading Heavyweight Development Teams," *California Management Review* 34 (Spring 1992): 9–28.

13. See Michael E. Porter and Victor E. Millar, "How Information Gives You Competitive Advantage," in Michael E. Porter, *On Competition* (Boston: Harvard Business School Press, 1996), 77.

14. The discussion of the evolution of information technology management that follows is drawn from Lynda M. Applegate and Joyce J. Elam, "New Infor-

mation Systems Leaders: A Changing Role in a Changing World," *MIS Quarterly* 16, no. 4 (December 1992): 469–490.

15. Ibid.

16. Jeanne W. Ross and Peter Weill, "Six IT Decisions Your IT People Shouldn't Make," *Harvard Business Review* 81, no. 11 (November 2002): 84–91.

17. Mark D. Lutchen, *Managing IT as a Business: A Survival Guide for CEOs* (Hoboken, NJ: Wiley, 2004), 8.

18. Ibid.

19. Friedman and Stewart, *Corporate Executive's Guide*.

20. Ibid.

21. Mike France and Louis Laville, "A Compelling Case for Lawyer-CEO's," *BusinessWeek*, 13 December 2004, 88.

22. According to the headhunting firm SpencerStuart, 10.8 percent of the CEOs of companies in Standard & Poor's 500-stock index have law degrees. They include Sumner M. Redstone (Viacom), Kenneth I. Chenault (American Express), and Richard D. Parsons (Time Warner).

23. P. Clendenen, "General Counsel for Changing Times," *Business Lawyer*, May/June 2002.

24. Ibid.

25. Friedman and Stewart, *Corporate Executive's Guide*.

26. James Kinnear, interview with the author, Boston, Massachusetts, 27 September 2004.

27. American Corporate Counsel Association, *In-house Counsel for the 21st Century* (Chicago, IL: American Corporate Law Association, 2001).

28. Friedman and Stewart, *Corporate Executive's Guide*.

29. "Interview: D. C. Yu—Corporation's Retention and Management of Outside Counsel," *Corporate Counsel Weekly*, 20 September 2000, 8.

30. Paul Rice, "Corporate Attorney-Client Privilege: Study Reveals Corporate Agents Are Uninformed; What They Don't Know Can Destroy the Privilege," American Corporate Counsel Association, August 1988, available at http://www.acca.com/vl/privilege/rice.html.

31. Ibid.

32. "Protecting the Privilege," *Corporate Counsel Weekly*, 21 August 2002, 261.

33. Robert Swaine, *The Cravath Firm*, vol. 2 (New York: Ad Press, 1948), 696.

34. *U.S. Law Week*, 19 August 1997.

35. *Upjohn Co. v. United States*, 449 U.S. 38 (1981).

36. This discussion is based in part on Dennis Block and Carol Remz, "After 'Upjohn': The Uncertain Confidentiality of Corporate Internal Investigative Files," in *American Bar Association Section on Litigation*, *Recent Developments in Attorney-Client Privilege*, *Work-Product Doctrine and Confidentiality of Communications Between Counsel and Client* (Chicago: American Bar Association, 1983).

37. Linowitz and Mayor, *The Betrayed Profession*, 4.

38. Ibid., 16.

39. "Rule 2.1," *American Bar Association Model Rules of Professional Conduct* (Chicago: American Bar Association Center for Professional Responsibility, 2002), 70.

40. Ibid.

41. Ibid.

42. Ibid.

43. Ibid.

44. See Andy Pasztor and Lucette Lagnado, “Ethics Czar Aims to Heal Columbia,” *Wall Street Journal*, 26 November 1997, B1.

45. Mitchell Pacelle, “Don’t Bet on Citigroup Being in the Clear Yet,” *Wall Street Journal*, 14 May 2004, C1.

46. Mara Der Hovanesian, Paula Dwyer, and Stanley Reed, “Can Chuck Prince Clean Up Citi?” *BusinessWeek*, 4 October 2004, 32–35.

47. Ken Magill, “Citigroup 4Q Profits Hit Record,” *New York Sun*, 21 January 2005. In the wake of a controversial European government bond trade that disrupted the electronic market and other regulatory problems, the Federal Reserve Board instructed Citigroup not to plan to do any big new mergers or acquisitions until it addresses “the deficiencies in compliance risk management.” David Wighton, “Fed Calls on Citigroup to Boost Controls,” *Financial Times* (London), 18 March 2005, 23. On March 1, 2005, Citigroup kicked off its “Five Point Plan” for new management training, tighter financial controls, and improved communications between employees and executives. Although the plan includes a mandatory online ethics training course for all 300,000 employees, it is not clear whether Citigroup also plans to increase the legal literacy of its employees. Attaining Chuck Prince’s articulated goal of turning Citigroup into the most respected global financial service company (Hamilton Nolan, “Citigroup Kicks Off Internal Efforts to Clarify Standards,” *PR Week*, 4 April 2005, 3) will almost certainly require a higher degree of legal astuteness than certain of Citigroup’s managers have exhibited in the past.