

# THE UNDER-EXAMINATION OF IN-HOUSE COUNSEL

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## I. INTRODUCTION

The emergence of in-house counsel<sup>1</sup> is one of the most significant shifts in the legal profession over the past half century.<sup>2</sup> Traditionally, in-house counsel were stereotyped as inferior legal service providers. They were unfairly viewed as lawyers “who had not quite made the grade as partner” at their corporation’s principal outside law firm.<sup>3</sup> Today, a broader conception of in-house legal departments prevails, and the corporate legal department function has transformed the delivery of legal services.<sup>4</sup> A growing number of corporations, facing increasing costs due to business and legal complexities, are deciding to “make versus buy” 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.<sup>5</sup> Just as greater divisionalization in

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<sup>1</sup> This article uses the term “in-house counsel” as interchangeable with general counsel, corporate counsel, and corporate legal departments.

<sup>2</sup> See Abram Chayes & Antonia H. Chayes, *Corporate Counsel and the Elite Law Firm*, 37 STAN. L. REV. 277, 293-94 (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).

<sup>3</sup> Chayes & Chayes, *supra* note 2, at 277.

<sup>4</sup> See Daly, *supra* note 2, at 1062-63.

<sup>5</sup> See, e.g., Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 AM. ECON. REV. 112-123 (1971) (describing vertical integration and the make-versus-buy decisions made by firms). 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*, LEGAL TECH. INSIDER, 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.”); George P. Baker & Rachel Parkin, *The Changing Structure of the Legal Services Industry and the Careers of Lawyers*, 84 N.C. L. REV. 1635, 1654 (2006) (“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. Armed with more talent and the goal of cutting costs, corporate law departments are performing an increasing share of legal work in-house.”); Daly, *supra* note 2, at 1059 (“Between 1970 and 1980, there was a 40-percent

the modern corporation can be explained, to a large extent, via transaction cost economizing, the growth of in-house legal departments can be viewed through a similar lens.<sup>6</sup> Moreover, “[i]mprovements in [the] reputation and skill of in-house lawyers . . . mark a watershed in legal demographics.”<sup>7</sup> Despite these important developments, there is a relative dearth of scholarship dedicated to this important transformation, as well as its impact on corporate governance.<sup>8</sup>

## II. REASONS FOR UNDER-EXAMINATION

The key reasons for the omission of in-house counsel in the corporate governance literature are not unfamiliar and resemble several general blind spots, namely: (i) the difficulty addressing corporate complexity; (ii) the preoccupation with director-shareholder dualism; and (iii) the overemphasis on symbolic procedures reflecting democratic values like independence.<sup>9</sup>

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increase in the number of lawyers working in-house; and between 1980 and 1991, there was a 33-percent increase.”).

<sup>6</sup> See, e.g., Oliver E. Williamson, *The Modern Corporation: Origins, Evolution, Attributes*, 19 J. ECON. LITERATURE 1537, 1537 (1981) (“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.”); see generally ALFRED D. CHANDLER, JR., *STRATEGY AND STRUCTURE: CHAPTERS IN THE HISTORY OF THE AMERICAN INDUSTRIAL ENTERPRISE* (1962).

<sup>7</sup> Steven L. Schwarcz, *To Make or to Buy: In-House Lawyering and Value Creation*, 33 J. CORP. L. 497, 498 (2008); see also Baker & Parkin, *supra* note 5, at 1637 (noting the significant “rise of corporate in-house counsels”).

<sup>8</sup> 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. . . . This is a subject matter that cries out for greater empirical research and scholarly analysis.”); see also Chayes & Chayes, *supra* note 2, at 298-99 (“[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. Thus far, these students remain the preserve of the firms.”); Deborah A. DeMott, *The Discrete Roles of General 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.”).

<sup>9</sup> See, e.g., Omari Scott Simmons, *Taking the Blue Pill: The Imponderable Impact of Executive Compensation Reform*, 62 SMU L. REV. 299, 341-42 (2009) (explaining that procedural requirements that mandate independence in the context of corporate governance may not achieve their objectives and fail to address certain issues); Eric W. Orts, *The Complexity and Legitimacy of Corporate Law*, 50 WASH. & LEE L. REV. 1565, 1587 (1993) (arguing that corporate law must acknowledge technical and normative complexity to retain its legitimacy); 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 the increasing

### A. Complexity

First, the difficulty with developing a concise theory of in-house counsel stems from the complexity of the role.<sup>10</sup> In-house counsel are the “Swiss army knife” of the legal profession.<sup>11</sup> Existing theories, standing alone, fail to capture this complexity; they are too abstract and detached to account for institutional detail. Sometimes “[r]eality is too complicated and admits of too many interactions to be modeled.”<sup>12</sup> On the other hand, the value of theory is not limited to its ability to make accurate predictions or simply reflect reality, but its ability to enhance the understanding of real world phenomena.<sup>13</sup> A presumption of immeasurability that often attaches to complexity may be so strong that no attempt is made to make observations about the so-called immeasurable value of in-house counsel.<sup>14</sup> 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 in-house counsel impact on corporate governance.

### B. Director-Shareholder Dualism

The second reason for the omission of in-house counsel from the corporate governance literature is a preoccupation with director-shareholder dualism that overlooks the impact of a range of internal actors, such as in-house counsel, on

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complexity of organizations). This list of blind-spots is illustrative and not intended as an exhaustive list.

<sup>10</sup> See, e.g., E. Norman Veasey & Christine T. DiGuglielmo, *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.”).

<sup>11</sup> See Sarah Helene Duggin, *The Pivotal Role of the General Counsel in Promoting Corporate Integrity and Professional Responsibility*, 51 ST. LOUIS U. L.J. 989, 1003-20 (2007) (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 manager, and arbitrator).

<sup>12</sup> Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 251 (1984).

<sup>13</sup> See *id.* at 252 (“The value of the model, however, rests not on how well it describes reality, but on whether it allows us better to understand it.”). 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).

<sup>14</sup> See DOUGLAS W. HUBBARD, HOW TO MEASURE ANYTHING: FINDING THE VALUE OF INTANGIBLES IN BUSINESS xi-xiv (2007).

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. The legal literature often vacillates between shareholder and director primacy, with occasional detours.<sup>15</sup> Even the more recent focus on gatekeepers is limited because observers often reflect a bias for outside actors versus internal agents of the corporation.<sup>16</sup> 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 capabilities.

### C. *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 in order to achieve effective governance and compliance with the law.<sup>17</sup> When assessing the quality of corporate

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<sup>15</sup> 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); see also Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 287-92 (1999) (acknowledging that directors, within their discretion, may consider non-shareholder interests in order to maximize the joint welfare of all firm stakeholders); see generally Lisa M. Fairfax, *The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms*, 31 J. CORP. L. 675 (2006) (describing the impact of stakeholder rhetoric); Marleen O'Connor-Felman, *Labor's Role in the American Corporate Governance Structure (Employees and Corporate Governance)*, 22 COMP. LAB. L. & POLICY J. 97 (2000).

<sup>16</sup> See, e.g., COFFEE, *supra* note 5, 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.”); Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 62 (1986) (emphasizing third-party gatekeepers); Sung Hui Kim, *Gatekeepers Inside Out*, 21 GEO. J. LEGAL ETHICS 411, 415 (2008) (“[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).”).

<sup>17</sup> See, e.g., Donald C. Langevoort, *The Human Nature of Corporate 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.”); see also Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 BUS. LAW. 921, 921-22 (1999) (examining the effectiveness of greater board independence); Simmons, *supra* note 9, at 359-60 (describing how corporate constituencies use symbolic procedures as a heuristic to discern reform quality); 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

reform or reformers, corporate constituents often look to mechanisms promoting independence as a proxy for value. This symbolic attachment or so-called “fetishization” of independence has, in part, blinded observers to the impact of in-house counsel.<sup>18</sup> 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 and other reputational intermediaries in promoting healthy corporate governance.<sup>19</sup> The independence or capture critique, even if correct, is often accepted by observers without a robust inquiry or empirical validation. 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 were more willing to monitor, “inside counsel have an overwhelming advantage in their ability to monitor.”<sup>20</sup> Moreover, economic pressures that may constrain in-house counsel also remain an issue for outside law firms.<sup>21</sup> The broader question is not necessarily the need for independence, but for virtuous agents to remain “faithful” to their profession and the client corporation.<sup>22</sup> Independence is

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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.”).

<sup>18</sup> See generally Rodrigues, *supra* note 17 (describing the overreliance on the use of “independent” actors for corporate governance).

<sup>19</sup> Jack Coffee’s insightful 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-house counsel cannot easily develop reputational capital that is personal and independent from the corporate client.

Coffee, *supra* note 5, at 195.

<sup>20</sup> Kim, *supra* note 16, at 417.

<sup>21</sup> See Duggin, *supra* note 11, at 1035 (“The 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 American Bar Association, *Recommendations of the American Bar Association Task Force on Corporate Responsibility* (Mar. 31, 2003), available at <http://www.abanet.org/media/corpgov.pdf>).

<sup>22</sup> See Rodrigues, *supra* note 17, at 451.

usually not an issue until a conflict or potential bias arises.<sup>23</sup> Most of the value-creating functions and daily duties performed by in-house counsel do not raise conflicts. Thus, a myopic focus on independence ignores a significant amount of value created by in-house counsel that, on balance, may outweigh the risks and probabilities associated with potential conflicts and insider bias.<sup>24</sup> While singing the virtues of independence, one cannot ignore the tangible and intangible value created by in-house counsel.<sup>25</sup>

### III. NEXT STEPS: FURTHER EXAMINATION

For the above-stated reasons, the impact of in-house counsel on corporate governance remains both under-examined and undervalued. Further examination of in-house counsel may: (i) illustrate how a well-positioned in-house legal presence, complemented by external gatekeepers, is an essential feature of healthy corporate governance for large publicly-traded firms; and (ii) yield more pragmatic resolutions to corporate governance issues.

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<sup>23</sup> See *id.* at 487; see also Langevoort, *supra* note 17, at 801-10.

<sup>24</sup> See Duggin, *supra* note 11, at 1034-35 (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).

<sup>25</sup> As Ronald Gilson observed, the best potential for private gatekeeping may actually lie with in-house counsel. See Ronald J. Gilson, *The Devolution of the Legal Profession: A Demand Side Perspective*, 49 MD. L. REV. 869, 915 (1990); see also Duggin, *supra* note 11, at 1036 (noting that, in certain situations, hiring “independent counsel” may be done at the expense of the shareholders and the company).