PROPOSED MODEL RULE 5.4: IS IT NECESSARY FOR CORPORATE STAFF COUNSEL?

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INTRODUCTION

The public debate surrounding the American Bar Association's Proposed Model Rules of Professional Conduct has focused primarily on the appropriate balance between an attorney's loyalty to his client and his professional responsibility to society at large, with particular emphasis on proposals expanding the scope of an attorney's obligation to disclose client confidences.[1] The Proposed Model Rules contain other changes of potential significant consequence, which, in contrast, have drawn little attention. One of these is proposed Model Rule 5.4, Professional Independence of a Firm, which, for the first time, would require "employment contracts" for, among others, corporate staff counsel.[2] The contracts purportedly would assure their professional independence.

This commentary examines the justification advanced in support of this proposed change, the inherent ambiguities in the provisions of the Rule itself, and its probable organizational consequences for managing corporate staff counsel. It concludes that, if adopted, Rule 5.4 should not apply to corporate staff counsel

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1. *See generally, e.g.*, Pickholz, *The Proposed Model Rules of Professional Conduct—And Other Assaults Upon the Attorney-Client Relationship: Does "Serving the Public Interest" Disserve the Public Interest?* 36 BUS. LAW. 1841 (1981); Redlich, *Disclosure Provisions of the Model Rules of Professional Conduct*, 1980 A.B.F. RES. J. 981; Wolfram, *Client Perjury: The Kutak Commission and the Association of Trial Lawyers on Lawyers, Lying Clients, and the Adversary System*, 1980 A.B.F. RES. J. 964. *See also* Kaufman, *A Critical First Look at the Model Rules of Professional Conduct*, 66 A.B.A.J. 1074 (1980); Kutak, *The Next Step in Legal Ethics: Some Observations About the Proposed Model Rules of Professional Conduct*, 30 CATH. U.L. REV. 1 (1980); Review Symposium: *The Model Rules of Professional Conduct*, 1980 A.B.F. RES. J. 921-1023.

2. ABA COMMISSION ON EVALUATION OF PROFESSIONAL STANDARDS, MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.4 (Proposed Final Draft, May 30, 1981) [hereinafter cited as PROPOSED FINAL DRAFT].

any more than it applies to members of traditional law firms when retained as counsel to corporations.

THE ROLE AND RELATIONSHIP OF CORPORATE STAFF COUNSEL

Many business corporations have long maintained internal "law departments" staffed with full time corporate staff attorneys under the direction of a general counsel or vice president-law who is himself an experienced lawyer.[3] These departments exist to provide legal services directly to their corporate clients. Their services have been supplemented, from time to time or on a regular basis, by the retention of independent law firms.

Corporate staff counsel generally perform as a law firm within the corporation and as a liaison between outside counsel and the corporation. In both instances the corporation is the client, and the attorney-client relationship between the corporation and both staff and outside counsel is well established.[4] Even though the corporation itself is customarily under the overall direction of non-lawyers (*i.e.*, subject to a board of laymen directors), that fact has not previously warranted imposing any special measures to insure professional independence.[5]

The lack of prior concern is not particularly surprising since the practice of corporate staff counsel closely resembles that of attorneys in independent law firms retained by corporations. The principal difference between the two is that the corporate staff attorney has a direct employment relationship with the corporation and usually works exclusively for his corporate client while the lawyer in the independent firm gets paid through the fee charged

3. Corporate law departments are not a new phenomenon. The Law Department of Union Pacific Railway Company (predecessor to the current Union Pacific Railroad Company) was established on February 1, 1880. See Appendix to Annual Report of the Law Department, Union Pacific Railway Co., 1885-86.

4. *See* Upjohn Co. v. United States, 101 S.Ct. 677 (1981). In *Upjohn*, both staff counsel and independent counsel were involved in a confidential investigation, and communications were held to be protected from discovery under the attorney-client privilege. *Id.* at 679, 686. No distinction was made between the types of counsel. The term "corporate counsel" was used to apply to both. *Id.* at 684.

5. *See* AMERICAN BAR FOUNDATION, ANNOTATED CODE OF PROFESSIONAL RESPONSIBILITY (1979) [hereinafter cited as ANNOTATED CODE]. The existing Code of Professional Responsibility addresses the issue of the relationship of corporate staff counsel and the corporate client mainly in Canon 5 (A Lawyer Should Exercise Independent Professional Judgment on Behalf of a Client). *Id.* at 187. Ethical Considerations (EC) 5-13, 5-18, 5-22, 5-23, and 5-24 and Disciplinary Rule (DR) 5-107 all deal more or less directly with questions of ethical duties and professional independence in staff attorney-client relationships. *Id.* at 252-59.

by his firm and may work for other clients as well.[6]

THE UNDERLYING JUSTIFICATION FOR PROPOSED MODEL RULE 5.4

Notwithstanding the similar client-attorney relationships that exist between corporate staff attorneys and retained counsel and their respective corporate clients, proposed Model Rule 5.4 would draw an arbitrary distinction between the two. It groups corporate law departments with other non-law firm organizations in requiring a written understanding governing attorney independence, but does not impose a comparable obligation on retained counsel. Proposed Model Rule 5.4 provides as follows:

> A lawyer may be employed by an organization in which a financial interest is held or managerial authority is exercised by a nonlawyer, or by a lawyer acting in a capacity other than that of representing clients, such as a business corporation, insurance company, legal services organization or government agency, but only if the terms of the relationship provide in writing that:
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> (a) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship;
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> (b) information relating to representation of a client is protected as required by Rule 1.6;
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> (c) the arrangement does not involve advertising or personal contact with prospective clients prohibited by Rules 7.2 and 7.3; and
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> (d) the arrangement does not result in charging a fee that violates Rule 1.5.[7]

This Rule would replace existing Code provisions which, while expressly allowing attorneys to be employed by business corporations, suggest (but do not require) a written agreement between the attorney and the corporation defining the relationship in order

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6. PROPOSED FINAL DRAFT Rules 5.1 and 5.2, *supra* note 2, at 171-72. These rules set forth the respective responsibilities of supervisory and subordinate lawyers. They do not distinguish between corporate law departments and independent law firms since the definition of "law firm" treats them equally. The chief legal officer, like a law firm partner, is responsible for the professional conduct of the junior attorneys.

7. PROPOSED FINAL DRAFT Rule 5.4, *supra* note 2, at 175. The term "firm" is not defined in the proposed Model Rules generally and the reference to "an organization in which a financial interest is held or managerial authority is exercised by a non-lawyer . . ." might arguably not apply to a corporate staff counsel. This ambiguity is resolved by the Comment accompanying the proposed rule which makes specific references to corporate law departments. PROPOSED FINAL DRAFT Rule 5.4 Comment, *supra* note 2, at 175.

"to prevent misunderstandings . . . ."[8]

The need to make such an agreement a condition of employment for attorneys employed by any of the organizations covered by the Rule is unclear. In the accompanying Comment, for example, the drafters point to the fact that "[o]ver the course of time, the law firm has evolved into a variety of organizations."[9] Within this group, they include multimember partnerships, firms employing paraprofessionals and professionals of other disciplines, professional corporations, insurance companies that employ counsel who represent insureds, law departments of private organizations and government agencies, legal service agencies and defender organizations, and group legal service organizations with non-lawyers acting as managers or directors. They cite the proliferation of these multivariant organizational forms as raising particular problems concerning the client-lawyer relationship. Rather than examining any of the client-lawyer relationships in detail, however, the drafters elected to require the application of proposed Model Rule 5.4 in all instances where law is practiced outside the "classical form" of law firm.[10]

The motivation for this decision appears to be reflected, at least in part, in their discussion of the proposed Rule. In the Notes the drafters recognize that group legal service organizations and prepaid legal insurance have been attacked on unauthorized practice grounds and that such attacks have impeded development of new methods of providing legal services.[11] They apparently see the written agreement as protecting the lawyer-client relationship in evolving forms of legal service organizations and thus encouraging evolution in form.

Whatever merit proposed Model Rule 5.4 might have for evolving legal service organizations, there appears little justification for extending it to established corporate law departments and corporate staff counsel. Furthermore, the drafters expressly recognize that "business corporations have been permitted to establish law departments that report to non-lawyer managers while being recognized as independent in terms of professional responsibility."[12]

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8. ANNOTATED CODE, EC 5-24, *supra* note 5, at 254.

9. PROPOSED FINAL DRAFT Rule 5.4 Comment, *supra* note 2, at 175.

10. *See id.*

11. PROPOSED FINAL DRAFT Rule 5.4 Notes, *supra* note 2, at 176-78. These Notes cite canons and cases narrowly construing what constitutes authorized practice, including a number of recent cases, *e.g.*, Phillips v. Tobin, 548 F.2d 408 (2nd Cir. 1976); Marshall & Assoc. Inc. v. Burleson, 313 A.2d 587, 599 n.34 (D.C. 1973); Automobile Club v. Hoffmeister, 338 S.W.2d 348 (Mo. Ct. App., 1960); Thompson v. Chemical Bank, 84 Misc. 2d 721, 375 N.Y.S.2d 729 (N.Y. Civ. Ct. 1975).

12. PROPOSED FINAL DRAFT Rule 5.4 Notes, *supra* note 2, at 178.

Consequently, there seems to be no logic for including corporate law departments within the category of legal service organizations at which Rule 5.4 apparently is directed. This point becomes particularly clear when one compares the lawyer-client relationship that exists between corporate staff counsel and the corporation, and that which exists in the context of legal service and other public service legal organizations.

The principal distinction between these relationships is that corporate staff attorneys are hired to provide legal services to their employer client whereas legal service counsel and attorneys engaged in prepaid legal services are hired to provide legal services to others. In the latter case, the attorney has loyalties to both his client and his employer. This raises the prospect of potential interference by his employer with his attorney-client relationship in situations where there is a conflict between the client and the employer, *e.g.*, where the client sues the employer or someone having a financial interest in the employer.[13]

In the corporate law department context the employer and the client are one and the same, and consequently there is no problem of dual loyalties.[14] This is undoubtedly one of the principal rea-

13. Congress, in the Legal Services Corporation Act, has prohibited the Legal Services Corporation from interfering with the staff attorney's responsibility to the client under the American Bar Association's Code of Professional Responsibility. On the contrary, the Corporation is affirmatively required to "ensure that activities [under the Act] are carried out in a manner consistent with attorneys' professional responsibilities." Legal Services Corporation Act, 42 U.S.C. § 2996e(b)(3) (1976). *See also* ANNOTATED CODE DR 5-107(B), *supra* note 5, at 254 which states: "A lawyer shall not permit a person who . . . employs . . . him to render legal services for another to direct or regulate his professional judgment in rendering such legal services." Thus, in this case if there is a problem of dual loyalty, there are appropriate statutory mechanisms or disciplinary rules to address the specific problem.

14. While admittedly questions can arise with respect to whether the "client" is the shareholders, the directors, the management or the "entity itself," these concerns do not change the underlying fact that the corporation, in some form, is the client. Moreover, both the current Code of Professional Responsibility and proposed Model Rule 1.13 expressly address this problem and draw no distinction between employed and retained counsel. They clearly specify that a lawyer representing a corporation, *whether he be retained or employed*, "owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity." ANNOTATED CODE EC 5-18, *supra* note 5, at 252; *see also* PROPOSED FINAL DRAFT Rule 1.13, *supra* note 2, at 82-83. However, as a practical matter, an attorney can represent the interests of the entity only by advising the directors or officers who are responsible for managing the entity. When the director or officer is acting as agent for the entity with respect to the matters which the attorney is providing counsel and the director or officer's interests are not in conflict with the interests of the entity, the director or officer becomes, in many ways, the "client." A good working relationship between the attorney and the director or officer "client" is crucial if the attorney is to be able to successfully represent the entity. Where the interests of the entity and its directors or officers diverge, the retained or employed counsel have the responsibility to rep-

sons why direct corporate employment of attorneys has resulted in few professional problems.

Even in the broader context, there appears to be little else in the provisions of the existing Code and/or the proposed Model Rules to support treating the independence of corporate staff counsel differently from that of retained counsel.[15] For example, proposed Model Rule 1.2 provides that "A lawyer shall abide by a client's decisions concerning the objectives of representation" and, subject to other limitations, shall "consult with the client as to the means by which they are to be pursued . . . ." At the same time, it requires that lawyers accept their client's decision on matters of settlement of litigation, waiver of jury trial, and client testimony.[16]

The Comment on Rule 1.2 further underscores the point that the client has the ultimate authority to determine the purposes to be served by legal representation within the limits of law and the attorney's professional responsibility, and has the right to consult with his lawyer about the means of achieving those objectives. At the same time, the attorney (regardless of his employment relationship) is not required to pursue improper objectives or employ unprofessional means simply because a client may wish him to do so, and the lawyer is clearly not permitted to assist a client in criminal or fraudulent conduct.[17] This proposed rule strikes a balance which retains the client's ultimate decision-making authority over the purpose and strategy of the engagement but preserves the attorney's professional latitude in achieving the desired ends, consistent with the law, established procedures and his professional responsibilities.

This rule mirrors the way in which the attorney-client relationship usually works in both the staff attorney and outside counsel contexts. The client is typically represented by the chief executive

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resent the entity under the current Code as well as the proposed Model Rules. *Id.* As past experience demonstrates, this is no easier for the retained attorney than the employed attorney. *See, e.g.*, Lewis v. Shaffer Stores, 218 F. Supp. 238 (S.D.N.Y. 1963). See also G. Hazard, Jr., & L. Silverman, Speech to the Association of the Bar of the City of New York on December 9, 1980, Will the ABA Draft Model Rules of Professional Conduct Change the Concept of the Lawyers Role?, *reprinted by* The Association of the Bar of the City of New York (1981), for a general debate on the effect of the proposed Model Rules on representing the corporate client.

15. It is interesting to note that the October, 1968, Tentative Draft (unpublished) of the existing Code contained the following sentence in the predecessor to EC 5-18: "A lawyer employed as such on a salaried basis by an entity, regardless of its type, is in a position distinct from that of other lawyers." The sentence was not present in the January, 1969, Preliminary Draft nor in the Final Draft of July, 1969. ANNOTATED CODE EC 5-18 Notes, *supra* note 5, at 224. At that time, at least, the idea of separate treatment was considered and rejected.

16. PROPOSED FINAL DRAFT Rule 1.2(a), *supra* note 2, at 11.

17. PROPOSED FINAL DRAFT Rule 1.2 Comment, *supra* note 2, at 12.

or other policy officer of the corporation who is responsible for a specific functional component of the corporation. The staff counsel (or through him, retained counsel) is called upon to provide legal advice and counsel. In each instance, the client is free to disregard this advice or act upon it. When the client elects to act upon the advice and counsel is called upon to assist, his participation will naturally be governed by professional standards, whether he is staff counsel or part of a retained firm.

Consequently, if there is a reason to question the independence of the corporate staff counsel and require their inclusion in proposed Model Rule 5.4, it must flow from some other aspect of the attorney-client relationship. One possibility is suggested by the general reference in the Comment to Rule 5.4 to the fact that non-lawyers in multivariant law firm organizations more frequently participate in the decision-making and management process.[18] This may have some relevance where the primary purpose of the organization is to provide legal services to third parties. But as noted previously, it is clearly not a major concern where corporate staff counsel practice under the supervision of a general counsel who, while perhaps a senior officer of the organization, is nevertheless a qualified attorney himself.

To the extent that the application of proposed Model Rule 5.4 to corporate staff counsel rests on an unstated concern that staff counsel cannot withdraw as easily from their legal engagement as independent counsel, it would also appear to be misguided. Proposed Model Rule 1.16, which governs termination, draws no distinction between staff attorneys and retained counsel.[19] Moreover, partners in law firms with corporate clients are subject to the same type of economic leverage which a staff counsel might feel in terms of his job.[20]

Overall, treating corporate staff counsel the same as legal service organizations for purposes of imposing an employment agreement ignores the organizational realities of corporate law practice

18. PROPOSED FINAL DRAFT Rule 5.4 Comment, *supra* note 2, at 175.

19. PROPOSED FINAL DRAFT Rule 1.16, *supra* note 2, at 101-02.

20. Ironically, in many circumstances, staff counsel are better positioned to assure not only their professional compliance but compliance of their corporate clients with applicable law as well. Their more intimate familiarity with the business of the corporation and their greater direct participation in the day to day decision-making process allows them, in many instances, to assert more influence and guidance over that process to assure compliance with the law. This, in turn, reduces the likelihood of situations where attorneys find that their clients are participating or are proposing to participate in unlawful or criminal acts and are thus faced with the quandaries of maintaining confidentiality and requirements for public disclosure.

and the strong similarities of that practice to that of independent law firms which would not be subject to that requirement. It also creates the false impression that corporate staff counsel have dual loyalties which must be given special professional treatment.

THE APPLICATION OF THE PROPOSED RULE TO CORPORATE STAFF COUNSEL

Assuming for purposes of argument that there is a reasonable basis for including corporate staff attorneys within the protected class of proposed Model Rule 5.4, the application of this rule to them is nevertheless unclear and confusing. Paragraph (a) provides that a written understanding between the staff attorney and the corporation must assure that there will be "no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship."[21]

The first part of this condition can be read in several ways in its application to corporate staff counsel. In its narrowest form, it could simply be intended to be an affirmation of proposed Rule 1.2, which assures that attorneys will be able to exercise their professional judgment with respect to the "means" of achieving the strategic legal objectives elected by the client. Since this Rule could merely have made reference to Rule 1.2 in this regard, but did not, it is open to a broader interpretation. For example, it might also be argued that because this provision is not limited to non-lawyer direction, it goes beyond simply assuring the attorney necessary professional latitude and was intended to give complete independence to staff attorneys in their relationship with their professional supervisors.

Taken to the extreme, for example, a young staff attorney might assert, based on this provision, that he was entitled to render his own legal opinion to lay management, or to represent the corporate client based on his own views regardless of the fact that the responsible senior legal officer might disagree with his professional judgment. In support of this position he would point to his written understanding as constituting a contract guaranteeing him this freedom. Such a position would naturally give rise to considerable problems in the efficient and professional management of a corporate legal function, and would also undermine the ultimate authority of the senior legal officer in rendering legal advice to and representing the corporate client.

In the analogous law firm setting, the authority of associates to

21. PROPOSED FINAL DRAFT Rule 5.4(a), *supra* note 2, at 175.

render opinions on behalf of the firm or represent clients is carefully circumscribed by tradition and good sense. Even within the law partnership structure, there is frequently a hierarchy regarding representation. There is little question about the authority of the partners to direct the professional conduct of the younger attorneys.

The second part of paragraph (a) requires that there be "no interference" with the "client-lawyer relationship." It seems to suggest that the corporate employer and the staff attorney each agree that the corporation will not interfere with the relationship between the corporation and the staff attorney. What is intended by this agreement in the context of corporate staff counsel is not at all clear since, as discussed above, the "dual loyalty" problem does not exist for corporate staff attorneys. If its purpose is to fortify or strengthen the attorney-corporate client privilege, it would duplicate the explicit reference to Rule 1.6 in paragraph (b) of Rule 5.4.[22] A possible interpretation is that it is intended to give the attorney some type of "tenure" in the organization which would protect him from discharge. If, in fact, this were the result, the organizational and professional consequences would be significant.[23]

Paragraph (b) of proposed Model Rule 5.4 provides that the written understanding contain a provision assuring that "information relating to representation of a client is protected as required by Rule 1.6."[24] Rule 1.6 governs the confidentiality of information and, as noted previously, has been the focus of considerable discussion.[25] Explicit incorporation by reference in the written agreement between attorney and client adds little, unless by entering into the written agreement the business corporation assumes some additional obligations. Of the several provisions of Rule 1.6, the most pertinent in this regard would appear to be the provision allowing the attorney discretion to disclose confidential client information.[26] Nevertheless, since corporate staff attorneys are already subject to this Rule, it is difficult to see how a written

22. PROPOSED FINAL DRAFT Rule 5.4(b), *supra* note 2, at 175.

23. Some have suggested that corporate staff attorneys should be given "tenure" to assure their independence. Kalish, *The Attorney's Role in the Private Organization*, 59 NEB. L. REV. 1 (1980); Schneyer, *Limited Tenure for Lawyers and the Structure of Lawyer-Client Relations: A Critique of the Lawyer's Proposed Right to Sue for Wrongful Discharge*, 59 NEB. L. REV. 11 (1980). There appears to be questionable merit in this suggestion, however. *See* Schaefer, *Professional Tenure: Is it Really a Solution?*, 59 NEB. L. REV. 28 (1980).

24. PROPOSED FINAL DRAFT Rule 5.4(b), *supra* note 2, at 175.

25. See note 1 *supra*.

26. PROPOSED FINAL DRAFT Rule 1.6(b), *supra* note 2, at 37.

understanding incorporating it by reference adds anything to it. If an attorney exercises his rights and responsibilities under this Rule, he is professionally protected regardless of the existence of a written agreement.

Paragraph (c) of proposed Model Rule 5.4 requires that the written understanding contain a provision to the effect that the employment arrangement "does not involve advertising or personal contact with prospective clients prohibited by Rules 7.2 and 7.3."[27] Since, as previously discussed, staff attorneys are full-time employees and usually restricted in their ability to engage in practice outside of their corporate employment, advertising or client solicitation would appear to be of little relevance.

Finally, paragraph (d) requires that the employment arrangement not result in the charging of unreasonable legal fees in violation of Rule 1.5.[28] Because staff attorneys are salaried employees, this provision would appear to have no application to corporate law practice.

Overall, the terms of the employment agreement suggested by Rule 5.4 would appear to have little practical value in the context of the corporate staff attorney since these attorneys appear as adequately protected by the Model Rules as independent practitioners.

THE ORGANIZATIONAL CONSEQUENCES OF THE PROPOSED RULE

If there were no possibility of adverse consequences, the adoption of proposed Model Rule 5.4 and its application to corporate staff counsel would be of little concern. However, as the prior discussion suggests, requiring staff counsel to have an employment understanding of the type contemplated in Rule 5.4 has broad, negative implications. Many corporations have job performance evaluation programs which cover all non-union employees. Attorney job positions and individual performance are evaluated within the framework of these programs. Salary increases, promotions, and other performance decisions are thus subjected to relatively uniform standards. Attorneys, like other officers who fail to measure up, can be denied salary increases, be passed over for promotion, or be discharged.

The existence of an "employment contract" would be incompatible with this process. Disappointed staff attorneys, for exam-

27. PROPOSED FINAL DRAFT Rule 5.4(c), *supra* note 2, at 175.
28. PROPOSED FINAL DRAFT Rule 5.4(d), *supra* note 2, at 175.

ple, might argue that the employment contract gave them independent employment rights. Not only would such an assertion create problems in managing the legal function, but the special employment status arguably afforded staff counsel would create jealousies in other client departments and thus threaten the effectiveness of the staff counsel function. Second, contractual protection of attorney independence could provide disincentives for staff counsel to maintain their professional skills, since, as "tenured" counsel, they could not be sanctioned. Third, the requirement of a written understanding could be viewed by the corporate client as infringing on his ability to manage the organization. Finally, the requirement of a written understanding for corporate staff counsel assuring their independence could certainly be expected to create presumptions about dual loyalties that do not exist or raise questions about their ability to maintain their independence through their own professional competence.

CONCLUSION

There has been no showing that the professional standards which do not distinguish corporate staff counsel from retained law firms are inadequate to protect staff counsel's independence. Nor has there been any showing that corporations are properly included with legal service organizations under proposed Model Rule 5.4. Consequently, proposed Model Rule 5.4, if adopted, should be modified to except corporate law departments from its application.