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LEGAL RISK:
DEFINITION, MANAGEMENT AND ETHICS

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executive report

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INTRODUCTION

This executive report examines the definition and management of legal risk in large corporates. The study is based on a review of relevant literature and interviews with 34 senior in-house lawyers and senior compliance staff in large corporates and similarly complex organisations. The sample divides between financial and other organisations, with a wide range of sectors involved.

This report is a summary of a more detailed study which we expect to publish later in the year on the definition and management of legal risk and the ethical issues posed by legal risk. The principal aim of this report is to explore important dimensions of risk management and deepen a debate within the risk and in-house legal communities about best practice.

This work comes at a time when risk generally, and conduct risk in particular, is high on corporate agendas, and when in-house lawyers face greater likelihood of scrutiny and punishment. BNP Paribas, Standard Chartered Bank, the News of the World, The Times, Barclays and General Motors have all recently faced significant allegations of wrongdoing involving their legal functions. Others will follow.

MAIN AIMS

When we began this project, our initial discussion with senior in-house lawyers and compliance professionals suggested:

- There was a shared sense that there was no defined, common or correct approach to legal risk.
- Companies falling short in the recent past, either in practice or in public perception, added to an anxiety as to whether current approaches were fit for purpose.
- They expected a greater regulatory focus on individuals arising from conduct risk; hence the need to identify the correct role and

responsibility for practitioners in managing legal risk.

- There was also a sense that the management of risk, and the articulation of risk appetite, might differ significantly within and across different business types.

This report confirms these problems and deepens our understanding of them. Whilst we offer our own thoughts and emphasis to these, it will be the in-house community and business leaders who decide whether and how to resolve the problems. We look forward to working further with these communities to stimulate discussion and search for solutions.

HOW SHOULD LEGAL RISK BE DEFINED?

Key Takeaways

Corporate understandings of legal risk should encompass both the legal consequences of business risk and business risks with legal origins (such as uncertain law or unsatisfactory legal work product).

The organisation and allocation of responsibility for those understandings would ordinarily reflect the organisation of the business and the ability to best influence key drivers of risk.

Best practice suggests the cultural importance of how legal risk is defined and managed on the perceived and actual approaches to risk within and outside the company.

Whether 'legal' leads on particular risks or not, it is should have the capacity, motivation and resources to be an important source of advice, support and monitoring of risks with legal origins or consequences.

There are two dominant approaches to defining legal risk:

- One is a broad definition of all business risks with legal consequences. This defines **"legal" risk as significant legal consequences** that flow from actions attributable to the business;
- The other is narrow, defining legal risk as **risk originating in legal work** product or legal

uncertainty (which in turn has significant business consequences)

Some definitions extend legal risk beyond strictly legal consequences (e.g. the risk of prosecution, regulatory action, claims or the loss of contractual or intellectual property rights) and look to:

- **reputational concerns** (especially, how a company's approach to legal obligations may be interpreted by non-legal audiences, most often captured in the idea of 'aggressive' tax avoidance); and,
- **intra-organisational culture** (e.g. should the definition of legal risk encompass not just complying with the letter of the law, but also complying with the spirit of the law?).[1]

This wider framing of legal risk looks beyond compliance with law towards broader ethical or commercial imperatives; to sustainable business relationships and being seen as 'doing the right things' by a variety of stakeholders. Cultural and reputational understandings of risk seek to prevent companies being seen as 'sharp', 'aggressive', 'tricky' or 'minimalistic' in their approach to legal obligations. Similarly, the definitions of legal risk have both practical significance (forming the basis of any system of legal risk management) and cultural significance (helping frame the corporate culture around law and ethics). It is a complex but specific instantiation of broader schemes of corporate governance.

Legal risk definition and management seeks to contribute to corporate governance in a number of ways. One is **facilitative**, enabling Boards (and others in the Company) to understand and respond to the most material legal risks they face by defining and

[1] See, for example, Benjamin W Heineman, *High Performance with High Integrity* (Boston, Mass.: Harvard **Business** Press, 2008).

then providing high level information on those risks. It also enables commercial calculations to be made balancing profit and risk, and enabling companies to take on more or less risk as circumstances dictate. At the strategic level, this process is big picture and so is likely to be reductive. It may employ graphical and quantitative understandings somewhat alien to most lawyers.

In a second sense legal risk management is about **controlling** risks, seeking to prevent them arise, or mitigating their impact through processes of assessment, decision-making and control. Process-driven risk assessment thus requires that significant risks are defined and then measured with some clarity. Those risks are then accepted as tolerable; reduced, mitigated or eliminated, where this is sensible and proportionate; or risks are avoided.

Whilst some regulators and corporate governance standards either directly or indirectly encourage legal risk management, they rarely provide guidance on what is meant by legal risk. Unless and until they do, companies are free to define and manage legal risk in ways which fit their business contexts. There is the potential for there to be a mismatch between what a regulator thinks of as legal risk (albeit the regulator has not publicly set out a definition) and what a company thinks of as legal risk.

Another key issue is whether corporate risk processes are sufficiently comprehensive and robust. The company as a whole needs to be satisfied it is managing legal risks that originate from law and legal work product and those 'business risks' that have legal consequences. Similarly, good practice suggests they should consider the reputational and cultural dimensions of legal risk.

The debate between the narrow and broader definition of legal risk highlights the third element of risk definition which is about **ownership:** seeking to specify which part of the business owns that risk, or

rather which part of the business takes lead responsibility for managing that type of risk. Splitting ownership of the assessment of legal risk, and ownership of management and control, is possible and may often be sensible. Hence, risks with legal consequences which are caused by a non-legal part of the business may need to be the principal responsibility of that part of the business, and risk originating in legal work product may similarly need to be the responsibility of legal. However, both types of risk give rise to legal consequences, with the potential for legal staff to contribute to the understanding, mitigation and management of that consequence *whether or not they are principally responsible for the day-to-day management of that risk.*

It follows that we think this split between legal risk defined from consequences and legal risk defined from origins is best seen as a matter of organisation and not one of definition. What few clues we can glean from regulatory (and from other) attempts to define legal risk suggest they contemplate a mixture of the two approaches. There is also the potential that stakeholders and regulators may be misled by robust processes for narrow definitions of legal risk (if broader risks with legal consequences were not subject to effective processes).

A broader approach also serves as a reminder that whilst primary responsibility for risks with legal consequences may lie outside legal functions (i.e. at Board/C-suite level), 'legal' is likely to be an important source of advice, support and (potentially) the monitoring of such risks. The responsibility for understanding, preventing and mitigating that risk is likely to be shared across the corporation. A broader definition should make it less likely that certain risks could fall between the cracks: in-house legal functions might be more likely to lead on legal risk in the narrow sense of risks flowing from legal work, but may (and, we would argue, should) report, monitor and advise

on how they see broader legal risk manifesting in the company.

The allocation of lead responsibility is an important one. Allocation of responsibilities for legal risk to lawyers is not without dangers. The debate about separating lines of reporting and accountability between audit, compliance and legal is a recognition that the role, work product and culture of lawyers in commercial organisations may sometimes exacerbate legal risk in a way more broad than creating faulty legal documents or failing to anticipate and navigate legal uncertainty. The recent General Motors investigation may be one example of this; internal lawyers are amongst those blamed (and losing their jobs) for not sharing information within the company on highly dangerous faulty ignition problems.

Finally, a narrow definition of legal risk suggests a narrow, 'technical' role for in-house lawyers minimises any responsibility for the legality and probity of a company's operations, limiting it to those tasks which legal is specifically asked to carry out.

For these and other reasons (in addition to definition, attitudes and approaches to legal risk), legal risk management can be seen as supporting or inhibiting a company's compliance culture. In this sense legal risk management is part of a broader drive to ensure standards of behaviour and to not fall foul of both legal obligations and standards which may lead to reputational crises. When companies think about organisational culture and behaviour, they should be aware of attitudes and approaches to legal risk, as well as the mechanics of definition and process.

WHAT KINDS OF DEFINITIONS ARE USED IN PRACTICE?

Key Takeaways

There is a need for in-house lawyers to reflect on how clear and confident their thinking on legal risk is.

A particular problem with a view of legal risk as the broad any-legal-consequences view is that it was often associated by our interviewees with a reactive, 'know it when I see it' approach to legal risk which inspired less confidence about the capacity for foresight and thematic and strategic thinking around legal risk.

A potential problem with a narrower, but more focused, definition of legal risk is that risk thinking became siloed, and that risks originating in other parts of the business which had legal dimensions or consequences to them would be missed or go under-appreciated.

There is a broad question as to whether the reputational and cultural impacts of legal risk on conduct within the company are understood, accepted and acted upon. Those interviewees with the most developed systems seemed most likely to see these as beneficially addressed in definitions of legal risk.

In broad terms, amongst our respondents:

- The definition of risk was often broad and gravitated towards the view that any action with a potentially significant legal consequence was a legal risk.
- Claims and regulator action were often to the fore in thinking about legal risk, one of the indicators that the broad approach may also have tended towards a reactive, not proactive, stance to predicting and managing risk.
- The broader approach to legal risk definition did not appear as well thought out or as organised as narrower approaches, but did allow the proponents of that approach to advocate a more mainstream role for legal personnel in understanding and 'catching' legal risk before it caused the business problems.
- A narrower definition of legal risk was common in organisations with developed risk systems (especially in financial institutions).
- A forward-looking view of risk, with planning and management of legal risks, was more often associated with organisations having broader (non-legal) risk frameworks and processes.
- Those employing narrower definitions within broader risk structures were less likely to respond to risk on a case-by-case basis, and more likely to take a thematic or global approach to understanding risks posed to the business within the legal function.
- Those processes engaging with narrower notions of legal risk appeared more comprehensive, in that they sought to engage a variety of organisational responses: leadership, messaging, behaviour-management, monitoring and so on.
- Conversely, those operating narrow definitions might be less engaged with other risks posed to the business which had legal components. This was partly seen as ensuring that the parts of the business closest to the risk were

responsible for that risk. However, that might lead to silos of understanding and managing risks which were beyond the view of legal personnel.

- Broader notions of legal risk (spirit of law violations and reputational concerns) were engaged by some of our respondents' risk definitions, but this was generally rarer.
- Those who did emphasise reputational concerns and the need to promote the spirit of law over and above the letter of the law saw the cultural significance of risk management within their organisations.
- Aside from providing a better guarantee of compliance, a systemic view of ethics, risk and compliance led them to suggest that promoting the spirit of the law may make companies better at managing the myriad of social relationships companies depend on to be successful.

HOW WAS RISK MANAGED IN PRACTICE?

Key Takeaways

Legal risk management is in its infancy.

Assumptions and ideas about practice in the field are not well understood or tested.

There is a need for in-house teams to reflect on the extent to which processes of legal risk engage rigorously in assessment, mitigation, communication, monitoring and overall evaluation of legal risk management.

The extent to which processes can be defined and designed to interlock should be considered. There is a good deal of variation in approaches to risk mitigation and monitoring.

Process driven, and experience-based, legal risk management may be susceptible to biases which need to be considered as part of any design. Bias can be countered by critical reflection on approaches, external input and review, and via the thoughtful collection and application of data relevant to legal risk (both its incidence and its management).

Some aspects of risk management may lead to overconfidence and approaches to mitigation which shift risk from the company to third parties, with the potential to raise questions about the appropriateness of this in certain circumstances.

Standard risk management processes involve:

- risk **identification,**
- the **assessment** of likelihood/impact of a risk,
- and the assessment and implementation of **mitigation and reduction** measures.

This is overlaid with processes of risk **communication** internally (with employees) and externally (with regulators and other stakeholders).

A decision to accept or avoid a risk conventionally follows the identification and assessment of a risk once the predicted effectiveness of mitigation has been taken into account.

Monitoring and review of the whole process leads to **evaluation** and process driven improvement. Mitigation and reduction can lead to the elimination of particular risks.

The processes collectively then make up the **risk management strategy** for the organisation.

Amongst those we interviewed, in broad terms, the management of legal risk sometimes went through something like these steps but it was often less organised. Many approaches appeared to be ad hoc

rather than systematic; that is, they often touched on some of these stages without having defined processes for dealing with each in ways that interlocked. Some steps were missed out, or were regarded by our interviewees as happening naturally in the course of their day-to-day work.

These less systematic approaches often relied upon an experiential or intuitive approach to managing legal risk. That is, these approaches principally relied on the experience of senior in-house lawyers to identify and manage legal risk, and were often aligned with the broader ('any legal consequences') approach to defining legal risk. Such approaches also appeared less likely to be informed by data or thematic review.

There is the potential for all approaches to be shaped by well-known biases in human judgment. Intuitive approaches may be more vulnerable to some of these biases, but process-driven approaches can also create particular problems. Systemic approaches typically incorporated, rather than relying haphazardly, on experience within legal teams (and sometimes outside).

Risk mitigation has the potential to reduce risky behaviour or it can seek to lay off the consequences of that behaviour on third parties (e.g. through insurance). Laying off risk has the potential to raise questions about ethicality, depending on the nature and understanding of those third parties, although our interviewees did not raise such questions.

Risk mitigation could also be purely defensive, protecting a company from regulators through reducing the likelihood of criticism or sanction, without necessarily changing the underlying behaviours or harms which might drive regulator concern.

There was a wide range in the depth and sophistication of techniques used to mitigate risk. These ranged from purely legal responses (e.g. what we put in a contract or what we advise the client they

can do), to a suite of other behavioural or managerial responses (such as training, communication, monitoring, process design and other work on the corporate culture). Greater depth and sophistication generally reflected a stronger sense that legal risk and compliance was a complicated, human problem with multiple dimensions capable of several interventions.

The broader and more systematic the approach generally within the corporation to risk, the more likely it appeared to be that our interviewees had identified elements of the process or other indicators of the risk which they felt could be meaningfully measured. To give some examples, metrics could be derived from the following:

- surveys were used to test whether supervision/training was being carried out; or to monitor culture;
- exception and error monitoring was part of the process for monitoring against product/service delivery (notification of potential claims) and problems with contracts;
- legal teams could monitor enquiries (the kinds of problems colleagues ask for advice on and where in the business they are coming from);
- audit (e.g. of contract processes or sales verification (to test sales processes));
- customer feedback (e.g. to test the perceived quality of advice and documentation);
- reputational monitoring (tracking reputation with regulators, joint ventures and mentions in the media);
- registers (e.g. for gifts, potential conflicts of interest);
- hotlines; and,
- whistleblower reports.

Qualitative reporting mechanisms are also likely to be important. This is partly because our interviewees were generally a long way from having a suite of quantitative metrics which enabled them to better understand the legal risks posed to their businesses,

and partly because of some of the inherent limitations in quantitative data.

Review of risk assessments, systems and their monitoring is generally seen as an essential part of the cycle of risk management and improvement. However, the review processes for many of our interviewees seemed relatively informal or unstructured. Some approaches emphasised:

- the importance of the company engaging seriously with individual business unit leaders and others responsible for risk;
- the need to test the nature and depth of colleague engagement with questions of risk and compliance; and
- data and broader engagement with business units to understand whether risk was really being taken seriously.

The potential importance of broader approaches to conceptualising and managing the assessment, mitigation and control of risk was underlined when we asked interviewees to consider case studies of risk problems. Such approaches suggested to us that those more familiar with the full range of responses to risk were likely to have more resources for greater foresight and control when faced with risk problems as well as a more strategic approach.

THE COMPLIANCE FUNCTION AND LEGAL RISK

Key Takeways

Attitudes and approaches to compliance mirrored attitudes to legal risk, with a range of narrow procedural and broader values based approaches advanced.

In general, the compliance function is both more procedural and more directly engaged with thinking about underlying risks and behaviours than with the drivers of those risks.

There was some suggestion that compliance personnel were more independent than in-house lawyers, who were said to have a stronger ethic of zealous loyalty to the 'client' than to compliance. Others saw compliance and legal as more entwined.

Some conveyed a sense that compliance may be something of a 'Cinderella service', with resourcing and status challenges.

Various commentators point to a difference between legal and compliance attitudes to legal and compliance risk. The basic thrust is that in-house lawyers may be more likely to take a defensive, adversarial approach to legally related matters which focuses on perhaps short term, company (or C-suite) interests. There is some (limited) evidence that senior compliance officers may be more ethical than General Counsel, although it can also be argued that separation of legal and compliance functions may be detrimental to the public interest. In-house lawyer defensiveness may impact on the way that facts are gathered and presented to the company and to

regulators. For similar reasons, it is suggested that compliance officers may need to report separately, rather than to General Counsel. US regulators have tended to drive a separation of reporting functions to ensure the compliance team has direct access to the corporate governing body and independent authority away from legal counsel.

To explore these and related issues, compliance officers were asked how they would describe the compliance function. The discussions ranged between two points on a continuum. One was a broadly procedural one emphasising compliance as the process by which legal or other obligations are better specified and transmitted through a company. The second emphasised broader behavioural and values-based approaches to understanding and ensuring compliance alongside the procedural.

A procedural approach largely saw compliance as fitting with a command-and-control model. Under this model, the legal teams provided advice on what needed to be complied with and how, whilst the compliance team developed the detailed systems for explaining or embedding those requirements, monitoring and enforcing them. There are limitations to such an approach.

A step along the continuum was taken by building assessment and reporting mechanisms into the process. Compliance functions were reported as improving the coordination, quality and purposefulness of risk documents and developing broader, behavioural dimensions to an effective compliance programme needed through process design. One possibility is that procedural systems help organisations move their understanding and responsiveness forward by generating knowledge and learning about risk. However, as we set out earlier in this report, there are limits to the data generated by such processes.

We are not able to say in a study of this size whether the more developed approach to compliance is or is not a success. It gives the appearance that success would be more likely, but that may simply reflect organisational size and specialisation.

As with legal risk generally, several respondents suggested that values, tone and culture played or should play a role in compliance. Our respondents suggested that the compliance function is both more procedural and more directly engaged with thinking about underlying risks and the behavioural drivers of those risks than the legal function. They also sometimes suggested they were more independent than in-house lawyers, who were said to have a stronger ethic of zealous loyalty to the 'client' than fidelity to the law. Others saw compliance and legal as more entwined.

The key challenges for compliance suggested by our interviewees included: having adequate time and resources to effect change; coping with being seen as a cost centre for the business (rather than a process that created value); coping with changing business and regulatory environments which threw up priorities beyond compliance; and the potential for poor division of responsibilities between legal, compliance and audit to lead to turf wars or battles to disclaim responsibility for a particular area. This echoes the difficulty of distinguishing 'legal' risk from business risks with a legal component that was discussed above. Some conveyed a sense that compliance may be something of a 'Cinderella service'.

RISK APPETITE AND DECISION MAKING

Key Takeways

Three types of attitude to risk were discerned: risk conservatives, risk acceptors and risk facilitators.

All were led by the business' view of risk appetite. Risk appetite was sometimes formal but was more often informal and cultural.

Organisations may need to consider how well articulated, understood and influential leadership on risk appetite is.

There is the potential for risk management to change risk appetite by altering perceptions of, and appetites for risk.

In general, risk management increased the appetite for risk because it increased confidence that risk was both understood and manageable.

This opens up for debate the question: is risk management as robust as such confidence suggests?

There were a variety of self-identified attitudes to risk in our sample of interviewees.

RISK CONSERVATIVES

Some saw their personal attitude as risk averse, and a group within that saw an alignment between their natural caution and the need for parts of the business to exercise caution in relation to risk. Thus legal, and in particular compliance, might be part of a deliberate corporate strategy of counterbalance to the commercial team. These 'risk conservatives' tended to see risk (usually regulatory risk - i.e. the risk of regulatory investigation and sanction) as something

they had been employed to resist. Their role was thus to manifest a deliberate tension within the business.

RISK ACCEPTERS

The next group of our interviewees accepted risk as something business drivers created, which corporations had then to define and manage. Our 'risk acceptors' tended to see risk as ubiquitous, tolerable and manageable, and that the need was to create a balanced, sensible risk appetite and to offload risk onto counterparties, insurers and the like who they typically regarded as savvy participants in a negotiation.

Both 'risk conservatives' and 'risk acceptors' saw themselves as being led by, as adapting to, the businesses risk appetite. Sometimes such appetites were formal, documented approaches to risk tolerances, no-go areas and processes of escalation whereby greater acceptance of risk had to be promoted up the hierarchy for decision. Often, however, risk appetite was 'known' informally but not defined. How robust or predictable such an approach is must be open to question. Unarticulated assumptions and subjective assessments of risk may mask significant variation in decision-making. Another line of thought deprecated formal risk appetites as inhibiting the taking of risk that might be merited on a commercial basis.

Whether or not respondents had a defined risk appetite, it was clear that risk appetite emerged from a complex set of commercial and social interactions, some formal and some ad hoc, and was primarily seen as business-led. It was suggested that individual teams or personnel could make a difference to legal risk appetite, as could leadership, geography and levels of growth but it was not generally apparent that lawyers led the businesses appetite for risk, and this included the business appetite for legal risk.

RISK FACILITATORS

Our third group stated a higher risk appetite than their employer or other lawyers, and sought to challenge the stereotype of lawyers as risk-averse - sales preventers or deal-killers. Yet, our 'risk facilitators' also saw themselves as leading more conservative colleagues. The encouragement towards risk could be quite subtle. Putting in place approaches to manage or reduce the consequences of risk, and describing the acceptance of risk as a "mature" decision were techniques used. Some linked the willingness to demonstrate a welcoming attitude to risk to their promotion within the corporation.

DOES RISK MANAGEMENT CHANGE RISK APPETITE AND RISK BEHAVIOUR?

Whether risk management changes risk appetite within organisations will depend in part on what risk appetite the business articulates for itself, sometimes consciously through formal policy and sometimes less deliberately, through the tone informally set on risk, through resources devoted to monitoring and controlling risk, and the like. The business's capacity to bear risk because of its financial and reputational situation may also be important to what appetite for risk the business has.

The more formalised the assessment and management of risk, the more it was felt to increase appetite for risk because the downsides of commercial activity were felt to be better understood and there was greater confidence that mitigation and control of risk was taking place. The potential downside is over-confidence and the normalisation of 'unacceptable' risk. The latter may occur quite subtly through framing of risks primarily in cost-benefit terms. Such framing effects have been shown to de-ethicalise and narrow judgement.

Thus we can see that risk assessment and management is somewhat double-edged. Risk is inevitable and cannot be avoided. Also, however,

companies can take on more or less risk. Risk assessment and management may enable companies to take more sensible, informed decisions about the costs and benefits of particular decisions. It may also improve behavioural predictability: ensuring consistency of approach and reducing deviance from compliance norms. It also helps, but does not guarantee, insulation from regulatory action and reputational scrutiny. This may give companies the confidence to take on risks that they would not previously have done.

Whether risk mitigation successfully contains these risks or not is moot. There are obviously limits to predicting the future, however sophisticated that prediction might appear. The more complex organisations tended to have evolved systems of monitoring and mitigation processes, and some went further to look closely at how their systems influenced actual behaviour. The robustness of the final stage of the risk cycle here involved evidence-based evaluation and improvement of the risk apparatus. We can also see in our interviewees' comments an emphasis on the behavioural and political elements to risks systems which showed an appreciation of the subjectivities operating within their organisations. Whether or not approaches to the assessment and mitigation of risk worked depended significantly not just on the rigour and quality of the processes and rules applied, but also on the spirit with which they were implemented.

ETHICS AND LEGAL RISK

Key Takeways

Legal risk management exemplifies and may amplify some of the ethical challenges of in-house practice.

Objectivity and independence are necessary for risk assessment to be accurate and useful to the business but are in tension with the pressures on in-house lawyers to be commercial team players. These tensions are both overt and implicit. There are overt pressures and implicit biases at work which may sometimes undermine objectivity.

Appetite for legal risk involves accepting, even welcoming, tolerance for conduct which may be, even may be likely to be, unlawful. This is sometimes in tension with the professional obligation to promote the rule of law and the guidance to solicitors that they must treat the public interest in the administration of justice as definitive of conflicts between professional obligations.

Such tensions also impact on corporate interests: there are relatively recent, serious conduct risk examples of allegations involving lawyers in and/or instructed by Standard Chartered Bank, the News of the World, Barclays, The Times newspaper, BNP Paribas and General Motors.

The extent and nature of these public interest facing obligations are neither understood, nor well-articulated in professional practice generally, nor in-house practice in particular.

There is an opportunity to debate and articulate the role of in-house legal teams so that they better meet the needs of the business and their ethical obligations as professionals.

The Centre for Ethics and Law will be encouraging such an initiative in partnership with in-house lawyers and leaders in the sector.

Risk assessment and management provides a new perspective on ethical questions about the role of in-house lawyers. Risk assessment requires professional objectivity for such assessment to be useful and accurate, yet the culture of 'being commercial' and the framing influences of a professional culture that emphasises putting the client first strains that objectivity. The professional obligation of independence is also sometimes called into question. The tensions play out in debates about whether in-house lawyers can be a moral compass for their organisations, or whether GCs that 'have the back' of the CEO or the board. Balancing this tension inappropriately may sometimes exacerbate rather than ameliorate legal risk.

As well as professional obligations to protect their independence and promote the best interest of the client, there are obligations to uphold the rule of law and the proper administration of justice. A solicitor's professional obligations give primacy to the public interest and the public interest in the administration of justice.[2] This raises the interesting question of how legal risk management, which tolerates, normalises, and sometimes promotes the desirability of taking risks with law fits with these broader professional obligations. It is not a question that we have seen addressed. There needs to be a full and frank discussion that begins the process of articulating what such obligations mean in the context of commercial

[2] Principles and guidance, SRA Handbook and Code of Conduct 2014, http://www.sra.org.uk/solicitors/handbook/handbookprinciples/content.page accessed 17 June 2014

law practice generally and in-house practice specifically.

Issues of objectivity and independence are most clearly raised in the context of in-housers being very sensitive to their place in the corporate network of influence. That sensitivity sometimes involves a negotiation between the lawyer's view of what is lawful and right, and their view of what is tolerable. Corporate codes and pleas to take a long-term sustainable view rather than a short term, narrowly commercial view were stronger drivers in that negotiation than professional principles.

Indeed, where professional principles were called upon it was most usually the obligation of independence that was summoned by our interviewees. The obligation to promote the rule of law and protect the public interest in the administration of justice had limited, if any, purchase. It was not a concept that was well articulated in their professional consciousness.

Similarly, when asked more specifically whether the management and assessment of legal risk raised professional ethics issues our interviewees broke down into three broadly similar sized groups:

- those who considered that the management of legal risk did not raise ethical issues;
- those who considered that the management of legal risk might raise ethical issues in theory, but because they had ethical employers such conflicts did not arise in practice; and,
- those who considered that professional ethical problems could and did arise (occasionally there was suggestion that such problems were fairly frequent).

Those interviewees who tended to say that there were not ethical problems tended to portray advice in binary terms: either something was lawful or it was not. In this way, advice clarified and made plain the law, and

clients then decided to act or to not act. This is a position at odds with the view of legal risk which sees law –depending on the particular law and context – as somewhat uncertain. Alternatively, these interviewees indicated that where law was ambiguous, ethical decisions were purely for the business and not for them as lawyers.

The closest articulation of professional rule of law obligations came implicitly when interviewees talked about the concept of 'comfort'. Interviewees contextualised getting 'comfortable' with law's ambiguity but not allowing that ambiguity to be abused within the broader role of the lawyer as business advisor. Each piece of advice was part of a broader series of interactions where the lawyers worked to persuade their colleagues of their utility, relevance and commitment to the business. This meant compromises needed to be made from time-to-time as part of the cost of having the legal department influence the company. Thus, one of the terrors of in-house lawyers was being perceived as 'difficult' and colleagues not then coming to them for advice when they ought.

Professional claims to independence by our interviewees were subtle and not naïve. Independence did not either exist or not exist – it manifested along a continuum and could be weaker or stronger, in the same person, at different times and in different contexts. Our interviewees understood that professional independence was (sometimes) in tension with their need to serve, and be seen to serve, the business. Conversely, professional independence could be reinforced by the business (e.g. sometimes respondents reported a deliberate attempt to align the professional claim to independence with a leadership desire to do, and be seen to do, the right thing within their businesses).

Corporate appetite to take on risk was reduced by very costly risks and the potentiality for criminal investigations, or sanctions, particularly where these could be aimed at senior officers/employees. Thus, the independence of the legal function was strengthened when dealing with criminal sanctions or where regulators had the potential to act severely, or had demonstrated an appetite for doing so. Equally, active stakeholders (most likely stimulated by media or activist scrutiny) accentuated the role of legal and the importance of independent judgement in defining risk. Judgement calls were sometimes strengthened towards independence by other factors:

- The potential for legal decisions to be public.
- General Counsel being on the Board (though some felt this weakened independence).
- Regulatory accountability (i.e. the risk of criminal sanction or – less often - conduct sanction through professional regulators):
- External shocks (e.g. where a business had faced a serious investigation or prosecution)

Independence could be weakened by the need to build a place within the network of corporate influence, particularly where that network was sceptical of the value of the legal team. More generally a corporate discipline was at work that protected the discretion of senior decision-makers and disciplined lawyers towards corporate norms. That discipline reminded lawyers that they were there to support the business; that they advise and do not decide.

The discipline was also sometimes disciplinary. Some saw or had experienced CEOs publicly or more subtly 'calling out' lawyers for being obstructive. Promotion and getting allocated interesting work incentivised behaviour. In general, in-house lawyers and the businesses they work within have an allergy to the word 'no' being exercised by anyone other than the ultimate decision-maker. The lawyer's role as adviser generally precluded them from being the ultimate

decision maker unless the business allocates the responsibility and power to do so.

We do not mean to suggest that for in-house lawyers saying 'no' was impossible, or that advising in robust terms never occurred, but saying 'no' was seen as a last resort and many saw it as a mark of their skill that they avoided situations where the need to do so arose. Saying 'no' was also a process which required political coalition building within the business if it was to succeed. 'No' could be hard and dangerous work.

REDLINES

Discomfort and concerns about independence effectively meant that on occasion our in-house lawyers felt that their companies were taking unreasonable positions on legal risk or, perhaps, untenable positions on the legality of their action. We sought to explore the outer limits of the comfort/discomfort boundary: what were our interviewees' 'redlines'? How did they define the ethical boundaries which they would not cross?

We noted the following characteristics of these discussions:

- The ability of our interviewees to articulate specific redlines was limited.
- There was often no apparent reliance on general ethical principles from their business' Code of Conduct, nor was there reliance on external professional principles (e.g. in the SRA Handbook).
- There was a tendency to look to the business to provide ethical leadership (in the same way as they looked to the business for a sense of risk appetite). This is not suggestive of independence or objective judgment.
- Those who indicated no red-lines tended to a view that the business, not the lawyer, took all ethical decisions. Their work was technical and without an ethical dimension. We would suggest that this view is misguided and, at the

very least, suggests a failure to properly engage with the professional obligations to which all regulated lawyers, including in-housers, are subject.

Whilst professional principles were generally not called upon, professional status was perceived as useful. It helped establish a level of independence within the businesses and a basis for making claims on that independence and on the public interest. It was also said to form the basis of a claim for higher objectivity.

One should be a little cautious about accepting such claims. There is research which shows that 'thinking of oneself as a professional' may – on its own – lead to a form of complacency that promotes greater unethicality. Commitment to the principles of professionalism, however, may promote ethicality.

The most commonly articulated redlines were:

- Risks of 'criminal' activity (some interviewees narrowed this to 'serious' or imprisonable criminal activity);
- Risks with existentially large financial consequences;
- Increased risks of personal injury, death or serious environmental harm; and,
- Dishonest/misleading disclosure and accounting.

In broad terms, the boundaries of tolerable risk in our cohort were generally formed by an amalgam of how ambiguous a legal question was; whether it was a criminal matter; whether increased risk to person or life could be attributable to the company's actions; reputational risks (often reflecting criminality, environmental damage and risk of injury or to life); and the costs and benefits of proceeding in the face of legal ambiguity (such as the risk of sanctions or enforcement). Some articulated a firmer notion of legality and resistance to creative compliance, whilst

acknowledging that legality was stretched or breached in practice.

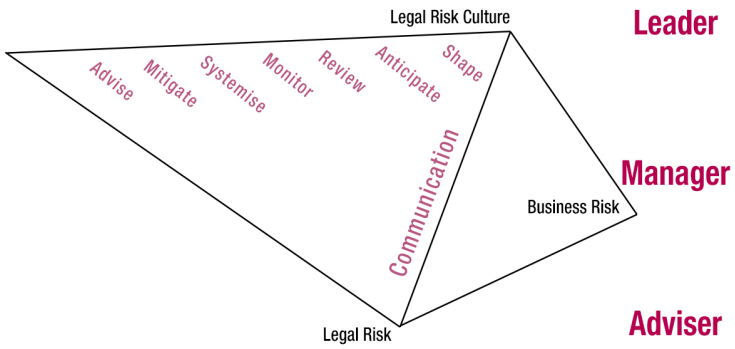
Whilst lawyers and businesses like to project a belief in legality or working within the law, in reality this often meant something different: not risking serious criminal sanction and having a defensible, if sometimes weak (or risky) argument that behaviour was otherwise within the law. Sometimes such arguments are a response to conflicts between mutually incompatible international standards or the understandable feeling that total compliance with complex and changing law cannot be achieved. Sometimes the arguments may be a cover for creative or selective compliance or the obfuscation of non-compliance. The elision of legality with criminal law was common, although in practice the distinction between criminal and other sanctions is not always clear.

SOME FINAL THOUGHTS: THREE DIMENSIONS OF DEFINITION AND MANAGEMENT OF RISK

It may be helpful to think of legal risk across three dimensions:

- The definition of legal risk;
- The skills and disciplines applied to legal risk management; and,
- The risk role for the in-house lawyer that emerges.

FIGURE 1: THE THREE DIMENSIONS OF LEGAL RISK



The definitional dimension of legal risk shifts between business risk that originates in legal (i.e. risk that originates in, or is driven by, the work of the legal department and from the uncertainty within law itself, and more particularly the risk that law changes) and legal risk that originates in the business (i.e. risk which originates in the business, including but not limited to origination in the legal function, and has legal consequences).

Additionally there are cultural dimensions to risk which see the way in which legal risk is (mis)managed as giving rise to reputational risks and to behavioural risks. Here, a culture which promotes compliance with the spirit of the law is seen as being more resilient and sustainable than a culture which promotes only compliance with the letter of the law.

The skills and disciplines of legal risk range from legal analysis informed by experience, to the design and delivery of effective risk management systems and processes, training and broader communication initiatives, to the collection, understanding and presentation of proportionate and meaningful information on risk.

The risk roles that emerge entail shifting back and forth between the traditional 'lawyer as advisor' role; the in-house lawyer as manager of processes; and, a leadership role which involves strategy formulation, review, communication and other aspects of leadership.

Clarity and confidence that each of these three dimensions is attended to, and that the definition of legal risk best reflects and fits with the risks of the organisation as a whole, is likely to be increasingly important. It is also likely to be increasingly important that a company's definition and management of legal risk aligns with how regulators, and others, frame and manage legal risk and who are seeking to understand whether a business has some level of control on the management of legal risk. With conduct risk becoming an increasingly important element of corporate governance, a broader notion of legal risk may be in the ascendant. That does not mean that it should necessarily be the legal function that is principally responsible for understanding and/or managing all legal risk, but it does mean that the Board needs to be sure that legal risk is being managed, and managed appropriately.

A broader framing of legal risk can be understood as part of a wider ethical or commercial imperative. As a result, the definition of legal risk has both practical significance (in that it forms the basis of any system of legal risk management), and cultural significance (in that it helps frame the corporate culture around compliance, law and ethics). This thicker notion of legal risk aims to be both more comprehensive, more persuasive and ultimately hopes to deliver better

outcomes for the business and its stakeholders. It should also, in theory at least, be more likely to operate ethically.

The way in which the in-house lawyer's role is perceived in relation to legal risk is important. All lawyers would argue they engage in advice, mitigation and (with greater or less degrees of systemisation) quantification of risk. Fewer in-house lawyers engage in the implementation of legal risk systems, in the review and monitoring of risk, or in the anticipation and shaping of risk.

We should acknowledge, as some our interviewees did, that risk management generally, and legal risk management in particular, are new disciplines with which corporations and lawyers are only just beginning to generate experience:

> I think it's always worth remembering …that …even the biggest law in-house legal functions are probably only really second generation management. …first generation of career senior in-house general counsel in large law departments… evolved the definition of what we do, what our function is. …as a trade we're really only 20 or 30 years old, so in that context you've still seen a lot of evolution going on... LF12

For GCs, this may speak to the composition of in-house legal teams and to the question of the importance of risk management and risk processes experience and expertise over subject specialism expertise (say, the need for a competition lawyer or an IP lawyer). How many GCs, in selection processes, question candidates about their knowledge of, and experience in, risk management? Similarly there was an emerging awareness that a broader set of skills and knowledge needed to be applied to 'solve' risk problems:

> I don't think [anyone] …is really leaning hard on the behavioural change elements…. I think we're just in an evolutionary phase of understanding what businesses need to do, to be seen as good corporate citizens in this part of the twenty-first century. LF01

These comments reflected a broader question of what kind of role was expected of, or sought by, in-house legal teams on legal risk. Legal risk could be defined narrowly or widely by reference to the legal consequences–legal origins dichotomy discussed in relation to definitions, but the process of understanding and managing risk could also be defined broadly or narrowly. The wider sense of process and understanding drew on more disciplines, a more clearly articulated process and a wider set of tools with which to tackle risk. This wider approach also sometimes reflected a more cultural dimension to risk as something beyond processes which impacted on attitudes and behaviours within the business. Ultimately, the wider approach sought to be more strategic and less reactive; more analytical and more human.

Part of this wider approach involves a consideration of the ethical dimensions of in-house lawyers as regulated individuals with professional obligations independent of their duties to the company as employer or client, but also as key roles in corporate governance. Such discussion needs to take in account of the fact that legal functions often span regulated and unregulated staff and highly and lightly regulated functions. Legal teams engage secondees, contractors and private practice firms, sometimes these give rise to problems of their own. Similarly, in global companies ethical issues cross jurisdictional boundaries, with competing and conflicting standards sometimes in play. Tempting as it may be, these issues should not be left in the 'too difficult to deal with' file.

There is an opportunity here to debate and articulate the role of in-house legal teams so that they better meet the needs of the business and their ethical obligations as professionals. Similarly, greater thought needs to be given to developing good practice in legal risk management and ethical leadership within the legal function. Best practice and education and training of in-house lawyers in professional ethics and risk management are areas ripe for specific consideration. The Centre for Ethics and Law hopes to stimulate discussion and concrete progress in partnership with in-house lawyers and leaders in the sector in coming months.

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