

Remarks: The Declining Role of Outside Counsel in Enhancing Ethical Conduct by Corporations

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Much ink has been spilled in recent years on how to enhance ethical conduct on the part of corporations. The implicit assumption is that there exists a “culture” that is common to most corporations and that can be altered—such as by regulations imposed from without or incentives promulgated from within—so as to make the culture more favorable to ethical behavior. While everyday experience suggests that there are some institutional characteristics common to most corporate entities, I am not sure these commonalities are as important, so far as enhancing ethical conduct on the part of employees is concerned, as some of the variables. During the nearly two decades I was in private practice, I represented many corporations; and because my specialty was “white collar” criminal law, I represented them in matters where their employees’ ethical conduct was most being questioned. The reactions to such situations varied considerably from corporation to corporation, and sometimes even changed radically in midstream, as when a CEO was deposed and replaced by a new one. If I were forced to generalize—which I find difficult to do—I would say that, while 100% of my corporate clients paid lip-service to observing the highest ethical standards, about half of them viewed doing so as a genuinely valuable asset (and even valuable in its own right); the other half simply viewed it as a necessary cost of doing business. I would be hard-pressed to explain why a given corporation fell into one or the other of these camps.

During the same two decades, I also represented a fair number of high-level executives accused of regulatory and often criminal misconduct, and some of them later “cut deals” and publicly admitted to the misconduct. The motivations for why they “did it” varied hugely from individual to individual; but only rarely were they affected by corporate culture in the sense that they took account of their companies’ ethical traditions and practices in making the calculation of whether, when and how to engage in misconduct. Indeed, some of my clients who were ex-

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executives in companies with strong traditions of ethical conduct nonetheless calculated that the “success” attendant on their bending the rules to enhance corporate profitability would materially better their positions in the companies.

Of course, it would be a mistake for me or anyone else to generalize too much from their own happenstance experiences. But broader data suggest similar conclusions. In particular, the Department of Justice has been engaged for the past twenty years or so in an attempt to alter corporate culture through such devices as deferred prosecutions, enhanced compliance requirements, corporate monitorships, and the like—and the data suggest that they have achieved little.

The most careful study of this is by Prof. Brandon Garrett in his book *Too Big to Jail*, which summarizes his detailed scrutiny of every deferred prosecution entered into by the federal government in the last two decades.¹ What he finds, overall, is that a great many companies that entered into deferred prosecutions subsequently engaged in serious misconduct, sometimes the very misconduct that first got them into trouble. For example, between 2002 and 2009, Pfizer Corporation entered into no fewer than four deferred prosecution agreements, all but the last of which was then followed by the company’s commission of the very misconduct the deferred prosecution agreements were designed to prevent.² Prof. Garrett believes that this was because the deferred prosecution agreements were not sufficiently enforced. But an alternative explanation is that such agreements are unlikely to change corporate culture, because such cultures are much more complicated than such agreements presuppose, because changing such a culture is much more difficult than the Government imagines, and because in any case the motivations of the executives who actually perpetrate the misconduct are only modestly affected by corporate culture.

Given the apparent failure of such devices as deferred prosecutions, one might look for more creative alternatives for enhancing ethical practices within a corporation. I don’t have any to suggest—indeed, my own belief, often stated, is that the best deterrent of corporate crime has nothing to do with trying to re-make corporate culture, but simply consists of criminally prosecuting and sending to prison the company employees and executives who actually commit the crimes. But, by way of suggesting the kind of institutional device that might serve to enhance more eth-

1. See BRANDON GARRETT, *TOO BIG TO JAIL: HOW PROSECUTORS COMPROMISE WITH CORPORATIONS* (2014).

2. *Id.* at 104–05, 166, 169–70; see also Jed S. Rakoff, *Justice Deferred Is Justice Denied*, N.Y. REV. BOOKS, Feb. 19, 2015, at 8, available at <http://www.nybooks.com/articles/2015/02/19/justice-deferred-justice-denied/>.

ical practices on the part of corporations, let me describe one such device that once helped serve this purpose but no longer does: the influence of outside counsel.

For many decades prior to the 1970s, corporations and other large institutions had a more or less permanent relationship with particular law firms: that is to say, nearly all the legal work of corporation X was given to legal firm Y. IBM gave all its legal work to Cravath, Chase Bank gave all its legal work to Milbank Tweed, and so forth. Rarely did large corporations divide their legal work among several law firms. As for in-house legal staffs, these were typically quite small, and were usually staffed by former associates of the outside law firm that had referred them to the company.

From an economist's point of view, these practices reeked of inefficiency, but one thing they fostered was a very close relationship between the top executives at the company and the top partners at its chosen law firm—a relationship that fostered candor and trust. And typically the lawyers in such relationships viewed it as part of their “professional” duty to enhance ethical practices on the part of the corporate client.

I witnessed an example of this in 1971 when, just two years out of law school, I was an associate at the large New York firm of Debevoise & Plimpton. A senior vice president at a corporation that had a long-term relationship with Debevoise had come up with a clever new business idea that would materially enhance the company's profitability (and likely would also increase his chances of becoming the next CEO). But when he ran the idea by the current CEO, the CEO told him to “check it with Oscar,” meaning Oscar Ruebhausen, a brilliant corporate lawyer who was the point-man at Debevoise for this particular client. So the executive sent a memo to Ruebhausen outlining his idea. Ruebhausen, in turn, asked a senior associate to research the lawfulness of the proposal, and the senior associate asked me to research an aspect of it.

The senior associate concluded that, while the proposal was “technically” legal, it was directly contrary to the spirit and purpose of various relevant SEC regulations. He wrote a searing memo to Ruebhausen, stating that he considered the senior executive's proposal “unethical” and “outrageous.” Oscar then asked the senior executive to come meet in his office and he also invited the senior associate and me to attend—I think as an object lesson as to how these situations should be handled. When the senior executive arrived, Mr. Ruebhausen congratulated him on the cleverness of his idea, and told him flat out that it did not technically violate the law and that the firm could issue an opinion stating so. But he then proceeded to describe how the proposal might be “somewhat risky,” because it might offend the SEC, with which the company had to remain

on good terms in the long run. Moreover, Ruebhausen said, even though the proposal was technically legal, it was “close enough to the edge” that the class action bar might challenge it, and, he added, “You know what they are like.” Ruebhausen then proceeded to outline some changes to the proposal that, while somewhat reducing its profit potential, would make it much less risky. The executive immediately accepted the proposed changes, and, it was my impression, left the meeting a happy man, knowing he would now get credit for a still-profitable new proposal that had “Oscar’s blessing.”

The real effect of the changes that Ruebhausen had suggested was to eliminate all the ethical objections the senior associate had raised and bring the proposal well within the spirit of the applicable regulations. The senior associate and I fully understood this; even though Ruebhausen never mentioned ethical concerns in his meeting with the senior executive, we had no doubt that it was those ethical concerns that animated Ruebhausen’s professional advice. I feel certain that this same scenario was duplicated a thousand times at other large law firms in that era. I am equally sure that it would not be duplicated today.

Why not? Because such relationships of candor and trust between law firms and their corporate clients are today a comparative rarity. The reasons for this trace to the late 1960s when, as a result of the new legislation, regulations, and initiatives associated with the “Great Society,” the percentage of the budget of Fortune 500 companies devoted to legal matters increased over 300%.³ From the companies’ viewpoint, this was wasted money. Unlike, say, money spent on research, it did not yield profits even in the long-run. At best, it prevented losses; but usually not even that. As a result, prudent corporate executives looked for ways to reduce their legal expenses; the most obvious way was to bring routine legal work in-house. Thus, for example, between 1960 and 1995, the number of in-house lawyers at General Electric increased from 120 to more than 500.⁴ More generally, though estimates vary, there is general agreement that starting in the late 1960s, the number of in-house corporate lawyers greatly increased.

In response, outside law firms, in order to remain profitable, became highly specialized, because corporations would only use them for

3. Arthur John Keefe, *Reducing Antitrust Exposure Is a Job for Management*, A.B.A. J., Feb. 1984, at 132 (noting that the typical Fortune 500 company spent “three and a half times” the amount on legal costs in the 1970s as in the 1960s).

4. See H.J. Aibel, *Corporate Counsel and Business Ethics: A Personal Review*, 59 MO. L. REV. 427, 427 (1994) (“When I joined GE in 1957 there were 120 lawyers”); Grace M. Giesel, *The Legal Advice Requirement of the Attorney-Client Privilege: A Special Problem for In-House Counsel and Outside Attorneys Representing Corporations*, 48 MERCER L. REV. 1169, 1169 n.3 (1997) (“[I]n 1996 General Electric had 507 in-house attorneys”)

the specialized work that their in-house lawyers were unable to perform. As a further result, law firms became known for particular specialties: Skadden Arps for M&A work, Weil Gotshal for bankruptcy work, etc. The combined result was that when corporations went outside for their legal work, which they now only did occasionally, they might use one firm for one kind of specialized work and another for a different kind of specialized work.

The net of all this was the near-collapse of a relationship of trust and candor between corporations and their outside counsel. Nor was it replaced by a relationship of trust and candor between corporate executives and their inside general counsel; for, with some exceptions, such counsel—totally dependent on the high-ranking corporate executives for their pay, bonuses and very employment—were poorly situated to say “no” to new corporate initiatives. Given, moreover, the greatly enhanced competition among outside firms, even outside counsel were in no position to say “no” either—for if they did, the corporation would just seek a “second opinion” from another firm eager to get the business. By the same token, the new kings of the outside law firms were the “rainmakers” who brought in new business. One did not become a rainmaker by saying no to a company’s innovative proposals.

In sum, the role once played by the fabled “lawyer-statesmen” of old in curbing corporate excess is largely a thing of the past. If effective alternatives are to be found, they will not, as indicated, take the form of deferred prosecutions. But what form they might take remains, at least to this writer, a mystery.