

The Chief Legal Officer as the “Indispensable Counsel”: 20 Years After Sarbanes-Oxley— Best Practices Are Clear, If Not Always Adopted

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The “indispensable” role of the chief legal officer (CLO) should be recognized by boards and senior executives as a foundational attribute of an effective corporate leadership team for the health care company.

The concept of the CLO as an “indispensable” corporate officer is one of the most material legacies of the Sarbanes-Oxley era. It is reflected in a series of best practices relating to the structure and authority of the position, its enhanced ethical responsibilities, and expectations of related board oversight. Corporate leadership that fails to embrace these practices places the health care organization at risk of being perceived as an outlier—with attendant concerns.

This 20th anniversary year of the Sarbanes-Oxley Act provides a timely opportunity to revisit the role and function of the CLO position and its organizational and leadership importance. The timeliness is underscored by (1) the changes to the board/management/CLO dynamic arising from pandemic challenges, and (2) the looming retirement of many CLOs who were in active practice during the Enron/Sarbanes era with their valuable historical recollection; a recollection that could otherwise be lost to members of the legal department.

Effective promotion of the “indispensable” nature of the CLO requires a combination of factors: historical perspective, awareness of related best practices, recognition of continuing pressures on the position,

and the board’s obligation to support the position’s effectiveness.

Roots of the Indispensable Counsel

The description of the CLO as “indispensable” has its roots in the eponymous 2012 book written by the well-known former jurist E. Norman Veasey and his colleague, Christine Di Guglielmo.¹ The authors described three specific elements that have combined to transform the role of the CLO: (1) the dynamic increase in the challenges and pressures faced by CLOs in recent years; (2) the “dramatic and ongoing changes” over time in the complexity of the corporate and legal environments; and (3) the substantial impact of the global economy on business realities.

The authors identified a variety of factors contributing to the characterization of the CLO as “unique” among corporate officers, including (1) the special combination of legal, business, and leadership skills expected of the CLO; and (2) the relationship of trust and confidence the CLO engenders with members of the senior business team (i.e., as both business partner and “guardian of the corporate integrity”). Similar factors have also been cited in recent years by prominent corporate law thought leaders such as Ira Millstein and Ben Heineman, Jr., and by the American Bar Association.² They offer a shared perspective of the CLO as technical expert, wise counselor, and business partner to management.



Elements of “Indispensability”

These and other leading observers view the CLO’s indispensable nature as grounded in her special responsibility to balance the perspectives of the various corporate constituencies while focusing on serving the best interests of the corporate client.

To effectively manage this organizational “balancing act,” the CLO is expected to possess a unique collection of capabilities: (1) high-level technical legal skills, (2) a counselor’s wisdom and judgment, (3) leadership posture, (4) independence, and (5) unquestioned integrity.³

In conducting this “balancing act,” the CLO performs as what Ben Heineman has referred to as the “lawyer-statesman.”⁴ The CLO addresses not only the “is it legal?” question traditionally expected of the lawyer, but also the more cosmic questions of “is it right?” and “what ought to be?” It is a role that involves shared responsibility for not only the corporation’s legal matters, but also for the development of its position on such critical issues as “ethics, reputation, public policy, communications, corporate citizenship, country, and geopolitical trends.”⁵ As a result, it extends the profile of the CLO from simply the technical expert to wise counseling and leadership roles, which are grounded in practical experience and judgment more than simply technical expertise.⁶

These unique skills are particularly necessary when the CLO is called upon, as a guardian of corporate integrity, to help ensure the proper “tone at the top”—i.e., the commitment of the board and senior management to compliance with the law while pursuing the long-term business interests of the corporation.

The CLO’s unique responsibilities also arise from the dual-reporting relationship: on the one hand, reporting to the chief executive officer (CEO) within the context of the management hierarchy; and on the other hand, a duty to report to and advise the board of directors. This dual relationship is the source of no small amount of tension for the CLO, as boards of directors seek to assert the level of independence from management that is a tenet of corporate responsibility. A tall order, indeed.

The Impact of the Enron Environment

The enhanced status of the “indispensable” CLO is primarily a response to the marginalized role of in-house counsel that contributed to the corporate scandals of the Enron era, which in turn led to the enactment of Sarbanes-Oxley and the resulting emphasis on corporate responsibility.

A common thread of these scandals was a culture in which the legal function “was less influential and

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less welcome than in a healthy corporate environment.”⁷ In many instances, the legal officers were not considered part of the senior executive leadership team and dealt with the CEO “only when [the CEO] felt it was necessary.”⁸ Furthermore, management-to-board reporting suffered when CLOs were forced to “pull their punches” on significant corporate risks for fear of inciting an abusive and intimidating response from the CEO.⁹ They were also often limited by lack of contact with senior management, lack of involvement in the inner workings of management, and inadequate support from senior management.¹⁰

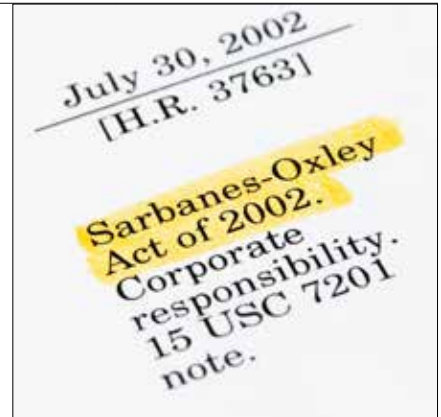
None of the investigative reports concluded that lawyers were complicit in or knowledgeable of the fraud that doomed the company. Yet all such reports documented structural problems and deficiencies within the company’s legal department that contributed to a corporate culture where such fraud could occur, i.e., “a virtual complete breakdown of proper corporate governance principles.”¹¹

A contributing factor to these scandals was how the pressure to keep or maintain business (by outside counsel) or the desire to advance within the corporate executive structure (by inside counsel) could “induce lawyers to seek to please the corporate officials with whom they deal rather than to focus on the long-term interests of their client, the corporation.”¹²

These and other systemic failures prompted the American Bar Association, and other bar groups, to propose a series of recommendations intended to revise and redefine the sensitive and critical role of legal counsel in the area of corporate governance, and also as it relates to its hierarchical organizational position. The recommendations were grounded in a view that an enhanced and empowered CLO position is critical to assuring that all of the participants in governance “act vigorously” in the best interest of the corporation and are empowered to exercise their responsibilities effectively.¹³

Recognized Best Practices

The recommendations have subsequently been accepted by a large part of the legal and governance communities and, with certain refinements, form the basis of many of the “best practices” and related principles currently associated with the CLO position.



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They include, but are not limited to, the following:

- ▶ The individual holding the position of CLO possesses the experience and temperament necessary to perform the responsibilities under the particular corporate circumstances.
- ▶ The board receives periodic education on the nature of the CLO role as counsel to both the board and the corporation (acting through management).
- ▶ The CLO holds a senior, influential hierarchical position within the organization (e.g., equivalent to that of the chief financial officer (CFO)).
- ▶ The CLO's job description includes the role of promoting compliance with the law and ethical standards.
- ▶ There exists a formal internal expectation that the CLO is to alert the board and executive leadership to potential major violations of law and reputational damage.
- ▶ The CLO must be provided the resources and authority necessary to perform its stated role.
- ▶ There is public acknowledgment within the organization of the CLO's role as a valued business partner to management.
- ▶ The board has a formal role in ratifying the hiring, compensation, and termination of the CLO.
- ▶ There is a reporting relationship from the CLO to either the CEO or, in limited circumstances, the chief operating officer.
- ▶ The CLO has direct access to the board and executive leadership in order to provide timely information on legal concerns.
- ▶ The CLO has access to, and can collaborate with, other corporate executives with risk, audit, and compliance portfolios.
- ▶ The CLO has a standing invitation to attend all meetings of the board and its key committees.
- ▶ The CLO is periodically invited to participate in executive session meetings of independent directors.

- ▶ Effective reporting relationships exist between the CLO and the in-house counsel assigned to corporate subsidiaries.
- ▶ There is formal participation by appropriately senior in-house counsel in board, committee, and management meetings relating to risk, legal, or compliance matters.
- ▶ Members of the internal legal team are specifically identified as contacts to whom employees may confidentially address concerns.
- ▶ Compensation of the CLO is not determined in a way that might reasonably be considered to compromise the independence of its legal advice.
- ▶ The CLO is responsible for the effective structuring and administration of the office of legal affairs.
- ▶ The CLO has the ultimate authority to engage and define the roles of external counsel to be hired by the company.

All leadership constituencies within the corporation are advised that the professional obligation of the CLO is to represent the interests of the corporation, acting through its recognized constituencies and not the constituencies themselves.¹⁴

The Corporation as the Client

Closely related to these best practices are amendments to state bar rules of professional conduct intended to underscore the "bedrock principle" that the corporate lawyer's responsibility is to the corporation (as opposed to the board of directors, officers, or other corporate agents with whom they ordinarily communicate in connection with their representation of the corporation).¹⁵

These amendments, enacted over the years since Sarbanes, address the lawyer's critical obligation of confidentiality and ability to communicate upstream to higher corporate authorities. They are intended to clarify the role of lawyers in facilitating the flow of legal compliance-related information within their client corporation and lessen the restrictions on the lawyer's ability to disclose to third parties with respect to criminal or fraudulent client conduct.¹⁶

The Continuing Relevance of Indispensability

While corporate issues and controversies have certainly evolved with the passage of time, the indispensable nature of the CLO role has similarly evolved. The CLO's role at the intersection of constantly changing corporate activity continues to reaffirm the CLO's key strategic capacity.

This is particularly the case as the business model of the health care sector has undergone a dramatic reconstruc-

tion driven by the pandemic demands and changing consumer focus. The extraordinary combination of continued industry consolidation, transformative technology, business disruption, and changes to the health care delivery system is creating health care companies of unprecedented size and operating sophistication. It requires a CLO who can “see the whole field,” i.e., can access necessary information and institutional knowledge, promote internal action, supervise outside counsel, and support compliance with applicable law.

This evolution and continued indispensability of the CLO role is underscored by the results of the 2022 edition of the Association of Corporate Counsel’s annual Chief Legal Officer survey.¹⁷ Its results show that in addition to managing the legal department and providing legal advice (which represents on average half of the CLO’s time), the CLO is also tasked with overseeing other critical business functions. These include most prominently corporate compliance, ethics and privacy, and business risk. The survey notes that out of 21 different business functions, more CLOs have direct oversight over 18 of these functions than they had in 2020.¹⁸

CLO oversight of environmental, social, and governance (ESG) issues is particularly demonstrative of its evolving role; the survey notes that nearly one-quarter of CLOs are now responsible for ESG, up nine percentage points from 2020.¹⁹

There’s Still Work to Be Done

Certainly, enormous strides have been made in the last 20 years in terms of embedding principles of corporate responsibility within the halls of corporate leadership and supporting the efforts of the CLO in connection with corporate governance and advice to executives on matters of legal and operational risk. Many of the Enron/Sarbanes-era lessons are well-established in the C-Suite. And, as recent surveys confirm, many of the leading best practices as to the office of the CLO have been widely adopted.

Yet, these surveys (and practical experience) suggest that there’s additional work to be done as to the CLO’s indispensability. For example, those same recent surveys reflect several disconcerting factors:

- Of those CLOs who do not report directly to the CEO, a disconcertingly high percentage (47%) report to the CFO, contrary to established governance principles.
- A surprisingly high percentage of CLOs (40%) still do not possess a reporting relationship with the board of directors, precluding the board from having ready access to its legal counsel.
- Less than 25% of surveyed CLOs have responsibility for ESG matters, despite increasing evidence that speaks to the qualifications of the CLO for that role.

- Of those CLOs who regularly attend board meetings, the percentage of those who have additional, significant contact with board and executive leadership (e.g., meet with/are sought out for advice by business leaders on risk and operations, who participate in executive sessions or otherwise have access to board members) is static if not declining when compared to 2021 survey results.

A closer look at the survey data also suggests that the concept of CLO as strategic counselor to management is not as widely accepted as one would normally expect. That’s particularly puzzling. Leading governance observers have long described the CLO as functioning “in a strategic capacity . . . at the intersection of most corporate activity.” This, in turn, affords the CLO “(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 preventative law.”²⁰

Indeed, there may exist a certain, small class of CEOs who truly reject the concept of the CLO as a strategic partner; who don’t see the CLO as worthy of a senior position within the executive leadership team; who view the CLO as “just another technical advisor”; who aren’t inclined to allow the CLO access to the board.

And no matter the emphasis on corporate responsibility, there will always be some executives who are openly hostile to legal advice or manifest a culture that marginalizes by personal intimidation the value and advice of the CLO and other key risk-oriented corporate officers.

In these and similar situations, the responsibility rests with the board of directors to rectify dissonance and assure operation of the CLO function in a manner consistent with best practice.

The Board’s Critical Oversight Role

It is undisputed that the company’s CEO will (in most instances) be the corporate officer who has hired the CLO and is the executive officer to whom the CLO typically reports. While the corporation is the CLO’s client, the CEO is the corporate executive constituent with whom the CLO has the most direct contact. The CLO is a member of the senior leadership team selected by the CEO and thus is expected to maintain an effective working relationship with the CEO and the other members of that team.

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But as mentioned above, the CLO also reports to the board of directors and serves as its principal legal advisor, especially with respect to the performance of the board's responsibilities and the exercise of its fiduciary duties. And from a corporate responsibility perspective, one of those critical duties is the oversight of the corporation's legal affairs. The exercise of active, independent, and informed oversight of the corporation's business affairs depends partly on the effectiveness of corporate legal function and the support it provides to the board in its efforts to act in the corporation's best interests.²¹

The board can best exercise this oversight responsibility through policies that allow it to approve or otherwise be engaged with decisions concerning the hiring, compensation, and termination of the CLO. They should also be involved with policies that call for the CLO to regularly attend board and key committee meetings, have regular access to the board chair, and participate in executive session meetings of independent directors, contributing significantly to effective oversight.

Enhanced formal management-to-board reporting protocols under the *Caremark* doctrine provide additional means by which the board can "keep its finger on the pulse" of the CLO's ability to perform her duties.

This close relationship between the board's oversight function and the vitality of the CLO position by necessity calls for the board to be the ultimate monitor of CLO prominence and legal department effectiveness. It is a responsibility of which the board should be well aware and which it should monitor with diligence—perhaps with the support of outside counsel and with periodic one-on-one communications with the CLO. This monitoring should proceed regardless of

the potential for conflict with the CEO. It is the ultimate corporate responsibility safety valve.

Conclusion

The role of the health industry chief legal officer has evolved in dynamic manner over the last several years, given the many trends, challenges, and opportunities that the CLO has been asked to confront arising from the industry's continuous volatility, disruption, and regulation. Perhaps more so than ever before, the CLO should be regarded as not only a technical expert, but also as a wise counselor and a business partner to management. In that regard, the CLO remains the "indispensable counsel" to the health care organization.

1 E. NORMAN VEASEY AND CHRISTINE T. DI GUGLIELMO, *INDISPENSABLE COUNSEL: THE CHIEF LEGAL OFFICER IN THE NEW REALITY* (Oxford University Press, Inc. 2012) (hereinafter Veasey).

2 *Id.*

3 Am. Bar Ass'n Task Force on Corp. Responsibility, *Report of the American Bar Association Task Force on Corporate Responsibility*, 59 BUS. LAW. 145 (Nov. 2003) (hereinafter Cheek Report).

4 Ben Heineman, Jr. *The General Counsel as Lawyer-Statesman*, Harv. L. Sch. Forum on Corp. Governance (2010), <https://corpgov.law.harvard.edu/2010/09/05/the-general-counsel-as-lawyer-statesman/> (hereinafter Heineman).

5 Veasey, *supra* note 1, at 3, 5, 45.

6 Heineman, *supra* note 4.

7 New York City Bar Ass'n, *Report of the Task Force on the Lawyer's Role in Corporate Governance*, at D-3 to D-4 (Nov. 2006 (nycbar.org)) (hereinafter NYCBar Report).

8 *Id.*, at D-5, 6, 17, 18.

9 *Id.*

10 *Id.*

11 *Id.*, at D-5.

12 Cheek Report, *supra* note 3, at 5 (Westlaw version).

13 *Id.*, at 9-10 (Westlaw version).

14 *See, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 1.13(a) ("Organization as Client").

15 *Id.*; *see, e.g.*, ILL. SUP. CT. R. 1.13.

16 Cheek Report, *supra* note 3, at 12 (Westlaw version).

17 Ass'n of Corp. Counsel, *2022 Association of Corporate Counsel Chief Legal Officers' Survey*, <https://accounsel.realmagnet.land/fy-2022-clo-survey>.

18 *Id.*

19 *Id.*

20 Veasey, *supra* note 1, at 45.

21 Cheek Report, *supra* note 3, at 7-8 (Westlaw version).

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