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I. INTRODUCTION

The emergence of the in-house counsel role, or "innkeepers" in the terminology of this Article,[1] is one of the most significant shifts in the legal profession over the past half century, and this development inevitably has implications for legal scholars, policymakers, and practitioners.[2] Historically, in-house counsel were stereotyped as inferior legal service providers.[3] They were unfairly viewed as lawyers "who had not quite made the grade as partner" at their corporation's principal outside law firm.[4] Today, however, in-house counsel, when compared to other legal providers, have a greater potential impact on corporate affairs, particularly by curbing corporate opportunism and creating value.[5] A broader conception of the in-house counsel role now prevails, and the in-house legal department function has trans-

[1] This article uses the terms "innkeeper" and "in-house counsel" as interchangeable with general counsel, corporate counsel, chief legal officer, and corporate legal departments. The term "innkeeper" serves as a shorthand moniker for the unifying theory of the in-house counsel role articulated herein. The following assertions concerning the impact of in-house counsel on corporate governance are aspirational in the sense that in-house counsel's ability to promote healthy governance is conditioned on the presence of favorable environmental factors.

[2] *See* Abram Chayes & Antonia H. Chayes, *Corporate Counsel and the Elite Law Firm*, 37 STAN. L. REV. 277, 294 (1985); Mary C. Daly, *The Cultural, Ethical, and Legal Challenges in Lawyering for a Global Organization: The Role of the General Counsel*, 46 EMORY L.J. 1057, 1057–59 (1997).

[3] *See* Chayes & Chayes, *supra* note 2, at 277.

[4] *Id.*

[5] *See* Ronald J. Gilson, *The Devolution of the Legal Profession: A Demand Side Perspective*, 49 MD. L. REV. 869, 915 (1990); *see also* Oliver E. Williamson, *Opportunism and Its Critics*, 14 MANAGERIAL & DECISION ECON. 97, 97 (1993) [hereinafter Williamson, *Opportunism*] (defining opportunism as a range of activities involving "self-interest seeking with guile"); Oliver E. Williamson, *Strategy Research: Governance and Competence Perspectives*, 20 STRATEGIC MGMT. J. 1087, 1099 (1999) [hereinafter Williamson, *Strategy*] (describing opportunism in broad terms capturing "moral hazard, adverse selection, shirking, filtering, undisclosed subgoal pursuit, distortions, and all other strategic deceits").

formed the delivery of legal services.[6] Moreover, significant improvements of in-house lawyer skill and reputation signal a defining moment for the legal profession.[7] A growing number of corporations, facing increasing costs due to business and legal complexities, are deciding to internalize a greater proportion of their legal needs in lieu of procuring legal services from the wide array of outside law firms available in the marketplace.[8] Just as greater divisionalization in the modern corporation can be explained, to a large extent, through transaction-cost economizing, the growth of in-house legal departments can be viewed through a similar lens.[9]

Despite these important developments, there is a relative dearth of legal scholarship dedicated to this transformation, as well as its pa-

[6] *See* Daly, *supra* note 2, at 1063; David E. Wilkins, *Team of Rivals? Toward a New Model of the Corporate Attorney/Client Relationship*, *in* CURRENT LEGAL PROBLEMS 2009 669, 692–93 (2010) (discussing the impact of in-house counsel on corporate procurement of legal services).

[7] *See* Steven L. Schwarcz, *To Make or to Buy: In-House Lawyering and Value Creation*, 33 J. CORP. L. 497, 498 (2008); *see also* George P. Baker & Rachel Parkin, *The Changing Structure of the Legal Services Industry and the Careers of Lawyers*, 84 N.C. L. REV. 1635, 1637 (2006).

[8] *See generally* Oliver E. Williamson, *The Modern Corporation: Origins, Evolution, Attributes*, 19 J. ECON. LITERATURE 1537 (1981) [hereinafter Williamson, *Modern Corporation*] (arguing that the modern corporation evolved in part by a desire to reduce transaction costs and other economic factors); Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 AM. ECON. REV. 112 (1971) [hereinafter Williamson, *Vertical*] (analyzing the benefits of internalization versus external procurement). In fact, "[i]n-house legal departments were the fastest-growing 'legal services sector' around the world over the last five years. In some markets, the growth reflects a compound increase of 15% per year." Richard Stock, *The Future for In-House Counsel*, INSIDER CORP. LEGAL, June 2008, at 1; *see also* JOHN C. COFFEE JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 223 (2006) ("As of 2002, there were some 65,000 in-house counsel in the United States."); Baker & Parkin, *supra* note 7, at 1654 ("Corporate legal departments have exhibited significant growth since the early 1980s and have continued this trend in recent years. Between 1998 and 2004, the 200 largest in-house legal departments grew from a total of 24,000 to 27,500 lawyers."); Daly, *supra* note 2, at 1059 ("Between 1970 and 1980, there was a forty percent increase in the number of lawyers working in-house; and between 1980 and 1991, there was a thirty-three percent increase.").

[9] *See, e.g.*, R.H. Coase, *The Nature of the Firm*, ECONOMICA 386 (1937) (asserting that in order to minimize transaction costs, it may be optimal to bring various labor functions within the firm to prevent costly "spot" labor market transactions); Williamson, *Modern Corporation*, *supra* note 8, at 1537 ("[T]he modern corporation is mainly to be understood as the product of a series of organizational innovations that have had the purpose and effect of economizing on transaction costs."). *See generally* ALFRED D. CHANDLER, STRATEGY AND STRUCTURE: CHAPTERS IN THE HISTORY OF THE INDUSTRIAL ENTERPRISE (1962) (discussing strategic divisionalization of the modern corporation).

rallel impact on business enterprises.[10] A concise, all-encompassing theory of the in-house counsel role has proven elusive for legal scholars. Most of the debate surrounding in-house counsel clusters around issues of independence and ethics for the purpose of analyzing the willingness and capacity of in-house counsel to perform their multiple roles, particularly gatekeeping.[11] Ironically, legal observers, with a few exceptions, have given very little attention to the analysis of how in-house counsel create value in the event these concerns regarding willingness and capacity are dispelled.[12] To be fair, arguments concerning in-house counsel's willingness and capability to take certain actions, as compared to outside counsel's, may have some validity, but these arguments are often overstated, conclusory,

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[10] *See* Daly, *supra* note 2, at 1067 ("Unfortunately, scholarly writers and researchers have paid very little attention to the combined effect of the growth in number, prestige, and power of in-house counsel and the globalization of the business and capital markets."); *see also* Deborah A. DeMott, *The Discrete Roles of Corporate Counsel*, 74 FORDHAM L. REV. 955, 957 (2005) ("[G]eneral counsel's position has a paradoxical quality: While a lawyer who serves as general counsel of a large corporation holds the clearly defined power associated with a hierarchical position in a large bureaucratic organization, the position itself is ambiguous in many ways that may prove troubling.").

[11] *See, e.g.*, Miriam Hechler Baer, *Corporate Policing and Corporate Governance: What Can We Learn From Hewlett-Packard's Pretexting Scandal?*, 77 U. CIN. L. REV. 523, 580 (2008).

> Board members lack the expertise to directly monitor the private law enforcers who are conducting investigations . . . . The company's internal counsel will therefore be relied upon to both monitor and design the corporation's police function. Corporate counsel, however, may either be too aligned with the company's investigators . . . or too out of the loop . . . to provide adequate guidance or oversight.

Id.; *see also* Chayes & Chayes, *supra* note 2, at 298 ("[C]orporate counsel's office may not be as professionally independent (although most general counsel would dispute it). This impression may account for the failure of corporate counsel to attract many students from prestige law schools."); Daly, *supra* note 2, at 1099 ("Whether in-house counsel can exercise the required degree of independence is a question that has universally troubled the legal profession."); Sung Hui Kim, *Gatekeepers Inside Out*, 21 GEO. J. LEGAL ETHICS 411, 446–60 (2008) (discussing whether in-house counsel are willing and have the capacity to monitor for misconduct as well as whether they have the capacity to interdict wrongdoers).

[12] Stephen Schwarcz addresses in-house counsel value creation exclusively from the perspective of transactional lawyering. *See* Schwarcz, *supra* note 7; *see also* Lyman Johnson & Dennis Garvis, *Are Corporate Officers Advised About Fiduciary Duties?*, 64 BUS. LAW. 1105, 1110, 1119 (2009) (discussing how in-house counsel are well-suited to advise officers on conduct that is harmful to the corporation). But value creation can also be seen in other key areas such as compliance and litigation. *See* discussion *infra* Part IV.B.2.

and lack empirical validation.[13] A debate on whether in-house counsel can, or better yet under what circumstances they can, effectively carry out certain functions should not trump the fundamental analysis of how in-house counsel create value. These two lines of inquiry can and should co-exist in harmony. The inability of legal scholars to expand the in-house counsel inquiry beyond independence is shortsighted and could lead to perverse consequences. For example, this dilemma is particularly evident within the European Union competition law context, where the European courts' negative perception of in-house counsel (i.e., the inability to render independent judgment) has influenced the denial of legal privilege to in-house counsel communications.[14] As a consequence, this narrow perspective forces corporations to undertake less effective and more costly measures through outside counsel, even where the use of in-house counsel would be optimal.[15] Moreover, this perspective may operate to suppress vital internal communications or information flow that would otherwise lead to the early identification and resolution of legal issues.

[13] *Compare* Kim, *supra* note 11, at 413 (claiming that corporate scandals in the twenty-first century have "lent support to the general consensus that insider lawyers are too 'captured' to exercise the independent judgment that is the hallmark of professionalism" and "have cast doubt about inside counsel's ability to fulfill their role as 'gatekeepers'"), *with* Daly, *supra* note 2, at 1100 ("Critics insist that a lawyer who is dependent on a single client, *i.e.*, the corporate employer . . . cannot provide independent advice and judgment of the same caliber as outside counsel whose financial ties to a single client are presumably much weaker. While this criticism may still linger in some corners of the professional responsibility community in the United States, bar association ethics committees and the courts in their capacity as regulators of the legal profession have soundly rejected it."), Sarah Helene Duggin, *The Pivotal Role of the General Counsel in Promoting Corporate Integrity and Professional Responsibility*, 51 ST. LOUIS U. L.J. 989, 1008 (2007) ("When suspicions of significant problems with potentially serious legal consequences arise within organizations it is often the general counsel who persuades corporate constituents of the need to pursue the matter and initiates an internal investigation."), *and* E. Norman Veasey, *Separate and Continuing Counsel for Independent Directors: An Idea Whose Time Has Not Yet Come as a General Practice*, 59 BUS. LAW. 1413, 1414 (2004) ("My thesis is that there should be a presumption that the general counsel is competent, has adequate resources, is ethical, and not conflicted in giving unvarnished advice to all the directors in carrying out their fiduciary duties.").

[14] Joined Cases T-125/03 & T-253/03, Akzo Nobel Chemicals Ltd. & Akros Chemicals Ltd v. Comm'n, 2007 E. C. R. II-3523 ¶¶ 167–71; Case 155/79, AM&S Europe Limited v. Comm'n, 1982 E.C.R. 1575 ¶¶ 21–22; *see also* Carolyn Lamm, ABA President, Remarks at the American Law Institute 87th Annual Meeting, May 17, 2010 (discussing the denial of attorney-client privilege to in-house counsel in Europe), *available at* http://2010am.ali.org/videos.cfm?video_id=2.

[15] For a detailed discussion of the advantages in-house counsel provide, see *infra* Part IV.

Understanding the value of in-house counsel starts with the examination of the environment within which modern corporations function. According to Adolf Berle, the modern corporation's quest to capture and preserve the economic power created by its activities is constrained by competition, profits, political intervention, and public sentiment.[16] Similarly, business economist Michael Porter identifies five forces that limit corporate economic power: industry competitors, potential entrants, buyers, suppliers, and substitutes.[17] Although the aforementioned factors are not exhaustive, a common thread runs through them all; they threaten the corporation's capacity to create value.[18] Corporations require legal support as an indispensible aid to manage these ongoing threats, which often involve a legal component. Examples such as failure to comply with a federal regulation, a poorly written supply contract, or a mishandled product lawsuit, all constitute a threat to corporate value. Prudent corporate managers cannot wait until such threats materialize; they require a type of consistent and strategic guidance that in-house counsel are uniquely positioned to provide.[19]

The evolving role of in-house counsel can be expressed in terms of value creation, which is the corporation's raison d'être.[20] Value can be both tangible and intangible and the particular metric for value may vary depending on the context or particular vantage point (e.g., corporation, employees, customers, financial experts, marketers, or society).[21] Consequently, there are numerous formulations of the value-creation concept in the business literature.[22] Legal observers such as Ronald Gilson have also applied the value-creation concept to business lawyers.[23] Yet, the available definitions of business-

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[16] ADOLF A. BERLE, JR., THE 20TH CENTURY CAPITALIST REVOLUTION 39, 54, 58 (1954).

[17] MICHAEL E. PORTER, COMPETITIVE ADVANTAGE: CREATING AND SUSTAINING SUPERIOR PERFORMANCE 6 (1985).

[18] *See infra* app. fig.1.

[19] *See* Johnson & Garvis, *supra* note 12, at 1110, 1119.

[20] *See* TIM HINDLE, THE ECONOMIST GUIDE TO MANAGEMENT IDEAS AND GURUS 201 (2008).

[21] *See id.* at 201–02. These issues create considerable debate on what metrics are the best proxies for corporate value (e.g., stock price, accounting or book value, net present value of future cash flows). *Id.* For example, financial experts may focus on metrics such as share price or book value as a proxy for value, whereas marketers may rely on more intangible measures such as perceived customer value above cost. *Id.*

[22] *See id.*

[23] Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 243 (1985) ("*If what a business lawyer does has value, a transaction must*

lawyer value creation, although helpful, are descriptively too narrow for the in-house counsel role because they (i) are often limited to transactional sources of value; (ii) are fragmented; or (iii) fail to capture the unique value that stems from in-house counsel linkages, networks, and integration with other firm activities.[24] This Article builds upon the existing business-lawyer value creation literature by articulating a robust unifying theory of the in-house counsel role—a dynamic concept involving the interaction of multiple parties and activities in the employment of corporate resources. In-house counsel value is not simply a function of individual value-producing activities; it also encompasses the networked and embedded nature of the role, which contributes to the enhancement of corporate value and competitive advantage in unique ways that outside counsel cannot easily replicate.[25]

Specifically, this Article posits that the strategic in-house counsel role, embodying consistent interaction with corporate operations and actors (e.g., management and employees), enables the modern corporation to significantly enhance its creation of value. Paradoxically, this theory further illustrates that being an innkeeper (i.e., an embedded employee with a single client) is not a vice as many legal observers often assume, but rather is a virtue promoting more pragmatic resolutions to a range of corporate issues.[26] When completed by competent professionals with well-honed ethical sensibilities, the strategic tasks that in-house counsel undertake add value because they are fundamentally different from the largely tactical outside law firm

be worth more, net of legal fees, as a result of the lawyer's participation." (emphasis in the original)).

[24] *See generally id.*; Schwarcz, *supra* note 7.

[25] *See* PORTER, *supra* note 17, at 36. According to Michael Porter, in-house counsel function as part of a firm's value chain, "a collection of activities that are performed to design, produce, market, deliver, and support its product." *Id.* "The value chain is a theory of the firm that views the firm as a collection of discrete but related production functions, if production functions are defined as activities." *Id.* at 39 n.3. Specifically, Porter categorizes legal departments as providing support activities like finance, accounting, and government affairs that support a firm's primary activities such as manufacturing. *Id.* at 38–43. Porter argues that "value activities [both primary and support] are the building blocks of competitive advantage" that operate individually and as part of "a system of interdependent activities" to create value. *Id.* at 48.

[26] *See* Ben Heineman, *Caught in the Middle*, CORP. COUNS., Apr. 2007, at 1–2 (asserting that general counsel must act as both "guardians" and "partners"); *see also* Williamson, *Strategy*, *supra* note 5, at 1090 ("The efficacy of governance is thus jointly determined by local efforts (self-help to craft mechanisms) and as a function of the institutional environment (polity; judiciary; laws of property and contract).").

role. Beyond providing a more robust descriptive assessment of the in-house counsel function, our theory has significant implications for corporate governance, the legal profession, and legal education.

Part II of this Article explores the reasons for the under-examination of in-house counsel. First, it describes factors that have impeded a more probing analysis of in-house counsel in corporate legal scholarship, namely, corporate complexity, shareholder-director dualism, and the overemphasis on symbolic procedural mechanisms. Second, it explores gaps in the corporate law framework that often glance over operational details and the important internal function of in-house counsel.

Part III describes the historical and environmental factors that led to the emergence of in-house counsel and corporate legal departments. This Part specifically examines the impact of the following factors on the emergence of in-house counsel: (i) the growth of the modern multi-division corporation, (ii) the shifting legal landscape, and (iii) the nature of legal services (i.e., the fungibility of legal services and the presence of credence characteristics).

Part IV articulates a unifying theory of the in-house counsel role. This theory illustrates how the strategic tasks in-house counsel undertake add value, in large part, because they are fundamentally different from the typical tactical role of outside law firms. The linkages, networks, and embeddedness characterizing the relationship between in-house counsel and other firm activities contribute to corporate value in unique ways. In order to provide a more robust descriptive assessment of in-house counsel value creation, this Part explores three questions: (i) What are the unique attributes of the in-house counsel role? (ii) What are the transactional and non-transactional sources of value created by in-house counsel? and (iii) Who are the internal and external beneficiaries of that value?

Part V addresses the significant implications of our theory for corporate governance, the legal profession, and legal education. Specifically, these implications highlight (i) the need for legal scholars and lawmakers to look inward in order to enhance corporate governance from the inside-out, (ii) a heightened corporate client focus on value and trusted partnerships (as opposed to independence) with respect to the provision of internal and external legal services, and (iii) legal education trends with greater emphasis on training for the in-house corporate setting. Finally, this Part proposes some additional areas for further research.

II. REASONS FOR IN-HOUSE COUNSEL UNDER-EXAMINATION

A. *Omissions in the Corporate Legal Scholarship*[27]

Corporate governance describes "all of the devices, institutions, and mechanisms by which corporations are governed."[28] This broad definition inevitably captures the under-examined nature of the in-house counsel function. Legal observers have examined, at length, a wide array of mechanisms to address the quintessential agency-cost problem described by Adolf Berle and Gardiner Means in the 1930s.[29] To address this problem, John Coffee identifies two strategies that have emerged among investors: (i) a legal strategy emphasizing *ex post* litigation, and (ii) an *ex ante* gatekeeper function relying on professional agents (i.e., third parties) to monitor management and alert investors to opportunistic behavior.[30] Notably, Coffee's gatekeeper definition excludes internal actors like in-house counsel.[31] In an attempt to promote better corporate governance, legal observers have

[27] Portions of this Part were recently published in Omari Scott Simmons, *The Under-Examination of In-House Counsel*, 11 TRANSACTIONS: TENN. J. BUS. L. 145 (2009).

[28] *Compare* JONATHAN R. MACEY, CORPRATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 2 (2008), *with* Lawrence A. Cunningham, *Comparative Corporate Governance and Pedagogy*, 34 GA. L. REV. 721, 722 (2000) ("I take the phrase 'governance' to mean the collection of law and practice that regulates the conduct of those in control of a business organization.").

[29] *See generally* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932) (describing how the separation of ownership and control gives rise to conflicts of interest between shareholders and management); *see also infra* app. fig. 2.

[30] COFFEE, *supra* note 8, at 9.

> To reduce these asymmetries, investors have two basic strategies that they can follow: First, they can employ an essentially legal strategy and rely on litigation in order to hold their corporate managers and agents accountable and redress any breach of fiduciary duty or contract right. Second, the major alternative to such a law-centered system is to rely on gatekeepers—that is, on professional agents who will monitor management and alert shareholders as to opportunistic behavior by their managers. This latter system works less based on litigation or even private contracting, and more based on bonding and reputational capital. The first strategy works *ex post*, while the second operates *ex ante*, seeking to detect and prevent problems before they become crises. The aim of both strategies, however, is to reduce informational asymmetries (and thereby produce a more transparent market).

Id.

[31] *See id.* at 7 ("In the absence of independent professionals—auditors, attorneys[,] and analysts—boards will predictably receive a stream of selectively edited information from corporate managers that presents the incumbent management in the most favorable light possible.").

(i) looked outside to third party gatekeepers, reputational intermediaries, and the market;[32] and (ii) emphasized democratically symbolic procedures reflecting values such as independence, participation, and transparency.[33] This quest for outside oversight and the attractive appeal of symbolic democratic structures as a means to prevent managerial opportunism, even if valuable, should not preclude the important task of improving the corporation's internal capacities. Descriptively, the corporation itself is more bureaucratic than democratic, and reform must address this institutional reality.[34]

The best prospects for corporate governance depend on leveraging a balance of internal and external capabilities. The valuable function of in-house counsel is perhaps the most salient example of embedding law into corporate operations and organizational culture.[35] Before embarking on an in-depth analysis of the in-house counsel role, it is instructive to highlight the key reasons for the omission of in-house counsel from the legal literature, namely: (i) the difficulty of addressing corporate complexity,[36] (ii) the preoccupation with director-shareholder dualism,[37] and (iii) the overemphasis on

[32] *See infra* app.fig. 2. *See generally* COFFEE, *supra* note 8.

[33] Simmons, *supra* note 27, at 146–49; *see also* Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 395 (1983); Lawrence Mitchell, *Protect Industry from Predatory Speculators*, FIN. TIMES (London), July 9, 2009, at 9 (highlighting the tension between envisioning the corporation as a democracy versus a bureaucracy); Omari Scott Simmons, *Taking the Blue Pill: The Imponderable Impact of Executive Compensation Reform*, 62 SMU L. REV. 299, 341–42 (2009).

[34] *See id.*; *see also* Usha Rodrigues, *The Seductive Comparison of Shareholder and Civic Democracy*, 63 WASH. & LEE L. REV. 1389, 1390 (2006). Notwithstanding, the corporation functions as an ubiquitous institutional force in modern democracy. *See e.g.*, Citizens United v. Fed. Election Comm'n, 130 Sup. Ct. 876 (2010) (holding that the First Amendment does not ban corporate funding of independent political campaign advertisements).

[35] *See* Lyman P.Q. Johnson & Robert V. Ricca, *(Not) Advising Corporate Officers About Fiduciary Duties*, 42 WAKE FOREST L. REV. 663, 688–90 (2007) (describing how general counsel should create a corporate code of conduct and help create a culture of legal compliance among senior officers and employees).

[36] *See, e.g.*, DAVID SKEEL, ICARUS IN THE BOARDROOM: THE FUNDAMENTAL FLAWS IN CORPORATE AMERICA AND WHERE THEY CAME FROM 6–10 (2005) (highlighting three enduring issues that stifle regulators: risk taking, competition, and complexity of organizations); Eric W. Orts, *The Complexity and Legitimacy of Corporate Law*, 50 WASH. & LEE L. REV. 1565, 1587 (1993) (arguing corporate law must acknowledge technical and normative complexity to retain its legitimacy).

[37] *See, e.g.*, STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE 8–12 (2008) (discussing shareholder primacy, director primacy, managerialism and stakeholder theoretical approaches).

symbolic procedures reflecting democratic values like independence.[38]

1. Complexity

First, the difficulty with developing a concise theory of in-house counsel stems in part from the complexity of the role.[39] In-house counsel are the "Swiss army knife" of the legal profession.[40] Existing theories, standing alone, fail to capture this complexity. They are too abstract and do not account for institutional or operational detail. Moreover, "[r]eality is too complicated and admits of too many interactions to be modeled."[41] On the other hand, the value of theory is not limited to its ability to make accurate predictions or simply reflect reality; it extends to the ability to enhance the understanding of real world phenomena.[42] A presumption of immeasurability that often attaches to complexity may be so strong that it precludes attempts to make observations about the so-called immeasurable value of in-house counsel.[43] A more pragmatic approach to examining in-house counsel is to consider whether theory can improve upon the existing knowledge of in-house counsel value creation and the concomitant impact of in-house counsel on corporate governance, the legal profession, and legal education.[44]

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[38] *See, e.g.*, Simmons, *supra* note 27, at 341–42 (explaining that procedural requirements that mandate independence in the context of corporate governance may not achieve their objectives).

[39] *See, e.g.*, E. Norman Veasey & Christine T. Di Guglielmo, *The Tensions, Stresses, and Professional Responsibilities of the Lawyer for the Corporation*, 62 BUS. LAW. 1, 5 (2006) ("A major factor contributing to the variety and complexity of the tensions faced by the general counsel is the multiplicity of roles counsel is expected to play.").

[40] *See* Duggin, *supra* note 13, at 1003–20 (noting the various roles of general counsel, which include legal advisor, educator on legal compliance, transactions facilitator, company advocate in litigation and with governmental authorities, investigator into potential legal issues within the organization, compliance officer, corporate ethics officer, manager of law department and of outside legal resources, management committee member, strategic planner, legal services marketer, ad hoc planning advisor, ethics counselor, crisis manger, and arbitrator).

[41] Gilson, *supra* note 23, at 251.

[42] *See id.* at 252. *But see* Milton Friedman, *The Methodology of Positive Economics*, *in* ESSAYS IN POSITIVE ECONOMICS 3–4 (1953) (asserting that the value of theory hinges on its ability to make accurate predictions).

[43] *See* DOUGLAS W. HUBBARD, HOW TO MEASURE ANYTHING: FINDING THE VALUE OF INTANGIBLES IN BUSINESS xi–xiv (2007).

[44] *See* discussion *infra* Part V.

2. Director-Shareholder Dualism

The second reason for the omission of in-house counsel from the corporate governance literature is a preoccupation with a director-shareholder dualism that overlooks the impact of a range of internal actors such as in-house counsel on corporate governance. A corporation is much more than directors and shareholders; it is a complex bureaucracy composed of multiple layers of management, where decision making occurs at all levels of the firm on an intertemporal basis.[45] The legal literature often vacillates between shareholder or director primacy with occasional detours.[46] Even the more recent focus on gatekeepers is limited because observers often reflect a bias for outside actors versus internal agents of the corporation.[47] Although the gatekeeper hypothesis rightly assumes the inevitability of outsourcing certain compliance responsibilities to independent third parties, this does not obviate the need for complementary internal legal counsel who are willing, able, and valuable.[48]

[45] Johnson & Garvis, *supra* note 12, 1108 n.23 (discussing how corporate law scholarship has largely neglected the role of corporate officers); *see also* Lyman P.Q. Johnson & David Millon, *Recalling Why Corporate Officers are Fiduciaries*, 46 WM. & MARY L. REV. 1597, 1600–01, 1609–10 (2005); Usha Rodrigues, *From Loyalty to Conflict: Addressing Fiduciary Duty at the Officer Level*, 61 FLA. L. REV. 1 (2009) (discussing the importance of conflict enforcement at the officer level).

[46] *See, e.g.*, BAINBRIDGE, *supra* note 37, at 8–12; *see also* Margaret M. Blair & Lynn Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 301 (1999) (acknowledging directors, within their discretion, may consider non-shareholder interests in order to maximize the joint welfare of all firm stakeholders); Lisa M. Fairfax, *The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms*, 31 J. CORP. L. 675, 698 (2006) (describing the impact of stakeholder rhetoric); Marleen O'Connor-Felman, *Labor's Role in the American Corporate Governance Structure*, 22 COMP. LAB. L. & POL'Y J. 97, 100 (2000).

[47] *See, e.g.*, COFFEE, *supra* note 8, at 7.

> The board of directors in the United States is today composed of directors who are essentially part-time performers with other demanding responsibilities. So structured, the board is blind, except to the extent that the corporation's managers or its independent gatekeepers advise it of impending problems. In the absence of independent professionals—auditors, attorneys[,] and analysts—boards will predictably receive a stream of selectively edited information from corporate managers that presents the incumbent management in the most favorable light possible.

Id.; *see also* Kim, *supra* note 11, at 415 ("[G]atekeeping scholars have traditionally conceived the *gatekeeper* as an outside professional services firm which has a contractual relationship with the primary enforcement target (the client)."); Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J. L. ECON. & ORG. 53, 62 (1986).

[48] *See* discussion *infra* Part IV, V.A.

3. Symbolic Procedural Mechanisms

The third and arguably most important reason for the omission of in-house counsel from the corporate governance literature is the overemphasis on symbolic procedural mechanisms reflecting independence to achieve effective governance and compliance with law. When assessing the quality of corporate reform or reformers, corporate constituents view the degree of independence as a heuristic for value.[49] This symbolic attachment or so-called "fetishization" of independence has blinded some observers to the impact of in-house counsel's value-creation role.[50] The most prevalent critique of in-house counsel in the corporate governance literature contends that in-house counsel's lack of independence or capture makes them less effective gatekeepers than outside lawyers or other reputational intermediaries in promoting healthy corporate governance. John Coffee's seminal book examining the critical role of gatekeepers on corporate governance embraces this critique:

> While the outside attorney has been increasingly relegated to a specialist's role and is seldom sought for statesman-like advice, the in-house general counsel seems even less suited to play a gatekeeping role. First, the in-house counsel is less an independent professional—indeed he is far more exposed to pressure and reprisals than even the outside audit partner. Second, the in-house counsel is seldom a reputational intermediary (as law and accounting firms that serve multiple clients are) because the in-

[49] *See, e.g.*, Simmons, *supra* note 33, at 359–60; Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 BUS. LAW. 921, 921–22 (1999); Donald C. Langevoort, *The Human Nature of Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 799 (2001) ("Current policymaking initiatives show an increasing tendency to assume the benefits of director independence and accountability, and hence the self-evident desirability of legal reforms to promote them.").

[50] *See* Usha Rodrigues, *The Fetishization of Independence,* 33 J. CORP. L. 447, 447 (2008).

> [I]ndependent directors are useful only in situations where a conflict exists. An independent director—a part-timer whose contact with the corporation is necessarily limited—is not inherently better suited to further the interests of shareholders than an inside director. Current rules thus over-rely on independence, transforming an essentially negative quality—lack of ties to the corporation—into an end in itself, and thereby fetishizing independence.

Id.

> house counsel cannot easily develop reputational capital that is personal and independent from the corporate client.[51]

The independence or capture critique, even if we assume it is valid, is often accepted by observers without a robust inquiry or empirical validation and does not adequately explore demand-side benefits.[52] It is a causation fallacy to assume that due to the employee status of in-house counsel, they are ineffective as gatekeepers or that outside counsel are more likely to act with virtue. Even if outside counsel and other gatekeepers were more willing to monitor, "inside counsel have an overwhelming advantage in their ability to monitor."[53] The economic pressures that may constrain in-house counsel also remain an issue for outside law firms.[54]

The broader question is not necessarily the need for independence, but for virtuous agents to remain "faithful" to their profession and the client corporation.[55] Ultimately, this is a question of (i) lawyer competence, and (ii) a shared understanding among corporate management and in-house counsel as to the latter's appropriate role.[56] Independence is rarely an issue until a conflict arises and most of the value-creating functions and daily duties performed by in-house counsel do not raise conflicts.[57] Thus, a myopic focus on independence ignores a significant amount of value created by in-house counsel that may outweigh the risks and probabilities associated with

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[51] COFFEE, *supra* note 8, at 195; *see also* Ben W. Heineman, Jr., *The General Counsel as Lawyer-Statesman*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Sept. 5, 2010, 11:17 AM), http://blogs.law.harvard.edu/corpgov/2010/09/05/the-general-counsel-as-lawyer-statesman (describing the changing legal landscape in which the role of general counsel has greater importance and value, but only in corporations that pair high performance with high integrity).

[52] *But see* Bhagat & Black, *supra* note 49, at 936 tbl.2 (empirical study showing that independence of directors had no appreciable impact on share price).

[53] Kim, *supra* note 11, at 417; *see also* Johnson & Garvis, *supra* note 12, at 1110, 1119–20.

[54] *See* Duggin, *supra* note 13, at 1035 ("[T]he report of the ABA Task Force on Corporate Responsibility specifically notes that '[t]he competition to acquire and keep client business, [like] the desire to advance within the corporate executive structure, may induce lawyers to seek to please the corporate officials with whom they deal rather than to focus on the long-term interest of their client, the corporation.'" (quoting AM. BAR ASS'N, RECOMMENDATIONS OF AMERICAN BAR ASSOCIATION TASK FORCE ON CORPORATE RESPONSIBILITY (Mar. 31, 2003), *available at* http://www.abanet.org/media/corpgov.pdf)).

[55] *See* Rodrigues, *supra* note 50, at 451.

[56] *See* discussion *infra* Part V.B.

[57] *See* Rodrigues, *supra* note 50, at 487.

conflicts.[58] While singing the virtues of independence, one cannot ignore the tangible and intangible value created by in-house counsel.[59] Instead of excluding in-house counsel from the corporate governance debate, one should consider how the input of in-house counsel could positively impact business enterprises and the design of corporate reform.[60]

B. Omissions in the Legal Backdrop[61]

The legacies of Enron Corp., Citigroup, Inc., American International Group, Inc. (AIG), and other examples of corporate dysfunction reveal that traditional corporate law and the presence of third-party gatekeepers do not, alone, adequately address the problem of corporate opportunism.[62] Traditional corporate law and theory say very little about the internal corporate organization, multiple layers of management, and how companies in specific industries should legally pursue the efficient production of products and services that customers value.[63] Corporate operations are the sum of various processes such as manufacturing, sales and marketing, finance and accounting, information technology, and research and development.[64] It is these internal operational processes in conjunction with corporate culture and external forces (e.g., markets) that ultimately determine the profitability and sustainability of business enterprise.

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[58] *See* Duggin, *supra* note 13, at 1034 (explaining how outside counsel may lack sufficient knowledge to effectively solve a legal problem for an organization, and how management may give outside counsel "selected" facts that will "circumvent unfavorable advice" from inside counsel).

[59] *See* Gilson, *supra* note 5, at 915; *see also* Duggin, *supra* note 13, at 1036 (noting that in certain situations, hiring "independent" counsel may be done at the expense of the shareholders and the company).

[60] *See* discussion *infra* Part V.A.

[61] Portions of this Part were recently published in Omari Scott Simmons, *Corporate Governance Reform as a Credence Service*, 5 J. BUS. & TECH L. 113 (2010).

[62] *Id.* at 115. *See generally* Michael Lewitt, *Wall Street's Next Big Problem*, N.Y. TIMES, Sept. 16, 2008, at A29 (discussing the looming failure of AIG and its use of default credit swaps); Jeffrey L. Seglin, *The Right Thing: Will More Rules Yield Better Corporate Behavior?*, N.Y. TIMES , Nov. 17, 2002, at B4 (describing Enron as an example of bad corporate behavior).

[63] *See* Johnson & Garvis, *supra* note 12, at 1106-07, Johnson & Millon, *supra* note 45, at 1609–10; Lawrence Mitchell, *Vulnerability and Efficiency (of What?)*, 2 BERKELEY BUS. L.J. 153 (2005); *see also* Langevoort, *supra* note 49, at 807–08 (describing the underestimation of middle management in the study of corporate governance). *But see* Gantler v. Stevens, 965 A.2d 695, 708–09 (Del. 2009) (recognizing the application of fiduciary duties to corporate officers as well as directors).

[64] *See* PORTER, *supra* note 17, at 38–43.

In a sense, corporate law functions like book ends and does not address a broad range of corporate activity, leaving it to managers, in most cases, to fill the gaps. Most routine operational decisions fall into the category of enterprise decisions.[65] Enterprise decisions are standard decisions made by management, such as the decision to build a foreign production plant or what products to produce.[66] These decisions are often protected under state law through the business judgment rule that rightfully vests in directors the authority and protection to make countless corporate decisions (often relying on skilled managers and advisors) without the prospect of judicial intervention.[67] Meanwhile, the federal government, to a large extent through the Securities and Exchange Commission (SEC), regulates the external trading of securities and disclosure without addressing the internal affairs of the corporation.[68]

On balance, American corporate law is conservative in form and function. Here, the use of the conservative label is value neutral.

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[65] *See generally* E. Norman Veasey, *The Defining Tension in Corporate Governance in America*, 52 BUS. LAW. 393, 394 (1997) (discussing the types of decisions Delaware courts address, which include enterprise, ownership, and oversight decisions).

[66] *See id.* Ownership decisions involve ownership changes, such as mergers, acquisitions, and corporate takeovers. Oversight decisions concern managers' monitoring role, such as ensuring employees execute their responsibilities in compliance with the law. *See id.*

[67] *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). Robert Clark describes the business judgment rule as follows:

> The rule is simply that the business judgment of the directors will not be challenged or overturned by courts or shareholders, and the directors will not be held liable for the consequences of their exercise of business judgment—even for judgments that appear to have been clear mistakes—unless certain exceptions apply.

ROBERT CHARLES CLARK, CORPORATE LAW § 3.4, 123–36 (1986); *see also* FRANKLIN A. GEVURTZ, CORPORATION LAW 278–79 (2000) ("After all, business decisions typically involve taking calculated risks."); Lyman P.Q. Johnson, *Corporate Officers and the Business Judgment Rule*, 60 BUS. LAW. 439 (2005) (arguing that the business judgment rule should not extend to corporate officers in the same way as directors); Lawrence Hamermesh & A. Gilchrist Sparks III, *Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson*, 60. BUS. LAW 865 (2005) (critiquing Johnson's argument for a liability scheme holding officers liable for negligence). In Delaware and many other states, directors receive an additional layer of legal protection from exculpation statutes that cover violations of fiduciary duty, but not breaches of the duty of loyalty and good faith. DEL. CODE. ANN. tit. 8, § 102(b)(7) (2010).

[68] *See* Simmons, *supra* note 27, at 327–29; Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 674–79 (2005). *But see* Robert B. Thompson & Hilary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859, 872–73, 878 (2003) (asserting that federal securities laws indirectly impose fiduciary duties on officers via disclosure and certification).

Historically, corporate lawmakers have been reluctant to upset the internal power relationships between management and shareholders or to address operational details.[69] Instead lawmakers have (i) outsourced such reform to third party gatekeepers, reputational intermediaries, and the market;[70] (ii) emphasized democratically symbolic procedures reflecting values such as independence, participation, and transparency;[71] and (iii) regulated business activity indirectly or outside of the traditional corporate law context (e.g., tax, antitrust, environmental, banking, and labor laws).[72] Thus, the content of traditional corporate law contains significant gaps, lacks a degree of contextual specificity, and provides substantial managerial discretion, making its impact on corporate governance (e.g., opportunism) difficult to discern.

III. DETERMINANTS OF IN-HOUSE COUNSEL EMERGENCE

A. *The Complexity of the Modern Corporation*

1. Divisionalization, Business Units, and Functions

Although there are many factors contributing to the complexity and form of the modern corporation, its current shape is largely a function of minimizing transaction costs.[73] Observers such as Oliver Williamson acknowledge the confluence of factors explaining the modern organizational form but prefer the explanatory power of the transaction cost narrative.[74]

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[69] *See* Johnson & Garvis, *supra* note 12, at 1106–09.

[70] *See generally* COFFEE, *supra* note 8; Sidney A. Shapiro, *Outsourcing Government Regulation*, 53 DUKE L.J. 389 (2003) (highlighting situations where government regulators have outsourced not only services but the origination and implementation of regulatory policy).

[71] *See generally* Easterbrook & Fischel, *supra* note 33; Mitchell, *supra* note 63, at 9 (highlighting the tension between envisioning the corporation as a democracy versus a bureaucracy); Simmons, *supra* note 27, at 341–42.

[72] *See* CLARK, *supra* note 67, at § 1.4, 30–32. There are, however, numerous laws and regulations impacting business enterprise that should not be overlooked. *See id.*

[73] Williamson, *Modern Corporation*, *supra* note 8, at 1537 ("While I recognize that there have been numerous contributing factors, I submit that the modern corporation is mainly to be understood as the product of a series of organizational innovations that have had the purpose and effect of economizing on transaction costs.").

[74] *Id.* at 1537. Williamson makes the following observations:

> Note that I do not argue that the modern corporation is to be understood exclusively in these terms. Other important factors include the quest for monopoly gains and the imperatives of technology. These mainly have a bearing on market shares and on the absolute size

Perhaps the greatest functional innovation in the development of the modern corporation was the emergence of the M-form, or multidivisional corporation, with "many distinct operating units and management by a hierarchy of salaried executives."[75] In theory, the board of directors manages the modern corporation, yet it delegates management authority to the CEO and senior executives.[76] Observers like the late Alfred Chandler assert that delegation to professional management was necessary to address transaction costs in the complex, modern, multi-division, publicly traded company.[77] Chandler specifically described the benefits of the M-form:

> The basic reason for [the M-form's] success was simply that it clearly removed the executives responsible for the destiny of the entire enterprise from the more routine operational activities, and so gave them the time, information, and even psychological commitment for long term planning and appraisal . . . [T]he new structure left the broad strategic decisions as to the allocation of existing resources and the acquisition of new ones in the hands of a top team of generalists. Relieved of operating duties and tactical decisions, a general executive was less likely to reflect the position of just one part of the whole.[78]

Notwithstanding these advances, the separation of ownership and control between managers and shareholders created an additional set of transaction costs or agency costs that Berle and Means identified.[79]

> of specific technological units; but decisions to make or buy, which determine the distribution of economic activity, as between firms and markets, and the internal organization (including both the shape and the aggregate size) of the firm are not explained, except perhaps in trivial ways, in these terms. Inasmuch as these are core issues, a theory of the modern corporation that does not address them is, at best, seriously incomplete.

Id.

[75] BAINBRIDGE, *supra* note 37, at 74–75.

[76] DEL. CODE ANN. tit. 8, § 141(a) (2010).

[77] *See generally* ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977) (examining the way in which management of US companies has become increasingly systematic).

[78] CHANDLER, *supra* note 9, at 309–10; *see also* Williamson, *Modern Corporation*, *supra* note 8, at 1565 ("The efficiency incentive to shift from the earlier U-form to the M-form structure is partly explained in managerial discretion terms: the older structure was more subject to distortions of a managerial discretion kind—which is to say that opportunism had become a serious problem in the large U-form firm."). *But see* ROBERT F. FREELAND, THE STRUGGLE FOR CONTROL OF THE MODERN CORPORATION: ORGANIZATIONAL CHANGE AT GENERAL MOTORS, 1924–1970, at 305 (Mark Granovetter ed., 2001) ("The GM case suggests that the textbook M-form is most appropriate as a mechanism for owner control when the division of labor among owners, top executives, and line managers is moderate but not extensive.").

[79] *See generally* BERLE & MEANS, *supra* note 29 (arguing that shareholders who own the company do not actually control it).

Most of the legal literature addresses this category of agency costs, along with the various mechanisms for mitigating these costs.[80] In-house counsel function as an additional mechanism (i.e., innkeepers) to mitigate transaction costs, especially those created by opportunism.[81]

2. Growth of the Legal Department Function

Just as greater divisionalization in the modern corporation can be explained via transaction-cost economizing, the growth of in-house legal departments can be viewed from a similar standpoint.[82] With respect to legal and other types of services, corporations often face a make-versus-buy decision.[83] Unlike divisional business units, legal departments are not profit centers. They are cost centers and operate as a corporate function, providing support to business units, like marketing, human resources, information technology (IT), environmental health and safety (EHS), finance and accounting, research and development (R&D), and government relations.[84] Therefore, internal legal departments must continually find ways to articulate their value to the business enterprise and justify legal expenditures.[85] Generally, corporations opt for a combination of internal and external legal services. The ratio between internal and external services often varies with the context. Recent trends illustrate that generally a

[80] *See, e.g.*, Robert P. Bartlett, III, *Venture Capital, Agency Costs, and the False Dichotomy of the Corporation*, 54 UCLA L. REV. 37, 37 (2006) (asserting that often both public and private firms face the same agency problems); Aleta G. Estreicher, *Beyond Agency Costs: Managing the Corporation for the Long Term,* 45 RUTGERS L.J. 513, 517 (1993) ("It is time to reexamine the 'managerialism' decried by Berle and Means and their modern-day counterparts. The preoccupation with agency costs has essentially blinded corporate scholars to these long-term costs to innovation and productivity."); Ronald J. Gilson & Charles K. Whitehead, *Deconstructing Equity: Public Ownership, Agency Costs, and Complete Capital Markets*, 108 COLUM. L. REV. 231, 231 (2008) (discussing the difference in agency costs between public and private ownership).

[81] *See* discussion *infra* Part V.A; *see also infra* app. fig. 2.

[82] *Cf.* Williamson, *Modern Corporation*, *supra* note 8, at 1565 ("The upshot is that a transaction-cost approach to the study of the modern corporation permits a wide variety of significant organizational events to be interpreted in a coherent way.").

[83] *See* Chayes & Chayes, *supra* note 2, at 291 ("Availability, current workload, and specialized legal knowledge not found within the department are all important to the decision to engage outside counsel. The need for quick turnaround is another major factor."); Williamson, *Vertical*, *supra* note 8, at 113–14.

[84] *See* PORTER, *supra* note 17, at 38–43.

[85] *See* Albert L. Vreeland, II & Jennifer L. Howard, *The Care and Feeding of In-House Counsel*, 67 ALA. LAW. 340, 344 (2006) ("Some companies . . . view legal budgets as nothing more than a drain on profits, and most in-house counsel are under constant pressure to contain and even reduce the company's legal expenses.").

greater portion of legal services are being performed internally; however, these trends are not sustainable, and leveraging external resources is already regaining popularity.[86] Despite these trends, the emergence of in-house counsel is a function of power not necessarily numbers. Surprisingly, the legal literature has only recently attempted to explain why in-house lawyers are increasing in power and "taking over."[87] A large piece of the answer lies with the strategic in-house counsel role that generates benefits for internal and external corporate constituencies.[88]

From a business perspective, there are distinct disadvantages and costs associated with procuring outside legal services in the market. Oliver Williamson asserts that the internal organization of procurement services as a market substitute yields significant advantages, which fall into three categories: (i) incentives, (ii) controls, and (iii) structural advantages.[89] Many external procurement problems stem from information asymmetries between the client corporation and the outside legal provider.[90] Legal services often exhibit credence characteristics, thereby making the client corporation more vulnerable to the opportunistic behavior of law firms seeking to extract high-

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[86] *See* Baker & Parkin, *supra* note 7, at 1654 ("Armed with more talent and the goal of cutting costs, corporate law departments are performing an increasing share of legal work in-house."); Stock, *supra* note 8, at 1 ("In-house legal departments were the fastest-growing 'legal services sector' around the world over the last five years. In some markets, the growth reflects a compound increase of 15% per year."). However, Thomas Sager, General Counsel, E. I. du Pont de Nemours and Company, in commenting on a draft of this article, noted that the use of external resources is regaining popularity and leveraging internal resources may not be sustainable. The "DuPont Legal Model" that he pioneered was designed to address this issue.

[87] *See, e.g.*, Schwarcz, *supra* note 7, at 486–88 (addressing this phenomenon exclusively from the perspective of transactional lawyering and from the vantage point of internal constituencies); *see also* Gilson, *supra* note 23 and accompanying text. The increase can also be seen in other key areas such as compliance counseling. *See* Richard S. Gruner, *General Counsel in an Era of Compliance Programs and Corporate Self-Policing*, 46 EMORY L.J. 1113, 1113–14 (1997) ("The activities of general counsel in corporate organizations are changing in response to increasing demands for corporate law compliance and expanding knowledge about how to effectively manage law compliance in organizational settings.").

[88] *See* Gilson, *supra* note 5, at 901–03; Karl S. Okamoto, *Reputation and the Value of Lawyers*, 74 OR. L. REV. 15, 15 (1995) ("'What do business lawyers really do?' With this question, Professor Ronald Gilson opened his seminal discussion of the role business lawyers play in 'creating value." (quoting Gilson, *supra* note 23, at 241)).

[89] *See* Williamson, *Vertical*, *supra* note 8, at 113–14.

[90] Gilson, *supra* note 5, at 889 ("The most distinctive characteristic of the demand side of the market for legal services is pervasive information asymmetry concerning product quality . . . .").

er profits.[91] In other words, the corporate client, without some degree of internal expertise, is not a sophisticated purchaser of legal services.

Another drawback to using outside legal services stems from high switching costs created when a corporate client becomes overly reliant on a single law firm.[92] High switching costs provide law firms with significant bargaining power.[93] Accordingly, the corporate client may have to endure a lack of responsiveness and inferior service from the outside firm. In response to these issues, corporations have invested in an internal legal function to both perform and procure legal services in the marketplace where necessary.[94] The aforementioned factors have led to the re-allocation of bargaining power between the corporate client and the outside law firm.[95] But not all legal observers agree on the reasons for the emergence of in-house counsel. John Coffee, although acknowledging economic forces driving the changing dynamics of legal services, suggests the quest for power is another explanation for the shift to in-house counsel:

> The participant in this drama who gained the most from this transition was the in-house general counsel, who now became as much a general manager of legal services as an actual counselor to management. For his or her own self-interested reasons, the general counsel typically did not want competition from outside counsel. He or she wanted to be the primary conduit of legal advice to management and hence sought to discourage any long-term, con-

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[91] *See* discussion *infra* Part III.C.2.

[92] Gilson, *supra* note 5, at 900 ("[A] pattern of practice developed that led to long-term lawyer-client relationships and full-service law firms. The result was that switching lawyers was costly to a client."); *see also* Robert Eli Rosen, *The Inside Counsel Movement, Professional Judgment and Organizational Representation*, 64 IND. L.J. 479, 508–09 (1989) ("The delivery of legal services requires and creates client-specific assets. When these assets are developed by an outside counsel, the corporation can capture them by rehiring the lawyer or firm.").

[93] *See* Rosen, *supra* note 92, at 509 (asserting that a corporation can improve its bargaining power by developing an in-house legal department).

[94] Chayes & Chayes, *supra* note 2, at 277–78 ("[T]he decision whether to retain outside counsel or handle the issue inside—the 'make or buy' decision—is made by the general counsel.").

[95] Gilson, *supra* note 5, at 902–03.

> Increasingly, general counsel . . . are capable of internalizing both the diagnostic and referral functions they previously performed on behalf of clients as outside counsel. . . . [I]nternalizing these functions eliminates the information asymmetry between the client and lawyer. . . . The consequence is a dramatic reduction in the switching costs facing clients and an elimination of lawyers' market power.

Id.

tinuing relationship between senior management and outside counsel. As much from this reason as to encourage price competition, the in-house counsel moved legal business around, thereby assuring his or her own monopolistic position as the supplier of legal advice to senior management. What shifted then was not the relative number of insider versus outside counsel, but the balance of power between them.[96]

B. *The Shifting Legal Landscape*

As corporations grew globally, in size and complexity, the potential for fraud, ethical lapses, and legal scandals involving greater numbers of corporate constituents also increased. This state of affairs prompted an exponential expansion of regulations and laws that impacted business enterprise and inevitably enhanced the need for internal legal capabilities to manage these risks.[97] The panoply of laws impacting business enterprise extends well beyond the traditional confines of corporate law.[98] Navigating the matrix of local, domestic, international, and industry-specific laws is a significant challenge even for companies with the greatest intentions.[99] Against this backdrop, the costs associated with legal compliance significantly increased.[100]

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[96] COFFEE, *supra* note 8, at 224.

[97] *See, e.g.*, Catherine Aman, *SOX HOP: The Nation Boogied to a New Lingo the Past Year as Corporate Scandals and Reform Filled the Front Pages*, CORP. COUNS., Apr. 2003, at 198; N.R. Kleinfield, *When Scandal Haunts the Corridors*, N. Y. TIMES, July 7, 1985, §3, at 1; James Sterngold, *Wall St. Looks Over Shoulder*, N. Y. TIMES, July 14, 1986, at D1; *see also* Gruner, *supra* note 87, at 1113–14; Lamm, *supra* note 14 (addressing globalization and the changing legal marketplace); Stock, *supra* note 8, § 3, at 1 ("In-house legal departments were the fastest-growing 'legal services sector' around the world over the last five years. In some markets, the growth reflects a compound increase of 15% per year.").

[98] *See* Gilson, *supra* note 23, at 296–97.

> A more complex transaction, like a corporate acquisition, touches a host of different regulatory systems, each of which can have an important impact upon the form taken by the transaction. Tax law, antitrust law, labor law, products liability law, ERISA, securities law, and corporate law do not exhaust the spectrum of regulatory oversight that may influence the format of a particular acquisition.

Id.; *see also* CLARK, *supra* note 67, at § 1.4, 30–32 (distinguishing between traditional corporate law and other laws affecting corporations); Strine, *supra* note 68, at 680–81 (distinguishing between corporate law in the traditional sense and laws affecting corporations tangentially).

[99] *Cf.* Daly, *supra* note 2, at 1057–58.

> [T]wo of the most significant changes in corporate legal practice in the United States over the past thirty years [are]: the growth in number, prestige, and power of in-house counsel and the globalization of the business and capital markets. Operating synergistically, these changes

1. Federal Sentencing Guidelines, Heightened Criminal Penalties, Amnesty and Whistleblower Programs

Generally, up to the 1990s, the costs of criminal convictions to companies were limited because corporations "were subject to the same penalties as individual defendants."[101] The federal criminal law did not provide incentives for companies to adopt compliance programs but instead provided disincentives. Because corporations were strictly vicariously liable for crimes committed by employees within the scope of their employment, corporations were reluctant to adopt compliance programs that created a flow of information to management and could potentially uncover detrimental evidence.[102] Making matters worse, the adoption of compliance programs did not result in amnesty or reduced sanctions.[103]

> are creating distinctive cultural, ethical, and legal challenges for the general counsel of global organizations.

Id.; Janet Stidman Eveleth, *Life as Corporate Counsel*, MD. B.J., Jan.–Feb. 2004, at 20 ("Many corporations are turning to in-house corporate attorneys for guidance and are finding their internal legal departments invaluable as they address the new federal Sarbanes Oxley Act, and its multitude of new rules . . . .").

[100] *See, e.g.*, Tamara Loomis, *Cost of Compliance Soars After Sarbanes-Oxley*, N.Y. L.J., May 1, 2003, at 1 ("[T]he average price of being public has close to doubled . . . .").

[101] Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEGAL STUD. 833, 838 (1994). There are, however, some exceptions such as the Foreign Corrupt Practices Act (FCPA). Foreign Corrupt Practices Act of 1977, 15 U.S.C. §§ 78dd-1 to 78dd-3, 78ff (2006)).

[102] Arlen, *supra* note 101, at 836.

> This regime of strict vicarious liability presents corporations contemplating enforcement expenditures with conflicting, potentially perverse, incentives. On the one hand, increased enforcement expenditures reduce the number of agents who commit crimes by increasing the probability of detection and thus each agent's expected cost of crime. On the other hand, these expenditures also increase the probability that the government will detect those crimes that are committed, thereby increasing the corporation's expected criminal liability for those crimes.

Id. As a general matter, compliance systems bring material information to management's attention. Information networks are key to governance. Compliance programs create a paper trail enhanced by technology, which may appear at odds with companies seeking to limit litigation risk. *See* Donald C. Langevoort, *Internal Controls After Sarbanes-Oxley: Revisiting Corporate Law's "Duty of Care as Responsibility for Systems,"* 31 J. CORP. L. 949, 954–55 (2006) (explaining that certain sections of the Sarbanes-Oxley Act require corporate officers to accept responsibility for the implementation of internal controls which are reasonably designed to bring material information to their attention).

[103] *See* Arlen, *supra* note 101, at 839–40.

By the mid-1990s, the federal corporate criminal law landscape had changed drastically.[104] Corporations could benefit from adopting a compliance program because, at least in theory, it could have a direct effect on reducing criminal penalties in the event of a crime and also serve an indirect deterrence function.[105] In addition, the risk and cost of criminal violations expanded through criminal regulations targeting business practices such as corruption, consumer and employee safety, and environmental protection.[106] The most notable developments included changes in the federal sentencing laws, which provided strong incentives for firms to adopt compliance programs.[107] For example, the Federal Sentencing Guidelines for Organizations were designed to reduce the criminal fine of any convicted corporation with an effective compliance program.[108] Thereafter, "some federal prosecutors [went] beyond the mitigation provisions of the Sentencing Guidelines[,] . . . refrain[ing] altogether from prosecuting

[104] Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687, 690 (1997) (The guidelines changed "the traditional rule imposing strict vicarious liability on the firm for its agents' wrongdoing with a 'composite' regime in which the firm incurs a reduced penalty if it has discharged certain compliance-related duties.").

[105] *Id*; Jay M. Cohen, *Compliance and the Code of Conduct*, *in* CORPORATE GOVERNANCE: LAW AND PRACTICE § 13.02[1] (Bart Schwartz & Amy L. Goodman eds., 2010).

[106] *See, e.g.*, 15 U.S.C. §§78m(b), (d)(1), (g)–(h), 78dd(1)–(3), 78ff (2006); Occupational Safety and Health Act of 1970, Pub. L. No. 91-596, 84 Stat. 1590.

[107] Cohen, *supra* note 105, at § 13.02[2][b]. "The FSGO [Federal Sentencing Guidelines for Organizations] . . . gave companies a very good reason to [develop and enforce written codes of conduct]. . . . In 1987, the Sentencing Commission issued the first binding sentencing guidelines applicable to individual defendants." *Id.* (discussing 1991 U.S.S.G. § 8).

[108] *See id.*

> The Sentencing Commission "structured its framework to create a model for the good 'corporate' citizen; use the model to make organizational sentencing fair and predictable; and ultimately employ the model to create incentives for organizations to deter crime." It is because of these incentives that the impact of the FSGO on organizational governance and compliance activities has been so profound.

Id. (quoting Report of the Ad Hoc Advisory Group on the Organizational Sentencing Guidelines (Oct. 7, 2003), at 14.) *Cf.* Memorandum from The Deputy Attorney General to All Component Heads and United States Attorneys (June 16, 1999), *available at* http://www.justice.gov/criminal/fraud/documents/reports/1999/charging-corps.pdf (discussing criminal conduct by corporations and prosecution of the culpable individuals and the corporation on whose behalf they acted); Memorandum from Paul J. McNulty, Deputy Attorney General, to Heads of Department Components and United States Attorneys (Dec. 12, 2006), *available at* http://www.justice.gov/dag/speeches/2006/mcnulty_memo.pdf (noting the Department of Justice's recent success in prosecuting corporate fraud).

firms with good compliance programs, reporting, and post-offense reforms."[109] The Federal Organizational Sentencing Guidelines, particularly with their seven key criteria to address a wide array of legal compliance issues (e.g., environmental, antitrust, export controls, discrimination, and government contracting), arguably had the greatest impact on legal departments and the development of sophisticated compliance programs. In 2005, the United States Supreme Court, in *United States v. Booker*, ruled that the sentencing guidelines do not impose mandatory restrictions on courts' sentencing decisions.[110] Notwithstanding the *Booker* decision, the sentencing guidelines remain an important advisory source for sentencing decisions.

Additionally, the introduction of amnesty programs together with incentives and immunities for whistleblowers dramatically increased the stakes for corporations, which now have a compelling interest to identify criminal behavior. A prime illustration is the antitrust arena where a corporation that is the first to report illegal cartel behavior to the Department of Justice (DOJ) or other enforcement bodies such as the European Commission may avoid criminal liability, reputational damage, and fines of potentially hundreds of millions of dollars.[111] Under the DOJ's antitrust leniency policies, corporations are also more likely to settle private follow-on civil class-action lawsuits more quickly and at relatively low cost. Without leniency, such civil claims would normally lead to treble damages.[112] Within this context, the presence of in-house counsel, who are able to detect even indirect indicators of anticompetitive behavior, gives a corporation a marked advantage over other entities that lack this capability.

2. *Caremark* and its Progeny

In the 1996 *Caremark* decision, the Delaware Court of Chancery, partly influenced by changes in federal sentencing laws concerning compliance programs, recognized a director's duty to monitor that

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[109] Arlen & Kraakman, *supra* note 104, at 690.

[110] 543 U.S. 220, 245 (2005).

[111] *Tailoring Compliance Programs to Address the Antitrust Division's Tools for Expanding Cartel Investigations,* WILMER HALE (June 3, 2009), http://www.wilmerhale.com/publications/whPubsDetail.aspx?publication=9161. Complete amnesty or leniency is contingent upon being first to report violations of anti-trust law. *Id.*

[112] *Id.* To qualify for leniency in the civil context, a corporation must fulfill several criteria such as furnishing documents, making personnel available for interviews, and responding truthfully and completely. Antitrust Criminal Penalty Enhancement and Reform Act of 2004, Pub. L. No. 108-237, § 213, 118 Stat. 665, 668.

included the implementation of internal compliance controls.[113] Although Chancellor Allen's dictum made clear that compliance systems were the responsibility of directors in modern corporations, it also set a high bar for plaintiffs because director liability was limited to knowing violations and not inadvertent neglect.[114] In 2006, the Delaware Supreme Court affirmed the *Caremark* decision and clarified the scope of director oversight duties:

> We hold that *Caremark* articulates the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations. Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.[115]

Whereas the Federal Organizational Sentencing Guidelines created a *de facto* requirement for compliance programs, *Caremark* clearly made legal compliance a traditional corporate law issue. Yet within the current legal framework, companies still have considerable discretion in designing compliance programs.[116]

[113] *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996) ("[A] director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system . . . exists, and that failure to do . . . may . . . render a director liable for losses incurred by non-compliance with applicable legal standards.").

[114] *Id.* at 971. The Court said in *Caremark*:

> Generally where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation . . . only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability.

Id.

[115] Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006). In 2009, the Delaware Supreme Court in *Gantler v. Stevens* extended liability for breaches of fiduciary duty to non-director corporate officers such as CFO's and general counsels. *See* Gantler v. Stevens, 965 A.2d 695, 708–09 (Del. 2009); *see also* Johnson & Garvis, *supra* note 12, at 1106–09 (discussing the fiduciary duties of non-director officers).

[116] *See* Langevoort, *supra* note 102, at 953 (explaining that the threat of liability "is restrained enough to leave ample room for business judgment on the specifics of compliance design").

3. Sarbanes-Oxley and the Compliance Industry

Against the backdrop of scandals involving companies such as Enron and Tyco emerged the historic Sarbanes-Oxley Act ("SOX Act").[117] The SOX Act formalized auditing requirements within publicly traded corporations. Although legal scholars harbor divergent views on the value of the SOX Act reforms,[118] the advent of the SOX Act without question led to an enhanced focus on internal controls and legal compliance.[119] More skeptical observers contend that the SOX Act also led to the expansion of the compliance industry and burdened corporations with unnecessary costs rather than tangible improvements in corporate practices.[120] But all perspectives regard-

[117] *See, e.g.*, Chad Bray, *Court Upholds Convictions of Former Tyco Executives*, WALL ST. J., Oct. 17, 2008, at B3; John Harwood, *Public's Esteem for Business Falls in Wake of Enron Scandal*, WALL ST. J., Apr. 11, 2002, at D5; *see also* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

[118] *Compare* David D. Aufhauser, *Overall, Sarbanes-Oxley Is Good for U.S. Competitiveness*, 12 TEX. REV. L. & POL. 433, 435–37 (2008) (arguing that Sarbanes-Oxley has many positive aspects), *with* Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (and It Might Just Work)*, 35 CONN. L. REV. 915, 977–78 (2003) (arguing that, on the merits, the SOX Act deserves "a B-, respectable, but surprisingly low given the attention showered on it by the press, law firms, executive suites, investor groups, and the public. . . . It is impossible to prove that the enactments would or would not deter or prevent the repetition of the scandals they are designed to deter or prevent."); *compare* Donald C. Langevoort, The Social Construction of Sarbanes-Oxley, 105 MICH. L. REV. 1817, 1820 (2007) (concluding that "[t]here is no clear-cut answer to the question of how much SOX benefits investors"), *with* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L. J. 1521, 1527–28 (2005) (finding that SOX "will not provide much in the way of benefit to investors").

[119] *See, e.g.*, Carole Basri et al., *From a Corporate Governance and Compliance Viewpoint: A Practical Guide to the Sarbanes-Oxley Act of 2002*, *in* CORPORATE LEGAL DEPARTMENTS 2003, at 11–45 (2003) ("Many provisions of [Sarbanes-Oxley] are aimed at corporate governance and corporate compliance conduct. These areas include the responsibility of the board of directors and its audit committee in connection with accounting regularities, conflicts of interest, whistle blowing complaints, insider trading and 'oversight responsibility' for corporate compliance programs."); Sarah Helene Duggin, *The McNulty Memorandum, the KPMG Decision and Corporate Cooperation: Individual Rights and Legal Ethics*, 21 GEO. J. LEGAL ETHICS 341, 394 (2008) ("[T]he deference accorded to compliance advice from corporate counsel has undoubtedly increased in the post-Sarbanes-Oxley world . . . ."); *see also* Symposium, *Corporate Compliance: The Role of Company Counsel*, 21 GEO. J. LEGAL ETHICS 491, 525–34 (2008) (remarks of Robert Lupone, Carol Rakatansky, & Sung Hui Kim).

[120] *See* William J. Carney, *The Costs of Being Public After Sarbanes-Oxley: The Irony of "Going Private,"* 55 EMORY L.J. 141, 141 (2005) (asserting that the costs of complying with Sarbanes-Oxley exceed the benefits of going public for many corporations, particularly those of modest size); Thomas E. Hartman, *Five Years After Sarbanes-Oxley, the Compliance Costs Remain Huge*, LEGAL TIMES, Nov. 19, 2007, at 37. *But see* J. Bonasia, *Sarbanes-Oxley Law Offers Side Benefits*, INVESTOR'S BUS. DAILY, Oct. 5, 2005, at A6 (ex-

ing the SOX Act, whether skeptical, favorable, or agnostic, implicate the need for greater internal expertise and the legal acumen of in-house counsel to control costs and manage legal threats.

Delaware jurisprudence, federal laws impacting corporate liability, and recent corporate scandals have all raised the profile of director oversight of corporate legal compliance. These developments contributed to the growth of the compliance industry and competition among outside service providers for lucrative corporate compliance business engagements.[121] In addition, these developments coincided with business efforts to integrate legal compliance under the broader strategy umbrella of Enterprise Risk Management (ERM).[122] Generally, ERM is an enterprise-wide attempt to ensure that corporations address risks in the business process.[123] It often involves the analysis and identification of risks as well as managing those risks via internal controls.[124] Legal risks, however, are just one species of risks that should be incorporated into business decisions.[125] Legal compliance risks engender a strong operational connection to corporate transactions and activity. Unsurprisingly, the implementation of corporate compliance and certain risk-mitigation measures of-

plaining that "some companies and groups have found that the law can make their business more effective" possibly because "North American investors say they're willing to pay a 13% premium for stocks that assure good governance"); Amy Borrus, *Learning to Love Sarbanes-Oxley: A Few Companies Have Discovered that Compliance Actually Helps to Cut Costs*, BUSINESS WEEK, Nov. 21, 2005, at 126, 128 ("A few companies are discovering, to their surprise, that taking stock of internal controls can help beyond just unmasking accounting problems. By forcing executives to dig deep into how their companies get work done, Section 404 [of Sarbanes-Oxley] is enabling business to cut costs and boost productivity.").

[121] *See generally* Rebecca Walker, *The Evolution of the Law of Corporate Compliance in the United States: A Brief Overview*, *in* CORPORATE COMPLIANCE AND ETHICS INSTITUTE 2009, at 15 (PLI Corp. Law & Practice, Course Handbook Series No. 18176, 2009) (explaining how Sarbanes-Oxley, among other pieces of legislation and administrative action, has resulted in more sophisticated compliance programs, increased government expectations regarding the effectiveness of these compliance programs, and the promotion of an ethical corporate culture.).

[122] *See generally* Matteo Tonello, *Emerging Governance Practices in Enterprise Risk Management* (The Conference Board, Research Report No. R-1398-07-WG, 2007).

[123] *See generally,* Stephen Bainbridge, *Caremark and Enterprise Risk Management*, 34 J. CORP. L. 967 (2009).

[124] *See* Carolyn Kay Brancatto et al., *The Role of U.S. Corporate Boards in Enterprise Risk Management* 10 (The Conference Board, Research Report No. R-1390-06-RR, 2006).

[125] Other types of risk include financial risk, reputational risk, human resource risks, operational risks, and brand equity risks. *See id.* at 11 fig.1.

ten occur under the direction of, or require significant involvement from, in-house counsel.[126]

C. The Nature of Legal Services

1. Fungibility of Legal Services

Legal services are more fungible than outside legal service providers may care to admit.[127] The reputational and expertise gaps between in-house and outside lawyers are becoming smaller and, in certain areas, nonexistent.[128] In addition, corporations are becoming more savvy and sophisticated purchasers of legal services.[129] Within this context, corporations are seeking value added beyond law firm reputation. Corporations and in-house legal departments often possess a more instrumental demand-side view of legal services and do

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[126] *See* Duggin, *supra* note 13, at 1012 ("[G]eneral counsel and other in-house lawyers play a major role in ensuring legal compliance throughout the entity. The 'conception of the lawyer as a promoter of corporate compliance with law emanates from the basic values of the legal profession,' and is a vital responsibility of contemporary general counsel." (quoting A.B.A., REPORT OF AMERICAN BAR ASSOCIATION TASK FORCE ON CORPORATE RESPONSIBILITY (Mar. 31, 2003), http://www.abanet.org/buslaw/corporateresponsibility/final_report.pdf)).

[127] *See* Baker & Parkin, *supra* note 7, at 1655.

> Because corporate clients now do much of their routine legal work in-house, they are more likely to hire outside firms only for large, complex, or specialized matters. . . . "Increasingly, clients view their legal counsel as a commodity that can be purchased from a number of sources" and often "shop" their work through a competitive selection process to a broader set of firms.

Id. (quoting John S. Lipsey, *Shift in Focus: Keeping Clients Happy*, NAT'L L.J., Jan. 29, 2001, at B20); *see also* Andrew Bruck & Andrew Canter, Note, *Supply, Demand, and the Changing Economics of Large Law Firms*, 60 STAN. L. REV. 2087, 2110–11 (2008) (discussing the "growing body of routine, fungible legal work [that] can be handled . . . by a smaller firm that charges lower rates"). Although occasional "high stakes" cases remain for companies who are "willing to pay exceptional prices to ensure success," many companies now employ a competitive bidding process to select providers of outside legal work. *Id.*

[128] *See, e.g.*, Rosen, *supra* note 92, at 479 ("Once castigated, inside counsel reportedly now are accorded not only 'admiration and respect' by their corporate employers but also 'growing prestige' within the bar."); *see also* Heineman, *supra* note 51.

[129] *See* Milton C. Regan, Jr., *Law Firms, Competition Penalties, and the Values of Professionalism*, 13 GEO. J. LEGAL ETHICS 1, 30 (1999).

> [A]s legal services have become a more significant component of its budget, the corporation has begun to internalize more of the provision of legal services by greatly expanding the size and role of its in-house legal department. . . . [In-house counsel] can serve as sophisticated consumers of outside legal services, reducing the asymmetry of information between the corporation and law firm attorneys.

Id.

not differentiate between legal services and other procured services. Depending on the type of legal work involved, multiple firms may adequately perform the task.[130] Other components of value, such as responsiveness and cost, can make a less reputable firm more attractive to the client corporation.[131] Thus, a five-star law firm may not be necessary where a three-star firm will suffice.

2. Credence Services

Legal services resemble credence services.[132] Credence services, which were first identified by Michael Darby and Edi Karni,[133] are services whose quality cannot fully be determined even after the search process and consumption (e.g., certain medical services, automobile repairs, and education).[134] Credence services have "high pre-buying costs and high post-buying costs of quality detection."[135] They exhibit an asymmetry between buyers and sellers concerning the acquisition of knowledge regarding service value.[136] In the credence service context, assessments of value will either be impossible to determine or

[130] *See* Baker & Parkin, *supra* note 7, at 1652 (discussing "the decline in relationship lawyering" and the rising fungibility of legal services). *But see* Schwarcz, *supra* note 7, at 498 (discussing how certain types of legal work are less likely to be considered a fungible commodity and more likely the bailiwick of outside law firms).

[131] *See, e.g.*, James P. Schratz, *I Told You to Fire Nicholas Farber: A Psychological and Sociological Analysis of Why Attorneys Overbill*, 50 RUTGERS L. REV. 2211, 2221 (1998) ("When any particular industry develops to the stage where the client considers the supplier of services to be offering a fungible commodity, purchasing decisions will be based primarily on costs at the expense of the supplier.").

[132] *See* Victor Fleisher, *Brand New Deal: The Branding Effect of Corporate Deal Structures*, 104 MICH. L. REV. 1581, 1600 (2006) (listing the three types of goods: (i) search goods, (ii) experience goods, and (iii) credence goods). The quality of search goods, such as clothing, footwear, and jewelry, can readily be discerned during the search process prior to consumption. *See id.* Search goods have "low pre-buying costs of quality detection." MEN-ANDRI BENZ, STRATEGIES IN MARKETS FOR EXPERIENCE AND CREDENCE GOODS 2 (2007); *see also* Philip Nelson, *Information and Consumer Behavior*, 78 J. POL. ECON. 311, 311 (1970) (analyzing consumer behavior with respect to search and experience goods). On the other hand, the quality of experience goods is not discerned during the search process, but rather after consumption. *See* Michael R. Darby & Edi Karni, *Free Competition and the Optimal Amount of Fraud*, 16 J.L. & ECON. 67, 68 (1973). Experience goods have "high pre-buying costs of quality detection," but low post-buying costs. BENZ, *supra*. Examples of experience goods include jobs, movies, newspapers, wine, and food. *Id.*

[133] *See* Darby & Karni, *supra* note 132, at 68–69 ("Credence qualities are those which, although worthwhile, cannot be evaluated in normal use.").

[134] *See* BENZ, *supra* note 132, at 2.

[135] *Id.*

[136] *Id.*

require costly information and other proper circumstances.[137] The other proper circumstances in this context apply to situations where the lapse of a considerable period of time may reveal the value of the service.[138]

There are two types of asymmetry implicated by credence characteristics.[139] The first type involves the customer's inability to know her needs or diagnose her problem.[140] The second type involves the customer's inability to determine the level of service necessary.[141] The interplay between diagnosis and service provision exacerbates the customer's dilemma because "consumer ignorance and [the] additional cost of separate diagnosis and repair provide motivation for a service firm to defraud its customers."[142] Oliver Williamson describes a similar issue of veracity risk whereby "information may be filtered and possibly distorted to the advantage of the [service] firm that has assumed the information collection responsibility."[143]

Consider the following example concerning the provision of legal services. An outside lawyer communicates to her corporate client that in order to comply with certain regulations the client must do *X*, *Y*, and *Z*. Would action *X* alone suffice and eliminate the threat of noncompliance? Because legal services involve questions of judgment against a backdrop of uncertainty, the client must depend on the outside lawyer's judgment not only to provide services but to determine the adequate level of service. In the above scenario, actions *X*, *Y*, and *Z* are inevitably more costly than action *X* alone.[144] Cre-

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[137] Darby & Karni, *supra* note 132, at 68–69.

[138] *See id.*

[139] *See* Brian Roe & Ian Sheldon, *Credence Good Labeling: The Efficiency and Distributional Implications of Several Policy Approaches*, 89 AM. J. AGRIC. ECON. 1020, 1020 n.1 (2007).

[140] *See id.* ("[O]nly an expert can diagnose the consumer's true needs, e.g., does the car need a minor or major repair?").

[141] *See id.* ("[O]nly the seller may know the level of service actually provided, e.g., was the car given the appropriate level of service?").

[142] Darby & Karni, *supra* note 132, at 77.

[143] Williamson, *Vertical*, *supra* note 8, at 120.

[144] *Cf.* Gilson, *supra* note 5, at 902–03.

> As Robert Mnookin and I stated four years ago, "[g]eneral counsel for major corporations are creating a revolution and are the primary agents of change." Increasingly, general counsel are former partners in large corporate firms who are capable of internalizing both the diagnostic and referral functions they previously performed on behalf of clients as outside counsel. The critical difference is that internalizing these functions eliminates the information asymmetry between client and lawyer, so that no relationship specific assets are created and no

dence characteristics enhance the likelihood of law firm opportunism because of information asymmetries caused by the coupling of diagnostic and service functions within an outside law firm.

On the other hand, in-house counsel, and more specifically general counsel, function as sophisticated purchasers by performing aspects of the diagnostic and service functions.[145] In this context, in-house counsel take some degree of market power and perverse incentives away from outside law firms because outside law firms are no longer needed to exclusively diagnose a legal problem.[146] With internalization, the client corporation has a greater awareness of the quality of service that outside law firms perform. The effective internalization of the diagnostic legal function requires that, under most circumstances, in-house counsel serve as the primary client contact

> lock-in effect results. The consequence is a dramatic reduction in the switching costs facing clients and an elimination of lawyer's market power.

Id. (quoting Ronald J. Gilson & Robert H. Mnookin, *Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 STAN. L. REV. 313, 381 (1985)).

[145] *See id.* at 914 ("A talented general counsel can internalize the diagnostic and referral functions that previously had contributed to creating switching costs. Reduced costs of changing lawyers made private gatekeeping an increasingly difficult proposition.").

[146] Gilson, *supra* note 23, at 292 n.143.

> The importance of the lawyer's reputation in shaping the character of the expected opinion can be clearly seen in the familiar debate over from whom the buyer will accept an opinion on behalf of the seller. For example, buyers will frequently object to receiving the opinion of the seller's in-house counsel with respect to certain items. Identifying the matters for which the buyer will or will not accept the opinion of the seller's in-house counsel is a good way to distinguish those aspects of the opinion of counsel that serve primarily an information-production function from those that serve primarily a verification function. In-house counsel will often have a cost advantage with respect to the information-production function because of their more intimate knowledge of their client. With respect to the verification function, however, the ability to serve as a reputational intermediary requires a sufficient diversity of clients such that a penalty will be imposed in future dealings if the intermediary cheats. As a result, opinions that serve a verification function are largely limited to outside counsel, while those that serve an information-production function are often accepted from in-house counsel.

Id. (internal citations omitted); *see also* Ronald J. Gilson & Robert H. Mnookin, *Foreword: Business Lawyers and Value Creation for Clients*, 74 OR. L. REV. 1, 4 n.14 (1995) (discussing the reduction in the information asymmetry between lawyers and clients and the concomitant reduction in outside lawyer market power).

for outside counsel.[147] Although legal observers rightfully indicate that incentives for outside lawyer opportunism decrease as a result of increased competition among outside law firms and reputational costs, this assertion is qualified by the presence of credence attributes.[148]

IV. A UNIFYING THEORY OF THE IN-HOUSE COUNSEL ROLE

Our theory posits that the strategic in-house counsel role, embodying consistent interaction with corporate operations and actors (e.g., management and employees), enables the modern corporation to significantly enhance its creation of value.[149] Although the discussion of how business lawyers create value is not new, our theory is more holistic and less static than the available theories or definitions provided by legal observers.[150] These available definitions, although useful, are descriptively too narrow because they (i) are limited to transactional sources of value; (ii) are fragmented; or (iii) fail to capture the unique value that stems from in-house counsel linkages, networks, and integration with other firm activities. By contrast, our theory is not limited to transactions as traditionally envisioned, but also encompasses intangible and non-transactional sources of value, such as corporate compliance, which help directors and officers fulfill their oversight duties.[151] Ignoring these additional sources of value, as

[147] Directors may, however, retain their own counsel regarding certain issues. *Compare* Geoffrey C. Hazard, Jr. & Edward B. Rock, *A New Player in the Boardroom: The Emergence of the Independent Directors' Counsel*, 59 BUS. LAW. 1389, 1410–12 (2004) (predicting more frequent and general use of outside special counsel to the independent directors), *with* Veasey, *supra* note 13, at 1418 (disagreeing with that premise and noting that special counsel to the independent directors should be on a special-need basis and the board should trust and rely on general counsel otherwise). Corporations may also employ separate law firms to provide audit and routine counseling in order to limit the prospect of outside law firm opportunism and biased advice. A law firm performing an audit of business activity made pursuant to their prior routine legal advice raises potential conflicts.

[148] Schwarcz, *supra* note 7, at 525 ("The central imperfection identified by [transaction cost economic] theory is ex post opportunistic behavior —meaning, in this Article's context, that outside counsel may try to take advantage of the client after being retained but before the transaction closes.").

[149] *See infra* app. fig.1.

[150] According to Ronald Gilson, the standard by which business lawyers are evaluated is simply: "*If what a business lawyer does has value, a transaction must be worth more, net of legal fees, as a result of the lawyer's participation.*" Gilson, *supra* note 23 (emphasis in original).

[151] *See* George W. Dent, Jr., *Business Lawyers as Enterprise Architects*, 64 BUS. LAW. 279, 294 (2009) ("Much work of business lawyers does not entail 'transactions.' Business lawyers advise corporate boards and officers in satisfying their fiduciary and

well as the unique value generated by in-house counsel integration and linkages, negatively distorts the impact of in-house counsel on corporate affairs.[152]

In order to proffer a more robust descriptive assessment of the in-house counsel function, it is helpful to address three important questions concerning in-house counsel value creation: (i) What are the unique attributes of the in-house counsel role? (ii) How do in-house counsel create value? and (iii) Who are the external and internal beneficiaries of this value? The ensuing analysis of these three basic questions renders a more comprehensive analysis of in-house counsel efficacy.

A. *What are the Unique Attributes of the In-House Counsel Role?*

Although in-house counsel and outside counsel both provide valuable legal services, there are notable differences in the respective roles that reveal the uniqueness of in-house counsel, namely, a single but multifaceted client, the non-discrete in-house counsel role, and a seat at the table (i.e., a strategic integrated function).[153]

1. The Single but Multifaceted Client

The principal distinction between in-house counsel and external legal counsel is that in-house counsel serve a single but multifaceted

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other legal duties. They oversee the firm's compliance with regulations and contracts. This work demands skills different from those needed in transactions."). At times, transactional and compliance sources of value creation may seem difficult to reconcile. *See* Baer, *supra* note 11, at 566. In the transactional mode, in-house counsel operate as "transaction costs engineers;" Ronald Gilson and others have highlighted this source of value creation. *See* Gilson & Mnookin, *supra* note 146, at 7–8; Schwarcz, *supra* note 7, at 499 (examining "the shift from outside to in-house 'transactional lawyering'—meaning the structuring, negotiating, contract drafting, advisory, and opinion-giving process leading to 'closing' a commercial, financing, or other business transaction"). Here, in-house counsel are more likely to be viewed as team members and facilitators. Yet, in the latter compliance mode, in-house counsel often adopt a more cautious monitoring, implementation, and policing function. Operating within the compliance mode, business people are more likely to view in-house counsel as inhibitors and impediments to business transactions. *See* Kim, *supra* note 11, at 441 ("Sobering accounts of inside lawyers who sued their employers under a claim of retaliatory discharge reveal that some inside lawyers are ostensibly fired for not being 'team players.'").

[152] *Cf.* Schwarcz, *supra* note 7, at 499 ("This Article does not address such non-transactional lawyering roles as litigation, lobbying, or compliance work because those roles do not normally involve, as does transactional lawyering, head-to-head competition between outside and in-house counsel.").

[153] *Id.* at 500 ("The recipient of value provided by in-house and outside lawyers is always primarily the client-company.").

client.[154] Ultimately, the corporation is the client, but its interests may, at times, conflict with senior executives, employees, and other corporate constituencies.[155]

2. The Non-Discrete Role of In-House Counsel

Another distinction is the non-discrete role of in-house counsel. In essence, in-house counsel are the "Swiss Army Knife" of the legal profession and perform a fusion of roles, often assuming organizational responsibilities well beyond those of their external counterparts.[156] For example, in-house counsel may serve as officers, directors, committee members, or lobbyists and may have significant compliance responsibilities that are non-legal.[157] The mixture of legal and business roles requires a broader set of skills particularly among general counsel, who must not only manage legal departments, but often navigate and influence corporate culture to limit legal risk and costs.[158]

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[154] *See, e.g.*, Sally R. Weaver, *Ethical Dilemmas of Corporate Counsel: A Structural and Contextual Analysis*, 46 EMORY L.J. 1023, 1027 (1997) ("The first, and perhaps most critical, difference between corporate counsel and their colleagues in private practice is the economic dependence of corporate counsel on a single client.").

[155] *See, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 1.13 (2007); Veasey & Di Guglielmo, *supra* note 39, at 8–13 (explaining that tensions may arise because of in-house counsel's relationship with corporate management and in spite of these tensions in-house counsel "must exercise independent judgment on behalf of the corporate client when advising directors, officers, and employees of the client."); Weaver, *supra* note 154, at 1028 ("[T]he close working relationship between management and corporate counsel may create confusion and uncertainty about the role of corporate counsel in the representation of the organization.").

[156] *See* Duggin, *supra* note 13, at 1003–16 (explaining that some of the "formal" functions of in-house counsel "[encompass] managerial duties and non-legal business related responsibilities," which include acting as manager of outside legal services, serving as a corporate officer, management committee member, and/or a director, and acting as a strategic planner). Duggin goes on to state that "in additional to fulfilling their formal or official duties, [general counsel] frequently play a variety of informal roles that have a less visible but sometimes even more powerful impact on client corporations." *Id.* at 1016–17. These informal roles include legal services marketer, ethics counselor, crisis manager, and arbitrator. *Id.* at 1017–20. *See also* Daly, *supra* note 2, at 1061 ("Clients came to expect their general counsel to be involved in any big strategic issue at the heart of the organization and to know very intimately what's going on in the minds of top executives.").

[157] *See* Weaver, *supra* note 154, at 1027 ("The second defining characteristic of the corporate counsel role is the tendency for the corporate counsel to assume responsibilities in the organization that exceed, and differ from, those of the typical attorney-client relationship.").

[158] *See* Chayes & Chayes, *supra* note 2, at 289. General counsel usually "[assume] managerial responsibility for all legal work performed for the corporation." *Id.* "Because most large legal departments must conform to the financial planning require-

3. A Seat at the Table

Generally, in-house counsel function in a strategic capacity whereas outside counsel primarily play a tactical role. In-house counsel (and particularly general counsel) often sit at the intersection of most corporate activity. Moreover, in-house counsel usually have or should have the opportunity to be part of the management team, whether at the pinnacle of an organization or somewhere in the middle ranks of the organization. This integrated strategic function (or seat at the table) affords in-house counsel (i) access to information and institutional knowledge, (ii) the power to promote internal action, (iii) responsibility for outside counsel, and (iv) the capacity to engage in preventive law.

a. Access to Information and Institutional Knowledge

In-house counsel's access to formal and informal information within the client corporation is a significant attribute.[159] In-house counsel often acquire institutional knowledge concerning business operations and corporate culture that inevitably allow them to offer legal guidance in a more proactive *ex ante* manner.[160] Oliver William-

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ments of the corporation and predict what had heretofore been regarded as unpredictable, the pressure to elaborate and use budgetary controls is growing." *Id.* at 292. Thus, when legal work is outsourced, "legal bills are scrutinized and almost universally must be approved by legal departments" in an effort to reduce costs. *Id.*; *see also* Carl D. Liggio, Sr., *A Look at the Role of Corporate Counsel: Back to the Future—or Is It the Past?*, 44 ARIZ. L. REV. 621, 631 (2002).

> Outside counsel did not have the luxury of making the business decision that not providing Rolls Royce reliability was an acceptable risk. Both for the fear of malpractice and injuring an important client relationship, outside counsel would typically leave no stone unturned, no case unread, and no possible issue unresearched. Corporate counsel, however, could (and began to) make the judgments that they could afford to assume the risk of not using a Rolls Royce approach on certain matters.

Id.

[159] *See* Weaver, *supra* note 154, at 1028 ("The third characteristic that defines the relationship between corporate counsel and their employer-clients is the access afforded corporate counsel to informal sources of information because of their physical proximity to their clients. Professor Hazard characterizes the information that flows from these informal sources as back-channel or 'water cooler' information." (citing Geoffrey C. Hazard, Jr., *Ethical Dilemmas of Corporate Counsel*, 46 EMORY L.J. 1011, 1018 (1997))).

[160] *See* DeMott, *supra* note 10, at 955–56 ("A general counsel may also be uniquely well positioned to champion a transformation of the organizational culture that shapes how the corporation addresses its relationships with law and regulation."); *see also* Chayes & Chayes, *supra* note 2, at 281–89 (discussing in-house counsel's involvement in corporate strategic planning and "programmatic prevention" to insure the

son highlights additional informational advantages that coincide with using internal procurement as a substitute for market services, such as superior access to *ex post* data.[161] Equipped with this institutional knowledge of business context, in-house counsel develop a dual competency or consciousness usually absent from outside legal service providers.[162] Admittedly, however, there is no reason why outside counsel cannot acquire a similar (or some rudimentary) understanding of a corporation's businesses and structures. But what truly distinguishes the in-house counsel role is the ability to understand the way things operate in a dynamic sense, for example, who needs to be consulted, who can be helpful, and who has significant influence within and outside of the management hierarchy.

b. Power to Promote Internal Action

In-house counsel have the power to promote actions within the corporation, which distinguishes them from outside counsel who lack executive authority. The general counsel of a corporation is usually an officer, for example, a senior vice president, and that position embodies certain forms of executive and financial power. Even if outside counsel are heavily involved in designing a compliance system or a patent strategy, it is the in-house counsel who ultimately have the power to implement such designs. Similarly, through "sign-off" or other procedures, in-house counsel have the power to block actions that threaten corporate value.

c. Responsibility for Outside Legal Services

General counsel normally have absolute control over the selection and management of outside counsel. This even applies to specialist areas such as tax or intellectual property where there may be internal specialists who are quite capable of working directly with outside legal providers. Although outside counsel could be asked to take on the role of supervising the provision of legal services on behalf of their corporate client, this scenario is unlikely to survive in the long term because it will often lead to conflicts of interest and relationship issues with other outside law firms.

company is in compliance with government regulations); Daly, *supra* note 2, at 1071 ("[C]lients involve [in-house counsel] in strategic business planning long before any deals are negotiated, often before the other side to a potential transaction is even approached. The proactive model is now a well established feature of in-house lawyering.").

[161] *See* Williamson, *Vertical*, *supra* note 8, at 113, 117, 119.

[162] *See* discussion *supra* Part IV.A.2.

d. The Capacity to Engage in Preventive Law

Despite claims to the contrary, it is not feasible for outside counsel to be integrated into the day-to-day operations of a corporate client in a comparable fashion to in-house counsel. Such integration, however, is essential to practicing strategic preventive law. Business managers may also be reluctant to hire outside counsel for the preventive and preemptive work in which in-house counsel engage because they prefer to work with colleagues who are known, trusted, and easily accessible. These relationships, or social capital, enhance the capacity of in-house counsel to engage in preventive law.

B. How Do In-House Counsel Create Value?

In-house counsel create value in a myriad of ways, but are normally associated with the transactional value they generate for business organizations. Over twenty years ago, Ronald Gilson asserted that business lawyers were, in essence, transaction cost engineers who created value by reducing transaction costs.[163] Although helpful, Ronald Gilson's model for business lawyering is incomplete in two ways. One limitation is that Gilson's scope of transactions is too narrow. He focuses on lawyers in "large acquisitions [and mergers], a highly specialized practice involving one phase of one-shot, arms'-length transactions" that are "at one end of a continuum of business law practice that ranges across repeat [or routine] transactions and relational contracts to internal transactions."[164] Another important omission from existing accounts of business-lawyer value creation is the absence of non-transactional sources of practice.[165] The following examples, although not exhaustive, illustrate the broad scope of transactional and non-transactional value created by in-house counsel.

1. Transactional Sources of Value

a. Standard Transactions

The standard transactional categories for many large corporations are much broader than those envisioned by Gilson and others. For many large scale organizations, routine sales, services, real estate, strategic alliances (such as joint ventures, licenses, franchises, and dis-

[163] Gilson, *supra* note 23, at 293–94; *see also* COFFEE, *supra* note 8, at 192 ("The corporate lawyer functions in a very different capacity from the advocate . . . . [T]he corporate lawyer acts principally as a transaction engineer.").

[164] Dent, *supra* note 151, at 282.

[165] *See id.*

tributorships), financing, intellectual property, and leasing transactions are the life blood for the business enterprise and of greater importance than infrequent or cyclical large acquisitions and mergers.[166]

b. Internal Transactions

There are also so-called "internal transactions" between various internal corporate constituencies (e.g., directors, shareholders, management, and employees) such as employment agreements that impact business operations.[167] Other examples of internal transactions include delegations of authority within the business enterprise as well as by-law amendments.[168] The use of standardized terms and contracting procedures also has internal governance implications for large companies with significant sales and procurement operations. Standardized terms and contracting procedures serve an important function by limiting the discretion of wayward, uninformed, and unauthorized employees who might otherwise expose the corporation to onerous terms and risk.

c. Relational Contracts

The important role of relational contracts is often understated in the legal literature.[169] But one cannot neglect that relational contracts, characterized by cooperation and extensive future dealings, are an important part of business practice. A company may have multiple linkages to third parties that influence its responses to contractual disputes. Consider the example of a chemical producer whose chief industry competitor is also a major customer or supplier. The chemical producer may seek to purchase product from its competitor rather than produce its own due to product shortages or high internal costs of production. This basic example illustrates how ties between businesses in certain industries are more complex and fluid

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[166] *See* Gilson & Mnookin, *supra* note 146, at 13–15; *see also* U.C.C. §§ 2, 2A (2005).

[167] *See, e.g.*, Bradley T. Borden, *Partnership Tax Allocations and the Internalization of Tax-Item Transactions*, 59 S.C. L. REV. 297, 301–02 (2008) (discussing a skilled attorney's ability to create employment agreements resembling partnerships whereby an employee and corporation share profits).

[168] Dent, *supra* note 151, at 292.

[169] *See* Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1089 (1991) (discussing relational contracts and why they "do not easily fit the presuppositions of classical legal analysis"); *see also* George Baker et al., *Relational Contracts and the Theory of the Firm*, 117 Q.J. ECON. 39, 39 (2002) (discussing the role of relational contracts in efficient ownership patterns).

than the legal literature often acknowledges.[170] Accordingly, litigation in these contexts is often disfavored over negotiation and concessions. In-house counsel have the distinct advantage of understanding this business context and choosing among a range of tactics to achieve inter-temporal business objectives.[171]

2. Non-Transactional Sources of Value

As previously mentioned, another serious omission from existing accounts of business lawyer value creation concerns non-transactional sources of practice.[172] The following examples, although not exhaustive, reflect non-transactional sources of in-house counsel value.

a. Legal Compliance

i. Advancing Compliance Program Goals

Compliance or regulatory costs can be viewed as a species of transaction costs, but the legal literature often makes a distinction.[173] For explanatory purposes, this Article will continue to observe this distinction. In-house counsel add value by "understanding their clients' regulatory concerns" and helping their client to conduct its business without compromising legal compliance.[174] In-house counsel must not only display competency in relevant topical legal areas, but also must have intimate knowledge of the corporate client's unique

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[170] *See, e.g.*, Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 61 (1963). The legal literature often assumes that litigation is the default option in business disputes. But where relational contracts exist, the decision to litigate is not always so clear. Professor Stewart Macaulay explains:

> Disputes are frequently settled without reference to the contract or potential or actual legal sanctions. There is a hesitancy to speak of legal rights or to threaten to sue in these negotiations. Even where the parties have a detailed and carefully planned agreement . . . often they will never refer to the agreement but will negotiate a solution when the problem arises . . . .

Id.; *see also* Stewart Macaulay, *An Empirical View of Contract*, 1985 WIS. L. REV. 465, 471 (1985) (asserting that relational contracts weaken when the amount of money in dispute is significant); David Charny, *Nonlegal Sanctions in Commercial Relationships*, 104 HARV. L. REV. 373, 376 (1990).

[171] *See* Rosen, *supra* note 92, at 487 ("Inside counsel possess knowledge of their clients that other lawyers—those who practice as free professionals—do not, and they use this knowledge to deliver high quality professional judgments on their clients' behalf.").

[172] *See* Dent, *supra* note 151, at 282.

[173] *See* Steven Schwarcz, *Explaining the Value of Transactional Lawyering*, 12 STAN. J.L. BUS. & FIN. 486, 492 (2007).

[174] *Id.*

business context and concerns. This dual competency allows in-house counsel to bridge the gap between legal promulgation and organizational implementation.

Corporate Legal Compliance (CLC) is integral to the daily operations of large companies. It often involves thousands of decisions made by various employees of the firm, throughout various regions of the world, over the course of a fiscal year. In most cases, the CLC function is either absorbed into the in-house legal department function or is situated in a self-standing compliance department that works closely with in-house counsel.[175] Moreover, in-house counsel, specifically general counsel, should regularly discuss compliance risks with senior executives and periodically brief the board of directors' compliance committee on key risks, occurrences of noncompliance, and best practices.[176] Other reasons to involve in-house counsel in the compliance process include promoting economies of scale, economies of scope, information economies, and preserving attorney-client privilege.[177]

As a general matter, compliance systems bring material information to management's attention.[178] Information networks and information flows are key to effective governance, as illustrated by the recognized *Caremark* duties to implement a system of controls.[179] Common features of compliance programs include a code of conduct, monitoring systems, training, reporting, and investigative capabilities. Compliance programs create a paper trail that will ostensibly

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[175] *See* Chayes & Chayes, *supra* note 2, at 287 ("The legal department bears primary, though not exclusive, responsibility for compliance efforts."); Daly, *supra* note 2, at 1065 ("[C]orporate clients [need] their general counsel to possess a substantive and procedural familiarity with the laws of other countries and to supervise competently the work of foreign in-house lawyers and outside law firms around the globe.").

[176] *See* E. Norman Veasey, Presentation to the Association of Canadian General Counsel, The New Realities for Chief Legal Officers of U.S. Public Companies, at 3–5, 13 (Oct. 16, 2009) (discussing multiple roles of general counsel that go beyond meeting minimum legal requirements); NAT'L ASS'N CORP. DIRS. BLUE RIBBON COMM'N, RISK GOVERNANCE: BALANCING RISK AND REWARD App. B (2009).

[177] *See* Schwarcz, *supra* note 173, at 493–94; *see also infra* Part IV.C.1.

[178] *See* Langevoort, *supra* note 102, at 958 ("[T]here are two separate but related objectives built into the internal controls requirement. One is to bring material information to management's attention, the other to permit monitors like auditors or board audit committees to verify the quality of the information flow and processing by management.").

[179] *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996). The U.S. Sentencing Guidelines also underscore the importance of compliance systems. *See* U.S. SENTENCING GUIDELINES MANUAL § 8 (1991).

flag improper conduct.[180] The panoply of rules and regulations that impact business enterprise are vast: global, national, and local.[181] Greater globalization of business enterprise has only added to the overall complexity of legal compliance. Consequently, the systems necessary for compliance may differ according to jurisdiction, industry, and operational context. In certain instances, jurisdictional laws on the same issue may be inconsistent or provide minimal guidance.[182]

Director and senior executive oversight with respect to legal compliance is distinguishable from other forms of oversight that may occur on a more infrequent basis.[183] The fluidity of business operations and context figure prominently into the CLC discussion. Consequently, there is no one-size-fits-all approach to compliance, and, as Donald Langevoort asserts, there are no meaningful benchmarks available to make comparisons and determine effectiveness.[184] Such effectiveness may hinge on the industry, on the operational context, and on whose interests the compliance program is intended to serve—for example, regulator, corporation, or both.[185] Ultimately, the form compliance programs take will likely stem from a type of

[180] At times, this may appear at odds with companies seeking to limit litigation risk. *See* Langevoort, *supra* note 102, at 972.

[181] *See* Lamm, *supra* note 14.

[182] Privacy regulation is an example. *See* Robert Gellman, *Conflict and Overlap in Privacy Regulation: National, International and Private, in* BORDERS IN CYBERSPACE: INFORMATION POLICY AND THE GLOBAL INFORMATION INFRASTRUCTURE 255, 255–56 (Brian Kahin & Charles Nesson eds., 2d ed. 1998) (1987) ("As national, international, and privately promulgated privacy rules expand, there is a real prospect of overlapping rules and direct conflict. . . . It becomes increasingly difficult to determine what rules apply to what institutions at any given time or for any set of transactions.").

[183] *See* Veasey, *supra* note 13, at 1416–17 (describing categories of corporate decisions).

[184] Langevoort, *supra* note 102, at 955.

[185] *See* Kristen K. McGuffey & Thomas C. Soldan, *Right-Sizing: Customizing Compliance to the Small Corporation, in* CORPORATE COMPLIANCE & ETHICS INSTITUTE 2007, at 255, 255–59 (PLI Corp. L. & Practice, Course Handbook Ser. No. B-1595, 2007). For example, "[a] company's efforts to 'effectively' structure its compliance program . . . will only be tested by the government when misconduct occurs and the company comes under investigation for potential wrongdoing[,] . . . at a critical time, when potential illegalities have been identified and the compliance program is being reviewed under the microscope of a cynical group of prosecutors or regulators . . . ." *Id.* at 259. Thus, when determining effectiveness of compliance programs, the industry standards and the regulators may be more important factors than the corporation which created the program. *See id.*

cost-benefit analysis conducted by management.[186] This does not necessarily mean that cost-benefit analysis should always be the sole determinant for compliance decisions.[187] To be candid, one-hundred percent compliance is not a realistic expectation for any compliance program in a complex organization. Human participation guarantees some degree of non-compliance. A more pragmatic goal for in-house counsel, and perhaps regulators, is to limit the amount of non-compliance occurrences substantially. In-house counsel are integral advisors to management in carrying out their oversight responsibilities in an ever-changing regulatory environment.[188] Assuming a company's general counsel has dual reporting responsibilities to both the CEO and the board of directors, in-house counsel are well-positioned to prevent managerial transgressions and expose flaws in a company's compliance systems. Donald Langevoort contends that managerial incentives may exist to implement less-than-perfect systems.[189] Cost is the most obvious incentive, but principal-agency issues are another plausible explanation.[190] For example, corporate scandals reveal how senior executives may conceal risky decisions and opportunistic behavior, keeping the board ignorant, to preserve their discretion. This scenario underscores the critical necessity for general counsels and in-house legal departments to foster an environment of ethical behavior, self-reporting, increased transparency, trust, verification, and active board engagement. A well-functioning compliance program coupled with competent in-house counsel can help constrain mana-

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[186] *See* Vincent Di Lorenzo, *Does the Law Encourage Unethical Conduct in the Securities Industry?*, 11 FORDHAM J. CORP. & FIN. L. 765, 766–67 (2006).

> The influence of cost-benefit evaluations on corporate behavior has been cast aside and, therefore, ignored under the Principles of Corporate Governance. However, the evidence strongly suggests that corporations are not ignoring cost-benefit evaluations when making decisions on legal compliance. . . . [C]orporate actors . . . view noncompliance with legal mandates as a reasonable decision.

Id.

[187] *See generally* SIDNEY A. SHAPIRO & ROBERT L. GLICKSMAN, RISK REGULATION AT RISK: RESTORING A PRAGMATIC APPROACH (2003) (discussing alternatives to pure cost-benefit approaches to decision making).

[188] *See* DeMott, *supra* note 10, at 965 ("[A] general counsel furnishes advice to senior management on major transactions or other situations. The general counsel's individual advisory role also encompasses discerning trends in the law and projecting their impact on the corporation. Under normal circumstances, the general counsel also furnishes legal advice to the corporation's board of directors."); *see also* Gantler v. Stevens, 965 A.2d 695, 709 (Del. 2009) (extending potential liability to non-director corporate officers such as general counsel).

[189] *See* Langevoort, *supra* note 102, at 957–58.

[190] *See id.* at 958.

gerial discretion and mitigate risk. Moreover, the presence of an internal emboldened whistleblower may alter internal decision-making and discussion as well as temper "fast and loose" approaches to legal compliance. Admittedly, circumstances may arise where a general counsel is ignored and even terminated because her position is at odds with senior managers. Yet, this is a risk general counsels and other in-house counsel must assume.[191] Professional integrity is non-negotiable.

In-house counsel perform both a routine monitoring (i.e., patrolling) and a crisis intervention (i.e., firefighting) function to promote compliance. In the former proactive approach, a well-positioned in-house counsel can be more effective in addressing compliance risks than simply operating from a defensive or firefighting posture; however, significant challenges remain. Despite the best initial intentions, organizational path dependencies may create additional compliance issues. For example, corporate compliance structures, once established, may become ineffective over time as an organization or its environment changes.[192] Managerial commitment to compliance may also shift over time as management pays attention to other issues. Change at this latter stage becomes much more expensive and "resisted for both economic and cognitive reasons."[193] Consider this basic illustration: Company X, a multinational conglomerate, acquires Company Y, a struggling petrochemical producer. Company X's management, at this juncture, is primarily concerned with cost-cutting measures, improving plant yields, layoffs, and increasing market share. Revamping compliance systems during this transition period, although important, is not the top priority. Here, in-house counsel can play a crucial role in mitigating legal risks and adapting compliance systems to a shifting business context and regulatory climate.

ii. A Pragmatic Perspective on Legal Compliance

The in-house counsel organizational experience illustrates the need for a pragmatic perspective on legal compliance. The proposition that corporations should comply with the law and regulations is

191 *See* Heineman, *supra* note 51.
192 *See* Langevoort, *supra* note 102, at 961 (asserting that the best structure for compliance shifts over time).
193 *Id.* at 959.

neither new nor controversial.[194] Excessive noncompliance creates negative externalities for third parties—as well as the corporation—in the short or long term.[195] Laws and regulations as well as commercial norms and culture create the box or environment within which the corporate entity functions. Yet commercial norms without legal intervention could have disastrous results as the following H.L.A. Hart comments reveal:

> [N]either understanding of long-term interest, nor the strength of goodness of will . . . are shared by all men alike. All are tempted at times to prefer their own immediate interests . . . . "Sanctions" are . . . required not as the normal motive for obedience, but as a *guarantee* that those who voluntarily obey shall not be sacrificed by those who would not.[196]

Conversely, commercial experience should, to a certain extent, inform legal structure. In-house counsel are keenly aware of this tension given their dual competencies. They are a pivotal force in ensuring that bureaucratic companies (i) act in accordance with relevant laws through their business activities,[197] and (ii) discourage business activity that might have the appearance of illegal or unethical conduct.[198] The presence of law is necessary for the firm to operate and

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[194] *See* E. Norman Veasey & Christine Di Guglielmo, *History Informs American Corporate Law: The Necessity of Maintaining a Delicate Balance in the Federal "Ecosystem,"* 1 VA. L. & BUS. REV. 201, 203–04 (2006) (providing a concise history of American corporate law). *See generally* Lucian A. Bebchuk, *Federal Corporate Law: Lessons from History*, 106 Colum. L. Rev. 1793 (2006) (discussing some of the federal interventions in corporate law over the past seven decades).

[195] When analyzing social problems, debate often focuses on the distinctions between market solutions and regulatory ones. Regulations are often deemed to impinge upon free markets and private contracting. Yet, when issues are framed in such a manner it distorts and underemphasizes the crucial role law or regulation plays in promoting freedom. *See* Joseph W. Singer, *Things that We Would Like to Take for Granted: Minimum Standards for the Legal Framework of a Free and Democratic Society*, 2 HARV. L. & POL'Y REV. 139, 141–42 (2008).

[196] H.L.A. HART, THE CONCEPT OF LAW 193 (1961); Williamson, *Opportunism*, *supra* note 5, at 98.

[197] *See* Chayes & Chayes, *supra* note 2, at 284, 287 ("By monitoring business activities . . . the legal department can determine whether regulatory requirements are understood and met. . . . The legal department bears primary, though not exclusive, responsibility for compliance efforts.").

[198] *See* DeMott, *supra* note 10, at 981 ("One function usefully served by counsel is acting as the CEO's 'conscience,' as a sounding board and source of sound judgment on questions in which ethical issues often shade legal determinations."); Geoffrey C. Hazard, Jr., *Ethical Corporate Counsel*, 46 EMORY L.J. 1011, 1021–22 (1997).

> The general counsel has made it clear . . . that his or her door is open for confidential discussion with any lawyer . . . who confronts an ethically troublesome situation. . . . The general counsel knows that being

function.[199] Nonetheless, there remains considerable skepticism among business people about the role of law and lawyers.[200] It often seems as if people "like the idea of law but shudder at the idea of being regulated."[201] Robert Clark reflects on the sources of business skepticism regarding legal compliance:

> Outside of litigation settings, one sometimes hears corporate managers and attorneys try to rationalize corporate noncompliance with regulatory statutes by complaining that the evil of fiduciary duties to shareholders made them do it. What they are complaining about, it seems to me, is not corporate law, which certainly does not tell them to break other laws in order to make their shareholders richer, but the unfortunate fact that if they do not take advantage of lax legal enforcement they may be ousted by aggressive managers who will.[202]

This anti-regulation rhetoric, however, does not comport with institutional reality where "state and federal statutes create a comprehensive network of regulations that set minimum standards for contractual relationships—minimum standards that we take for granted."[203]

A pragmatic approach to legal compliance falls within the ambit of what Robert Clark describes as "modest idealism."[204] The central premise of "modest idealism is that corporate managers should cause their corporation to comply with applicable laws and regulations even when noncompliance would increase the corporation's net present

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> open but tough-minded about ethical problems is much more effective than being sanctimonious.

Id.

[199] *See, e.g.*, Singer, *supra* note 195, at 141.

> [T]he liberty we care about includes just laws. The legal realists taught us that this truth also applies to the market. The free market is not the war of all against all; it is a zone of social life structured by law. The free market operates against a backdrop of regulations—regulations we too often take for granted.

Id.

[200] *See* Tom Alberg, *Cost, Quality: Concerns of In-House Counsel*, NAT'L L.J., Dec. 12, 1988, at 15; *see also* Lisa H. Nicholson, *SarbOx 307's Impact on Subordinate In-House Counsel: Between a Rock and a Hard Place*, 2004 MICH. ST. L. REV. 559, 597 (2004) ("[S]ome view the law as an enemy, or an obstacle to overcome in order to forestall 'the negative drag on profits' . . . . [C]orporations purportedly seek 'can do' individuals who can tell them 'how to do something,' not restrict their wants . . . .").

[201] Singer, *supra* note 195, at 140.

[202] CLARK, *supra* note 67, at 686.

[203] Singer, *supra* note 195, at 150.

[204] CLARK, *supra* note 67, at 684.

value."[205] Stated differently, managers should maximize long-term shareholder wealth subject to the constraint that the corporation meets its legal obligations. Modest idealism makes the constraint of legal compliance less discretionary. Under this approach, managers are not required to solely take into account cost-benefit analysis when deciding whether to meet legal obligations.[206] To do so would provide justification for non-compliers resisting regulation. A pure cost-benefit approach supports the view that companies should be able to make a rational decision to "roll the dice" where noncompliance is profitable and courts should not condemn such conduct.[207] To assess the efficacy of this approach, one need only consider the unfortunate situation where a board, upon undergoing a cost-benefit analysis, approves noncompliance with a regulation that later becomes disastrous for the implicated employees, shareholders, and corporate entity. Such a decision would run afoul of the current legal framework because an intentional board decision, if captured in a written record, could give rise to liability under *Caremark*.[208]

There are prudent reasons for adopting Robert Clark's so-called modest idealism approach to legal compliance, such as (i) reducing negative business side effects and curtailing negative externalities, for example, environmental pollution, health and safety to employees and third parties, monopolistic behavior, nuclear technology sold to terrorist organizations or rogue nations, and perhaps damage to a company's reputation that may impact stock price and brand equity; (ii) limiting transaction costs, for example, by internalizing law and regulations companies limit the costs of enforcement to regulatory authorities; (iii) creating a more predictable business climate; and (iv) enhancing the legitimacy of legal institutions, regulators, and re-

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[205] *Id.* at 684–85.

[206] *See id.* at 685–86.

[207] Under such circumstances, the corporation may opt to simply pay a fine. *But see* Nicholson, *supra* note 200, at 597.

> Others view the law as a 'neutral constraint,' whereby the general counsel's task is to objectively assess the risks and weigh the benefits associated with noncompliance, then to game the rules and work around the legal constraints. If some constraints are unavoidable, the lawyer will advise breaking the rules and paying the penalty if the client can still make a profit.

Id. *See generally* SHAPIRO & GLICKSMAN, *supra* note 187 (exploring decision-making alternatives other than cost-benefit analysis). Taking such an approach raises additional problems because there are asymmetric types of harm and costs at issue.

[208] *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996).

viewing courts.[209] This approach, however, is not above critique.[210] And the critiques may serve as exceptions that circumscribe the general rule. For example, one critique is that the line between legal and illegal conduct is not always black and white but often gray.[211] Moreover, regulations may lag behind industry advances and may not adequately address current or future circumstances, thereby leaving gaps and little real-time guidance for businesses.[212] These critiques, however, do not outweigh the benefits of the modest idealism approach to legal compliance. Here, imperfection is not synonymous with ineffectiveness.

Although the key concern of CLC is to prevent corporate activity that falls short of applicable legal obligations, it is also important to note that businesses may decide to act in a manner that exceeds existing legal requirements and employ best practices.[213] Other species of business risk, such as reputation and brand equity, may outweigh legal risks.[214] In this scenario, in-house counsel are in a special position to participate in a discursive process working within corporate teams and contributing to broader business strategies, thus assuring that le-

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[209] *See* CLARK, *supra* note 67, at 687–88.

[210] *See id.* The key arguments against the modest idealism approach are two-fold. First, modest idealism may lack workability because of problems related to collective action. *Id.* at 687. There will be free riders and others who shirk responsibilities to profit (prisoner's dilemma). In reality, companies may act with both modest idealism and calculating opportunism to compete. The second critique of modest idealism concerns the legitimacy of laws and regulations. *Id.* at 688. In other words, to what extent do such laws reflect optimal policy? The lawmaking process is imperfect. The public choice literature debunks the myth that regulation is costless and universally reflects the public interest. *See generally* JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY (1962). To the extent that companies have influence and an audience with legislators, the regulatory concerns of business are mitigated. *See* Jill E. Fisch, *How Do Corporations Play Politics?: The Fedex Story*, 58 VAND. L. REV. 1495, 1544–56 (2005).

[211] *Cf.* Veasey, *supra* note 176, at 13 (discussing the use of best practice guidelines by corporate officers and directors).

[212] *See generally* Orly Lobel, *The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought*, 89 MINN. L. REV. 342 (2004) (exploring the shift in legal thought about policy and regulating to a post-New Deal governance model of modern thought).

[213] *See* Heineman, *supra* note 51 (discussing how global company standards on issues may exceed legal requirements in certain jurisdictions).

[214] *See* Alice M. Tybout & Michelle L. Roehm, *Let the Response Fit the Scandal*, HARV. BUS. REV., Dec. 2009, at 82, 87–88.

gal risks are addressed and best practices are employed in the business process.[215]

b. Litigation

Although litigation is the largest legal service area outsourced to outside counsel, in-house counsel nonetheless play a significant role in the prevention or resolution of litigation matters.[216] Litigation has both a proactive (i.e., offensive and preventive) and a reactive (i.e., defensive and mitigation) dimension.

i. Proactive

Litigation has important instrumental functions. For example, litigation, or the threat thereof, can be used proactively for offensive and preventive purposes. Without resorting to the actual filing of a claim, the simple threat or prospect of litigation may be enough to influence cooperative behavior such as bringing a party back to the bargaining table or making concessions.[217] When threats alone are not sufficient, actual litigation may be necessary to promote business objectives and preserve corporate assets. For example, domestic manufacturers of commodities like steel and aluminum may bring actions under protectionist U.S. trade laws to limit industry competition from foreign producers of like or similar products.[218] Similarly, pharmaceutical and technology firms may vigorously implement an intellectual property strategy to preserve their investments in research and development as well as protect and facilitate the commer-

[215] *See* discussion *supra* Part IV.A.3.

[216] *See* Chayes & Chayes, *supra* note 2, at 291; Mary Thompson & Bridget Rienstra, *In-House Counsel . . . And the Preservation of Privilege*, HOUS. LAW., Jan–Feb. 1998, at 21, 21 (discussing the desire of a corporation facing litigation to have its in-house counsel take an active role in the investigation of the underlying facts).

[217] *See* Loukas Mistelis, *International Arbitration—Corporate Attitudes and Practices—12 Perceptions Tested: Myths, Data, and Analysis Research Report*, 15 AM. REV. INT'L ARB. 525, 553 (1996) ("[C]orporations believe that many contractual arrangements may be appropriate to explore the possibility of a negotiated settlement, or at least a cooling-off period of time, before the parties can resort to court or arbitration."). The mere threat of litigation may prove useful in inducing cooperation and accountability. *Cf.* Elaine Draper, *Preventative Law by Corporate Professional Team Players: Liability and Responsibility in the Work of Corporate Doctors*, 15 J. CONTEMP. HEALTH L. & POL'Y 525, 592 (1999) (discussing the health-care industry, but explaining that "[t]he threat of lawsuits tends to supplant strict regulation in many arenas and can be very useful in expanding individual accountability, getting companies to curtail hazardous conditions, and promoting beneficial social policies").

[218] *See* International Trade Administration Antidumping and Countervailing Regulations, 19 C.F.R. §351.101–215 (2010).

cialization of their products.[219] Here, litigation functions as one of the many instruments used to pursue a broader business strategy.

In-house counsel also add value by preventing costly litigation and regulatory exposure stemming from business activities.[220] This preventive approach engages in-house counsel in early business discussions and strategy sessions.[221] In-house counsel often help design compliance incentives that may decrease the required amount and cost of compliance oversight. This *ex ante* approach is more effective at controlling litigation and regulatory risks than a more reactive "firefighting approach."[222]

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[219] *See, e.g.*, Arti K. Rai et al., *Pathways Across the Valley of Death: Novel Intellectual Property Strategies for Accelerated Drug Discovery*, 8 YALE J. HEALTH POL'Y L. & ETHICS 1, 7 (2008); Dennis Fernandez & Mary Chow, *Intellectual Property Strategy in Bioinformatics and Biochips*, 19 SANTA CLARA COMPUTER & HIGH TECH. L.J. 491, 492–93 (2003).

[220] *See* Hazard, *supra* note 198, at 1021 ("The general counsel [in a well-run legal department] knows that early interception of legally improper conduct is much easier than cleaning up a mess after the fact."); Margaret Ann Wilkinson et al., *Mentor, Mercenary or Melding: An Empirical Inquiry into the Role of the Lawyer*, 28 LOY. U. CHI. L.J. 373, 379 (1996) ("Unlike the counselor-lawyer approach, no duty is imposed on the hired gun [outside] lawyer to ensure that the client's decision to litigate is a thoughtful one.").

[221] *See* Chayes & Chayes, *supra* note 2, at 280–81 (asserting that since internal corporate counsel have taken a preventative role, they are present as a matter of right at important business conferences).

> A major part of programmatic preventive law is the education of operating personnel whose daily duties and contacts determine the corporation's compliance . . . . By monitoring business activities, whether through limited, informal canvass, spot checks, or detailed and systematic audit, the legal department can determine whether regulatory requirements are understood and met.

Id. at 284.

[222] *See* Chayes & Chayes, *supra* note 2, at 281.

> The very existence of a properly established inside counsel pushes back the involvement of lawyers to an earlier phase of a transaction and shifts the mode from reactive to proactive. For example, when a corporation seriously contemplates an acquisition, the general counsel will participate in the early discussions, and will analyze, or engage outside counsel to analyze, possible legal complications—long before the deal is struck.

Id. See also Symposium, *Business Lawyering and Value Creation for Clients*, 74 OR. L. REV. 1, 9 (1995) [hereinafter *Value Creation Symposium*] ("Lawyers can often play a role in creating incentive structures that dampen the potential for opportunistic behavior. . . . [L]awyers can often create procedures and institutional structures that diminish the risks by either minimizing asymmetries or aligning incentives.").

ii. Reactive

Even where litigation, a compliance lapse, or crisis proves unavoidable, competent in-house counsel can be an invaluable corporate asset. In-house counsel can mitigate legal and non-legal business risks during times of crisis because they have the ability to recognize how the confluence of legal and non-legal risks impact broader business objectives. In responding to a crisis, in-house counsel do not operate within a vacuum. They interact with other functional units within the corporation, such as marketing and public relations, to address pressing issues. Discursive team interaction and decision making is important because a proper response may require a company to go beyond its legal obligations and take additional action to preserve intangible corporate assets such as customer goodwill, political capital, brand equity, and reputation.[223] Thus, in-house counsel, individually and as part of a team of internal decision-makers, are more likely aware of these additional factors that may require extra-legal responses.

The response to the 1980s Tylenol cyanide scandal is an example of a corporation taking extra-legal measures to preserve corporate value.[224] In that instance, McNeil Consumer Products, a subsidiary of Johnson & Johnson, knew that they were not responsible for the deaths of seven customers in the Chicago area but still exceeded their legal obligations by halting all advertising of Tylenol and recalling the product across the country.[225] These steps amounted to the destruction of twenty-two million bottles of product and a loss of approximately $100 million.[226] In addition, Johnson & Johnson president James Burke, assisted by general counsel, "initiated a company wide effort to recommit managers to its credo" which promises to "put safety above profit."[227] Despite the magnitude and expense of this crisis management response, it is regarded as a tremendous success and

[223] *See* Tybout & Roehm, *supra* note 214, at 86–88.

[224] *See* Steven Prokesch, *Tylenol: Despite Sharp Disputes, Managers Coped*, N. Y. TIMES, Feb. 23, 1986, at 1, 30; Peter Behr, *Corporate Character*, WASH. POST, Dec. 6, 1984, at D1.

[225] *See* Edward Walsh, *Tylenol Maker, Families Settle in Cyanide Deaths*, WASH. POST, May 14, 1991, at A3 ("[T]he settlement involved no admission of culpability by Johnson & Johnson or McNeil Consumer Products."); Prokesch, *supra* note 224.

[226] Paul Betts, *U.S. Group to Relaunch Tylenol Painkiller*, FIN. TIMES (London), Nov. 12, 1982, at 18; Jerry Knight, *Tylenol's Maker Shows How to Respond to Crisis*, WASH. POST, Oct. 11, 1982, at 1.

[227] Prokesch, *supra* note 224.

credited with preserving Tylenol brand equity and customer goodwill.[228]

Another example is the response of Odwalla, Inc. to a juice contamination crisis in 1996.[229] During this crisis, Odwalla recalled its product, implemented a public relations strategy expressing concern for consumers who had become ill, worked with federal authorities to identify the problem, and ultimately, resolved the problem by implementing a pasteurization process.[230] Odwalla attorneys worked closely with FDA officials to institute an innovative "flash pasteurization" process, which made the juice safer for consumers (i.e., eliminating *E. coli* bacteria) without compromising taste or quality.[231] These efforts helped reinstate consumer and investor confidence in the Odwalla brand.[232] The Odwalla experience reveals the benefits of a collaborative crisis response that combines public relations and legal strategies.[233]

These examples reveal the potential advantage in-house counsel may have when responding to a corporate crisis. Specifically, in-house counsel may possess a broader panoramic view of a crisis that extends beyond short-term legal and profit concerns. This capability is an important facet of the in-house counsel role.

c. Corporate Culture

Although there is no agreed upon definition for corporate culture,[234] the significant impact of in-house counsel on corporate cul-

[228] Oliver Moore, *For Companies, Surviving a Recall Crisis Takes Forthrightness*, GLOBE & MAIL (London), Aug. 26, 2008, at A9 ("The Tylenol case, which caused the product to vanish from the shelves, has become a textbook example of crisis management . . . ."). Not all attempts at crisis management prove successful. *See* Tybout & Roehm, *supra* note 214, at 86–88.

[229] *See generally* Kathleen A. Martinelli and William Briggs, *Integrating Public Relations and Legal Responses During a Crisis: The Case of Odwalla, Inc.*, 24 PUBLIC RELATIONS REV. 443 (Winter 1998).

[230] *See id.*

[231] *See id.* Furthermore, Odwalla attorneys took major steps to ensure compliance with the Hazard Analysis & Critical Control Points (HACCP) system the FDA mandates for juice pasteurization. *See "Freshology"*, ODWALLA, http://www.odwalla.com/Freshology.jsp (last visited Jan. 7, 2011); *Juice HACCP,* FED. FOOD & DRUG ADMIN., http://www.fda.gov/Food/FoodSafety/HazardAnalysisCriticalControlPointsHACCP/JuiceHACCP/default.htm (last visited Jan. 7, 2011).

[232] *See* Martinelli, *supra* note 229.

[233] *See id.*

[234] *See, e.g.*, TOYOHIRO KONO & STEWART CLEGG, TRANSFORMATIONS OF CORPORATE CULTURE: EXPERIENCES OF JAPANESE ENTERPRISES 23 (1998) ("First, corporate culture

ture is unquestionable.[235] Laws and procedures do not operate in isolation. Cultural norms may, in certain instances, constrain corporate misconduct better than external regulations.[236] In-house counsel of-

aids simplification and adaptation. It determines the best method of decisions. Second, it can foster affiliation and integration. It can replace more explicit and imperatively framed management processes. Third, it encourages member motivation and activation. Shared values explain the meaning of working."); Juan D. Carrillo & Denis Gromb, *Cultural Inertia and Uniformity in Organizations*, 23 J.L. ECON. & ORG. 743, 743 (2007) ("Despite its relevance, organizational culture remains rather ill-defined in economic theory. In fact, its resistance to a precise description is one of its rare uncontroversial attributes."); Geoffrey M. Hodgson, *Corporate Culture and the Nature of the Firm, in* TRANSACTION COST ECONOMICS AND BEYOND 249, 255 (John Goenewegen ed., 1996) ("Corporate culture is more than shared information: through shared practices and habits of thought, it provides the method, context, values, and language of learning, and the evolution of group and individual competences."); Donald C. Langevoort, *Opening the "Black Box" of Culture in Law and Economics*, 162 J. INSTITUTIONAL & THEORETICAL ECON. 1, 6 (2006) ("The primary role of corporate culture is to operate as a sense-making device that simplifies the cognitive tasks within the group or organization, creating a buffer that gives priority to that which facilitates cooperative exchange among agents of the firm over that which is distracting or anxiety producing."); Charles M. Yablon, *Corporate Culture in Takeovers*, 19 CARDOZO L. REV. 553, 553 (1997) ("By corporate culture, I mean that set of ineffable and hard to quantify variables like compatibility of management styles, strategic fit, and complementary approaches to employee autonomy and decisionmaking structures . . . ."); Shin'ichi Hirota et al., *Does Corporate Culture Matter? Evidence from Japan* 25 (Waseda Institute for Advanced Study, Discussion Paper No. 2008-001, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1118196 ("Corporate culture, often viewed as unobservable, ambiguous, and hard to measure by academics, is a crucial determinant of corporate policies and performance. Japanese companies have long been thought to have derived competitive advantages from the corporate cultures that they have developed."). Donald Langevoot further explains:

> First, culture plays a simplifying role by identifying perceptions and behavior that need not constantly be negotiated in the endless interactions among agents of the firm. Absent a strong mechanism for determining what can be taken for granted, far less productive work would get done in the firm." Secondly, these cultures "potentially add value, and should be seen as a counterweight to, not necessarily a manifestation of, group-level agency costs.

Langevoot, *supra*, at 5.

[235] Langevoort, *supra* note 234, at 81–82.

> One of the main objections to invoking corporate culture in rigorous legal analysis is that there is no clear definition of corporate culture. Ultimately, organizations are collections of individuals, who bring their own particular knowledge, preferences, and cognitive habits to work. Much socialization has occurred before any given person becomes part of the firm, and the boundaries between work and other spaces occupied by that person are blurred so that other cultural influences will constantly compete with corporate culture, even at work.

Id.

[236] *See* Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1737–38 (2001); *see, e.g.*, KONO &

ten serve as a sounding board for risk-prone ideas and, when appropriate, provide alternative options and opportunities for business clients.[237] When equipped with adequate organizational standing and management support, in-house counsel also may reinforce a sense of order, authority, and legitimacy to corporate activities.[238] In a sense, in-house counsel can function like a spiritual advisor, but not the sanctimonious variety.[239] Perhaps the greatest impact in-house counsel may have on the corporate organization is promoting a culture of legal compliance at the top, middle, and bottom rungs of the organization.[240] In-house counsel effectiveness both shapes and is shaped by corporate culture.[241]

CLEGG, *supra* note 234, at 13 ("Corporate culture integrates the behavior of organization members, enabling them to adapt to changes in their environment. A pattern of behavior also harmonizes behavior. It can thus replace formal rules."); Edward B. Rock & Michael L. Wachter, *Norms & Corporate Law*, 149 U. PA. L. REV. 1607, 1608 (2001) ("Norms may help explain the manner in which the law, in the absence of bright line rules, influences corporate governance. Norms may also explain why standards rather than rules work well in a corporate setting."). Miriam Baer discusses two different forms of governance, a classical approach, and a more modern form, in which businesses are "governed" by a dominant culture that encourages compliance. *See* Baer, *supra* note 11, at 543 ("Whereas the classical governance approach relies on a combination of institutional structures, incentives, and sanctions to deter wrongdoing . . . cultural governance theory relies on education, mediating institutions, and a more democratic workplace in which employees' comments are solicited and valued."). Rock and Wachter also explain, "[L]egal rules matter . . . not only in establishing the corporation's charter and bylaws, but also in setting standards of behavior for directors and executive officers. At the same time, corporate law is more a set of default and enabling terms . . . . [C]orporations can still follow their own norms and still do it 'right.'" Rock & Wachter, *supra*.

[237] *See* Schwarcz, *supra* note 173, at 495.

[238] *See id.*

[239] *See id.* (comparing in-house counsel, in their role as guides to understanding legal social order, to spiritual advisors). In-house counsel can prevent some situations which may create an unethical culture if left unattended. *See, e.g.*, Weaver, *supra* note 154, at 1035.

> [C]orporate counsel should ensure that their clients understand the steps . . . require[d] if an agent or representative of the client persists in taking an action that is "a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization."

Id. (quoting MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (1996)).

[240] DeMott, *supra* note 10, at 955–56.

> Positioned as an officer within a corporation, a general counsel who is an influential member of the corporation's senior management can help to shape its activities and policies in highly desirable directions, exercising influence that may extend well beyond the bare bones of ensuring legal compliance. A general counsel also may be uniquely well

There is not, however, a singular corporate culture. Instead, there may be a dominant (or core) culture, subcultures, and countercultures operating within the same organization. Anthropologists and sociologists first used the term "subculture" to describe culturally distinct communities that were part of larger societies.[242] In the corporate context, subcultures operate in a similar fashion within a broader dominant corporate culture.[243] Countercultures, on the other hand, are subcultures with norms and behavior at odds with the dominant corporate culture and are generally undesirable.[244] In-house counsel effectiveness may depend on what cultural category—dominant culture, subculture, or counterculture—legal compliance occupies and what category prevails in certain circumstances. In-house legal departments and other functional departments within an organization, such as finance and accounting, public relations, and

> positioned to champion a transformation of the organizational culture . . . .

Id.

[241] The addition of in-house legal departments encourages the formation of ethical cultures within organizations. *See* Baer, *supra* note 11, at 542 ("The creation of the organization's ethical culture is generated by the company's directors and officers . . . by its lawyers and accountants . . . .").

> [T]he corporate "tone at the top" that has, to date, most preoccupied the government is not the tone of transparency or procedural justice . . . management establishes with the company's employees, but rather, the 'tone' the company's general counsel adopts when he or she speaks with federal agents and prosecutors during the government's investigation.

Id. at 554.

[242] *See generally* J. Milton Yinger, *Counterculture and Subculture*, 25 AM. SOCIOLOGICAL REV. 625, 625–28 (1960).

[243] *See* KONO & CLEGG, *supra* note 234, at 13.

> [T]he greater the sources of differentiation between people, the greater the opportunities for subcultural formation . . . . The existence of subcultural groups may not necessarily be good or bad in its own right. In certain circumstances, such differentiation may lead to a fatal weakness of strategic resolve and purpose; in others, pluralism can be a source of great strength.

Id.

[244] *Id.* at 16.

> The 'counterculture' is a culture that articulates against the philosophy and the policies of the corporation. If the members believe that they should not try new things, because punishment will follow if failure results, or that they 'should not work hard, because it will result in lay-offs by increased efficiency,' they are members of a counterculture. Countercultures often find support in factors such as labor unions that are antagonistic towards the firm.

Id.

marketing, may form different subcultures, norms, and methods, but ultimately share in the broader corporate mission.[245] Although some observers contend that a homogenous corporate culture is preferable for transacting business,[246] a healthy mixture of the dominant culture and various subcultures is sometimes preferred.[247] Indeed, cultural heterogeneity may bring about additional costs, but these may be outweighed by the enhanced adaptive capabilities of a more heterogenous organization.[248]

Within the organizational context, managers at the top are crucial to the formation of healthy corporate cultures of legal compliance. But managers may also perpetuate harmful countercultures that lead to opportunism and other vices at odds with the dominant culture.[249] Nonetheless, the presence of an in-house legal department may embed and reinforce a culture of legal compliance or, at a min-

[245] *Id.* at 93.

> An example of the processes by which subcultures develop is the case where different goals are assigned to different departments as part of a common strategy, for instance, an organization might request the research department to develop a new shared basic technology thereby encouraging creativity, and simultaneously ask the development department to develop successful new products, thereby encouraging a customer orientation.

Id.

[246] Carrillo & Gromb, *supra* note 234, at 765 ("[A] more homogenous cultural structure provides the organization's agents with better incentives to undertake culture specific investments, which improves the organization's performance."). Carrillo and Gromb further state:

> In organizations in which multiple cultures coexist, agents have weaker incentives to undertake culture-specific investments. Conversely, cultural uniformity is more conducive to such investments. . . . [Therefore,] the gains associated with cultural diversity must be weighted [not only against the costs of restructuring but also] against the cost of reduced incentives.

Id. at 759.

[247] KONO & CLEGG, *supra* note 234, at 98 ("A desirable mixture of dominant culture and different subcultures is one that results in better performance by the organization and satisfaction of the members.").

[248] Carrillo & Gromb, *supra* note 234, at 759.

[249] *See* Douglas M. Branson, *Enron—When All Systems Fail: Creative Destruction or Roadmap to Corporate Governance Reform?*, 48 VILL. L. REV. 989, 991 (2003).

> Enron, our other governance imbroglios, the political and market reactions thereto and all the other fallouts have led to creative destruction of the 'winner's culture,' 'the good deal exemption' culture and the 'rising tide floats all boats' (and covers up mistakes and opportunism) culture. . . . Later in the 1990s . . . that culture constituted the real cancer in our system of corporate governance.

Id.

imum, influence corporate actors to consider the legal ramifications of their decisions. Legal observers who remain skeptical of the in-house counsel role in corporate governance need only ponder what corporate culture would be like in the absence of in-house counsel, with only rationally-bound, third-party gatekeepers, regulators, institutional investors, and other corporate constituents to rein in corporate opportunism.

d. Mediation

In-house counsel, particularly general counsel, may also perform an important function of mediating between different corporate constituencies to resolve internal corporate disputes.[250] In-house counsel are perhaps well suited for this function because they develop a broad panoramic view of corporate problems that extends well beyond provincial departmental concerns and legal expertise. In-house counsel integration with corporate activities makes such mediation possible.

C. Who are the Internal and External Beneficiaries of In-House Counsel Value?

The in-house counsel value inquiry extends beyond the mere question of how in-house counsel create value, to determining who are the beneficiaries of this value. The primary recipient of value provided by in-house counsel is the client corporation.[251] But in-house counsel generate significant transactional and non-transactional value, even if indirectly, for a broader set of internal (e.g., management, shareholders, and employees) and external (e.g., customers and government regulators) corporate constituents.[252] Failure to acknowledge how in-house counsel generate value for multiple corporate constituencies negatively distorts the analysis of in-house counsel impact.

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[250] *See* Veasey & Di Guglielmo, *supra* note 39, at 6.

[251] *See, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 1.13 (2007); *see also* Schwarcz, *supra* note 7, at 500 (describing the client corporation as the primary client for in-house and outside counsel).

[252] *Cf.* Gilson & Mnookin, *supra* note 146, at 7–10 (noting the various ways in which lawyers can create value by acting as "transaction cost engineers").

1. Internal Corporate Constituencies

a. Managers: Directors and Senior Executives

As a respected member of the management team, in-house counsel, acting as general counsel, keep managers abreast of legal risks throughout the organization.[253] Their intimate knowledge of the organization and legal acumen makes them an important part of the overall information flow within a corporation that assists corporate managers in carrying out their duties and tasks.[254] Although reporting structures across companies might vary, general counsel normally have multiple channels of formal and informal communication with senior executives and board members through the appropriate board committees.[255] Anecdotally, the growing number of general counsels ascending to the chief executive officer position is perhaps a reflection of the perceived value of in-house counsel expertise and experience.[256]

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[253] *See* DeMott, *supra* note 10, at 960 ("[C]ost pressures, standing alone, do not explain the enhanced prominence of general counsel as a member of senior management . . . . One explanation for general counsel's enhanced managerial stature is the nature of the advisory services that general counsel may provide . . . .").

[254] *See* Rosen, *supra* note 92, at 487 ("Inside counsel can use the information, organizational power, and trust they obtain from being part of the client organization to participate in corporate planning, anticipating legal problems and maintaining legal compliance."); Johnson & Garvis, *supra* note 12 (discussing the in-house counsel's role in advising managers on their fiduciary duties); ABA Task Force on Corporate Responsibility, *Report of the American Bar Association Task Force on Corporate Responsibility*, 59 BUS. LAW. 145, 161 (2003) ("Public corporations should adopt practices in which . . . [g]eneral counsel meets regularly and in executive session with a committee of independent directors to communicate concerns regarding legal compliance matters, including potential or ongoing material violations of law by, and breaches of fiduciary duty to, the corporation.").

[255] CAROL CREEL & JAMES R. HILTON, AM. CORP. COUNSEL ASS'N, SPECIAL REPORT: THE VIEW FROM THE TOP 8, 10 (2002).

> General counsel report to the company CEO in nearly three-quarters of the reporting companies. COOs, executive vice presidents, and CFOs manage general counsel in approximately 20 percent of the reporting companies.
>
> Virtually every respondent indicated that general counsel are considered to be among the top executives in their organizations; over 90 percent placed them among the top 10 executives.

Id. at 10.

[256] *See* Mark Curriden, *CEO Esq.*, A.B.A. J., May 2010, at 30, 30. (investigating why lawyers are being asked to lead some of the nation's largest corporations). As of May 2010, nine attorneys serve as CEO at Fortune 50 corporations: Brian Moynihan of Bank of America (J.D., Notre Dame Law School), David Dillon of Kroger (J.D., Southern Methodist University Dedman School of Law), Frank Blake of Home Depot (J.D., Columbia Law School), Edward Rust, Jr. of State Farm (J.D., Southern Method-

b. Shareholders.

In-house counsel promote long-term shareholder value in a number of ways.[257] Three important methods through which this value is achieved include (i) promoting economies of scale and scope, (ii) strengthening information economies, and (iii) minimizing agency costs.[258]

i. Economies of Scale and Scope

Generally, "[a]n economy of scale is the savings resulting from the greater efficiency of large-scale processes."[259] In-house counsel can achieve economies of scale and greater efficiencies compared to outside counsel especially through repetitive transactions (e.g., sales of commodities and licensing) and even major deals.[260] The exposure of in-house counsel to repetitive transactions and the business environment fosters the development of unique expertise and skills not readily available in the external marketplace at an acceptable price. These acquired skills and expertise can also promote economies of

ist University Dedman School of Law), Angela Braly of WellPoint (J.D., Southern Methodist University Dedman School of Law), C. Robert Henrikson of MetLife (J.D., Emory University School of Law), Lloyd Blankfein of Goldman Sachs (J.D., Harvard Law School), Jeffery Kindler of Pfizer (J.D., Harvard Law School), Jeff Smisek of Continental Airlines (J.D., Harvard Law School) and W. Bruce Johnson of Sears Holdings (J.D., Duke University School of Law). *See id.* at 35. Other notable CEOs who once served as general counsel or have legal backgrounds include: Gerald Levin of AOL Time Warner, Richard Parsons of Time Warner, Charles Prince formerly of Citigroup, Kenneth Chenault of American Express. *See* Mike France, *A Compelling Case for Lawyer-CEOs*, BUS. WK., Dec. 13, 2004, http://www.businessweek.com/magazine/content/04_50/b3912101_mz056.htm.

[257] In-house counsel create shareholder value by enabling corporations to take advantage of economies of scale and scope. *See Value Creation Symposium*, *supra* note 222.

> Many economic transactions in which lawyers play a critical role involve pooling the production or consumption facilities of different parties so that the unit cost will drop as a function of increasing volume or range of activities. Creating or preserving the structures that capture such economies is an important source of value creation.

Id.

[258] Shareholder value is created through in-house counsel's control of outside counsel billing procedures. *See* Rosen, *supra* note 92, at 511 ("Inside counsel certainly can play a role in keeping a rein on outside fees. They can explain to the corporation why more expensive lawyering is not necessarily better given their needs."). The examples below are mere illustrations and by no means an exhaustive list of in-house counsel value to shareholders. Moreover, the following examples may not exclusively benefit shareholders but may accrue to other corporate constituents.

[259] Schwarcz, *supra* note 7, at 506.

[260] *See id.* at 506–07.

scope.[261] Although similar to economies of scale, economies of scope generally pertain to the savings and efficiencies created by in-house counsel involvement in multiple corporate functions (e.g., compliance, risk management, government relations).[262] This may in part explain why the corporate compliance, human resources, and corporate secretary functions report to the general counsel in certain companies.

ii. Information Economies

In-house counsel enhance long-term shareholder value by promoting economies of information exchange that are an integral part of effective governance.[263] With access to internal control mechanisms as well as ongoing internal relationships, in-house counsel can gather information more efficiently and at a lower cost, allowing them to conduct more precise *ex ante* and *ex post* evaluations of corporate legal performance. Otherwise, the external acquisition of this information could be costly and increase veracity risks, where "information may be filtered and possibly distorted to the advantage of the [third party service] firm that has assumed the information collection responsibility."[264]

[261] John C. Panzar & Robert D. Willig, *Economies of Scope*, 71 AM. ECON. REV. 268, 268 (1981).

> Several years ago we coined the term 'economies of scope' to describe a basic and intuitively appealing property of production: cost savings which result from the scope (rather than the scale) of the enterprise. There are economies of scope where it is less costly to combine two or more product lines in one firm than to produce them separately. While the concept itself is not completely novel, especially since multi-product firms are the rule rather than the exception in our economy, we have attempted to make this terminology precise, both in common parlance and in theoretical analyses.

Id.

[262] Schwarcz, *supra* note 7, at 508–09.

> An economy of scope represents the savings resulting from having the same investment support multiple profitable activities in combination rather than separately. This hypothesis predicts that in-house counsel who are already familiar with their company's regulation and its organizational and operational structure may be able to achieve economies of scope by avoiding the learning curve of having to become educated about these matters.

Id.

[263] *See* Williamson, *Vertical*, *supra* note 8, at 113–14, 119–20.

[264] *Id.* at 120.

iii. Agency Costs

In-house counsel provide value to shareholders by mitigating two primary varieties of agency costs: (i) agency costs between management and ownership, and (ii) agency costs between the corporation and outside legal providers. With respect to the former variety, in-house counsel are important to helping managers (i.e., directors and officers) fulfill their oversight duties.[265] With respect to the latter variety, in-house counsel limit agency costs through practices such as monitoring and convergence.[266]

c. Employees

The presence of in-house counsel benefits rank-and-file employees in the sense that employees have a sounding board to discern the legal implications of their own conduct as well as that of others. Without the internal presence of in-house counsel, employees are left to make their own interpretations and justifications of appropriate conduct.[267] Under such circumstances, employees may simply co-opt the views espoused by superiors and more experienced co-workers.

2. External Constituencies

a. Regulators

In-house counsel perform an important internal regulatory function that consists of monitoring, formulating company procedures and policies, and enforcement.[268] This internal regulatory function lowers the monitoring costs for government actors.[269] In a sense, the

[265] *See* Schwarcz, *supra* note 7, at 505 ("According to this hypothesis, in-house counsel are in a better position than outside counsel to observe any misbehavior by company managers."); discussion *supra* Part IV.B.2.a.

[266] *See* Schwarcz, *supra* note 7, at 506 ("Being part of the client organization, in-house counsel can monitor outside counsel, 'question fees, deny disbursements, and insist on strict case management procedures.'") (quoting LARRY SMITH, INSIDE OUTSIDE: HOW BUSINESSES BUY LEGAL SERVICES 173 (2001)); *see also* discussion *supra* Part IV.C.1.b.iii.

[267] *See* Duggin, *supra* note 119, at 394 ("While the deference accorded to compliance advice from corporate counsel has undoubtedly increased in the post-Sarbanes-Oxley world, corporate lawyers, *especially in-house counsel*, must work hard to keep lines of communication with employees open.") (emphasis added).

[268] *See* Baer, *supra* note 11, at 525.

[269] Government officials can lighten the load for their regulators by merely encouraging cultures of corporate compliance. *See* Baer, *supra* note 11, at 547–48 (explaining that the government through policies and regulations, including the president through speeches, has encouraged companies to have higher ethical standards as well as effective compliance programs).

Federal Organizational Sentencing Guidelines, SEC up-the-ladder reporting regulations, and other federal regulations, with their emphasis on internal compliance programs, attempt to deputize, or at least acknowledge, the necessity of internal actors like in-house counsel in their attempts to promote law-abiding conduct.[270] Specifically, section 307 of the SOX Act addresses minimum standards for lawyers and part 205 of the regulations establishes more detailed requirements for when lawyers must report evidence of material violations up the corporate ladder and when they may report outside to the SEC.[271] There is a presumption that corporate compliance programs can more cheaply and effectively regulate corporate employees than external regulators who face information and resource constraints.[272] Without willing and competent in-house counsel, the efforts of regulators are, without question, less effective. The following statement by Senator John Edwards during the 2002 Sarbanes-Oxley debates on the Senate floor highlights this concern:

> The truth is that executives and accountants do not work alone. Anybody who works in corporate America knows that wherever you see corporate executives and accountants working, *lawyers* are virtually always there looking over their shoulder. If executives and/or accountants are breaking the law, you can be sure that part of the problem is that the *lawyers* who are there and involved are not doing their jobs.[273]

b. Customers

Customers, and society, also benefit from the presence of in-house counsel. Outside counsel are less likely to possess institutional history and industry knowledge that might mitigate against a sub-optimal course of action.[274] For example, in-house counsel with a panoramic view of company operations are more likely to consider other business concerns, such as customer goodwill, that may require company actions that exceed mere legal compliance with express

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[270] Arlen, *supra* note 101, at 835 (asserting that corporations are better suited than government to detect certain crimes); Baer, *supra* note 11, at 525–26 ("The in-house lawyers who supervise compliance programs are often referred to as '[p]rivate attorneys general.'" (quoting Lisa Kern Griffin, *Compelled Cooperation and the New Corporate Criminal Procedure,* 82 N.Y.U. L. REV. 311, 342 (2007))).

[271] *See* 15 U.S.C. § 7245 (2006); 17 CFR pt. 205 (2010) (implementing section 307 of the SOX Act).

[272] *See* Baer, *supra* note 11, at 525–26.

[273] 148 CONG. REC. S6524-02, S6551 (daily ed. July 10, 2002) (statement of Sen. Edwards) (emphasis added).

[274] *See e.g.,* Prokesch, *supra* note 224.

contractual provisions and looking beyond short-term profit declines.[275] In certain instances, in-house counsel are more likely to be non-adversarial and consider customer relationship concerns than their external counterparts.

V. IMPLICATIONS

In addition to providing a robust descriptive assessment of the in-house counsel role, our theory has important implications for corporate governance, the legal profession, legal education, and further research.

A. *Looking Inward: Corporate Governance from the Inside-Out*[276]

Our theory of the in-house counsel role has important normative implications for corporate governance. Namely, it highlights the need for legal scholars and regulators to look inward at internal governance mechanisms. In-house counsel function as a type of corporate governance mechanism to address agency cost problems, particularly corporate opportunism.[277] In the absence of opportunism, "all of the following would vanish: moral hazard, adverse selection, shirking, filtering, undisclosed subgoal pursuit, distortions, and all other strategic deceits."[278] Whereas other corporate governance mechanisms, such as shareholder voting, director independence, disclosure, and third-party gatekeepers, have all been explored by legal observers, the innkeeper inquiry is in its infancy.[279] The study of corporate governance, however, should not overlook or discount the influence of internal legal actors who implement law in a complex business en-

[275] *See* discussion *supra* Part IV.B.2.b.ii. Although not the focus of this article, in-house counsel also provide a valuable social function for non-profits and NGOs.

[276] Portions of this section were recently published in Omari Simmons, *Corporate Governance Reform as a Credence Service*, 5 J. BUS. & TECH L. 113 (2010).

[277] *See infra* app. fig.2; *see also* Williamson, *Opportunism, supra* note 5, at 97 (defining opportunism as "self interest seeking with guile."). Agency costs within a firm that might be characterized as a particular species of transaction costs are often ignored in the value-creation analysis. *See* Geoffrey Miller, *From Club to Market: The Evolving Role of Business Lawyers*, 74 FORDHAM L. REV. 1105, 1109 (2005) (discussing this omission in Gilson's model of attorneys as transaction cost engineers). Another shortcoming of the value-creation literature is that it often excludes self-interested conduct or opportunism from the transaction cost analysis. *See* STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 27 (2002) (asserting that in corporate law the greatest transaction costs are "uncertainty, complexity, and opportunism").

[278] Williamson, *Strategy*, *supra* note 5, at 1099.

[279] *See infra* app. fig.1.

vironment.[280] The role of in-house counsel is not simply to promote compliance with the law, but also to assist corporations with their broader objectives and strategies on an ongoing basis.[281] To be clear, a lawyer must understand the relevant business context in order to adequately detect and solve problems.[282] More than any other legal professionals, in-house counsel work from the frontlines of the business enterprise and, among lawyers, arguably have the greatest impact on corporate governance.[283] Whereas the legal literature often downplays the operational aspects of business enterprise, the theory articulated herein recognizes the routine functioning of business operations and context.[284] In-house counsel do not operate in a legal vacuum but must consistently weigh both legal and business concerns in a dynamic environment plagued with uncertainty. This dual competency enables in-house counsel to develop a pragmatic understanding of business strategies (both short term and long term), risk-management initiatives, global operations, and the relevant legal environment. Well-positioned innkeepers, especially when complemented by external gatekeepers, are an essential feature of healthy corporate governance in large corporate firms.[285]

1. Bias Versus Benefit

Legal observers often question whether a general counsel, who, in large part, is hired by the CEO, can exhibit the requisite independence to pursue the corporation's interests. Meanwhile, little attention is given to the various benefits in-house counsel generate. Mechanisms such as remuneration formulas emphasizing value-based

[280] Delaware courts only recently recognized that fiduciary duties attach to corporate officers in addition to directors. *See* Gantler v. Stevens, 965 A.2d 695, 709 (Del. 2009).

[281] *See* Derek Hayes, Consultant, Strikeman Elliot, Address at the Canadian Centre for Ethics and Corporate Policy: How do Ethical Standards Apply to In-House Counsel? (May 23, 2002) ("In addition to the opinions on legal questions, the lawyer may be asked for or expected to give advice on non-legal matters such as business, policy or social implications involved in a question or the course of action that the client should choose.").

[282] Dent, *supra* note 151, at 310.

[283] *See* Johnson & Garvis, *supra* note 12, at 1119.

[284] Moreover, there are significant differences across industries that may require different corporate governance mechanisms or a mixture thereof. The current financial crisis is a prime example.

[285] *See* Williamson, *Strategy*, *supra* note 5, at 1090 ("The efficacy of governance is thus jointly determined by local efforts (self-help to craft mechanisms) and as a function of the institutional environment (polity; judiciary; laws of property and contract).").

compliance metrics, restricted stock with holding periods, enhanced severance, and sign-on bonuses could be used to align in-house counsel interests with the corporation's, as well as embolden in-house counsel to police corporate opportunism. Even if one were to assume in-house counsel lack sufficient independence, they are not the only parties subject to bias. Just as internal corporate actors may be too close to problems to think critically about them and thereby prone to provincialism, lawmakers and other outside observers may rely on crude, readily available heuristics, such as share price, that do not provide adequate insight into the health of a corporate organization.[286]

Outside observers like regulators and third-party gatekeepers often, out of necessity, look at aggregated, readily available information, but may fail to adequately identify problems at an operational or micro level. Moreover, an outside regulator or gatekeeper's mindset may be at odds with internal corporate values that are important to the internal organization, like trust and loyalty.[287] Organizational theorists such as Oliver Williamson have touted the advantages of internal governance mechanisms such as access to internal machinery and information.[288] More recently, new governance theorists have articulated the advantages of decentralization, and more specifically, the principle of subsidiarity.[289] Orly Lobel describes the principle of subsidiarity:

> As a guiding principle of social organization, subsidiarity maintains that all governmental tasks are best carried out at the level closest to those affected by them. Central authorities should leave the widest scope possible for local discretion to fill in the details of broadly defined policies. Those closest to the problem possess the best information leading toward a potential solution. Therefore, the specific elaboration and application of common standards needs local knowledge to reach the desired objectives. Local entities are consequently understood to be more properly situated to manage functions by which they are affected than a dominant central organization [or regulator].[290]

[286] *See* Langevoort, *supra* note 49, at 807.

[287] Baer, *supra* note 11, at 535–36. *See generally* TAMAR FRANKEL, TRUST AND HONESTY: AMERICA'S BUSINESS CULTURE AT A CROSSROAD (2006) (discussing the abuse of trust and honesty in American society and the need for a cultural shift in American attitudes).

[288] *See generally* Williamson, *Vertical*, *supra* note 8; Williamson, *Strategy*, *supra* note 5.

[289] *See* Lobel, *supra* note 212, at 382.

[290] *Id.* at 398.

2. Harnessing In-House Counsel Expertise

The need for in-house counsel expertise is further underscored by the fact that the current capabilities of corporate regulators simply do not match those of the regulated. Existing reforms often lag far behind industry trends and transformations. Consequently, regulators are often regulating historic problems rather than current or future issues on the horizon.[291] Matching the capabilities of regulated entities and keeping up with all industry trends and transformations is perhaps too ambitious, but closing an unacceptable gap is not. To help address this gap, corporate lawmakers should harness internal industry expertise.

Lawmakers, by harnessing the internal expertise of in-house counsel in the design of corporate reforms, may (i) create a symmetrical de-biasing mechanism offsetting or countering predictable outsider biases;[292] (ii) prevent unintended consequences and promote more pragmatic, flexible, current, and forward-looking solutions; (iii) enhance the legitimacy of resulting reforms; and (iv) provide balance that may deter hasty decisions that are inconsistent with internal corporate norms and would dampen productivity, risk taking, and entrepreneurship.[293] Moreover, intimate knowledge of industry specific operational processes could assist regulators in prospectively identifying risky business practices and perhaps fraud.[294] Boosting the internal capabilities and industry specific expertise of regulators is not synonymous with regulatory capture or self-regulation; it is a necessary step to enhance lawmaker effectiveness. Our theory envisions a strong external regulatory presence but recognizes the limits of external mechanisms to adequately control corporate opportunism.[295] This approach also envisions a broader *ex ante* and *ex post* role for lawyers characterized by multi-disciplinary engagement and adaptation in diverse social arenas.[296]

[291] *See id.*

[292] Langevoort, *Human Nature*, *supra* note 49, at 807.

[293] *See* Baer, *supra* note 11, at 571.

[294] *See* Pamela H. Bucy, *Information as a Commodity in the Regulatory World*, 39 HOUS. L. REV. 905, 941 (2002) ("Knowledgeable insiders can identify abuses that public regulators do not even know to look for.").

[295] *See infra* app. fig.2.

[296] *See* Lobel, *supra* note 212, at 406.

Despite the aforementioned benefits, internal knowledge of operational practices is often taken for granted.[297] Some of the most prominent corporate scandals over the past decade have concerned operational issues that arguably could have been detected earlier or perhaps even prevented had regulators possessed intimate knowledge of corporate operations across industry sectors. Consider Eliot Spitzer's famed investigation of Citigroup and other Wall Street banks that unraveled abusive practices between equity research and investment banking units.[298] Here, operational cross-selling practices and conflicts figured prominently into the former New York attorney general's investigation.[299] More recently, AIG's operational practices involving the sale of largely unregulated credit-default swap derivatives to numerous counterparties not only subjected AIG to excessive risk requiring a federal bailout but also introduced significant instability into the broader financial system.[300]

The above examples illustrate the importance of internal operational knowledge and the information asymmetry that exists between regulators and internal corporate actors. Addressing this asymmetry requires ongoing interaction between lawmakers and internal actors such as in-house counsel. This type of interaction differs from stan-

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[297] For example, corporate finance, although important, is usually a means to achieving operational ends. Similarly, mergers are often conducted for operational benefits such as achieving economies of scale, expanding research and development, and boosting sales capabilities. *See* Alan A. Fisher & Robert H. Lande, *Efficiency Considerations in Merger Enforcement*, 71 CALIF. L. REV. 1580, 1599–600 (1983) ("[O]perating efficiencies such as those derived from economies of scale, resource allocation, technological complementarities . . . and various kinds of transaction-cost economies . . . [are likely to arise] from horizontal or vertical mergers . . . .").

[298] *See Citigroup Proposes Rules Limiting Conflicts*, L.A. TIMES, July 16, 2002, § 3, at 4 (reporting that Mr. Spitzer investigated analysts at Salomon and Morgan Stanley who tailored their public opinions of companies to win lucrative banking work for their firms). *See generally* BROOKE A. MASTERS, SPOILING FOR A FIGHT (2006) (providing detailed information about Spitzer's investigations into several corporations, including Citigroup).

[299] *See* MASTERS, *supra* note 298, at 262; Patrick McGeehan, *Spitzer Sues Executives of Telecom Companies Over 'Ill Gotten' Gains*, N.Y. TIMES, Oct. 1, 2002, at C1 (reporting that Mr. Spitzer prosecuted former top officials of five telecommunications companies for steering investment banking business to Citigroup in exchange for inflated ratings on their companies' stock and new shares of other companies).

[300] *See* Mary Williams Walsh, *A.I.G. Lists Firms to Which It Paid Taxpayer Money*, N.Y. TIMES, Mar. 16, 2009, at A1 (explaining that AIG's investments in subprime mortgages, credit default swaps, and other shaky loans exposed the company to high risk, and, when AIG's investments turned sour, the stability of the entire financial system was jeopardized).

dard lobbying, notice, and comment procedures.[301] Instead, the desired type of interaction is more discursive, continuous, cooperative, and interactive, where "[i]ndustry is expected to participate as part of a search for common goals, not just rigidly asserting its narrow economic or political interests."[302] This perspective finds theoretical support in transaction cost economics, organizational theory, cultural and norm-based theories of corporate governance, as well as new governance theories of institutional reform that promote decentralization, subsidiarity, and inside-out perspectives.[303]

In-house counsel are an essential facet of healthy corporate governance, and our theory of the in-house counsel role highlights the need to harness both internal and external expertise to achieve pragmatic corporate governance responses and reform. A more detailed analysis of the precise mechanism through which in-house counsel might interact with lawmakers and other corporate constituencies is beyond the scope of this Article; however, new governance theorists have articulated a range of alternatives, for example, various types of agency advisory groups.[304]

B. The Legal Profession

Our theory of the in-house counsel role has significant implications for the legal profession, particularly concerning the delivery of corporate legal services by both internal and external lawyers.

1. In-House Counsel

A greater corporate focus on the strategic in-house counsel role articulated herein will lead to enhancements in the reputation and status of in-house counsel within the broader legal profession, among academics, law firms, and judges. But most importantly, it will lead to more pragmatic and effective legal resolutions to business issues.[305]

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[301] *See generally*, Juan J. Lavilla, *The Good Cause Exemption to Notice and Comment Rulemaking Requirements Under the Administrative Procedure Act*, 3 ADMIN. L.J. 317 (1989) (discussing the possibility of reconciling case law and administrative action regarding the Administrative Procedure Act); Lobel, *supra* note 212, at 390.

[302] Lobel, *supra* note 212, at 377.

[303] *See, e.g.*, FRANKEL, *supra* note 287, at 152–60; Blair & Stout, *supra* note 236, at 1737–38; Frank B. Cross, *Law and Trust*, 93 GEO. L. J. 1457, 1495 (2005); Lawrence E. Mitchell, *Trust and Team Production in Post-Capitalist Society*, 24 J. CORP. L. 869, 869 (1999); Williamson, *Strategy*, *supra* note 5, at 1090 (discussing the efficacy of joint internal and external governance); *see also* Lobel, *supra* note 212, at 382.

[304] *See generally* Lobel, *supra* note 212.

[305] *See* discussion *supra* Part IV and V.A.

As Ronald Gilson acknowledges: "For those concerned about the future of the professional project, the growing prominence of inside counsel within the profession, reflecting their market power, is not a threat but an opportunity, perhaps our only one."[306] These advancements, however, are conditioned on the presence of the following two factors: (i) a shared understanding between management and in-house counsel as to the latter's role, and (ii) lawyer competence.

a. A Shared Understanding Between Management and In-House Counsel Concerning the Latter's Role

If in-house counsel are to provide the valuable role described above, the corporation, particularly management, must grant in-house counsel the freedom to exercise objective and balanced judgment. On the other hand, if management views in-house counsel as a "rubber stamp," "a necessary evil," or an "internal police force obstructing business," significant value will be lost and management pressure may potentially distort lawyer judgment. The critical factor here is not independence *per se*, but rather a shared understanding between corporate management and in-house counsel as to the latter's role. This understanding can be reinforced through appropriate internal mechanisms such as remuneration formulas that emphasize key metrics developed to enhance value creation. Effective reporting relationships are also critical. The general counsel must report to the board of directors or, at least, the CEO. Anything less than this will inhibit the functioning of the value-creation attributes that are vital to in-house counsel effectiveness.[307]

b. Competence

Management's endorsement of the in-house counsel role is necessary but not sufficient. It is absolutely essential that in-house counsel behave and are perceived to behave in ways that justify their presence. This is largely a question of competence. If in-house counsel are, in fact, simply failed or second-rate private practitioners, as observed in the opening paragraph of this Article, there is little hope that they will be capable of fulfilling the complexities of their

[306] Gilson, *supra* note 5, at 916.

[307] *See* Sue Reisinger, *Talk to Me: Bank of America GC Now Reports to CEO as Part of Shake Up*, CORP. COUNS., Jan. 14, 2010, http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202437913504&Talk_to_Me_Bank_of_America_GC_Now_Reports_to_CEO_as_Part_of_ShakeUp (describing a situation where it was important for the general counsel to report to the CEO).

value-creation role. As previously mentioned, the skills needed for the in-house role, whether at the general counsel level or at other organizational levels, are not the same as those required of outside counsel, and therefore, require additional development and training. With enhancements in the reputation of in-house counsel coupled with economic factors, one might expect barriers to recruiting highly competent in-house lawyer staff to diminish. The ability to recruit highly competent in-house lawyers could be a function of a number of corporate factors, including the reputation or financial health of the company, the remuneration structure, work-life balance, and the overall career path offered. Historically, high caliber lawyers may have perceived the options offered by outside law firms, including better remuneration, the degree of challenge, specialization in the legal work, and reputational enhancement, as more attractive. Today, however, companies often offer in-house lawyers compensation packages, particularly stock options and other risk and reward incentives, which make the compensation for in-house lawyers quite competitive without demanding the type of client development work that outside lawyers practice incessantly. In light of the current economic climate, in-house legal departments are becoming an even more attractive career choice due to their work-life balance and focus on value rather than billable hours.[308]

2. Outside Law Firms

Our theory of the in-house counsel role also has several implications for external legal service providers, but the most important among these are enhanced competition for client business and legal personnel, greater corporate client emphasis on value creation, and trusted partnerships with outside law firms. The days of the "bespoke" lawyer with bargaining power over the corporate client are numbered.[309] Corporate clients focused on value creation are requir-

[308] *See* Alex Williams, *No Longer Their Golden Ticket*, N.Y. TIMES, Jan. 15, 2010, at ST1.

[309] Wilkins, *supra* note 6, at 727 (quoting RICHARD SUSSKIND, THE END OF LAWYERS? RETHINKING THE NATURE OF LEGAL SERVICES (2008)); *see also* Larry E. Ribstein, *The Death of Big Law*, 2010 WIS. L. REV. 749, 760 (2010).

> [T]he alternative to buying outside is 'making' in-house—in this case by hiring in-house counsel to provide direct legal advice and information about outside lawyers. When clients have the technical expertise to dispense with specialists and can figure out on their own which individual lawyers are reliable and meet their specific needs, they will have less need to buy outside legal services based on personal relationships with individual lawyers or to rely on a stable of 'preferred provider' Big

ing even greater oversight of their outside legal providers as well as encouraging the adoption of value-based metrics and internal controls by once poorly managed outside law firms.[310] Innovations such as law firm partnering and convergence can be viewed as attempts to extract more value from outside firms via more ongoing, mutually beneficial, relationships that provide greater opportunities for law firms to develop more in-depth knowledge concerning the client's business.[311] Similarly, David Wilkins posits that the traditional "agency model is no longer a helpful template for understanding the relationship between corporations and their outside [law] firms."[312] Instead, Wilkins identifies a current trend toward client relationships resembling strategic alliances that corporate clients share with other types of suppliers.[313] Today, the relationships between in-house counsel and outside counsel are less adversarial, and the trend is toward viewing outside law firms more as trusted partners and extensions of the internal corporate legal function.

C. *The Legal Education Project*

The above examination of in-house counsel raises an important question concerning the appropriate role of legal education. Namely, does (or can) legal education provide appropriate training for in-house lawyers? The traditional legal education model has been criticized for its narrow focus.[314] Indeed, changes are needed and being made to provide students with a broader view of the legal profession and practice by encouraging students to think like lawyers and function as lawyers. Legal observers have recommended different ap-

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> Law firms. The increased role of in-house counsel is therefore a significant threat to Big Law.

Id.

[310] *See* Elizabeth Chambliss & David B. Wilkins, *The Emerging Role of Ethics Advisors, General Counsel, and Other Compliance Specialists in Large Law Firms*, 44 ARIZ. L. REV. 559, 565–69 (2002) (discussing the development of ethics compliance specialists in law firms); Elizabeth Chambliss, *The Professionalization of Law Firm In-house Counsel*, 84 N.C. L. REV. 1515, 1551–76 (2006).

[311] *See* THE NEW REALITY: TURNING RISK INTO OPPORTUNITY THROUGH THE DUPONT LEGAL MODEL 2 (Silvio J. Decarli & Andrew L. Schaeffer eds., 5th ed. 2009). DuPont was one of the first companies to take this direction and a large number of companies have followed. Wilkins, *supra* note 6, at 695.

[312] Wilkins, *supra* note 6, at 672–73.

[313] *See id.*

[314] *See generally* WILLIAM M. SULLIVAN ET AL., EDUCATING LAWYERS: PREPARATION FOR THE PROFESSION OF LAW 186 (2007) (suggesting improvements in legal education). Portions of the book are available at http://www.carnegiefoundation.org/sites/default/files/publications/elibrary_pdf_632.pdf.

proaches to educating business lawyers.[315] These observations are instructive but not definitive. Observers such as Ronald Gilson contend that the interdisciplinary aspects of business lawyering require a greater emphasis on finance, transaction cost economics, and skills courses such as drafting and negotiation to prevent lawyers from being displaced by other service providers.[316] Other legal observers have taken the position that law schools on their own are not well positioned to provide the technical level of knowledge business lawyers need to be at the forefront of their profession.[317] But not all observers view the case method and legal focus as ineffective training. Steven Schwarcz highlights the value of applying legal concepts to real world problems through the case method.[318]

To a degree, all of the above proposals have merit, but one cannot discount the enduring value of "real" experience to hone valuable innkeeper skills that have both behavioral and technical dimensions. Experience and expertise are not necessarily the same.[319] The strategic in-house counsel role adds value precisely because it is fundamentally different from the largely tactical role of outside law firms. Legal education must recognize this reality and provide foundational academic instruction as well as training for the in-house counsel role.[320] These steps have the potential to significantly enhance the competence and reputation of in-house counsel.

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[315] *See* Dent, *supra* note 151, at 318; *see also* Ribstein, *supra* note 309, at 814.

> The use of law in finance, the increasing importance of in-house counsel, lawyers' increasing roles within businesses, and the combination of law with other types of expertise, among other developments, create a demand for lawyers who can function within business rather than just delivering technical legal advice from the outside. Law school therefore may need to offer more business background in both advanced seminars and basic courses like business associations, securities regulation, antitrust, and bankruptcy.

Id.

[316] Gilson, *supra* note 23, at 301–05.

[317] Roberta Romano, *After the Revolution in Corporate Law,* 55 J. LEGAL EDUC. 342, 352–53 (2005).

[318] Schwarcz, *supra* note 173, at 507–08; *see also* Dent, *supra* note 151, at 286; Karl S. Okamoto, *Teaching Transactional Lawyering*, 1 DREXEL L. REV. 69, 109–11 (2009).

[319] Lobel, *supra* note 212, at 454 (explaining the distinction between experience and expertise and the limits of the latter).

[320] *See generally* SULLIVAN ET AL., *supra* note 314.

D. Further Areas for Research

Historically, the in-house counsel role has been under-theorized in the legal literature. A key goal of this Article has been to advance the discussion concerning the in-house counsel's rise to prominence—an area that remains ripe for further scholarly exploration. Further research of the in-house counsel role may explore issues such as (i) factors influencing in-house law department effectiveness; (ii) qualitative assessments of in-house counsel professional identity; (iii) the use of incentives, such as remuneration to embolden and align in-house counsel interests with those of the corporation; and (iv) improved metrics for assessing in-house counsel impact on corporate entities and external constituencies. The issue of improved in-house counsel value metrics is particularly important to our theory. As the above discussion illustrates, in-house counsel generate value in myriad ways that are both tangible and intangible. Yet the preventive aspect of the in-house counsel role, at times, makes the measurement of in-house counsel value akin to measuring anti-terrorism efforts. Simply viewing in-house counsel efficacy from the perspective of whether there has been a scandal, a mishap, or mistake does not adequately capture the benefits of in-house counsel value creation. Instead, meaningful in-house counsel value metrics, even if indirect, should be empirically studied across companies and industries. The results of this exercise could lead to the development of metrics that better align with in-house counsel value creation.[321]

Ultimately, further study of the in-house counsel role is important because it has the potential to advance the understanding of modern corporate governance, provide novel insights concerning the efficacy of legal education, and illuminate key trends and transformations in the legal profession. In-house counsel will inevitably be at the forefront of key legal and business developments for years to come generating greater attention from legal observers.

[321] Such metrics are likely to differ depending on the particular source of value (e.g., compliance, litigation, commercial transactions) and can be objective, subjective, tangible, or intangible. For example, in the compliance arena, a company might measure how many training sessions and audits are conducted as well as how many issues are averted through whistleblowers. Meanwhile, in the commercial transaction context, companies may balance objective criteria such as the number or size of transactions with subjective feedback from business clients to gauge value.

APPENDIX

Figure 1

THREATS TO CORPORATE VALUE

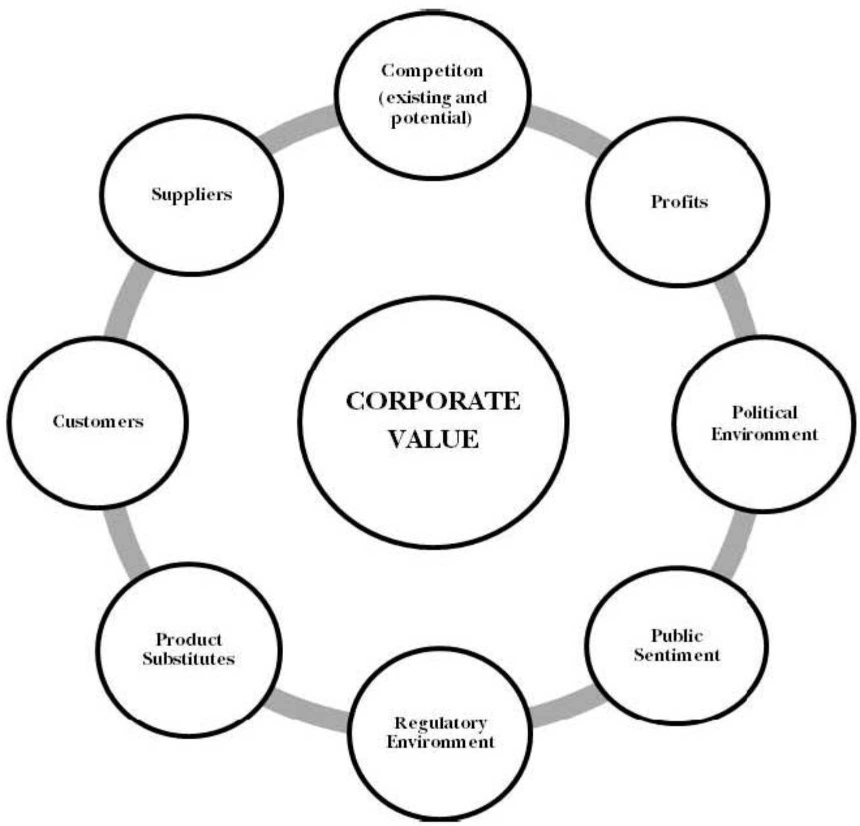

Figure 2

CORPORATE GOVERNANCE MECHANISMS