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CORPORATE LAWYERS AFTER THE BIG QUAKE: THE CONCEPTUAL FAULT LINE IN THE PROFESSIONAL DUTY OF CONFIDENTIALITY

THOMAS G. BOST*

Introduction ... 335
I.Enron ... 339
II. Enron's Lawyers ... 342
III.The Sarbanes-Oxley Act of 2002 ... 347
IV.The Model Rules of Professional Conduct: 2003 Amendments ... 355
V.The "Erosion" of the Attorney-Client Privilege For Corporate Clients and the ABA ... 362
VI.The Duty of Confidentiality: The SEC, The ABA, and The States ... 369
VII.The Duty of Confidentiality: The SEC, The ABA, and California ... 370
VIII.The Corporate Lawyer As Counselor ... 379
IX.The Corporate Lawyer As Counselor and The Duty of Confidentiality ... 382
Conclusion: The Conceptual Faultline In The Professional Duty of Confidentiality ... 388

INTRODUCTION

As most observers of the American legal scene are aware, the past four years or so have witnessed a convulsion and consequent seismic shift in the roles, duties, expectations, and liabilities of corporate lawyers. This upheaval in the standards of mandated lawyer responsibility is the result of the commonly-held perception that lawyers have failed to adequately guard investors from the devastation that accompanied the great corporate scandals of the recent past. Lawyer reform came first from the Securities and Exchange Commission ("SEC"), in response to the mandates of the Sarbanes-Oxley Act of 2002, and then from the American Bar Association ("ABA"), in response to the urgings of the ABA's Task Force on Corporate Responsibility. Although the details of these reforms differ, their general thrust and effect are similar and in general alignment.

The primary focus of reform has been on the lawyer's duty of confidentiality, and the primary effect of the SEC and ABA initiatives has been to create or confirm significant exceptions to that duty. The lawyer's duty

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* Professor of Law, Pepperdine University School of Law. I wish to thank Matthew Gershman for his invaluable research assistance. [Editorial Note: this article is reprinted here with permission from the Georgetown Journal of Legal Ethics. The original article may be found at 19 GEO. J. LEGAL ETHICS 1089, 1139 (2006).]

of confidentiality has always been regarded as basic:

> A fundamental principle in the client-lawyer relationship is that, in the absence of the client's informed consent, the lawyer must not reveal information relating to the representation .... This contributes to the trust that is the hallmark of the client-lawyer relationship. The client is thereby encouraged to seek legal assistance and to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter. The lawyer needs this information to represent the client effectively and, if necessary, to advise the client to refrain from wrongful conduct. Almost without exception, clients come to lawyers in order to determine their rights and what is, in the complex of laws and regulations, deemed to be legal and correct. Based upon experience, lawyers know that almost all clients follow the advice given, and the law is upheld.[1]

However, vigorous challenges to crucial aspects of the SEC and ABA initiatives have been mounted by critics from around the nation, with the most vocal and sustained organized opposition coming from lawyers from the state of California, which has the distinction of having the strictest confidentiality rules in the nation.[2] These disparate views each reflect a different vision of corporate lawyering: what does it mean to be a counselor, advisor, and advocate for a business enterprise? The conceptual fault line between the competing visions is fundamental and lies at the core of the legal profession and its role in society.

The discussion in this article begins with the corporate scandal resulting in the sudden demise of Enron Corporation, with particular attention paid to Enron's lawyers. In significant respects, the SEC and ABA reforms were reactions to the perceived inadequacies in the performance of these lawyers. Critics asserted that these lawyers suffered from a dual failure of vision—losing sight of who their client was—the corporation itself, as opposed to any particular corporate agent with whom they were dealing—and seeing their role in unacceptably narrow terms—as mere implementers or transaction engineers, rather than as broadly-gauged corporate counselors or advisors.[3]

There followed closely the enactment of the epochal Sarbanes-Oxley Act of 2002 with its Section 307 directing the SEC to adopt rules setting forth "minimum standards of professional conduct for attorneys appearing and practicing" before the SEC, including a rule requiring lawyers with evidence of a "material violation" of law to report that evidence up the ladder, beginning, in the typical case, with the company's chief legal officer and ending with the board of directors if those below did not "appropriately respond."[4] In January 2003, the SEC duly adopted comprehensive rules setting forth a mandatory elaborate up the ladder reporting regime while also permitting lawyer disclosure of confidential information to the SEC if the lawyer reasonably believes that disclosure is

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[1] MODEL RULES OF PROF'L CONDUCT R. 1.6 cmt. 2 (2004) [hereinafter MODEL RULES]. *See generally* 1 GEOFFREY C. HAZARD, JR. & W. WILLIAM HODES, THE LAW OF LAWYERING § 9.3 (3d ed. 2001 & Supp. 2005-1).

[2] *See infra* notes 249-321 and accompanying text.

[3] *See, e.g., infra* notes 72-73 and accompanying text.

[4] *See* 15 U.S.C. § 7245 (2005).

necessary to prevent the company from committing a material violation likely to cause substantial financial injury to the company or to investors, or to rectify such injury in the case of past violations.[5] The SEC rules purport to preempt conflicting state rules.[6]

The ABA followed, in August 2003, with comprehensive amendments to Rules 1.6 and 1.13 of the Model Rules of Professional Conduct. As amended, Model Rule 1.6 permits the lawyer to disclose confidential information to prevent the client from committing a crime or fraud reasonably certain to result in financial loss to a third party, or to prevent, mitigate, or rectify financial loss to a third party that is reasonably certain to result from, or has resulted from, the client's past commission of a crime or fraud, if, in all instances, the lawyer's services were used by the client in furtherance of the crime or fraud.[7] Amended Model Rule 1.13 adopts a presumptive up the ladder reporting duty for the corporate lawyer in the case of a corporate agent's violation of law that is likely to result in substantial injury to the corporation and permits the lawyer to disclose confidential information to third parties if the lawyer's up the ladder reporting efforts have been in vain.[8]

Since the ABA adopted these amendments in 2003, they have been somewhat persuasive; at least twenty-one jurisdictions have either adopted or proposed rule changes that would partially or fully conform to the new ABA rules.[9] However, there remains a deep division among the jurisdictions over the disclosure of intended non-criminal fraud and the disclosure of past crime or fraud for the purpose of mitigation or rectification. Jurisdictions are more or less evenly divided between those mandating or permitting disclosure in those circumstances and those prohibiting such disclosure.

In six jurisdictions—Alabama, California, Kentucky, Missouri, Montana, and Rhode Island—disclosure is prohibited in all of the circumstances contemplated by the 2003 ABA amendments, with no proposals for change pending.[10] Particularly notable in dissent have been California lawyers who have been aggressive and unremitting in pressing before every conceivable forum that the disclosure of client confidences permitted under the Sarbanes-Oxley rules and the ABA amendments will seriously and irreparably erode the attorney-client relationship, negatively impacting the lawyer's ability to provide effective counsel for her client.[11] Significantly, California lawyers argue that the SEC's asserted preemption of conflicting state laws is not effective, and that, therefore, lawyers disclosing client confidences under the SEC rules face a substantial risk of state bar discipline or liability for breach of fiduciary duty for violating California's strict confidentiality rules.[12]

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[5] Commodity and Securities Exchanges, 17 C.F.R. pt. 205 (2006).

[6] *Id.* § 205.6(c).

[7] MODEL RULES R. 1.6.

[8] MODEL RULES R. 1.13.

[9] *See infra* notes 243-248 and accompanying text.

[10] *See infra* note 247 and accompanying text.

[11] *See infra* notes 300-310 and accompanying text.

[12] *See infra* notes 314-321 and accompanying text.

Closely related to the professional duty of confidentiality are the attorney- client privilege and the work product doctrine, which share the common goal of encouraging full and frank client communication between client and lawyer by establishing the requisite degree of client trust. Over the course of several years, the U.S. Attorney General, the U.S. Sentencing Commission, and the SEC have developed policies viewing a corporation's waiver of the attorney-client privilege and work product doctrine as a favorable indication that the corporation is fully cooperating with the investigation in question, thereby meriting the mitigation or elimination of punitive measures.[13] Corporations have reported that waivers are becoming routine due to the fear of severe consequences to the corporation if governmental requests for waiver are not granted and that, therefore, the intended protections of the attorney-client privilege and work product doctrine have been severely eroded. As a result, corporations and lawyers report that corporate employees are becoming increasingly reluctant to communicate with corporate lawyers because they have no reasonable assurance of confidentiality.[14]In August 2005, the ABA expressed its strong support for the preservation of the attorney-client privilege and work product doctrine and its opposition to the routine practice by government officials of seeking privilege waivers.[15]

Although significant in its own right, the ABA's action in 2005 regarding the attorney-client privilege can be viewed as having an opposite thrust from the ABA's action in 2003 regarding the duty of confidentiality. In 2005, the ABA moved to enhance the interests of corporate clients in maintaining confidentiality, thereby diminishing the competing law enforcement interests of government. On the other hand, in 2003, the ABA moved to further the protection of the financial interests of third parties, thereby diminishing the competing interests of corporate clients in maintaining confidentiality. The ABA's failure to expressly reconcile these two measures is striking.

The article concludes with a discussion of the vision of lawyering that will best achieve the goal of the corporate lawyer functioning as a trusted counselor for her client, rather than merely as an implementer or transaction engineer. The lawyer who is the client's counselor exercises independent judgment, renders candid advice, and necessarily engages in a moral discourse with her client. The lawyer's ability to function as a counselor is to a significant degree dependent upon the client's willingness to communicate fully and frankly with her. The foundational assumption of the ethics codes is that the client's trust in the lawyer is a necessary prerequisite to his willingness to engage in full, or at least, adequate self- disclosure. It is in this context that the duty of confidentiality is crucial: without it, the client would not trust his lawyer to the extent necessary for effective representation.

The Sarbanes-Oxley rules and the 2003 amendments to the Model Rules are based on the implicit premise that even though the lawyer's primary allegiance is to his client, he is accountable to a significant degree to those third parties having

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[13] *See infra* notes 209-231 and accompanying text.

[14] *See infra* notes 375-381 and accompanying text.

[15] *See infra* notes 239-240 and accompanying text.

legitimate interests in being protected against the client's misdeeds. In contrast, under the state professional responsibility rules prohibiting disclosure in the circumstances contemplated by Sarbanes-Oxley and the 2003 amendments, the lawyer is unabashedly the client's partisan, with a near absolute duty of confidentiality. The conceptual fault line dividing these two visions is fundamental. The debate on which of these visions engenders the degree of trust necessary for the lawyer to be the client's counselor is ongoing and robust.

I. ENRON

Although Enron Corporation was not the first, the only, or the largest company to be involved in the recent wave of corporate scandal (the names of Cendant, Adelphia, Dynergy, Tyco, Rite Aid, ImClone and, most spectacularly, WorldCom come to mind), its demise, the fraud that accompanied it, and, most significantly for present purposes, the performance of its lawyers, were most imbedded in the public consciousness at the time of the professional responsibility reforms mentioned above.[16] In significant respects, these reforms were reactions to the perceived inadequacies in the performance of Enron's lawyers.

It could be said that the first temblor leading to professional responsibility reform was an article by Wall Street Journal staff reporters John Emshwiller and Rebecca Smith appearing in the Journal's October 17, 2001 issue.[17] The subject of the story was an announcement made the previous day by Enron, which had only recently been regarded as one of America's most admired companies,[18] of a charge against earnings of about $1 billion and a reduction in shareholders' equity of approximately $1.2 billion.[19]Although the company's massive write-downs were news in and of themselves, what particularly piqued the reporters' attention was a relatively puny $35 million

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[16] "Enron" became, and remains, a symbol of systemic corporate and legal corruption and dysfunction and the need for reform. *See, e.g.*, ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS (Nancy B. Rapoport & BalaG. Dharan eds., 2004) (extensive collection of articles and papers on Enron, business, law, ethics, and society)[hereinafter ENRON: CORPORATE FIASCOS]; Roger C. Cramton, *Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues*, 58 BUS.LAW 143 (2002); Robert W. Gordon, *A New Role for Lawyers?: The Corporate Counselor After Enron*, 35 CONN. L. REV. 1185 (2003); Deborah L. Rhode & Paul D. Paton, *Lawyers, Ethics, and Enron*, 8 STAN. J.L. BUS. & FIN. 9 (2002).

[17] John Emshwiller & Rebecca Smith, *Enron Jolt: Investments, Assets Generate Big Loss*, WALL. ST. J., Oct.17, 2001, at C1. The following account is based primarily on a discussion in Thomas G. Bost, *The Lawyer as Truth-Teller: Lessons from Enron*, 32 PEPP. L. REV. 505, 506-14 (2005).

[18] *See* REBECCA SMITH & JOHN R. EMSHWILLER, 24 DAYS: HOW TWO *WALL STREET JOURNAL* REPORTERS UNCOVERED THE LIES THAT DESTROYED FAITH IN CORPORATE AMERICA 4 (2003); *see also* MIMI SWARTZ WITH SHERRON WATKINS, POWER FAILURE: THE INSIDE STORY OF THE COLLAPSE OF ENRON 3 (2003) ("In just five years, Enron grew to rival 1990s tech giants like Cisco and Microsoft, and behemoths like GE . . . . *Fortune* Magazine hailed Enron as the country's most innovative company for five years in a row, and included Enron in the top quarter of its list of the 'Best 100 Companies to Work for in America.'").

[19] Neal Batson, FINAL REPORT OF NEAL BATSON, COURT-APPOINTED EXAMINER (2003), *available at* 2003 WL 22853260, at 7; WILLIAM C. POWERS, JR. ET AL., REPOERT OF INVESTIGATION BY THE SPECIAL INVESTIGATIVE COMMITTEE OF THE BOARD OF THE DIRECTORS OF ENRRON CORP. (2002), *available at* 2002 WL 198018, at 2-3.

charge the company said related to the "early termination... of certain structured finance arrangements."[20] Quick checking by the reporters confirmed that these "arrangements" included transactions between Enron and the so-called "LJM" partnerships, controlled by Enron's Chief Financial Officer Andrew S. Fastow. Although the LJM entities had been previously disclosed in Enron's filings with the Securities and Exchange Commission, the descriptions of the arrangements in the filings "were so complicated as to be practically indecipherable."[21] Nevertheless, some aspects of the arrangements had become known to investment analysts and other securities professionals who had expressed concern about the potential conflict of interest presented by Mr. Fastow's participation on both sides of the transactions.[22] Citing internal documents previously obtained by Emshwiller and Smith, the Journal story noted that Mr. Fastow had management fee arrangements with the LJM entities that could produce "millions" of dollars of compensation for him if the entities met performance goals.[23]

Enron's steep decline into ruin had begun. Following in rapid succession were further announcements of mammoth restatements of more than $500 million in the earnings of the four previous fiscal years and reductions of shareholders' equity of more than $2 billion.[24] Negative press coverage was intense.[25] Enron's situation rapidly deteriorated, with a dizzying plunge in stock price, the drastic lowering of its debt ratings, and the activation of credit triggers. The company filed for bankruptcy on December 2, 2001.[26]

Conspicuous among the restatements was the unraveling of investments in, and transactions with, hundreds, if not thousands, of affiliated business entities, including the LJM partnerships, often called "special purpose entities" ("SPEs"), that were found to have had little business purpose for Enron other than to artificially accelerate income, defer loss or expense, book cash flow from operations on its statement of cash flows, or remove debt from its balance sheet.[27]

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[20] Press Release, Enron Corp., Enron Reports Recurring Third Quarter Earnings of $0.43 Per Diluted Share; Reports Non-Recurring Charges of $1.01 Billion After-Tax; Reaffirms Recurring Earnings Estimates of $1.80 for 2001 and $2.15 for 2002; and Expands Financial Reporting (Oct. 16, 2001), *available at* http://picker.uchicago.edu/Enron/EarningsRelease(10-16-01).pdf.

[21] John R. Emshwiller & Rebecca Smith, *Murky Waters: A Primer on Enron Partnerships*, WALL. ST. J., Jan. 21, 2002, at C1.

[22] Emshwiller & Smith, *supra* note 17.

[23] *Id.* The documents were supplied to the reporters by an anonymous internal informant (dubbed "Our Mutual Friend" by the reporters). SMITH & EMSHWILLER, *supra* note 18, at 47-56.

[24] POWERS, *supra* note 19, at 2-3; United States Securities and Exchange Commission Enron Corp. Form 8-K, Item 5 (filed Nov. 8, 2001), *available at* http://www.sec.gov/Archives/edgar/data/1024401/000095012901503835/0000950129-01-503835.txt (advising that audit reports for the previous four years "should not be relied upon").

[25] *E.g.*, SMITH & EMSHWILLER, *supra* note 18, at 102-03 (noting that Enron was the subject of ten major *Wall Street Journal* headlined stories in the approximately six-week period beginning with the first earnings restatement and ending with the bankruptcy filing).

[26] POWERS, *supra* note 19, at 17.

[27] *See generally* Milton C. Regan, *Teaching Enron*, 74 FORDHAM L. REV. 1139 (2005) (comprehensive discussion of these transactions). On Enron's "SPE" transactions, see generally POWERS, *supra* note 19, at 2-4, 18-20; *Lessons Learned from Enron's Collapse: Auditing the Accounting Industry: Hearing Before the House Comm. on Energy and Commerce*, 107th Cong. 87-96

Although details varied considerably, these complex arrangements usually involved the formation of a partnership or limited liability company to serve as an SPE capitalized with equity investment and debt financing from independent equity investors and institutional lenders.[28] This structure was designed to comply with Financial Accounting Standards Board regulations, which accorded independent third party status to the SPE as long as Enron did not control it.[29] As such, the SPE would not be viewed as an Enron subsidiary or affiliate, and transactions between Enron and the SPE would be treated as transactions between unrelated parties. Thus, for example, Enron's financial statements would reflect gains realized on assets sold to the SPEs and cash flow from operations thereon, but would not reflect losses or liabilities incurred or assumed by the SPEs. Some of the most significant transactions with SPEs were hedging transactions in which Enron and the SPEs entered into derivative contracts whereby the SPE assumed the risk of loss on a particular asset, thereby mitigating losses offsetting income or gain previously realized by Enron.

Subsequent review of the transactions revealed that in all too many instances their substance bore little resemblance to their form. In a number of cases, Enron provided some or all of the equity capital injected by the ostensibly independent investors and, in effect, guaranteed the debts incurred by the SPEs to the institutional lenders. Further, Enron executives participated as principals in some of the entities or otherwise directed their activities, and Enron employees performed essential services for them. Thus, in no real sense were the SPEs financially or operationally independent of Enron's control. Accordingly, the gains realized on assets sold to the SPEs should not have been reflected on Enron's income statement, the cash generated by the transactions should not have been reported as cash flow from operating activities, and the losses and debt incurred or assumed by the SPEs should have been reflected on Enron's income statement and balance sheet.[30]

The apparent scope of these transactions was staggering: Enron may have improperly transferred as much as $5 billion in assets to the entities, and Mr. Fastow probably received over $60 million in fees from the entities.[31]

Enron's bankruptcy was a precursor to a host of indictments relating to the company's misuse of the SPEs that resulted in a number of convictions or guilty pleas. Caught up in this legal maelstrom were Enron's auditor, Arthur Andersen,

(2002) (testimony of Bala G. Dharan, Professor, Rice University Graduate School of Management), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname107_house_hearings&docidf:77986.pdf, *reprinted in* ENRON: CORPORATE FIASCOS, *supra* note 16, at 113. For press coverage, see John R. Emshwiller & Rebecca Smith, *Corporate Veil: Behind Enron's Fall, A Culture of Operating Outside Public's View . . .* , WALL ST. J. Dec. 5, 2001, at A1; Emshwiller & Smith, *supra* note 21; Daniel Fisher, *Shell Game: How Enron Concealed Losses, Inflated Earnings—And Hid Secret Deals from the Authorities*, FORBES, Jan. 7, 2002, at 52.

[28] *See* POWERS, *supra* note 19, at 18-20.

[29] *Id.*

[30] *See, e.g.*, Regan, *supra* note 27, at 1156-72 (analysis of Enron's "structured finance transactions").

[31] John R. Emshwiller, *Enron May Have Improperly Moved up to $5 Billion*, WALL ST. J., Mar. 6, 2003, at C10.

LLP ("Andersen") and a number of Enron officers, including Chairman and Chief Executive Officer Kenneth Lay, former Chief Executive Officer Jeffrey Skilling, and Mr. Fastow.[32] Within a week of the first Wall Street Journal story, the first of many securities fraud lawsuits, based primarily on the SPE transactions, had been filed by Enron shareholders against Enron's officers, directors, investment bankers, attorneys, and accountants.[33]

II. ENRON'S LAWYERS

It comes as no surprise that the performance of Enron's corporate and transactional lawyers was almost immediately subjected to the merciless gaze of 20/20 hindsight, with particular attention paid to Enron's primary outside law firm, Vinson & Elkins LLP ("V&E"). Over the years V&E had represented Enron in a wide range of matters, with Enron paying the firm legal fees of over $162 million in the five years ending with 2001.[34] In 2001, Enron's fees of $35.6 million represented almost 8% of V&E's revenues.[35]

The press began examining V&E's relationship with, and representation of, weeks of Enron's bankruptcy.[36]Enron within V&E's conduct was further scrutinized by an investigative committee of Enron's Board of Directors chaired by William C. Powers, Jr., an Enron director and Dean of the University Of Texas

[32] As for Arthur Andersen, see Amon Burton & John S. Dzienkowski, *Reexamining the Role of In-House Lawyers After the Conviction of Arthur Andersen*, *in* ENRON: CORPORATE FIASCOS, *supra* note 16 at 689, 692-711 (discussion of indictment and conviction for obstruction of justice of Arthur Andersen, LLP). *See A Profession Under a Cloud*, WASH. POST, Dec. 30, 2002, at E1 ("Enron . . . led to the indictment and fall of Arthur Andersen LLP . . . ."); *see also Andersen Fades Away*, WASH. POST, Sept. 8, 2002, at H2 ("Arthur Andersen . . . surrendered its licenses to practice accounting in all 50 states."). *But see* Arthur Andersen LLP v. United States, 544 U.S. 696 (2005) (reversing Andersen's conviction for obstruction of justice because of improper jury instructions), *rev'g* United States v. Arthur Andersen, LLP, 374 F.3d 281 (5th Cir. 2004). As for Enron officers, see John R. Emshwiller, *Last Stand: An Audacious Enron Defense: Company's Moves Were All Legal*, WALL ST. J., Jan. 20, 2006, at A1. Also see *Enron's Roll Call*, WASH. POST, Feb. 22, 2004, at F2 ("Skilling was charged with three dozen counts of fraud, insider trading and conspiracy in a lengthy indictment . . . ."); Carrie Johnson, *Lay Feels Betrayed by Enron 'Whiz Kid'; Company's Board Believed Fastow, Former Chairman's Lawyer Says*, WASH. POST, Jan. 16, 2004, at E1 ("Fastow, who pleaded guilty to two conspiracy charges Wednesday, will turn over $29 million in ill-gotten gains and will be sentenced to 10 years in prison."). As for investment bankers, see *3 Sentenced for Enron Deal*, N.Y. TIMES, May 13, 2005, at C12 (noting the conviction of four former Merrill Lynch employees involved in fraudulent transactions with Enron).

[33] Newby v. Enron Corp., 188 F. Supp. 2d 684 (S.D. Tex. 2002), *aff'd*, 302 F.3d 295 (5th Cir. 2002). These actions have resulted in settlement payments to date exceeding $7 billion. *See, e.g.*, Kurt Eichenwald, *Canadian Bank Will Pay Fine and Drop Unit in Enron Accord*, N.Y. TIMES, Dec. 23, 2003, at C1; Kurt Eichenwald & Riva D. Atlas, *2 Banks Settle Accusations They Aided in Enron Fraud*, N.Y. TIMES, July 29, 2003, at A1; Robin Sidel & Mitchell Pacelle, *J.P. Morgan To Settle Enron Lawsuit*, WALL ST. J., June 15, 2005, at A3; Randall Smith, *CIBC To Pay $2.4 Billion over Enron*, WA WALL ST. J., Aug. 3, 2005, at A3.

[34] BATSON, *supra* note 19, at 22.

[35] Ellen Joan Pollock, *Limited Partners: Lawyers for Enron Faulted Its Deals, Didn't Force Issue*, WALL ST. J, May 22, 2002, at A1.

[36] *Id.; see also* James V. Grimaldi, *As Enron Irregularities Mount, Outside Law Firm Subtly Tries To Deflect, and Reassign, Blame*, WASH. POST, Mar. 25, 2002, at E11; Tom Hamburger & Kathryn Kranhold, *Law Firm Reassured Enron on Accounting*, WALL ST. J., Jan. 16, 2002, at A18; Richard A. Oppel, Jr., *Enron's Many Strands: The Hearings; Lawmakers Contend Lawyers for Enron Should Have Raised Concerns*, N.Y. TIMES, Mar. 15, 2002, at C7; John Schwartz, *Enron's Many Strands: The Lawyers; Troubling Questions Ahead for Enron's Law Firm*, N.Y. TIMES, Mar. 12, 2002, at C1.

School Of Law. The committee issued its report (the "Powers Report") on February 1, 2002, less than two months after the company's bankruptcy.[37] In addition, in the months leading up to the SEC's adoption of its rules governing corporate lawyers, various legal commentators subjected V&E's performance to careful, and often critical, review.[38]On May 22, 2002, Neal Batson was appointed Examiner in the Enron bankruptcy by the Bankruptcy Court to investigate the SPE transactions and related matters. Over the course of the next eighteen months, Examiner Batson issued four comprehensive reports, with the final report (the "Batson Report") issued on November 8, 2003.[39] Included in the Batson Report was a comprehensive examination of the conduct of Enron's in-house and primary outside counsel, including, of course, V&E.[40] The Batson Report was issued too late to directly influence the deliberations of the SEC and ABA in the adoption of their new lawyer responsibility rules. However, it should be noted that, with regard to V&E, the Batson Report substantially confirmed conclusions reached earlier by the other observers noted herein.

Much attention was directed to the role of V&E in the so-called "Watkins Investigation." In August 2001, Sherron Watkins, an Enron financial executive, sent Kenneth Lay the first of several letters and other written communications expressing her deep concern about the bona fides and accounting treatment of several of the SPE transactions.[41] Watkins stated that she was "incredibly nervous that we will implode in a wave of accounting scandals" and recommended that the company commission a review by independent counsel and accountants, specifically cautioning that V&E should not be retained for that purpose because of its previous involvement in the structuring and disclosure of the SPE transactions.[42]

Shortly after receiving Watkins's first communication, Enron's General Counsel James Derrick met with V&E attorneys and requested their assistance in responding to Watkins's stated concerns.[43] Specifically, Derrick told the V&E attorneys that Enron's objective was to quickly determine "whether Watkins's concerns were widely shared among Enron's senior management group and whether the letter presented new facts that were not understood by those individuals."[44] Although the V&E attorneys knew that the firm had performed substantive legal work on several of the transactions specifically questioned by Watkins, they accepted the assignment, but did not inform Derrick of the potential conflict of interest posed by the firm's previous involvement in the

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[37] POWERS, *supra* note 19.

[38] *See, e.g.*, Roger C. Cramton, *supra* note 16, at 166; Gordon, *supra* note 16, at 1201; Rhode & Paton, *supra* note 16.

[39] BATSON, *supra* note 19.

[40] NEAL BATSON, FINAL REPORT OF NEAL BATSON, COURT-APPOINTED EXAMINER, APPENDIX C (ROLE OF ENRON'S ATTORNEYS), *available at* 2003 WL 22853263.

[41] The "Watkins Investigation" is described *id.* at 59-77; SWARTZ, *supra* note 18, at 273-315, 369-73; Bost, *supra* note 17, at 506-14; Cramton, *supra* note 16, at 162-67; Hamburger & Kranhold, *supra* note 36, at A18.

[42] BATSON, *supra* note 40, at 9.

[43] *Id.*

[44] *Id.* at 60.

transactions in question.[45] V&E understood its assignment as a "fact finding mission," with further independent legal and accounting review dependent upon the responses of the Enron and Andersen personnel to be interviewed.[46] In accepting the assignment, V&E agreed that the scope of its review would be subject to several significant limitations imposed by Enron: V&E would not "second guess" the accounting judgments of Andersen reflected in the Enron financial statements; "dig down" into the transactions in question; attempt to study the particular structure of the transactions; or analyze the adequacy of disclosure of the transactions by "rebuilding" the disclosure process.[47]

Over the next two weeks or so, V&E interviewed eight Enron executives, two Andersen partners, and Watkins. It appears that, other than a review of minutes of the Audit and Finance Committees of the Enron Board of Directors, V&E's investigation consisted solely of these interviews.[48] Based on the interviews, V&E concluded that none of the Enron interviewees believed that Enron had suffered from the SPE transactions or that the transactions were not in Enron's best interest, and that the Andersen interviewees were comfortable with the accounting treatment of the transactions.[49] The Batson Report notes that V&E did not determine how the Enron interviewees had reached their sanguine view, even though a V&E transactional attorney who had been substantively involved in a number of the SPE transactions in question had expressed significant reservations about the substance of the transactions in internal V&E conversations during the course of the investigation.[50] V&E did not communicate those reservations to Enron.[51]

About a month after initiating its review, V&E orally reported its conclusions first to Lay and Derrick, then to the chair of the Audit Committee of the Enron Board, and finally to the full Audit Committee.[52] On October 15, 2001, V&E submitted a nine page written report on its assignment, which it characterized as a "preliminary investigation," to Derrick.[53] After describing the procedures followed in the investigation and the responses of the interviewees to some of the concerns raised by Watkins and restating its conclusions as noted above, V&E closed the report by stating "that a further widespread investigation by independent counsel and auditors" was not warranted.[54] Concern was expressed over the "bad cosmetics" of the SPE transactions and the consequent risk of negative publicity (such as "a Wall Street Journal expose or class action

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[45] *Id.* at 61.

[46] *Id.*

[47] *Id.*

[48] *See id.* at 1-64.

[49] *Id.* at 63.

[50] *Id.*

[51] *Id.* at 64.

[52] *Id.*

[53] Letter from Max Hendrick III, Vinson & Elkins, L.L.P., to James V. Derrick, Jr., Executive Vice President and General Counsel, Enron Corp. (Oct. 15, 2001), *available at* 2001 WL 1764266 [hereinafter Hendrick Opinion Letter].

[54] *Id.* at 7.

lawsuit").[55] Ironically, within two days of V&E's letter, the first Wall Street Journal article specifically referring to the SPE transactions appeared,[56] and, within a week, a securities fraud class action suit had been filed.[57]

There are a number of questions about both the nature and scope of V&E's engagement in the Watkins Investigation. As to its nature, why would Enron commission its lawyers to determine and report on the opinions of corporate and accounting insiders, all of whom were immediately and directly available and, in fact, beholden, to corporate management? As to its scope, why would Enron impose limitations on V&E's involvement that would almost necessarily insure that only the views of those insiders would be reported, rather than fresh insights that might result from an independent investigation and review by counsel? What is clear is that V&E's acceptance of the nature and limited scope of the engagement determined its outcome. As the Powers Report states: "[t]he result of the V&E review was largely predetermined by the scope and nature of the investigation and the process employed."[58] In a very real sense, V&E had foreclosed its ability to tell the truth about the substance of the SPE transactions by: (1) limiting the investigation to conversations with Enron and Andersen insiders, almost all of whom "had substantial professional and personal stakes in the matters under review;"[59] (2) eschewing substantive legal and accounting (presumably with the assistance of accounting experts) review of the SPE transactions; and (3) failing to report its own institutional (in the person of its transactional partner who had firsthand knowledge of the SPE transactions) reservations concerning the substance of the transactions. The Powers Report notes, with commendable restraint, that V&E's investigation was "structured with less skepticism than was needed to see through these particularly complex transactions."[60]

Observers have not been shy in ascribing unsavory motives to Enron for framing an assignment with such narrow scope and nature. A very real possibility is that Enron management wanted its sophisticated and trusted legal counsel to issue a report on its prestigious letterhead that had the appearance (but not the reality, if closely and discerningly read) of blessing the SPE transactions. It may have desired a "protective document"[61] from a credible source that would "provide cover on the broader question: 'There is no problem that deserves a full investigation.'"[62] Its object may have been to use the V&E report "to paint a gloss of respectability (sprinkle holy water, as it were) on dubious transactions."[63] Examiner Batson noted that "[m]any times Enron officers appear to have obtained opinions or advice from professionals merely as a necessary step to justify

[55] *Id.*

[56] *See* Emshwiller & Smith, *supra* note 17.

[57] Newby v. Enron Corp., 188 F. Supp. 2d 684 (S.D. Tex. 2002), *aff'd*, 302 F.3d 295 (5th Cir. 2002).

[58] POWERS, *supra* note 19, at 81.

[59] *Id.*

[60] *Id.*

[61] Cramton, *supra* note 16, at 166.

[62] *Id.* at 164.

[63] Gordon, *supra* note 16, at 1201.

questionable decisions rather than as a tool to assist them in reaching a considered business decision based upon the risks."[64] The Watkins Investigation is cited as a supporting example.[65] Enron management may have been particularly interested in having a soothing message conveyed to the Audit Committee of the Board. The Powers Report notes the Board's heavy reliance on V&E's "perceived approval" of the structure and disclosure of the SPE transactions.[66]

Critics of V&E have focused on (1) V&E's acceptance of an assignment of such narrow scope even though it was apparent that a broader question—"Do we have a problem here?"—should, in fact, have been posed; (2) the conflict of interest posed by V&E's assessing the propriety of transactions in which it had previously been involved as Enron's transactional counsel; (3) the perfunctory nature of the investigation and review carried out by V&E; and (4) V&E's assumption of the role of mere interviewer and scrivener, conveying a generally reassuring message even though it had institutional knowledge that at least some of the SPE transactions were problematic.[67]

The conclusion can be drawn that V&E did not serve its client well in the Watkins Investigation. V&E's transmission to the Board's delegated Audit Committee of the self-serving assurances of interested insiders, or its conclusion that no further investigation was warranted, without expressing any of the internal reservations held by members of the law firm, did not assist the Board of Directors in fulfilling its responsibilities as ultimate manager and director of the business and affairs of the company. V&E's communications to the Audit Committee provided no brighter illumination or deeper understanding of the essential truth about the SPE transactions, the very transactions that brought the company down. In fact, V&E may have obscured the Board's understanding of the truth by delivering a communication that could be taken as clearing the SPE transactions of suspicion and reassuring the Board that no further inquiry was necessary.

From time to time, attorneys at V&E participating in the structuring and disclosure in SPE transactions had raised concerns about the conflict-of-interest issues posed by the financial and managerial involvement of Mr. Fastow and other Enron employees on both sides of SPE transactions, and had also questioned the economic reality, and, hence, the legal effectiveness, of a number of the SPE transactions.[68] Although V&E lawyers generally shared their concerns with the in-house Enron lawyers with whom they were directly involved in the transactions, they chose not to take these concerns "up the ladder" to the company's senior executives or to the Board.[69] Significantly, former V&E managing partner Harry Reasoner was quoted as questioning the propriety of going over the heads of the firm's direct contacts at Enron:

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[64] BATSON, *supra* note 19, at 45.

[65] *Id.* at 46.

[66] POWERS, *supra* note 19, at 15.

[67] *See* Cramton, *supra* note 16, at 163-69.

[68] Pollock, *supra* note 35.

[69] *Id.*; *see* Regan, *supra* note 27, at 1164.

> We were giving our advice to the people we were instructed to give it to under their protocol, the in-house lawyers . . . .The implication that we should have gone around their in-house lawyers and their executives directly to the board, I would say we had no basis for believing that such an extraordinary action would have been appropriate or necessary.[70]

Because V&E viewed "going up the ladder" as inappropriate and unnecessary, there was nothing to cause the Board to forsake its heavy reliance on, in the words of the Powers Report, "the perceived approval of Vinson & Elkins of the structure and disclosure of the [SPE] transactions."[71]

Examiner Batson concluded his review of the role of Enron's lawyers in the debacle by noting that the lawyers "could have provided a check and balance against the Enron officers' wrongdoing."[72] He concludes, however, that they failed to do so because of a dual failure of vision—a failure to see who their client was and a failure to see what their role was:

> One explanation for the attorneys' failure may be that they lost sight of the fact that the corporation was their client. It appears that some of these attorneys considered the officers to be their clients when, in fact, the attorneys owed duties to Enron. Another explanation may be that some of these attorneys saw their role in very narrow terms, as an implementer, not a counselor. That is, rather than conscientiously raising known issues for further analysis by a more senior officer or the Enron Board or refusing to participate in transactions that raised such issues, these lawyers seemed to focus only on how to address a narrow question or simply to implement a decision (or document a transaction).[73]

The reform of the role of corporate counsel that followed the collapse of Enron was intended to address this fundamental failure of vision.

III. THE SARBANES-OXLEY ACT OF 2002

The Sarbanes-Oxley Act of 2002 (variously, "Sarbanes-Oxley" or the "Act")[74] was passed by Congress with nearly unanimous votes and signed into law by President Bush on July 30, 2002, less than seven months after the Enron bankruptcy. The Act, described by the President as incorporating "the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt,"[75] was intended to re-establish investor confidence in the public securities markets by reforming public company accounting, reforming the

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[70] Pollock, *supra* note 35.

[71] POWERS, *supra* note 19, at 15.

[72] BATSON, *supra* note 19, at 52.

[73] *Id.* (emphasis added).

[74] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, 784 (codified as amended in various sections of 11, 15, 18, 28 and 29 U.S.C.) The Act is formally comprised of four separate but complimentary titles: the "Public Company Accounting Reform and Investor Protection Act of 2002"; the "Corporate and Criminal Fraud Accountability Act of 2002"; the "White-Collar Crime Penalty Enhancement Act of 2002"; and the "Corporate Fraud Accountability Act of 2002."

[75] President George W. Bush, President Bush's Remarks as He Signs the Sarbanes-Oxley Act of 2002 at the White House (July 30, 2002), *available at* http://www.whitehouse.gov/news/releases/2002/07/print/ 20020730.html.

governance of public companies, improving the quality of public company disclosure and financial reporting, and enhancing the objectivity of securities analysts.[76] By late January 2003, the SEC had adopted most of the implementing rules contemplated by the Act, completing what its former chairman called "the most intense rule-making period in its history."[77]

A central feature of the Act's corporate governance reform is Act Section 307, which mandates the issuance by the SEC of "minimum standards of professional conduct" for lawyers representing public companies.[78] Section 307 was the result of an amendment to Senate Bill 2673, the Senate version of the Act, proposed by Senator John Edwards of North Carolina.[79] In a letter dated June 18, 2002, to SEC Chairman Harvey Pitt, Senator Edwards expressed the view that, under the federal securities laws, a "lawyer with knowledge of managers' serious, material, and unremedied violations of federal securities law should have an obligation to inform the board of those violations.... Recognition and enforcement of this important but limited obligation could prevent substantial harms to shareholders and the public."[80] Thus, Senator Edwards made it clear that he believed it should be mandatory, under federal law, for an attorney to go up the ladder to the board of directors, an action that V&E's Mr. Reasoner viewed as being "extraordinary" and neither "appropriate or necessary" in the case of Enron.[81] On July 10, 2002, not having received a response from Chairman Pitt,[82] Senator Edwards proposed the amendment to S. 2207 that would become Section 307.[83] With little debate, the Section was approved by the Senate five days later without a single negative vote,[84] and, over the course of the next two weeks, it was approved by both the House[85] and Senate[86] as a part of the Act.

Section 307 directed the SEC to issue rules within 180 days of enactment setting forth "minimum standards of professional conduct" for lawyers "appearing and practicing" before the SEC in the representation of "issuers," i.e., entities, both domestic and foreign, subject to the filing, disclosure, and reporting requirements of the Securities and Exchange Act of 1934, and companies

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[76] For a brief summary of the Act and the circumstances of its enactment, see generally Thomas G. Bost, *The Sarbanes-Oxley Act of 2002: A Summary*, BRIEFLY ... PERSP. ON LEGIS. REG. & LITIG., Apr. 2003, at 1-7, *available at* 2003 WL 1909734, at 1-4. Also see Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 4-18, 62 67 (2002).

[77] Arthur Levitt, Jr., *The SEC's Repair Job*, WALL ST. J.., Feb. 10, 2003, at A14.

[78] 15 U.S.C. § 7245 (2005).

[79] For a helpful discussion of the events surrounding the adoption of Act Section 307, see Thomas D. Morgan, *Sarbanes-Oxley: A Complication, Not a Contribution, in the Effort to Improve Corporate Lawyers' Professional Conduct*, 17 GEO. J. LEGAL ETHICS 1, 11-18 (2003).

[80] Letter from John Edwards, Senator, U.S. Senate, to Harvey Pitt, Chairman, SEC (June 18, 2002), *reprinted in* 148 CONG. REC. S5652, S5653 (daily ed. June 18, 2002) (statement of Sen. Edwards).

[81] Pollock, *supra* note 35.

[82] 148 CONG. REC. S6552, S6552 (daily ed. July 10, 2002) (statement of Sen. Edwards).

[83] *Id.* at S6552, S6559.

[84] 148 CONG. REC. S6734, S6778 (daily ed. July 15, 2002).

[85] 148 CONG. REC. H5462, H5480 (daily ed. July 25, 2002).

[86] 148 CONG. REC. S7350, S7365 (daily ed. July 25, 2002).

with filed, but not yet effective or withdrawn, registration statements under the Securities Act of 1933.[87] The standards of conduct so adopted were required to include a rule requiring a lawyer covered by Section 307 to report evidence of a "material violation" of securities law, a breach of fiduciary duty, or a similar violation by the company or any of its agents to the company's chief legal counsel or chief executive officer.[88] Further, the adopted rule had to provide that if the designated officer did not "appropriately respond" to the evidence by adopting appropriate remedial measures or sanctions, the lawyer must make a similar report to the company's audit committee, other board committee comprised exclusively of non-employee directors, or the full board of directors.[89]

In response to Section 307's directive, the SEC issued proposed rules on November 21, 2002,[90] and, after receiving 167 comment letters, issued final rules on January 29, 2003,[91] to become effective on August 5, 2003.

The rules of practice issued by the SEC set forth "minimum standards of professional conduct for attorneys."[92] As such, the SEC rules are intended to supplement, rather than to limit, the ability of the various states to impose additional professional obligations consistent with them, but they do purport to preempt state rules if the latter conflict with them.[93] A lawyer complying "in good faith" with the SEC rules of practice is not to be subjected to discipline under inconsistent state practice standards.[94] Although a lawyer's violation of the SEC rules will subject her to the penalties and remedies generally applicable to securities law violations,[95] the SEC rules create no private right of action against any lawyer or company based upon noncompliance.[96]

In implementing the "up the ladder" reporting scheme of the Act, the SEC rules confirm the Act's underlying premise that the company "as an organization," as opposed to any particular company director, officer, or employee, is the lawyer's client.[97] Thus, communication to the officers or directors as agents of the company does not constitute an unauthorized disclosure of confidential

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[87] 15 U.S.C. §§ 7201(7), 7245 (2005). For convenience, the term "company," rather than the statutory term"issuer," is used herein.

[88] *Id.* § 7245.

[89] *Id.*

[90] *See* Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. 71670 (proposed Dec. 2, 2002) (to be codified at 17 C.F.R. pt. 205) [hereinafter Proposed Rules Release].

[91] Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6296 (codified at 17 C.F.R. pt. 205), *available at* http://www.sec.gov/rules/final/33-8185.htm [hereinafter Final Rules Release]. For analysis and critique of the SEC rules, see Roger C. Cramton, George M. Cohen & Susan P. Koniak, *Legal and Ethical Duties of Lawyers After Sarbanes-Oxley*, 49 VILL. L. REV. 725 (2004); Morgan, *supra* note 79, at 29-34; Sabino Rodriguez III & Robert Knuts, *Representing the Public Company: A Post-Sarbanes-Oxley Governance Paradigm for In-House Lawyers and Outside Counsel*, BRIEFLY . . . PERSP. ON LEGIS. REG. & LITIG., Jan. 2004.

[92] Commodity and Securities Exchanges, 17 C.F.R. § 205.1 (2006).

[93] *Id.*

[94] *Id.* § 205.6(c).

[95] *Id.* § 205.6(a).

[96] *Id.* § 205.7(a).

[97] *Id.* § 205.3(a).

or privileged information.[98]

The reach of the SEC rules of conduct is broad. Under the rules, a lawyer will be viewed as "appearing and practicing" before the SEC, and therefore within the reach of the rules, if in the context of providing legal services to a company with whom she has an attorney-client relationship, she (1) transacts business or communicates with the SEC, (2) represents the company in an SEC administrative proceeding or in connection with an SEC investigation, inquiry, information request, or subpoena, (3) advises the company concerning federal securities laws or SEC rules in connection with a document that the attorney has notice will be filed with or submitted to the SEC, or (4) advises the company as to whether information or a statement, opinion, or other writing is required to be filed or submitted to the SEC under the securities laws or the SEC rules.[99]

Belying the apparent simplicity of the "up the ladder" reporting concept, the SEC rules establish a complex, if not byzantine,[100] reporting scheme for lawyers. If a lawyer "appearing and practicing" before the SEC in the representation of a company becomes aware of evidence of a "material violation," i.e., a material violation of federal or state securities law or any other federal or state law or material breach of fiduciary duty by the company or any of its officers, directors, employees, or other agents,[101] she must either report such evidence to the company's chief legal officer (or jointly to the chief legal officer and the chief executive officer) or to the "qualified legal compliance committee" ("QLCC") of the board if the board has such a committee.[102]

If the reporting lawyer chooses the first route, the company's chief legal officer in turn has a choice of routes: either he may cause an inquiry into the reported evidence of a material violation as he reasonably believes appropriate to determine whether the violation has occurred, is ongoing, or is about to occur, or he may refer the reported evidence to a pre-existing QLCC.[103] If the chief legal officer chooses the first route, and he determines that no material violation has occurred, is ongoing, or is about to occur, he must notify the reporting lawyer of that determination and basis therefore.[104] On the other hand, "[u]nless the chief legal officer . . . reasonably believes that no material violation has occurred, is ongoing, or is about to occur," he must take all reasonable steps to cause the company to adopt an "appropriate response" and so advise the reporting lawyer.[105]

Unless the reporting lawyer reasonably believes that the chief legal officer or chief executive officer has provided an "appropriate response" within a

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[98] *Id.* § 205.3(b)(1).

[99] *Id.* § 205.2(a). A "non-appearing foreign attorney" is not viewed as "appearing and practicing" before the SEC. *Id.* § 205.2(a)(2)(ii), (j).

[100] *See* Rodriguez & Knuts, *supra* note 91, at 16-21 (6 page, 3 chart, and 28 question diagrammatical exposition of the SEC reporting rules).

[101] Commodity and Securities Exchanges, 17 C.F.R. § 205.2(i) (2006).

[102] *Id.* § 205.3(b)(1), (c)(1).

[103] *Id.* § 205.3(b)(2), (c)(2).

[104] *Id.* § 205.3(b)(2).

[105] *Id.*

reasonable period of time, she must report the evidence of material violation either to (1) the audit committee of the board, (2) a board committee comprised solely of non-employee directors (if there is no audit committee), or (3) the full board of directors (if there is no board committee comprised solely of non-employee directors).[106] Further, if the reporting lawyer reasonably believes that it would be futile in the first instance to report the evidence of material violation to the chief legal officer and chief executive officer, she may bypass these officers and come directly before the audit committee, the committee of non-employee directors, or the full board of directors to make her report.[107] If the reporting lawyer does not reasonably believe that the company has made an appropriate response within a reasonable time to the report or reports described above, she must give an explanation of the reasons for her belief to the chief legal officer, the chief executive officer, and the board or board committee receiving her initial report.[108] On the other hand, if the lawyer receives what she reasonably believes to be an appropriate response in a timely manner, then there is no obligation to pursue the matter further.[109]

A reporting lawyer may come to the conclusion that there has been an "appropriate response" to her report of evidence of a material violation if, based upon the response received, she reasonably believes that: (1) no material violation has occurred, is ongoing, or is about to occur; (2) the company has adopted appropriate remedial measures to stop an ongoing material violation, prevent a future material violation, or remedy and minimize the likelihood of recurrence of a past material violation; or (3) the company, with the consent of the board of directors, QLCC, or other committee comprised of non-employee directors has retained or directed a lawyer to review the reported evidence and has either implemented the remedial recommendations made by the reviewing lawyer after reasonable investigation and evaluation or been advised by the reviewing lawyer that he may assert a colorable defense on behalf of the company or its agents in any investigation or administrative or judicial proceeding relating to the reported evidence of material violation.[110]

If the reporting lawyer chooses to go directly to the QLCC, she need make no determination as to whether the QLCC has made an appropriate response to the evidence of the material violation presented.[111] Similarly, if the chief legal officer refers the matter to the QLCC rather than conducting an inquiry, then his only remaining duty is to inform the reporting lawyer of the referral.[112] Thereafter, the responsibility for disposing of the matter rests with the QLCC.[113]

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[106] *Id.* § 205.3(b)(3).

[107] *Id.* § 205.3(b)(4).

[108] *Id.* § 205.3(b)(9). If an attorney formerly employed by the company reasonably believes that she was discharged for reporting evidence of a material violation, she may notify the board or any committee thereof of such belief. *Id.* § 205.3(b)(10).

[109] *Id.* § 205.3(b)(8).

[110] *Id.* § 205.2(b).

[111] *Id.* § 205.3(c)(1).

[112] *Id.* § 205.3(c)(2).

[113] *See id.* § 205.2(k)(3)(iii)-(4).

As may be evident from the preceding discussion, the existence of a QLCC would appear to make life easier for the reporting lawyer and chief legal officer. Referral of evidence of a material violation by the reporting lawyer or chief legal officer to a QLCC would simplify and streamline the process because there would be no need on the part of either of them to report the evidence further "up the ladder," or to otherwise assess the appropriateness of the company's response to the reported evidence.

The rules define a QLCC as a committee of the board of directors that:

(1) consists of at least one member of the audit committee and two other non-employee directors;

(2) has adopted written procedures for the confidential handling of reports of evidence of a material violation;

(3) has been established by the company's board with the authority and responsibility (a) to inform the chief executive officer and the chief legal officer of any report of evidence of a material violation received by it, (b) to determine whether an investigation of such evidence is necessary and, if it determines to investigate, to so notify the audit committee or the full board and initiate the investigation to be conducted by the chief legal officer or outside counsel and with such other expert assistance as it deems necessary, and (c) at the conclusion of the investigation to recommend that the company implement an appropriate response to the evidence of material violation and so inform the chief executive officer and chief legal officer; and

(4) has the authority to take any other appropriate action including notifying the SEC if the company fails to implement in any material respect the appropriate response recommended by the QLCC.[114]

Interestingly, relatively few companies have adopted QLCCs.[115]Professor Robert Rosen concludes that lawyers have resisted the formation of QLCCs because they want to prevent the Board of Directors, acting through the QLCC, from managing legal compliance, thereby assuming a function presently exercised by counsel.[116] On the other hand, Susan Hackett, Senior Vice President and General Counsel for the Association of Corporate Counsel, speculates that corporate boards have decided not to form QLCCs because of their reluctance to create "yet another board committee structure with concomitant director liability" that would relieve company counsel of their reporting and monitoring responsibilities under the Section 307 rules.[117]

The lawyer's duty to report evidence of a material violation is not universal; exceptions to the duty exist in three primary situations. First, a lawyer retained or

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[114] *See id.* § 205.2(k).

[115] Robert Eli Rosen, *Resistance To Reforming Corporate Governance: The Diffusion of QLCCs*, 74 FORDHAM L. REV. 1251, 1252 (2005) (as of September 30, 2005, only 456 out of over 18,000 companies subject to the Act had formed QLCCs).

[116] *Id.* at 1309-11.

[117] Susan Hackett, *QLCCs: The In-House Perspective*, WALL ST. LAW., May 2004, *available at* http://www.realcorporatelawyer.com/wsl/wsl0504.html.

directed by the chief legal officer to investigate evidence of a material violation has no duty to report up the ladder if he duly reports the results of his investigation to the chief legal officer and either (1) both he and the chief legal officer reasonably believe that no material violation has occurred, is ongoing, or is about to occur, or (2) upon receiving the investigating lawyer's report, the chief legal officer sends the report up the ladder as described above.[118] Second, a lawyer who has been retained by the chief legal officer to assert a "colorable defense" on the company's behalf in the course of an investigation or administrative or judicial proceeding relating to evidence of a material violation has no duty to report up the ladder if the chief legal officer makes timely reports on the status of such proceedings to the board, appropriate board committee, or QLCC, as the case may be.[119] Third, a lawyer retained by a QLCC to investigate or assert a colorable defense concerning evidence of a material violation has no duty to report up the ladder.[120]

The Section 307 rules permit lawyer disclosure of client confidences under several circumstances. Any report of evidence of a material violation and response thereto may be used by a lawyer in connection with any investigation, proceeding, or litigation in which the lawyer's compliance with the Section 307 rules is at issue.[121] More significantly, the lawyer is permitted to disclose to the SEC, without the company's consent, "confidential information related to the representation" of the company to the extent that the lawyer "reasonably believes" that disclosure is necessary to: (1) prevent the company from committing a material violation likely to cause substantial injury to the financial interest or property of either the company or investors; (2) prevent the company, in an SEC investigation or administrative proceeding, from committing or suborning perjury or perpetrating a fraud upon the SEC; or (3) rectify the consequences of a material violation by the company that has caused, or may cause, substantial injury to the financial interest or property of the company or investors in the furtherance of which the lawyer's services have been used.[122] This disclosure of client confidences operates more or less independently of the other Section 307 rules. For example, the lawyer's reporting of evidence of a material violation to the chief legal officer, or to any board committee, is not a prerequisite to the disclosure of confidential information to the SEC under the circumstances noted above.

The rules on lawyer responsibility have been among the most controversial adopted by the SEC under the Act.[123] The so-called "noisy withdrawal" feature of the proposed rules, which existed in tandem with the predecessor of the permissive disclosure rules discussed above, was most hotly debated.[124] Under the noisy withdrawal proposal, if a lawyer reporting evidence of a material

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[118] Commodity and Securities Exchanges, 17 C.F.R. § 205.3(b)(6)(i) (2006).

[119] *Id.* § 205.3(b)(6)(ii).

[120] *Id.* § 205.3(b)(7).

[121] *Id.* § 205.3(d)(1).

[122] *Id.* § 205.3(d)(2).

[123] *See infra* notes 128-136 and 305-321 and accompanying text.

[124] *See infra* notes 128-136 and accompanying text.

violation has not received an appropriate response to her report, and reasonably believes that a material violation is ongoing or about to occur and is likely to result in substantial injury to the financial interest or property of the company or investors, then she must withdraw from representing the company, indicate that the withdrawal was based on "professional considerations," and, within one day of her withdrawal, so notify the SEC, again indicating that the action was based on "professional considerations."[125] Further, the lawyer must promptly disaffirm to the SEC any opinion, document, representation, affirmation, or characterization in any document submitted to or filed with the SEC that the lawyer had prepared and now reasonably believes to be false or misleading.[126] It should be noted that no obligation of noisy withdrawal would fall on the lawyer if the evidence of material violation were reported directly to the QLCC.[127]

Reaction to the noisy withdrawal proposal ranged from strong and sometimes vehement objections coming primarily from the organized bar and law firms, to staunch support coming most noticeably from the academic community.[128] The ABA's comment letter to the SEC was typical of the bar's response.[129] The ABA first noted its belief that the noisy withdrawal rule risked "creating divided loyalties[,] driving a wedge into the attorney-client relationship," destroying the trust and confidence that companies should reasonably place in their counsel, thus increasing the possibility that companies would not consult qualified attorneys on close disclosure issues.[130]Further, mandating a speedy noisy withdrawal was seen as removing the flexibility and time that lawyers need to effectively counsel their clients concerning their obligations under the law.[131] Finally, the noisy withdrawal rule could place a lawyer in an untenable situation because if in hindsight her belief that a material violation was "ongoing or about to occur" was determined not to have been "reasonable," the lawyer could be subject to a malpractice action for her effective waiver of the attorney-client privilege and disclosure of confidential client information.[132]

Contrary to the ABA's criticism were views expressed by Professors Susan Koniak, Roger Cramton, and George Cohan, joined by forty-eight academics expressing general agreement on the efficacy of the noisy withdrawal rule.[133]

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[125] Proposed Rules Release, *supra* note 90, at 71688.

[126] *Id.* If the material violation has occurred in the past but is not ongoing or about to occur, Proposed Rule Section 205.3 permits, but does not require, withdrawal, notification, and disaffirmance. *Id.*

[127] *Id.* In-house counsel would be subject to noisy withdrawal requirements similar to those for outside counsel except that resignation ("withdrawal") would not be required. *Id.* at 71688-89.

[128] *See* Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6324, 6324-6325 (proposed Feb. 6, 2003) (to be codified at 17 C.F.R. pts. 205, 240, 249).

[129] Letter from Alfred P. Carlton, Jr., President, Am. Bar Ass'n, to SEC (Dec. 18, 2002), *available at* http://www.sec.gov/rules/proposed/s74502/apcarlton1.htm.

[130] *Id.* pt. VI.B.

[131] *Id.*

[132] *Id.*

[133] Letter from Susan P. Koniak, Roger C. Cramton & George M. Cohen (endorsed by named academics), to SEC (Dec. 17, 2002), *available at*

Professors Koniak, Cramton, and Cohan noted that the noisy withdrawal proposal was consistent with rules of professional ethics in most states, in that the lawyer's disaffirmance of documents or representations tainted by crime or fraud was permissible "in virtually all states."[134]They further opined that most companies would likely adopt the QLCC mechanism, resulting in the elimination of the lawyer's "reporting out" obligation.[135] Finally, the obligation of the lawyer to noisily withdraw was seen as a deterrent to erring company managers or boards who would not be deterred from material violations by the possibility of a quiet withdrawal by counsel.[136]

In the face of the extensive comments it received on the noisy withdrawal proposal, the SEC reserved that portion of the rules and invited further comment.[137] In addition, the SEC invited comment on an alternative proposal that would require the company, rather than the lawyer, to notify the SEC of the lawyer's withdrawal from representation because of the company's failure to appropriately respond to her report of evidence of a material violation, i.e., a withdrawal of counsel based on "professional considerations."[138] The comment period for both of these proposals expired on April 7, 2003,[139] and there has been no official SEC communication on whether either of the proposals will be adopted.

IV. THE MODEL RULES OF PROFESSIONAL CONDUCT: 2003 AMENDMENTS

On March 28, 2002, about midway between the dates of the Enron bankruptcy and the Senate's adoption of Sarbanes-Oxley Section 307, ABA President Robert Hirshon appointed a "Task Force on Corporate Responsibility" (variously, "Corporate Responsibility Task Force" or "Task Force"), chaired by James H. Cheek, III. The Task Force was charged with examining "systemic issues relating to corporate responsibility arising out of the unexpected and traumatic bankruptcy of Enron and other Enron-like situations which have shaken confidence in the effectiveness of the governance and disclosure systems applicable to public companies in the United States."[140] Among the "systemic issues" to be examined was "the framework of laws and regulations and ethical principles governing the roles of lawyers, executive officers, directors, and other key participants," with such issues to be studied

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http://www.sec.gov/rules/ proposed/s74502/skoniak1.htm.

[134] *Id.* pt. 3.

[135] *Id.*

[136] *Id.*

[137] Implementation of Standards of Professional Conduct for Attorneys, *supra* note 128, at 6325.

[138] *Id.* at 6324.

[139] *Id.*

[140] ABA Task Force on Corp. Responsibility, *Report of the American Bar Association Task Force on Corporate Responsibility*, 59 BUS. LAW. 145, 145-46 (2003) [hereinafter Final Report]. On the work of the Task Force, see Cramton, Cohen & Koniak, *supra* note 91, at 729 33, 736-40, 779-86; Lawrence A. Hamermesh, *The ABA Task Force on Corporate Responsibility and the 2003 Changes to the Model Rules of Professional Conduct*, 17 GEO. J. LEGAL ETHICS 35 (2003); Morgan, *supra* note 79.

"in the context of checks and balances designed to enhance the public trust in corporate integrity and responsibility."[141] Thus, it was clear from the outset that a primary focus of the Task Force's work would be on the role of lawyers in providing, in Examiner Batson's words, "a check and balance against the . . . wrongdoing" of corporate officers and other agents.[142]

On July 16, 2002, the day after the Senate unanimously approved the Edwards amendment adding Section 307 to the Act, the Task Force issued its Preliminary Report recommending reforms in internal corporate governance and the professional conduct of lawyers.[143] As for lawyer reform, the Preliminary Report cited Senator Edwards's letter to Chairman Pitt and the Senate's passage of Section 307 of the Act the day before, and recommended several changes to the Model Rules of Professional Conduct.[144] Model Rule 1.6 would be revised to permit a lawyer to disclose confidential client information to prevent or rectify the consequences of crime or fraud that was reasonably certain to result, or had resulted, in "substantial injury to the financial interests or property of another," and in furtherance of which the client had used, or was using, the lawyer's services.[145] In addition, Rule 1.6 would be further amended to require, rather than merely permit, disclosure in such circumstances to prevent client conduct known by the lawyer to involve a crime (not merely non-criminal fraud), including "violations of federal securities laws and regulations."[146] Finally, Rule 1.13 would be amended to make clear that the corporate lawyer would be required to pursue remedial or preventive measures, including reporting "up the ladder" to the board of directors, if necessary, concerning misconduct by a corporate officer, employee, or other agent involving crime or fraud, including federal securities law violations, in a matter related to the lawyer's representation or where knowledge of such misconduct had come to the lawyer through that representation.[147]

There has been speculation that the Preliminary Report, issued with a note of urgency and recommending changes only recently rejected by the ABA House of Delegates in its consideration in 2001 of the so-called "Ethics 2000" proposals,[148] was, in part, an attempt to sidetrack Senator Edwards's amendment in the Conference Committee process by demonstrating renewed ABA resolve on the issue of corporate lawyer conduct.[149] If this were the case, the ABA's motivation would no doubt have been the desire to preserve the primacy of state bar rules in regulating corporate lawyer conduct, in which, of course, the

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141 Final Report, *supra* note 140, at 146 (emphasis added).

142 BATSON, *supra* note 19, at 52.

143 ABA Task Force on Corp. Responsibility, *Preliminary Report of the American Bar Association Task Force on Corporate Responsibility*, 58 BUS. LAW. 189, 201 n.21 (2002) [hereinafter Preliminary Report].

144 *Id.* at 201-02 & n.21.

145 *Id.* at 205.

146 *Id.* at 206.

147 *Id.* at 204.

148 *See* 1 HAZARD & HODES, *supra* note 1, § 1.18; Hamermesh, *supra* note 140, at 37-39.

149 *See* Morgan, *supra* note 79, at 16.

ABA plays a primary formative role.[150] In any event, Congress was unmoved and was determined to federalize the rules governing the conduct of lawyers for public companies.[151]

Following the issuance of the Preliminary Report, the Task Force conducted hearings and received comments and, on March 31, 2003, about two months after the SEC had issued its final rules under Section 307 of the Act, issued its Final Report.[152] Consistent with Chairman Hirshon's initial charge, the Final Report focused on public corporation governance, with particular attention paid to the role of directors and corporate lawyers.[153] As for lawyers, the Task Force Report reinforced the role of the lawyer as, "first and foremost," a counselor promoting his corporate client's business interests in compliance with the law.[154] Although the report acknowledged that a corporate lawyer might be forced to assume an adverse or even "arm's length" relationship with the client's senior officers only in rare and "clearly defined" circumstances, the report was clear that the lawyer must keep in mind the "bedrock principle" recognized in Model Rule 1.13 that the corporation, rather than any of the officers, directors, or other agents with whom he deals, is his client.[155] Thus, the lawyer's professional judgment must be exercised in the interests of the corporation "independent of the personal interests of the corporation's officers and employees."[156] Loyalty to the corporate client demands of the lawyer a "professional detachment that allows [the lawyer] to recognize and point out issues of legal compliance, even at the risk of being perceived as unduly pessimistic or obstructive of the business plans sought by the corporation's executive officers."[157] The Task Force's words were reminiscent of Examiner Batson's observations that Enron's lawyers "lost sight of the fact that the corporation was their client" and "saw their role in very narrow terms, as an implementer, not a counselor."[158] The purpose of the Task Force's recommendations was to correct this perceived lack of vision.

Significantly, the Task Force withdrew the recommendation made in the Preliminary Report that Model Rule 1.6 be amended to mandate disclosure of client confidences by the lawyer for the purpose of preventing client activity that the lawyer knows to be criminal.[159] This proposal had engendered strong criticism[160] on substantially the same grounds as later expressed by the ABA in its criticism of the SEC's proposed "noisy withdrawal" provisions:[161] the

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[150] *See id.* at 3, 14-18. *See generally* 1 HAZARD & HODES, *supra* note 1, § 1.9.

[151] *See supra* notes 92-96 and accompanying text.

[152] Final Report, *supra* note 140.

[153] *See id.*

[154] *Id.* at 156.

[155] *Id.* at 156-57.

[156] *Id.* at 157.

[157] *Id.*

[158] BATSON, *supra* note 19, at 52.

[159] Final Report, *supra* note 140, at 173-74.

[160] *See id.* (noting opposition to the proposal).

[161] *Cf.* Letter from Alfred P. Carlton, Jr., *supra* note 129, pt. VI.B (expressing the ABA's grounds for criticism of the noisy withdrawal rule).

attorney-client relationship would be negatively impacted, making it less likely that clients would consult lawyers with regard to questionable conduct.[162]

The Task Force's other proposal with regard to Rule 1.6 was identical to that rejected by the ABA House of Delegates in 2001 in its consideration of the "Ethics 2000" proposals. In August 2003, the House of Delegates, no doubt reflecting a post-Enron professional consciousness, changed its mind and adopted the proposal, albeit narrowly, adding new Rules 1.6(b)(2) and (3).[163] New Rules 1.6(b)(2) and (3) permit a lawyer to reveal information relating to the representation of a client to the extent he reasonably believes necessary:

> (2) to prevent the client from committing a crime or fraud reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services; [and]
>
> (3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services.[164]

While acknowledging the beneficial purposes of the general duty of lawyer confidentiality,[165] the Task Force justified its recommendation for the creation of two new exceptions to that duty on the ground that the client's use of the lawyer's services for crime or fraud "constitutes an abuse by the client of the client-lawyer relationship, forfeiting the client's absolute entitlement to the protection of Model Rule 1.6."[166] In this instance, the policies of preserving lawyer integrity and protecting third parties were seen as overriding the competing policy of preserving client-lawyer trust.[167] The Task Force further noted that the lawyer disciplinary rules of forty-one states permitted lawyer disclosure of confidential information in the case of client criminal fraud and that eighteen states permitted such disclosure for the purpose of rectifying third party loss caused by client crime or fraud.[168] Thus, by adopting the new Rules, the ABA was merely catching up with the states in the case of client criminal fraud,[169] although clearly going beyond a substantial majority of the states in the other areas covered by the new Rules.

Commentators have noted that there may be one potentially significant consequence of the 2003 amendments to Rule 1.6 that has not yet been fully appreciated.[170]Model Rule 4.1(b) has long provided that in the course of representing a client, a lawyer shall not knowingly "fail to disclose a material

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[162] *See* Hamermesh, *supra* note 140, at 39.

[163] *Id.* at 35-36 (proposal approved by a vote of 218-201).

[164] MODEL RULES R. 1.6(b)(2)-(3).

[165] Final Report, *supra* note 140, at 170-72.

[166] *Id.* at 173-74.

[167] *Id.* at 172.

[168] *Id.* at 171.

[169] *See* Cramton, Cohen & Koniak, *supra* note 91, at 730-33; Morgan, *supra* note 79, at 3-11, 23.

[170] *See* Cramton, Cohen & Koniak, *supra* note 91, at 783; Thomas D. Morgan, *"The Client(s) of a Corporate Lawyer,"* 33 CAP. U.L. REV. 17, 35-36 (2004).

fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6."[171] Prior to the 2003 amendments, there were no exceptions to Rule 1.6's general prohibition of disclosure of confidential client information that would permit disclosure of client crime or fraud, except in the case of a crime likely to result in imminent death or substantial bodily harm.[172] Therefore, the lawyer's obligation to disclose a client's financial crime or fraud found in Rule 4.1(b) was negated for all practical purposes by the prohibition on disclosure in Rule 1.6. However, as amended in 2003, Rules 1.6(b)(2) and (3) permit the lawyer to reveal client information in the cases of a client's financial crime or fraud.[173] Therefore, the cross reference in Rule 4.1(b) to the prohibitions on disclosure of Rule 1.6 is no longer significant in the context of the client's financial crime or fraud, with the result that the lawyer's disclosure of confidential client information would appear to be mandatory if necessary to avoid assisting the client's financial crime or fraud.[174] Open for consideration is the extent to which the lawyer's passive non-disclosure could be viewed as "assisting" her client's criminal or fraudulent misdeeds.

Although the Final Report cites Rule 4.1(b) as a "well established" exception to the general rule of confidentiality, it indicates no awareness on the part of the Task Force that the amendment to Rule 1.6 would be so far-reaching as to create a general rule mandating disclosure in the case of client financial crime or fraud.[175] Further, the new comments to Rule 4.1(b) cannot be read as creating a mandatory disclosure rule for the situations described in Rules 1.6(b)(1) and (2). Rather, these comments state that a lawyer may "ordinarily" avoid assisting the client's crime or fraud by merely withdrawing from the representation.[176] Disclosure of confidential information to third parties is said to be relegated to "extreme cases."[177] Nevertheless, a broad reading of Rule 4.1(b) could transform the permission granted by Rule 1.6(b)(2) and (3) into a mandate in most of the circumstances contemplated in those rules. Thus, an unsettling ambiguity has been created for lawyers attempting to comply with the Rules.

The Final Report also recommended proposals that would amend Model Rule 1.13, which covers the "organization" as a client.[178] Model Rule 1.13 adopts the "entity theory" in that the organization itself is the client, as opposed to any of its "constituents," e.g., officers, directors, employees, shareholders, or other stake-

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[171] MODEL RULES R. 4.1(b) (emphasis added).

[172] MODEL RULES OF PROF'L CONDUCT R. 1.6 (2002) (Pre-2003 version of Rule 1.6 contained exceptions to the general rule of confidentiality in the cases of (1) prevention of death or substantial bodily harm, (2) securing legal advice about compliance with the Rules, (3) establishing a claim or defense in a controversy with the client, and (4) "to comply with other law or court order.").

[173] MODEL RULES R 1.6(b)(2)-(3).

[174] Cramton, Cohen & Koniak, *supra* note 91, at 783 ("[T]he permission under Rule 1.6(b) becomes a mandate under Rule 4.1(b)."); Morgan, *supra* note 170, at 36.

[175] *See* Final Report, *supra* note 140, at 170.

[176] MODEL RULES R. 4.1(b) cmt. 3.

[177] *Id.*

[178] *See* Final Report, *supra* note 140, at 174-77.

holders.[179] Although the Task Force's primary concern was the role of the lawyers retained or employed by public companies, the breadth of the term "organization" ensured that the recommendations would cover lawyers for a wide variety of entities, including non-public companies, labor unions, charities, and other nonprofit organizations, governmental agencies, and unincorporated entities.[180] The Task Force's proposals regarding Rule 1.13 were also subject to substantial debate in the House of Delegates, but were eventually approved by a wider margin than were the changes to Rule 1.6.[181]

Amended Rule 1.13(b) leaves essentially unchanged the Rule's pre-existing requirement that a lawyer "shall proceed as is reasonably necessary in the best interest of the organization" if the lawyer knows that an officer, employee, or other person associated with the organization is acting, or intends or refuses to act in a matter related to the lawyer's representation that is a violation of law or a legal obligation to the organization, and that is likely to result in substantial injury to the organization.[182] However, where Rule 1.13(b) had previously listed going "up the ladder" to senior officers or the board of directors as being among the actions that a lawyer "may" take if she determines such to be in the "best interest of the organization,"[183] amended Rule 1.13 creates, in effect, a presumption that going up the ladder will be the lawyer's usual response in this situation. More specifically, amended Rule 1.13(b) provides that "unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so," she shall refer the matter to "higher authority in the organization including, if warranted by the circumstances to the highest authority that can act on behalf of the organization."[184]

The Task Force's Final Report made a significant further proposal concerning Rule 1.13 that was not contained in the Preliminary Report but instead arose from comments received, primarily from Professor Stephen Gillers,[185] during the period between the issuance of the Task Force's Preliminary and Final Reports. The thrust of these comments was that the Task Force's proposed amendments to Rules 1.6 and 1.13 would fail to protect the organization itself, as opposed to third parties, from injury arising from violation of law or acquiescence therein by the organization's "highest authority."[186] Thus, for example, if the board of directors of a corporation were to engage in, or knowingly tolerate, crime

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[179] *See* MODEL RULES R. 1.13(a) & cmt. 1. *See generally* 1 HAZARD & HODES, *supra* note 1, § 17.2; Morgan, *supra* note 170; William H. Simon, *Whom (or What) Does the Organization's Lawyer Represent?: An Anatomy of Intraclient Conflict*, 91 CAL. L. REV. 57 (2003).

[180] *See* 1 HAZARD & HODES, *supra* note 1, § 17.4.

[181] Hamermesh, *supra* note 140, at 35-36 & n.5 (proposal approved by a vote of 239-147).

[182] MODEL RULES R. 1.13(b).

[183] MODEL RULES OF PROF'L CONDUCT R. 1.13(b) (2002).

[184] MODEL RULES R. 1.13(b) & cmt. 4 ("Generally, referral to a higher authority would be necessary.").

[185] Written Testimony from Stephen Gillers, Vice Dean and Professor, New York University School of Law, to ABA Task Force on the Attorney-Client Privilege Public Hearing (Oct. 25, 2002), *available at* http://www.abanet.org/buslaw/corporateresponsibility/hearings02/20021025/gillers_testimony.pdf.

[186] *See id.* at 3-5.

or fraud reasonably certain to injure a third party, then the lawyer would, under the recommendations of the Preliminary Report, have a duty to reveal confidential information if all of the conditions of Rule 1.6(b)(2) were met. On the other hand, if the party injured were the corporation itself, no similar duty of disclosure for the purpose of preventing injury to the corporation would exist.[187]

The Task Force responded to this perceived deficiency by proposing new Rules 1.13(c) and (d). Rule 1.13(c) provides that if, despite the lawyer's efforts under Rule 1.13(b), including going up the ladder in the presumptive case, the organization's highest authority

> insists upon or fails to address in a timely and appropriate manner, an action or refusal to act, that is clearly a violation of law, and the lawyer reasonably believes that [such action or refusal to act] is reasonably certain to result in substantial injury to the organization, then the lawyer may reveal information relating to the representation. . . but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.[188]

The Final Report noted that the permissive disclosure contemplated by this Rule would be particularly important in the situation in which the board of directors is "disabled" from acting in the organization's best interest because of, for example, self-interest on the part of board members, or personal involvement of board members in violation of law.[189]

External disclosure under Rule 1.13(c) could be seen as a "loyal" disclosure designed to protect the lawyer's client which, of course, is the corporation itself rather than any of its agents, from the disloyal action of one of the lawyer's fellow agents.[190] However, the principles permitting "loyal" disclosure are not seen as applying to a lawyer's representation of a corporation in the investigation or defense of an alleged violation of law. In the context of an adversarial dispute, the corporation is seen as having a reasonable expectation of the confidentiality necessary to the investigation or defense. Thus, Rule 1.13(d) prohibits the lawyer engaged in either of those purposes to disclose client information outside the organization.[191]

Finally, under Rule 1.13(e), if a lawyer reasonably believes that he has been discharged because he has made a disclosure permitted under Rules 1.13(b) and (c), or if the lawyer withdraws from the representation as permitted by the Model Rules (e.g., because of the client's crime or fraud),[192] then he "may proceed as [he] reasonably believes necessary to assure that the organization's highest

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[187] *See id* at 3. (noting that the amendments to Model Rule 1.6 originally proposed by the Task Force were not sufficient to protect the client (corporation) from harm because sometimes the harm may be to the client alone, not to third parties, or because the language of the confidentiality exceptions would not apply); *cf.* Hamermesh, *supra* note 140, at 45-46.

[188] MODEL RULES. R. 1.13(c).

[189] Final Report, *supra* note 140, at 176-77.

[190] MODEL RULES. R. 1.13(a); *see* MODEL RULES. R. 1.13(c) (phrasing the question of disclosure in terms of perceived harm to the organization); 1 HAZARD & HODES, *supra* note 1, § 17.11.

[191] MODEL RULES. R. 1.13(d).

[192] *See, e.g.*, MODEL RULES. R. 1.16(b)(2).

authority is informed of [his] discharge or withdrawal."[193]

A paradox arises when the Sarbanes-Oxley Section 307 rules are compared with parallel provisions of the ABA Model Rules of Professional Conduct, as amended in 2003. Although they differ significantly on almost every point of scope, definition, and application, the general reporting and disclosure schemes that the rules overtly establish are similar in purpose and effect. Indeed, one might agree with Professor Thomas Morgan's assertion that the Section 307 rules "added nothing of substance" to the Model Rules.[194] Both establish or confirm three basic principles. First, the corporation, rather than any of its agents, is the client.[195] Second, the lawyer who becomes aware of a past, present, or future violation of law generally must report such "up the ladder," and, if necessary, all the way up to the board of directors.[196] Third, the lawyer is permitted to disclose client confidences to non-clients if necessary to prevent or rectify substantial injury to the financial interests of the corporation or third parties caused by the violation of law.[197]

One significant substantive contrast between the Section 307 rules and amended Model Rule 1.6 should be emphasized however. Under Rule 1.6, the attorney's disclosure of confidential information for the purpose of preventing the client from committing a crime or fraud reasonably certain to result in financial injury to third parties is permitted only if the client uses the lawyer's services "in furtherance of" the crime or fraud, thereby arguably making the lawyer his unwitting accomplice in wrongdoing.[198] However, the Section 307 rules contain no such limitation, instead permitting disclosure of confidential information in that circumstance regardless of whether the lawyer's services bear any relationship to the crime or fraud.[199] Further, there is substantial asymmetry between the two regulatory schemes if Rules 1.6 and 4.1 are read as requiring disclosure in the case of client crime or fraud. If such is the case, only an adoption by the SEC of some form of noisy withdrawal would restore general symmetry in that regard.

V. THE "EROSION" OF THE ATTORNEY-CLIENT PRIVILEGE FOR CORPORATE CLIENTS AND THE ABA

Closely related in purpose to the lawyer's duty of confidentiality arising under the rules of professional responsibility are the attorney-client privilege, which is a rule of evidence, and the work product doctrine, which is a

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[193] MODEL RULES. R. 1.13(e).

[194] Morgan, *supra* note 79, at 16. Professor Morgan compares the Section 307 rules to the *Model Rules* provisions as they existed *prior* to the 2003 amendments and concludes that the Section 307 rules "added nothing of substance, yet [they have] created arbitrarily rigid and senseless requirements to the daily work of persons trying to be responsible, effective corporate lawyers." *Id.* at 29.

[195] *See* Commodity and Securities Exchanges, 17 C.F.R. § 205.3(a) (2006); MODEL RULES. R. 1.13(a).

[196] *See* Commodity and Securities Exchanges, 17 C.F.R. § 205.3(b); MODEL RULES. R. 1.13(b).

[197] *See* Commodity and Securities Exchanges, 17 C.F.R. § 205.3(d)(2); MODEL RULES. R. 1.6(b)(2)-(3); MODEL RULES. R. 1.13(c).

[198] MODEL RULES R. 1.6(b)(2).

[199] Commodity and Securities Exchanges, 17 C.F.R. § 205.3(d)(2).

discovery rule. Wigmore's often-quoted formulation of the attorney-client privilege contains eight elements:

> (1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal advisor, (8) except the protection be waived.[200]

Case law and more recent codes of evidence extend the privilege's protection to communications from the lawyer to the client.[201] The work product doctrine "protects from discovery or compelled disclosure material that lawyers, or people associated with them, have put together in preparing for and conducting litigation."[202] The doctrine's goal is to protect from discovery the lawyer's thought processes as evidenced by documents, notes, and other tangible indicia.[203]

The purpose of the attorney-client privilege recently has been stated by the ABA Task Force on Attorney-Client Privilege as intended to

> encourage persons to seek legal advice freely and to communicate candidly during consultations with their attorneys without fear that the information will be revealed to others. This enables clients to receive the most competent legal advice from fully informed counsel so that the client can fulfill his or her responsibilities under the law and benefit from the law's protection .... [T]he client's better understanding of his or her legal obligations enhances the law's efficacy.[204]

The protection accorded attorney work product has a similar basis: the lawyer cannot fully and adequately represent her client, who seeks to "benefit from the law's protection," if the product of her careful and thorough preparation for trial will be available to the client's adversary.[205] Thus, the triad of the duty of confidentiality, attorney-client privilege, and work product doctrine share the goal of enhancing the likelihood of the client's obtaining effective legal counsel. Although closely allied in purpose, the duty of confidentiality and attorney- client privilege are quite different in scope and operation. According to Professors Hazard and Hodes:

> The chief difference between the professional duty of confidentiality and the evidentiary attorney-client privilege is that the former applies to virtually all information coming into a lawyer's hands concerning a client, and forbids virtually all disclosures, whereas the latter only applies when the question is

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[200] 8 WIGMORE ON EVIDENCE § 2292 (McNaughton ed. 1961), *quoted in* Geoffrey C. Hazard, Jr. et. al., THE LAW AND ETHICS OF LAWYERING 258 n.3 (4th ed. 2005). *See generally* 1 HAZARD & HODES, *supra* note 1, § 9.7.

[201] 1 1 HAZARD & HODES, *supra* note 1, §9.7, at 9-26.

[202] *Id.* § 9.14, at 9-54.

[203] *See id.*

[204] ABA Task Force on the Attorney-Client Privilege, *Report of the American Bar Association's Task Force on the Attorney-Client Privilege*, 60 BUS. LAW. 1029, 1032 (May 2005), *available at* http://www.abanet.org/buslaw/attorneyclient/materials/hod/report.pdf.

[205] *Id.*

> whether a lawyer can be compelled to testify about her professional communications with a client.[206]

It is well settled that the attorney-client privilege applies to corporations, with the general result that communications between lawyers and directors, officers, and employees of client-corporations are protected by the privilege.[207] One further note of importance is that the attorney-client privilege is subject to the so-called "crime-fraud" exception, under which communications made between clients and lawyers in the course or furtherance of the client's crime or fraud are not protected by the privilege.[208]

In September 2004, the ABA established the Task Force of the Attorney-Client Privilege (variously, "Attorney-Client Task Force" or "Task Force") "to evaluate issues and recommend policy related to the attorney-client privilege and work-product doctrine."[209] The Attorney-Client Task Force was created in response to widespread concern over the perceived serious and accelerating erosion of the protection afforded by the attorney-client privilege as a result of a number of governmental initiatives over the past six years or so.[210] Included among those initiatives were two memoranda: the "Holder Memorandum" issued in 1999 by then-serving Deputy Attorney General Eric Holder[211] and the "Thompson Memorandum" issued by then-serving Deputy Attorney General Larry D. Thompson.[212] The purpose of the memoranda was to identify specific factors—eight in the Holder Memorandum and nine in the Thompson Memorandum—to be considered by U.S. Attorneys in determining whether to bring criminal charges against a corporation.[213] The fourth factor to be considered by prosecutors was "the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product protection."[214] Although a decision to forego prosecution was not conditioned upon receiving a waiver of

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[206] 1 HAZARD & HODES, *supra* note 1, § 9.7, at 9-25.

[207] *See* Upjohn Co. v. United States, 449 U.S. 383 (1981). *See generally* 1 HAZARD & HODES, *supra* note 1,
§ 9.8.

[208] 1 HAZARD & HODES, *supra* note 1, § 9.10, at 9-41. As might be expected, communications about a crime or fraud made after completion of the crime or fraud (presumably in a defense context) are subject to the privilege. *Id.*

[209] ABA Task Force on the Attorney-Client Privilege, *supra* note 4, at 1029.

[210] *See generally* Berwin Cohen et al., *Protecting a Public Company's Confidences*, BRIEFLY . . . PERSP. ON LEGS.REG. & LITIG., at 72-86, *available at* 2005 WL 934476.

[211] Memorandum from Eric Holder, Deputy Attorney General, U.S. Dep't of Justice, to All Component Heads and U.S. Attorneys (June 16, 1999), *available at* http://www.usdoj.gov/criminal/fraud/policy/ Chargingcorps.html [hereinafter Holder Memorandum].

[212] Memorandum from Larry Thompson, Deputy Attorney General, U.S. Dep't of Justice, to Head of Department Components and U.S. Attorneys (Jan. 20, 2003), *available at* http://www.usdoj.gov/dag/cftf/ corporate_guidelines.htm [hereinafter Thompson Memorandum]. With a few exceptions, the Thompson Memorandum was identical to the Holder Memorandum. *See* Carmen Couden, *The Thompson Memorandum: A Revised Solution or Just a Problem?*, 30 J. CORP. L. 405, 407 (2005).

[213] Holder Memorandum, *supra* note 211, § II.A; Thompson Memorandum, *supra* note 212, § II.A.

[214] Thompson Memorandum, *supra* note 212, § II.A.4 (internal reference omitted).

the privilege, such a waiver was viewed as a significant indicator of the extent of the corporation's cooperation.[215] The prosecutor was authorized to gauge the degree of cooperation by taking into account the corporation's "willingness to identify the culprits within the corporation, including senior executives; to make witnesses available; to disclose the complete results of its internal investigation; and to waive attorney-client and work product protection."[216] A corporation's comprehensive waiver of attorney- client and work product protection would be favorably viewed by the prosecutor because it would permit him to "obtain statements of possible witnesses, subjects, and targets, without having to negotiate individual cooperation or immunity agreements."[217] The waiver of privilege to be sought would normally be that pertaining to "the factual internal investigation and any contemporaneous advice given to the corporation concern the conduct at issue," rather than that relating to the criminal investigation itself.[218]

Also raising concerns among corporations and their lawyers were the United States Sentencing Commission's amendments to the Federal Sentencing Guidelines made in November 2004 to the Commentary to Chapter 8, Section 8C2.5, and dealing with "organizations."[219] Under Sections 8C2.5(g)(1) and (2), the "culpability score" for a corporation would be reduced for criminal sentencing purposes, if, among other things, the corporation "fully cooperated in the investigation."[220] The Commission's Commentary on this provision notes that this cooperation must be both "timely and thorough,"[221] and discusses the relationship of the attorney-client privilege to this factor, noting that "[w]aiver of attorney-client privilege and of work product protections is not a prerequisite to a reduction in culpability score under [Sections 8C2.5(g)(1) and(2)] unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization."[222] Even though waiver of the attorney-client privilege is not mandatory under the Commission's Commentary, a corporation facing the possibility of the harsh consequences arising from criminal prosecution and sentencing might find itself hard put to resist a prosecutor's request to waive the privilege. This prospect was viewed with some alarm by the ABA.[223] In August 2004, at a time when the Commentary to Section 8C2.5 had been proposed but not yet adopted, the ABA House of Delegates adopted a resolution that the "Commentary should be revised 'to state affirmatively that waiver of the attorney-client privilege and work product

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[215] *Id.* pt. VI.B.

[216] *Id.* pt. VI.A.

[217] *Id.* pt. VI.B.

[218] *Id.* n.3.

[219] U.S. SENTENCING GUIDELINES MANUAL § 8C2.5 cmt. n.12 (2004), *available at* http://www.ussc.gov/2004guid/8c2_5.htm.

[220] *Id.* § 8C2.5(g)(1)-(2).

[221] *Id.* § 8C2.5, cmt. n.12. The United States Supreme Court's holding in United States v. Booker, 543 U.S. 220, 245 (2005), rendered the Federal Sentencing Guidelines advisory and not mandatory for sentencing judges. However, courts are still required to consider the guidelines. *Id*

[222] U.S. SENTENCING GUIDELINES MANUAL, *supra* note 219, § 8C2.5 cmt. n.12 (emphasis added).

[223] ABA Task Force on the Attorney-Client Privilege, *supra* note 4, at 1044-45.

protection should not be a factor in determining whether a sentencing reduction is warranted for cooperation with the government.'"[224] This would, of course, effectively have reversed the thrust of the Commentary.

A third item of concern to public corporations and the bar was the issuance by the SEC on October 23, 2001, of a Report of Investigation[225] of a cease-and-desist proceeding against a former controller of a subsidiary of Seaboard Company.[226] In announcing that it was not taking enforcement action against Seaboard, the SEC noted that Seaboard "gave complete cooperation to our staff"[227] in the course of the investigation, observing that, "[a]mong other things, [Seaboard] produced the details of its internal investigation, including notes and transcripts of interviews of [the former controller] and others; and it did not invoke the attorney-client privilege, work product protection or other privileges or protections with respect to any facts uncovered in the investigation."[228]

The SEC then listed criteria that it would consider in determining whether, and to what extent, "self-policing, self-reporting, remediation and cooperation"[229] would be taken into account in making a decision to mitigate or forego imposing sanctions on a public company. Included in the criteria was the company's degree of cooperation with the SEC's investigation, indicated by, among other things, the company's promptly making available to the SEC the results of its internal review, its identification of possible violative conduct and evidence thereof with sufficient precision to enable the SEC to bring enforcement actions against lawbreakers, and its voluntary disclosure of information not directly requested or otherwise discovered by the SEC staff.[230] In this context, the SEC discussed the attorney-client, work product, and "other privileges, protections and exemptions," noting that it did not "view a company's waiver of a privilege as an end in itself, but only as a means (where necessary) to provide relevant and sometimes critical information to the Commission staff."[231]

Observers have taken little comfort in the SEC's seeming disclaimer of the need for an automatic waiver of the attorney-client privilege, noting that waiver is almost always the order of the day for the SEC in its quest for, in the words of the Seaboard release, "relevant and sometimes critical information."[232] The testimony submitted to the Attorney-Client Task Force by the United States Chamber of Commerce is typical of the corporate view of the SEC's position with regard to

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[224] *Id.* at 1045.

[225] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 44,969, 76 S.E.C. Docket 220 (Oct. 23, 2001), *available at* 2001 WL 1301408 [hereinafter Seaboard Report].

[226] This report is often referred to as the *Seaboard Report* or the *Seaboard Release* because it "described actions taken by Seaboard Corporation upon its discovery that it might have violated federal securities laws." ABA Task Force on the Attorney-Client Privilege, *supra* note 4, at 1046-47.

[227] Seaboard Report, *supra* note 225, at 1.

[228] *Id.* at 2.

[229] *Id.*

[230] *Id.* at 3.

[231] *Id.* at n.3.

[232] *Id.*

waiver:

> [T]he SEC considers waiver of the attorney-client privilege an important element of cooperation in its investigations; and our members report that enforcement staff often begin their communications with a company's counsel by asking for privileged information. A company that refuses to turn over this information, or even postpones a decision about whether to do so, is viewed as uncooperative. Few companies want to be labeled as uncooperative by the SEC for the reasons discussed above. As a result, the Commission staff typically gets what it wants.[233]

Following months of deliberation and consideration of written and oral testimony received from individuals and representatives of the bar, industry, and the academy, the Attorney-Client Task Force issued its report and recommendations to the ABA House of Delegates on May 18, 2005. In the report, the Task Force echoed the concerns expressed by corporations that, in light of the probability that their "voluntary" disclosure of attorney-client communications would be viewed as a waiver of the privilege, their willingness to retain and confide in counsel would be reduced because of the risk that government agencies "subject to scant internal standards, safeguards and guidelines, may later demand and obtain access to confidential communications with counsel, thereby in turn making those communications available to private litigants."[234]

Summarizing "what many have suggested to the Task Force,"[235] the report quotes with approval a passage on the deleterious effect of an erosion of the attorney-client privilege that appeared in a November 2003 article, "At Every Peril": New Pressures on the Attorney-Client Relationship,[236] by the Corporations Committee of the Business Law Section of the State Bar of California:

> Over time, clients will . . . become reluctant to consult proactively and fully with legal counsel about issues. Knowing that the enforcement authorities will be privy to all information developed in any self-investigatory process will also serve as a disincentive for clients to self-investigate and remediate . . . . Pressure on corporations to waive client confidentiality protections thus creates additional risks of harm to investors and innocent targets of investigation and, even to the public itself.[237]

The Task Force pledged continued dialogue with the relevant government

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[233] Testimony from U.S. Chamber of Commerce, to ABA Task Force on the Attorney-Client Privilege Public Hearing 7 (Feb. 22, 2005) (footnote omitted), *available at* http://www.abanet.org/buslaw/attorneyclient/publichearing20050211/testimony/chamberofcommerce.pdf.

[234] ABA Task Force on the Attorney-Client Privilege, *supra* note 4, at 1049.

[235] *Id.*

[236] Keith Paul Bishop et al., *A Public Commentary from the Corporations Committee: 'At Every Peril' New* Pressures on the Attorney-Client Relationship, 23 CAL. BUS. L. NEWS 4 (2003) [hereinafter At Every Peril].

[237] ABA Task Force on the Attorney-Client Privilege, *supra* note 4, at 1049 (quoting *At Every Peril, supra* note 236, at 19).

agencies for the purpose of deriving guidelines that would protect against the erosion of the attorney-client privilege and work-product doctrine.[238]

On August 9, 2005, the ABA House of Delegates unanimously adopted resolutions recommended to it by the Attorney-Client Task Force with slight Modification.[239] In so doing, the House of Delegates (1) expressed its "strong[] support" for "the preservation of the attorney-client privilege and work product doctrine"; (2) expressed its opposition to procedures of "governmental bodies" having the effect of "eroding the attorney-client privilege and work product doctrine" and its support of procedures recognizing the "value of those protections"; and (3) opposed "the routine practice by government officials of seeking to obtain a waiver of the attorney-client privilege or work product doctrine through the granting or denial of any benefit or advantage."[240] Since the adoption of the resolutions, the ABA has actively pressed its position in discussions with the Justice Department and the United States Sentencing Commission, both of whom have commenced re-evaluations of their privilege waiver policies.[241]

Interestingly, the Attorney-Client Task Force noted in a footnote to its report that its

> recommendations . . . although limited to the attorney-client privilege and work-product doctrine, are consistent with the client confidentiality provisions of the ABA Model Rules of Professional Conduct, including the amendments to Rules 1.6 and 1.13 adopted by the ABA House of Delegates in August 2003 . . . . The client confidentiality provisions of the [Model Rules] reflect a judgment that, absent a compelling public interest, confidentiality is of paramount importance to ensure an effective lawyer-client relationship. The [Attorney-Client] Task Force's recommendations are consistent with this judgment.[242]

Other than this oblique reference, no attempt was made by the Attorney-Client Task Force to reconcile its strong opposition to governmental initiatives effectively paring back confidentiality protections under the attorney-client privilege with the ABA's own 2003 initiatives paring back confidentiality

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[238] ABA Task Force on the Attorney-Client Privilege, *supra* note 4, at 1055.

[239] ABA Task Force on the Attorney-Client Privilege, Task Force Releases Report and Recommendation to the ABA House of Delegates (as adopted by the ABA House of Delegates August 9, 2005), *available at* http://www.abanet.org/buslaw/attorneyclient.

[240] ABA Task Force on the Attorney-Client Privilege, *Report to the House of Delegates, Recommendation 111*, *available at* http://www.abanet.org/buslaw/attorneyclient/materials/hod/recommendation_adopted.pdf (last visited May 18, 2006).

[241] *See* Letter from Michael S. Greco, President, Am. Bar Ass'n (Jan. 31, 2006), *available at* http://www.abanet.org/op/greco/memos/attyclientprivt.pdf (stating that U.S. Attorneys are beginning to adopt local privilege waiver review procedures and expressing the intention to file comments with the U.S. Sentencing Commission); Terry Carter, *Privilege Waiver Policy Dumped: But Federal Prosecutors May Still Seek Waivers from Corporations*, ABA E-REP., Apr. 14, 2006, http://www.abanet.org/buslaw/attorneyclient/ (stating that the United States Sentencing Commission had decided to delete (effective November 1, 2006, unless Congress directs otherwise) the Commentary to the Federal Sentencing Guidelines that was seen as encouraging prosecutors to seek waivers of the attorney-client privilege).

[242] ABA Task Force on the Attorney-Client Privilege, *supra* note 4, at 1051 n.93.

protections under the duty of confidentiality.

VI. THE DUTY OF CONFIDENTIALITY: THE SEC, THE ABA, AND THE STATES

Although there is general harmony between the Sarbanes-Oxley Section 307 regulations and the amended ABA Model Rules concerning the lawyer's disclosure of confidential information, there remains substantial diversity in the corresponding rules of the fifty states and the District of Columbia. There has been movement toward the ABA position in the two years since the approval of the amendments to Rules 1.6 and 1.13, although substantial holdouts remain. As of January 2006, the positions of the various jurisdictions can be summarized as follows:

- As to a client's intention to commit criminal fraud reasonably certain to result in injury to the financial interest or property of another person (Model Rule 1.6(b)(2)), four jurisdictions require disclosure, thirty-nine permit disclosure (with one jurisdiction proposing that disclosure be mandated), and eight prohibit disclosure.
- As to a client's intention to commit non-criminal fraud reasonably certain to result in injury to the financial interest or property of another person (Model Rule 1.6(b)(2)), two jurisdictions require disclosure, nineteen permit disclosure, twenty- nine prohibit disclosure (with four jurisdictions proposing that disclosure be permitted and one jurisdiction proposing that disclosure be mandated), and one requires withdrawal with notice thereof to persons likely to suffer injury.
- As to a client's prior commission of a crime or fraud resulting in injury to the financial interest or property of another person (Model Rule 1.6(b)(3)), two jurisdictions require disclosure, twenty-five permit disclosure, twenty-three prohibit disclosure (with three jurisdictions proposing that disclosure be permitted), and one requires withdrawal with notice thereof to persons likely to suffer injury.
- As to a client's ongoing criminal or fraudulent act (Model Rule 4.1(b)), forty-four jurisdictions require disclosure, three permit disclosure, two prohibit disclosure (with one jurisdiction proposing that disclosure be mandated), and one requires withdrawal with notice thereof to persons likely to suffer injury.[243]

In adopting the 2003 amendments to the Model Rules, the ABA has proven persuasive to a point, with at least twenty-one jurisdictions either adopting or

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[243] The data on status of the professional conduct rules of the various jurisdictions is derived from and based upon Attorney's Liability Assurance Society (ALAS), *Ethics Rules on Client Confidences, reprinted in* THOMAS D. MORGAN & RONALD D. ROTUNDA, 2005 SELECTED STANDARDS ON PROFESSIONAL RESPONSIBILITY 144-56 (2005) (reflecting the status of professional conduct rules as of March 2004) [hereinafter ALAS Memorandum], as supplemented by American Bar Association Joint Committee on Lawyer Regulation, Status of State Review of Professional Conduct Rules, http://www.abanet.org/cpr/jclr/ethics_2000_status_chart.pdf (Jan. 6, 2006), and American Bar Association Center for Professional Responsibility, Links to Other Legal Ethics and Professional Responsibility Pages 2005, http://www.abanet.org/cpr/links.html (last visited May 18, 2006) [hereinafter collectively ABA Status Reports].

proposing rule changes that would fully or partially conform to the new ABA Rules.[244] However, there remains a deep division among the jurisdictions over disclosure of intended non-criminal fraud (Model Rule 1.6(b)(2)) and disclosure for the purpose of mitigation or rectification of past crime or fraud (Model Rule 1.6(b)(3)), with the jurisdictions more or less evenly divided between those that either mandate or permit disclosure and those that prohibit disclosure, assuming the adoption of pending proposed amendments.[245] It appears that only twelve jurisdictions have "loyal" permissive disclosure rules similar to those of Model Rule 1.13(c).[246] In six jurisdictions—Alabama, California, Kentucky, Missouri, Montana, and Rhode Island—disclosure is prohibited in all of the circumstances contemplated by the 2003 amendments to Rules 1.6 and 1.13 and no proposals for change are pending.[247] Finally, one state—California—dissents from the ABA position in all of the areas described above, having the distinction of being the only jurisdiction in the nation to prohibit disclosure in the case of an ongoing financial crime or fraud (Rule 4.1(b)), with no pending proposal for change.[248]

These divergent views of lawyer confidentiality reflect significant differences in judgment concerning the proper balance to be drawn between the general duty of trust-inducing confidentiality owed by the lawyer to his client, on the one hand, and the obligation or option of the lawyer to breach the duty of confidentiality to protect other persons from the client's financial crime or fraud, on the other. It is unclear whether this wide gulf between the two camps will become a permanent feature of the landscape or will be merely transitory as jurisdictions conform to the amended Model Rules in greater numbers.

VII. THE DUTY OF CONFIDENTIALITY: THE SEC, THE ABA, AND CALIFORNIA

Particularly notable in dissent have been California lawyers who, with passion and persistence, have opposed the creation and expansion by the SEC and ABA of further exceptions to the lawyer's duty of confidentiality. These lawyers have been aggressive and unremitting in pressing the case that disclosures of client confidences permitted under the Sarbanes-Oxley Section 307 rules and the 2003 amendments to the ABA Model Rules will seriously and irreparably erode the attorney-client relationship, negatively impacting the lawyer's ability to provide effective counsel to her client.[249] Further, they have expressed skepticism as to the validity of the provisions of the Section 307 rules purporting to preempt conflicting state ethics rules concerning the attorney's disclosure of confidential client information.[250]

As indicated by the previous discussion of state bar conformance to the ABA

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[244] *Id.*
[245] *Id.*
[246] *Id.*
[247] *Id.*
[248] *Id.*
[249] *See infra* notes 300-321 and accompanying text.
[250] *See infra* notes 314-321 and accompanying text.

2003 amendments, California imposes the strictest duty of lawyer's confidentiality in the nation.[251] Under California's unique system of regulating lawyers, rules of professional conduct are established both by statute in the State Bar Act[252] and by the Rules of Professional Conduct of the State Bar of California ("California Rules"),[253] which are adopted by the Board of Governors of the State Bar and approved by the Supreme Court of California.[254] Unlike other jurisdictions in the United States, California follows neither of the ABA prototypes, the earlier Model Code of Professional Responsibility[255] nor the Model Rules.[256] Nevertheless, as might be expected, a number of the California rules are similar in substance to corresponding provisions of other jurisdictions.[257] However, such is not the case with the lawyer's professional duty of confidentiality.

Section 6068(e)(1) of the State Bar Act provides that "[i]t is the duty of an attorney. . . to maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client."[258] Until July 1, 2004, this statutorily-imposed duty was, by the express terms of the statute, absolute. However, on that date, a statutory amendment enacted in 2003[259]became effective, creating an exception to the confidentiality rule by adding Section 6068(e)(2):

> Notwithstanding paragraph (1), an attorney may, but is not required to, reveal confidential information relating to the representation of a client to the extent that the attorney reasonably believes the disclosure is necessary to prevent a criminal act that the attorney reasonably believes is likely to result in death of, or substantial bodily injury to, an individual.[260]

As of the same date, the California Supreme Court approved the adoption

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[251] See supra note 243-248 and accompanying text; see also Corporations Committee of the Business Law Section of the California State Bar, Conflicting Currents: The Obligation To Maintain Inviolate Client Confidences and the New SEC Attorney Conduct Rules, 32 PEPP. L. REV. 89, 109-10 (2004) [hereinafter Conflicting Currents]; Kevin E. Mohr, California's Duty of Confidentiality: Is It Time for a Life-Threatening Criminal Act Exception?, 39 SAN DIEGO L. REV. 307, 309 (2002); Fred C. Zacharias, Privilege and Confidentiality in California, 28 U.C. DAVIS L. REV. 367, 372 (1995).

[252] CAL. BUS. & PROF. CODE §§ 6000-6238 (West 2003 & Supp. 2005).

[253] CAL. RULES OF PROF'L CONDUCT R. 1-100(A) (2005), *reprinted in* THOMAS D. MORGAN & RONALD D. ROTUNDA, 2005 SELECTED STANDARDS ON PROFESSIONAL RESPONSIBILITY 406-07 (2005), *available at* http:// www.calbar.ca.gov/calbar/pdfs/ethics/2005_Pub_250_RPC.pdf [hereinafter CAL. RULES].

[254] *See* CAL. RULES R. 1-100(A).

[255] MODEL CODE OF PROF'L RESPONSIBILITY (1983).

[256] *See* Mohr, *supra* note 251, at 312; Zacharias, *supra* note 251, at 372.

[257] *Compare* CAL. RULES R. 3-310 (avoiding the representation of adverse interests), *and* CAL. RULES 4-200 (fees for legal services), *with* MODEL. RULES R. 1.7 (conflict of interest: current clients), *and* MODEL. RULES 1.5 (fees), respectively.

[258] CAL. BUS. & PROF. CODE § 6068(e)(1) (West Supp. 2005).

[259] Act effective July 1, 2004, ch. 765, § 1, 2003 Cal. Legis. Serv. 4523-25 (West) (codified at CAL. BUS. & PROF. CODE § 6068(e)(2) (West Supp. 2005)).

[260] CAL. BUS. & PROF. CODE § 6068(e)(2) (West Supp. 2005).

of California Rule 3-100 reflecting Section 6068(e) as amended.[261] In addition to restating the general rule of confidentiality and the exceptions thereto in the cases of the client's informed consent to disclosure or disclosure for the purpose of preventing criminal death or substantial bodily injury,[262] Rule 3-100 additionally provides that, before revealing confidential information as permitted under the death and bodily injury exception, the lawyer must, "if reasonable under the circumstances," (1) make a good faith effort either to persuade his client not to commit the crime or to persuade the client to pursue a course of conduct that will prevent death or injury, and (2) inform the client of his ability or decision to reveal the confidential information as permitted by the Rule.[263] The Rule further provides that the lawyer may reveal no more confidential information than necessary to prevent the criminal act.[264] The "Discussion" accompanying Rule 3-100 characterizes the newly-created exception to the general rule of confidentiality as a "narrow" one justified by the "overriding value of life."[265]

By so amending Section 6068(e), California at last joined all of the other jurisdictions in the nation in providing either mandatory or permissive disclosure of confidential information for the purpose of preventing death or bodily injury.[266] In retrospect, it is clear that the statutory amendment was necessary for the creation of this exception to the duty of confidentiality in California, even though the California Evidence Code had long provided a general crime-fraud exception to the attorney-client privilege[267] and, since 1993, had provided, in Evidence Code Section 956.5, a specific exception to the privilege in the case of threatened death or substantial bodily harm.[268] Although there had been scholarly discussion of the possible applicability of the privilege exception to the duty of confidentiality in the years preceding the amendment to Section 6068(e),[269] the salient fact is that three times in the seventeen years prior to the adoption in 2004 of the amendment to Section 6068(e), the State Bar had proposed to the California Supreme Court amendments to the California Rules that would have created exceptions to the professional duty of confidentiality, including, in each instance, an exception in the case of life-threatening crime.[270] Each such proposal was rejected by the court.[271] Although the court gave no explanation for these

[261] *In re* Request of the State Bar of Cal. for Approval of Rule 3-100, RULES OF PROF'L CONDUCT, 20 CAL. OFFICIAL REPORTS 18 (2004) (noting the adoption of the rule in the Supreme Court Minutes), *available at* http://www.courtinfo.ca.gov/presscenter/documents/rule3-100.pdf.

[262] CAL. RULES. R. 3-100(A)-(B).

[263] CAL. RULES. R. 3-100(C).

[264] CAL. RULES. R. 3-100(D).

[265] CAL. RULES. R. 3-100 discussion 3.

[266] *See* ALAS Memorandum, *supra* note 243, at 144-56.

[267] CAL. EVID. CODE § 956 (West 1995).

[268] CAL. EVID. CODE § 956.5 (West 1995 & Supp. 2005). In 2003 and 2004, Section 956.5 was amended to closely parallel Section 6068(e)(2). Act effective July 1, 2004, ch. 765, § 2, 2003 Cal. Legis. Serv. 4525 (West); Act of July 19, 2004, ch. 183, § 94, 2004 Cal. Legis. Serv. 783 (West) (codified at CAL. EVID. CODE § 956.5 (West 1995 & Supp. 2005)).

[269] *See* Mohr, *supra* note 251, at 329; Zacharias, *supra* note 251.

[270] *See* Mohr, *supra* note 251, at 368-72.

[271] *Id.*

rejections, the most likely explanation for its actions is that given by Professor Kevin Mohr: "[The rejections] more likely evince the court's belief that it [did] not have the authority to upend the absolute language of... section 6068(e), notwithstanding the existence of 956.5."[272] Although closely allied in purpose, the attorney-client privilege and duty of confidentiality are distinct in scope and operation, and the court refused to graft a privilege exception into the duty of confidentiality without legislative authorization.

It goes without saying that neither Section 6068(e) nor California Rule 3-100 has anything remotely resembling the permissive "reporting out" provisions of the Sarbanes-Oxley Section 307 rules or Model Rule 1.6(b) and (c). Thus, the California confidentiality rules stand in stark contrast to the SEC and ABA standards.[273]

California Rule 3-600 covers the organization as a client,[274] directing the lawyer to conform his representation "to the concept that the client is the organization itself" acting through its authorized officers or other constituents.[275] Although sharing this foundational concept with Model Rule 1.13, the operating standards of Rule 3-600 are sharply divergent therefrom. Rather than permitting the lawyer to make "loyal" disclosure outside of the organization in the case of the refusal of the organization's highest authority to deal with a violation of law, Rule 3-600 reiterates the lawyer's duty to conform to the confidentiality rule of Section 6068(e). Thus, if the lawyer "knows" that an agent of the organization intends to act in a manner that is or may be a violation of law imputable to the organization, or in a manner likely to result in substantial injury to the organization, the lawyer "shall not violate his or her duty of protecting all confidential information as provided in . . . section [6068(e)]."[276] Rather, she "may take such actions as appear to [her] to be in the best lawful interest of the organization."[277] Such actions may include, "among others," urging reconsideration of the action or referring the matter to the "next higher authority" in the organization, including, "if warranted by the seriousness of the matter," referral to the organization's "highest internal authority."[278]

If, despite the actions taken by the lawyer, the organization's highest authority insists on an action or a refusal to act that is a violation of law likely to result in substantial injury to the organization, then the lawyer's "response is limited to [her] right, and, where appropriate, duty to resign in accordance with [California Rule] 3-700."[279] California Rule 3-700 provides for mandatory and permissive withdrawal by the lawyer in a number of circumstances, the most likely in this scenario being withdrawal because the client "seeks to pursue an illegal

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[272] *Id.* at 379.

[273] *See* PAUL W. VAPNEK ET AL., CALIFORNIA PRACTICE GUIDE: PROFESSIONALY RESPONSIBILITY ¶¶ 7:70-7:71.15, 7:128-7:129.1 (2005).

[274] CAL. RULES R. 3-600; *see Conflicting Currents, supra* note 251, at 125-28.

[275] CAL. RULES R. 3-600(A).

[276] CAL. RULES R. 3-600(B).

[277] CAL. RULES R. 3-600(B) (emphasis added).

[278] CAL. RULES R. 3-600(B).

[279] CAL. RULES R. 3-600(C).

course of conduct, or insists that the [lawyer] pursue a course of conduct that is illegal."[280]

Again, the contrast between California Rule 3-600 and the corresponding SEC and ABA rules is clear. In the case of an uncorrected violation of law, the Section 307 rules mandate the lawyer's reporting up the ladder and the Model Rules make that course of action the lawyer's usual response. Both sets of rules permit the lawyer to "report out" confidential information if necessary to avoid injury. On the other hand, the California Rule forbids "reporting out" under any circum- stance other than threatened death or substantial bodily injury and provides that reporting up the ladder is discretionary with the lawyer.[281]

Despite its absolute language, the confidentiality rule of Section 6068(e)(1) is in fact subject to exceptions in addition to the criminal death and injury exception of subsection (e)(2). These additional exceptions are "forced," in the words of Professors Hazard and Hodes,[282] by the operation of other statutory or case law. Thus, disclosure of confidential information is either permitted or required, depending upon the circumstances, in, inter alia, the following situations:[283]

- Disclosure required by law, such as disclosure by a criminal defense counsel to the court of his opinion of his client's competence to stand trial[284] and disclosure of client information, such as trust account records, in connection with a State Bar disciplinary proceeding against the lawyer.[285]
- Disclosure implicitly authorized by the attorney-client relationship, such as disclosure to other members of the attorney's law firm and disclosure to joint clients.
- Disclosure to the court necessary to avoid making false or misleading factual representations[286] or to avoid suppressing evidence that the lawyer or client is obligated to produce.[287]
- Suit by in-house counsel for retaliatory discharge when she either (1) alleges termination of employment for refusing to violate a mandatory ethical rule under the California Rules, or (2) (a) alleges conduct of the kind that would support a retaliatory discharge claim by a non-attorney employee, and (b) statutory exceptions to the attorney-client privilege (e.g., the crime-fraud exception of Evidence Code section 956) are

[280] CAL. RULES R. 3-700(C)(1)(b)-(c).

[281] *See supra* notes 100-122, 178-193, 266-272 and accompanying text.

[282] 1 HAZARD & HODES, *supra* note 1, § 9.24.

[283] *See generally* VAPNEK, *supra* note 273, ¶¶ 7.85-7.140.1. A number of situations involving exceptions to the attorney-client privilege, (e.g., attorney's testimony in response to client suit against him or attorney's testimony in his suit against a client for fees), are characterized by commentators as involving exceptions to the rule of confidentiality. *See, e.g., id.* ¶¶ 7.121, 7.126.

[284] CAL. PENAL CODE §§ 1367.1, 1368 (West 2000).

[285] *See* CAL. BUS. & PROF. CODE §§ 6068(i), 6069 (West 2003).

[286] *See id.* § 6068(d); CAL. RULES R. 5-200(B).

[287] CAL. RULES R. 5-220.

applicable to her disclosures in court.[288]

The stated rationale for the duty of confidentiality imposed on California lawyers under Section 6068(e) does not differ from that of the Model Rules. In fact, the Discussion accompanying California Rule 3-100 justifies the duty of confidentiality in language almost identical to that of the comments accompanying Model Rule 1.6.[289] What may set apart the California approach is the intensity with which the duty of confidentiality is applied and justified. That intensity may emanate from the words of the statute itself: the attorney is to "maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client."[290] In contrast is the rather bland pronouncement of Model Rule 1.6(a)—"[a] lawyer shall not reveal information relating to the representation"—the meaning of which is virtually identical to that of Section 6068(e)(1), but the emotional impact of which pales in comparison.[291]

Accordingly, the California Supreme Court has on several occasions asserted the primacy of the lawyer's duty of confidentiality,[292] noting in a recent case that "[p]rotecting the confidentiality of communications between attorney and client is fundamental to our legal system,"[293] and labeling the attorney-client privilege "a hallmark of our jurisprudence."[294] Notable is the rhetoric of some of the California cases in which the duty of confidentiality and the attorney-client privilege are maintained and applied. For example, in language bordering on hyperbole, an often-quoted Court of Appeals concurring opinion emphasizes the centrality of the attorney-client privilege:

> The privilege of confidential communication between client and attorney should be regarded as sacred. It is not to be whittled away by means of specious argument that it has been waived. Least of all should the courts seize upon slight and equivocal circumstances as a technical reason for destroying the privilege. Here the attorney was compelled to testify against his client under threat of punishment for contempt. Such procedure would have been justified only in case the defendant with knowledge of his rights had waived the privilege in open court or by his statements and conduct had furnished explicit and convincing evidence that he did not understand, desire or expect that his statements to his attorney would be kept in confidence. Defendant's attorney should have chosen to

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[288] Gen. Dynamics Corp. v. Super. Ct., 876 P.2d 487 (Cal. 1994) (retaliatory discharge); *see also* Fox Searchlight Pictures, Inc. v. Paladino, 106 Cal. Rptr. 2d 906 (Cal. Ct. App. 2001) (wrongful termination). For discussions on whether *General Dynamics* incorporates the attorney-client privilege exceptions into the duty of confidentiality under Section 6068(e), and generally concluding that it does not, see *Conflicting Currents*, *supra* note 251, at 120-25; Mohr, *supra* note 251, at 337-47; Zacharias, *supra* note 251, 378-81.

[289] *Compare* CAL. RULES R. 3-100 discussion 1, *with* MODEL RULES R. 1.6 cmt. 2.

[290] CAL. BUS. & PROF. CODE § 6068(e)(1) (West 2003) (emphasis added).

[291] MODEL RULES R. 1.6.

[292] *See, e.g.*, People *ex rel* Dep't. of Corps. v. SpeeDee Oil Change Sys., Inc., 980 P.2d 371, 378 (Cal. 1999); Mitchell v. Super. Ct., 691 P.2d. 642, 646 (Cal. 1984); D.I. Chadbourne, Inc. v. Super. Ct., 388 P.2d 700, 709 (Cal. 1964) (confirming that an "artificial person [i.e., a corporation] [should] be given equal opportunity with a natural person to communicate with its attorney, within the professional relationship, without fear that its communication will be made public").

[293] *Speedee Oil Change Sys.*, 980 P.2d at 378.

[294] *Id.*

> go to jail and take his chances of release by a higher court. This is not intended as a criticism of the action of the attorney. It is, however, a suggestion to any and all attorneys who may have the misfortune to be confronted by the same or a similar problem.[295] 295

As mandatory and permissive disclosures of confidential information have been proposed, considered, and adopted in some instances and rejected in others by the SEC and ABA over the past several years, California lawyers have made a concerted effort to oppose the creation of further exceptions to the duty of confidentiality, arguing that doing so would have a negative impact on the attorney-client relationship.[296]Primarily involved in this effort have been representatives of two committees of the State Bar of California: the Committee on Professional Responsibility and Conduct ("COPRAC"), a standing committee of the State Bar Board of Governors, and the Corporations Committee, a standing committee of the Business Law Section of the State Bar.[297] COPRAC's primary responsibility is "the issuance of advisory ethics opinions."[298] It also reviews proposed changes to the California Rules, as well as other proposed laws and rules affecting professional responsibility.[299]

COPRAC's letter of January 13, 1999,[300]to the ABA "Ethics 2000" Commission opposing the proposed Ethics 2000 changes to Model Rule 1.6 adopted in August 2003 by the ABA House of Delegates after their initial rejection by the same body in 2001,[301] well-articulated the themes that would be echoed by California lawyers over the next several years. COPRAC's basic position was that the new confidentiality exceptions in Rule 1.6(b)(2) and (3) would

> interfere with the ability of lawyers to be counselors, a role which depends on receiving a free and unguarded flow of information from the client. Lawyers cannot fulfill their function as counselors, guiding their clients towards more ethical alternatives, nor can they competently fulfill their roles as advocates, if clients withhold information because they fear the lawyer's response to it.[302]

Thus, basic to COPRAC's stated position was the premise that the lawyer would be thwarted in her effort to be the client's wise counselor, the role idealized by Examiner Batson in his critique of Enron's lawyers.[303] The letter

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[295] People v. Kor, 277 P.2d 94, 100-01 (Cal. Ct. App. 1954) (Shinn, Presiding J., concurring) (emphasis added).

[296] *See infra* notes 300-321 and accompanying text.

[297] *See infra* notes 300-321 and accompanying text.

[298] State Bar of California, Committee on Professional Responsibility and Conduct (COPRAC), http://www.calbar.ca.gov/state/calbar/calbar_generic.jsp?cid 10130&id 1104 (last visited May 18, 2006).

[299] *Id.*

[300] Letter from Harry B. Sondheim, Chair, Comm. on Prof'l Responsibility and Conduct, to Susan Campbell, Comm'n on the Evaluation of the Rules of Prof'l Conduct (Jan. 13, 1999), *available at* http://www.abanet.org/cpr/e2k/selegue.html [hereinafter Sondheim Letter].

[301] *See supra* notes 163-169 and accompanying text.

[302] Sondheim Letter, *supra* note 300 (emphasis added).

[303] *See supra* notes 72-73 and accompanying text.

envisioned a corrosive effect on an effective and vital attorney-client relationship:

> We do not believe that lawyers should accept confidential information from clients for the purpose of providing them with confidential counsel, only to reveal that information to others if, in the lawyer's unilateral judgment, the client might do or has done something wrong . . . . The mere possibility of such disclosure destroys the trust that forms the basis for an effective lawyer-client relationship—the kind of relationship in which a lawyer forthrightly can tell a client when the client has or is about to step over a legal or ethical line, and can present to the client a range of alternative courses of actions and their risks and costs.[304]

Although arguments such as these won the day in the ABA House of Delegates prior to Enron and the wave of corporate scandals that followed, they seemed less persuasive after those debacles. Nevertheless, California lawyers have yet to abandon this basic line of attack.

On December 16, 2002, the Corporations Committee, joining a host of other commentators,[305] commented on the proposed rules issued by the SEC in November 2002.[306] Predictably, the Committee expressed its view that the permissive "reporting out," "noisy withdrawal," and attorney disaffirmance features of the proposed rules were not only inconsistent with California professional conduct rules, but were also bad policy: "[reporting out] requirements are likely to impair the effective assistance of counsel, converting attorneys from advisors and advocates for their clients into quasi-regulators and judges of their clients."[307] Further, in the opening shot of a controversy that continues today, the Committee asserted that Sarbanes-Oxley Section 307 did not bestow on the SEC the authority to preempt state attorney professional conduct rules "relating to attorney-client confidences, withdrawals, or waivers of privilege."[308]

On April 7, 2003, both COPRAC and the Corporations Committee responded with skepticism to the SEC's proposal, set forth as an alternative to its original noisy withdrawal proposal, that the withdrawal of company counsel for "professional considerations" be communicated to the SEC by the company rather than by counsel.[309] The Committee expressed its concern that the specter of any form of public notice of attorney withdrawal would prevent clients from confiding candidly and completely in their counsel, with resulting harm to the attorney-client relationship.[310]

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[304] Sondheim Letter, *supra* note 300.

[305] *See supra* notes 90-91 and 129-136 and accompanying text.

[306] Letter from Timothy G. Hoxie et al, Chair, Business Law Section, to Jonathan G. Katz, Secretary, SEC (Dec. 16, 2002), *available at* http://www.sec.gov/rules/proposed/s74502/tghoxiq1.htm [hereinafter December 2002 Letter].

[307] *Id.*

[308] *Id.*

[309] Letter from Kevin E. Mohr, Chair, Comm. on Prof'l Responsibility and Conduct, to Jonathan G. Katz, Secretary, SEC (Apr. 4, 2002), *available at* http://www.sec.gov/rules/proposed/s74502/copracsbc040403.htm; *see also* Letter from Timothy G. Hoxie, Chair, Business Law Section, to Jonathan G. Katz, Secretary, SEC (Apr. 7, 2003), *available at* http://www.sec.gov/rules/proposed/s74502/tghoxie1.htm [hereinafter April 2003 Letter].

[310] *See* April 2003 Letter, *supra* note 309.

In March 2004, COPRAC and the Corporations Committee issued an "Ethics Alert" to California lawyers cautioning them about the "seemingly conflicting duties" imposed by the Sarbanes-Oxley Section 307 rules, on the one hand, and Section 6068 and the California Rules, on the other, and providing "guidance" to lawyers facing the resulting conundrum.[311] The Alert addressed three issues. The first involved the mandatory reporting "up the ladder" to higher corporate authority under the Section 307 rules.[312]This was seen as not generally conflicting with California law in light of the provisions of California Rule 3-600 permitting such reporting.[313]

The second issue discussed in the Alert was more problematic: could a California lawyer's disclosure of client confidences in compliance with the Section 307 rules permitting such disclosure[314] subject him to the possibility of State Bar discipline if, as would be likely, such disclosure were forbidden under the provisions of Section 6068(e) and California Rule 3-100? The Section 307 rules, which expressly preempt inconsistent state rules of practice[315] and excuse lawyers who comply "in good faith" with the SEC rules from discipline or liability arising under inconsistent state practice standards,[316] would appear to indicate a negative answer to the question. For attorneys "appearing and practicing" before the SEC, the apparently conflicting state rules would be irrelevant. However, to COPRAC and the Corporations Committee, the opposite conclusion was more likely:

> While the [Section 307] Rules purport to preempt state law, the preemption issue has not been resolved by any court and is currently the subject of much debate. Notwithstanding the "good faith" defense of Rule 205.6(c), if the [Section 307] Rules are held not to preempt state law, California attorneys disclosing client confidences to the SEC could potentially be subject to State Bar discipline and/or breach of fiduciary duty claims. Even if the SEC's claim of preemption is upheld, an attorney must take into account the risk that a court could conclude he or she did not satisfy the "good faith" defense. Thus, California attorneys cannot presume there is a safe harbor if they disclose client confidences to the SEC.[317]

The third issue addressed in the Alert naturally presented itself: in light of this situation, what should California lawyers do? To COPRAC and the

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[311] Corp. Comm. of the Bus. L. Section & Comm. on Prof'l Responsibility and Conduct, *Ethics Alert: The New SEC Attorney Conduct Rules v. California's Duty of Confidentiality* (Mar. 2004), *available at* http://www.calbar.ca.gov/calbar/pdfs/SEC-ethics-alert.pdf [hereinafter *Ethics Alert*].

[312] *Id.*; *see* Commodity and Securities Exchanges, 17 C.F.R. § 205.3 (2006).

[313] *Ethics Alert*, *supra* note 311, at 4.

[314] Commodity and Securities Exchanges, 17 C.F.R. § 205.3(d)(2); *see supra* note 122 and accompanying text.

[315] Commodity and Securities Exchanges, 17 C.F.R. § 205.1.

[316] *Id.* § 205.6(c).

[317] *Ethics Alert*, *supra* note 311, at 4. For criticism of this warning to California lawyers, see Cramton, Cohen & Koniak, *supra* note 91, at 807-08 ("[The California Bar's] interest is not in protecting its members who choose to disclose in good faith compliance with the SEC rules, but in deterring such disclosure.").

Corporations Committee, deference to the California rules was in order: "[I]t might be safer for California attorneys not to accept the SEC's invitation to disclose client confidences to the SEC, at least until such time as the preemption and good faith issues have been decided by a court of competent jurisdiction."[318] Although the validity and effectiveness of the SEC's asserted preemption of conflicting state confidentiality rules has been the subject of vigorous debate,[319] to date there has been no judicial resolution of the issue. Thus, for the time being at least, for California lawyers heeding the Alert's cautionary advice, California's vision of lawyer confidentiality will reign supreme and the SEC's "reporting out" provisions will be a dead letter.

Finally, in December 2004, the Corporations Committee published a sixty-one page law review article, Conflicting Currents: The Obligation to Maintain Inviolate Client Confidences and the New SEC Attorney Conduct Rules.[320] The article comprehensively examines and critiques the Section 307 rules, reviews and justifies California's strict confidentiality rules, and argues against the effectiveness of the SEC's asserted preemption of inconsistent state confidentiality rules.[321] Although the article concludes with a cautionary note to California lawyers strongly reminiscent of that of the Ethics Alert, it appears that the intended reading audience is broader, with the article being the latest salvo in the California Bar's dogged battle for acceptance of its vision of lawyer confidentiality.

VIII. THE CORPORATE LAWYER AS COUNSELOR

The professional conduct reforms of the Sarbanes-Oxley Section 307 rules and the 2003 amendments to the ABA Model Rules were direct responses to perceived inadequacies in the performance of corporate counsel during the recent corporate scandals, with the most publicity given to the failings of Enron's lawyers.[322] As later summarized by Examiner Batson, there was a dual failure of vision on the part of Enron's lawyers.[323] First, they lost sight of the fact that the corporation, rather than its officers, was their client.[324] Second, by functioning solely as "implementers" or, to use Professor John Coffee's term, "transaction engineers,"[325] they lost sight of their proper role as "counselors" to their client.[326] Only in that latter, broader role could the lawyers have acted as an

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[318] *Ethics Alert*, *supra* note 311, at 4.

[319] *Compare* Cramton, Cohen & Koniak, *supra* note 91, at 788-809 (arguing for validity and preemptive effect of SEC's permissive disclosure rules), *with Conflicting Currents*, *supra* note 251, at 128-50 (arguing that a court "should conclude" that the SEC's permissive disclosure rules do not effectively preempt inconsistent state confidentiality rules).

[320] *Conflicting Currents*, *supra* note 251.

[321] *Id.*

[322] *See supra* notes 16-73 and accompanying text.

[323] *See supra* notes 72-73 and accompanying text.

[324] *See supra* note 73 and accompanying text.

[325] *See* John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293, 1302 (2003).

[326] *See supra* note 73 and accompanying text.

effective "check and balance against the Enron officers' wrongdoing."[327]

Both the Section 307 rules[328] and Model Rule 1.13[329] confirm that the corporation is the lawyer's client as opposed to any of its directors, officers, employees, or other agents. It is axiomatic that the business and affairs of the corporation are managed by and under the direction of its board of directors.[330] The members of the board, as well as their delegated officers, have a duty to the corporation to perform their corporate functions in good faith, in the best interests of the corporation, and with the care that would be expected of an ordinarily prudent person.[331] Thus, in representing the corporation, the lawyer is ultimately responsible to the board of directors, which is charged with management and direction of the corporation. The "up the ladder" reporting obligations imposed on the lawyer by the Section 307 rules and Model Rule 1.13 are manifestations of this fundamental responsibility of the lawyer. Thus, the corporate lawyer cannot be content with confining her comments and advice to her immediate in-house contact, but must be conscious that she represents the corporation and, therefore, must do her best to reach the board of directors, the corporation's ultimate authority, if the circumstances warrant.

Further, in addition to being a capable implementer or transaction engineer, the corporate lawyer is called to be the client's counselor, or in the words of the Model Rules, the client's "advisor."[332] The breadth of this role is indicated by Model Rule 2.1: "In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors that may be relevant to the client's situation."[333]

Independence, candor, and a broad view are mandated for the lawyer-advisor. Indeed, the comments to the Rule encourage the lawyer to go beyond strict legal advice when appropriate: "Advice couched in narrow legal terms may be of little value to a client, especially where practical considerations, such as cost or effects on other people, are predominant."[334] So, whether acting as "counselor" or "advisor," the rules urge the lawyer to provide the client with the benefit of perspective by focusing on the "big picture" in addition to the immediate legal necessity. The lawyer should assist the client in determining its real objectives and in weighing the short-term advantages of a proposed course of action against its long-term costs. He should attempt to identify all of the consequences and then ask the client, "Do you really want to do that?"

The comments further note that the client is entitled to receive "straightforward" legal advice, even if that advice involves unpleasant facts or

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[327] *See supra* note 72 and accompanying text.

[328] Commodity and Securities Exchanges, 17 C.F.R. § 205.3(a) (2006).

[329] MODEL RULES R. 1.13(a).

[330] *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2005).

[331] *See, e.g.*, AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS, § 4.01 (1994).

[332] MODEL RULES R. 2.1.

[333] MODEL RULES R. 2.1.

[334] MODEL RULES R. 2.1 cmt. 2.

unwelcome courses of action.[335] Therefore, the lawyer-counselor is a truth-teller by necessity.[336] Professor Albert Alshuler posits an obligation on the part of the lawyer to tell the truth to her client "even when doing so may be costly" in the terms of lost favor or billings.[337] As Professor Alshuler notes, "'No,' however, is rarely the advice clients want to hear."[338] Nevertheless, the client needs the truth even if it does not necessarily want to hear it at the time.[339] In reflecting on the Enron debacle, what stands out in clear relief was the client's need for at least one of its bevy of lawyers to relay to the board of directors the whole truth, as he understood it, about the SPE transactions.

Even when the client does not overtly engage the lawyer to act as moral advisor, the comments to the Rule note that "moral and ethical considerations impinge upon most legal questions and may decisively influence how the law will be applied."[340] Professor Thomas Shaffer asserts that a lawyer-client discussion invariably presents an opportunity for "moral discourse":[341]

> My argument is that law office conversations are almost always moral conversations. This is so because they involve law; law is a claim which people make on one another—a claim resting on obligation, a moral claim—and one upon which they may seek the sanction and coercion of the state. In this derivative sense, a conversation about rights and duties is by definition a moral conversation. A conversation of this sort also usually involves issues on what to do about rights and duties, and of consequences to third persons . . . Law office choices and decisions often involve consideration of the social effect of what clients do, and of an effect on the character of a particular institution, such as a family or a business within the civil community. If it is possible for a serious conversation, between a lawyer and a client, in a law office, to be without moral content, I cannot think of an example.[342]

According to Professor Shaffer, the opportunity for meaningful moral discourse is optimized if the lawyer's ethics are an "ethics of care" in which lawyer and client "depend on one another and influence one another."[343] Their relationship is thus one of "mutuality and interdependence,"[344] marked by a "mutual commitment to be honest."[345]

As a result of their moral discourse, lawyer and client may be able to jointly

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[335] MODEL RULES R. 2.1 cmt. 1.

[336] *See generally* Bost, *supra* note 17.

[337] Albert W. Alshuler, *Law and the Truth: Roundtable: The Lawyer's Responsibility to the Truth: Lawyers and Truth-Telling*, 26 HARV. J.L. & PUB. POL'Y 189, 192 & n.17 (2003) (citing as a negative example the V&E report in the Watkins Investigation).

[338] *Id.* at 192.

[339] Lawyer-statesman Elihu Root is quoted as saying, "About half the practice of a decent lawyer consists in telling would-be clients that they are damned fools and should stop." MARY ANN GLENDON, ANATION UNDER LAWYERS 37 (1994).

[340] MODEL RULES R. 2.1 cmt. 2.

[341] Thomas L. Shaffer, *The Practice of Law as Moral Discourse*, 55 NOTRE DAME L. REV. 231 (1979).

[342] *Id.* at 232.

[343] *Id.* at 244.

[344] *Id.* at 250.

[345] *Id.* at 251.

determine the "right" thing to do; that is, to take the course of action that is not only "right" in the sense of that which is wise and prudent under the circumstances,[346] but "right" in the sense of that which is moral or virtuous.

For some, the Model Rules' evocation of "moral and ethical considerations"[347] as an appropriate topic for lawyer-client discussion, and Professor Shaffer's vision of that discussion constituting a "moral discourse"[348] between lawyer and client, may seem to be a bit quaint, harkening back to a simpler time of small-town lawyers and their trustful local, long-time clients. However, the corporate lawyer cannot take that view if she is to function as a counselor or advisor to her corporate client, rather than confining herself to the role of implementer or transaction engineer. One thing is clear: the scandals involving Enron and its ilk were, at their core, moral failings. Opinions differ over whether the lawyers caught up in the scandals were knowing agents of corporate fraud,[349] hapless victims of corporate fraud,[350] or mere bystanders trying to avoid involvement in corporate fraud. Regardless, the lawyer who dares to act as counselor for her corporate client will "conscientiously" raise[351] for full consideration and discussion those mixed issues of legality and illegality, wisdom and foolishness, and right and wrong that have come to her attention within the scope of her professional engagement. Therefore, a moral discourse will likely ensue.[352]

IX. THE CORPORATE LAWYER AS COUNSELOR AND THE DUTY OF CONFIDENTIALITY

Consideration of the corporate lawyer as a counselor rather than mere implementer or transaction engineer necessarily brings the focus of attention back to the lawyer's duty of confidentiality. This is the case because the lawyer's ability to function as his client's wise counselor by intelligently exercising his "independent professional judgment"[353] and consequently rendering "candid advice"[354] to the client is to a significant degree dependent upon the client's

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[346] According to Dean Anthony Kronman, these are the values of the "lawyer-statesman" of an earlier, but sadly, no longer existing era. ANTHONY T. KRONMAN, THE LOST LAWYER: FAILING IDEALS OF THE LEGAL PROFESSION 3 (1993).

[347] MODEL RULES R. 2.1 cmt. 2.

[348] *See* Shaffer, *supra* note 341.

[349] *See* Susan P. Koniak, *When the Hurlyburly's Done: The Bar's Struggle with the SEC*, 103 COLUM. L. REV. 1236, 1237 (2003) ("Lawyers structuring bogus deals, vouching for nonexistent 'sales,' writing whitewash reports to keep the sheriff fooled and away.").

[350] *Cf.* Morgan, *supra* note 79, at 24-29. Corporate lawyers are hindered in their role as corporate counselors because of the "problem of divided information," "the ambiguous boundaries of legitimate corporate conduct," and the "need to make professional judgments . . . on the findings and conclusions of others." *Id.* at 24-26.

[351] BATSON, *supra* note 19, at 52 ("That is, rather than *conscientiously raising* known issues for further analysis by a more senior officer or the Enron Board . . . these lawyers seemed to focus only how to address a narrow question or simply to implement a decision . . . . " (emphasis added)).

[352] *See* Final Report, *supra* note 140, at 177 (ABA Task Force counsels corporate lawyers "to provide an ethical, as well as a legal, perspective in their advice" to corporate officers.).

[353] MODEL RULES R. 2.1.

[354] MODEL RULES R. 2.1.

willingness "to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter."[355] The foundational assumption is that the client's trust in the lawyer is a necessary prerequisite to the client's willingness to engage in full or at least adequate self-disclosure. The distrustful client will be less likely to disclose the information needed by the lawyer for effective representation. Further, it goes without saying that mutual trust is necessary if the lawyer and client are to engage in a moral discourse marked by "mutuality and interdependence" and a "mutual commitment to be honest," as envisioned by Professor Shaffer.[356]

As classically stated in the comments to Model Rule 1.6, the duty of confidentiality owed by the lawyer to his client contributes to the "trust that is the hallmark of the client-lawyer relationship."[357] Thus, the duty of confidentiality is justified on instrumental grounds: without it, the client would not trust his lawyer, or at least would not trust his lawyer to the extent necessary for effective representation. As succinctly put by the Corporations Committee of the Business Law Section of the State Bar of California: "Over time, clients will . . . become reluctant to consult proactively and fully with legal counsel about issues."[358] The utility of the duty of confidentiality has been confirmed in both advocacy and counseling situations: "[t]he lawyer-client privilege rests on the need for the advocate and counselor to know all that relates to the client's reasons for seeking representation if the professional mission is to be carried out."[359]

Criticism of the 2003 amendments to ABA Model Rules 1.6 and 1.13 has focused on the asserted loss of client trust resulting from the dilution of the duty of confidentiality. For example, Lawrence Fox, a practicing lawyer, former Chair of the ABA Standing Committee on Ethics and Professional Responsibility, and persistent critic of the rules as then-proposed and subsequently adopted by the ABA, has vividly set forth his fears of the negative effect of the amendments on the vitality of the lawyer-client relationship:

> In my view, more is at stake with these proposed amendments to Rule 1.6 than just issues of confidentiality, as important as they are. What I see is a complete redefinition of what it means to be a lawyer. Not only will this proposal change the way the representation is formed but also the entire course of conduct between lawyer and client. Today I look my clients in the eye, urge them to trust me, explain the confidentiality that cloaks the relationship and reiterate again and again how important it is that I know everything. The truth is my stock in trade. Tell me the truth, and I can advise the client to the best of my ability. What I don't want is surprise, half stories, or convenient omissions. Those are the gremlins that play havoc to my ability to provide the best services for my clients. Mostly I succeed. Yet even with my attempt at a trust-generating speech, clients don't tell me everything. I do, however, get a lot closer to the ideal than I would if I

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[355] MODEL RULES R. 1.6 cmt. 2.

[356] Shaffer, *supra* note 341, at 250-51.

[357] MODEL RULES R. 1.6 cmt. 2.

[358] *See supra* note 237 and accompanying text.

[359] Trammel v. United States, 445 U.S. 40, 51 (1980), *quoted in* Upjohn Co. v. United States, 449 U.S. 383, 389 (1981) (applying the attorney-client privilege to communications between corporate employees and corporate counsel).

> didn't start the representation with my little speech about my commitment to keep my client's confidences and how I am on the client's side.
>
> Now, under the proposed rule, the client is entitled to be told that anytime I know or should know that the client is about to commit a fraud or has already committed one that I can rectify or mitigate, I reserve the right to disclose my client's wrongdoing—the only assumption consistent with my duty to communicate with client under Model Rule 1.4. My clients and I, henceforth, are going to start off on the wrong foot, and things will simply deteriorate from the formation of the relationship. Is there anything about the required speech I will now have to give my clients that is likely to foster trust, encourage full disclosure, and arm me with the tools to provide the client with the best advice? Hardly. Rather, we will have created a situation in which clients will be discouraged from seeking legal advice at all. When they do so, they will certainly—to a far greater extent than they presently do—withhold some key information because they will be concerned that disclosure will turn their trusted legal advisor into the best cop on the beat.[360]

This is a classic statement of the traditional view of the lawyer as both partisan and counselor. The vision of lawyering described by Mr. Fox is that reflected in the ABA Model Rules prior to the 2003 amendments and still maintained in California and the other five jurisdictions prohibiting disclosure in all of the circumstances contemplated by the amendments.[361] This vision emphasizes the sole allegiance of the corporate lawyer to her client, the corporation, and has a high view of the role of confidentiality in enabling her to be an effective advisor, counselor, and advocate for her client. Therefore, exceptions to the duty of confidentiality are quite limited in scope, being restricted to those situations involving risk to life and limb,[362] the lawyer's self-protection against loss or liability arising out of her professional activity,[363] and compulsion of law or court order.[364]

On the other hand, the 2003 amendments to Model Rules 1.6 and 1.13, as well as the generally comparable provisions of the Sarbanes-Oxley Section 307 rules,[365] permit the lawyer to reveal confidential information concerning his corporate client to third parties under specified circumstances in the case of client financial crime or fraud or, under Sarbanes-Oxley, in the case of a "material violation."[366] Further, as commentators have noted, Model Rule 4.1(b) imposes upon the lawyer a mandatory disclosure duty if disclosure is "necessary to avoid assisting" the client's financial crime or fraud which, depending upon the breadth of its reading and application, could have the effect of making disclosure

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[360] Lawrence J. Fox, *It Takes More Than Cheek To Lose Our Way*, 77 ST. JOHN'S L. REV. 277, 285-87 (2003) (footnotes omitted) (emphasis added).

[361] The other five jurisdictions are Alabama, Kentucky, Missouri, Montana, and Rhode Island. *See supra* notes 243-247 and accompanying text.

[362] *See* MODEL RULES R. 1.6(b)(1).

[363] MODEL RULES R. 1.6(b)(4)-(5).

[364] MODEL RULES R. 1.6(b)(6).

[365] Commodity and Securities Exchanges, 17 C.F.R. § 205.3(d)(2) (2006).

[366] *See supra* note 1 and accompanying text.

mandatory in the situations described in the new provisions of Rule 1.6.[367]

In providing for permissive and mandatory reporting in these circumstances, the new rules necessarily create for the lawyer a degree of accountability to non-client third parties. Even as to those circumstances in which disclosure would be permissive rather than mandatory, the lawyer would of necessity consider the financial interests of persons other than his client in deciding whether or not to disclose. Presumably, the lawyer would assess the magnitude of potential or actual financial harm to non-clients and determine whether it would be sufficient to justify breaching the general duty of confidentiality. Under the new rules, "balanced against the importance to the client-lawyer relationship of the principle of confidentiality"[368] (in the words of the Corporate Responsibility Task Force) is the importance of protecting, by means of the lawyer's disclosure, third parties, be they shareholders, employees, creditors, investors, or other "constituents," against financial loss from the crime, fraud, or material violation of the corporate client. This "balancing of competing policy interests"[369] will necessarily result in a reduction in the scope and degree of confidentiality that reasonably can be expected by the client at the outset of the engagement.

Will the dilution of the lawyer's duty of confidentiality resulting from the expansion of disclosure opportunities or obligations under the Section 307 rules and the 2003 ABA amendments strengthen the lawyer's ability to function as the counselor to his corporate client envisioned by Examiner Batson? Or, will the dilution of the duty of confidentiality have the opposite effect of dissuading the client from taking the lawyer into its confidence in the first place with the result that the lawyer's ability to rise above the role of implementer or transaction engineer will be impaired? If one accepts the proposition that gaining and keeping the client's trust is necessary for the lawyer to be accepted and to function as the client's counselor, then the answers to these questions should be relatively clear: the dilution of the confidentiality expectations of the client with its resultant erosion of trust will, at least to some extent, hinder the lawyer who seeks to function as the counselor or advisor envisioned by Model Rule 2.1.[370]

Support for this proposition comes from a seemingly unlikely source—the ABA itself, acting through the Attorney-Client Task Force in its review of the perceived "erosion" of the attorney-client privilege resulting from various governmental law enforcement initiatives.[371] In summarizing testimony submitted by a number of individuals and groups, the Attorney-Client Task Force noted:

> The Task Force heard consistently the concern that from the perspective of a corporation faced with a legal problem, the willingness to retain counsel and confide candidly and truthfully in counsel will be reduced because of the risk that government agencies . . . may later demand and obtain access to confidential

[367] *See supra* notes 170-177 and accompanying text.

[368] Final Report, *supra* note 140, at 173.

[369] *Id.* at 172 (emphasis added).

[370] *See* MODEL RULES R. 2.1.

[371] *See supra* notes 209-242 and accompanying text.

> communications with counsel.[372]

Stated otherwise, the dilution of the confidentiality expectations of the corporate client may prevent the creation or maintenance of the level of trust needed for there to be the "candid" and "truthful" client disclosure that is the hallmark of a client-counselor relationship. Significantly in this regard, the Task Force cited Model Rule 2.1 and its reference to "moral, economic, social and political factors" as being among those factors appropriate for inclusion in the attorney's advice to her client.[373] The Task Force continued:

> Accordingly, the privilege plays an important role by allowing the lawyer to obtain information that enables the attorney to function in the role of "counselor," a role that is of ultimate benefit to society. For example, it is to society's benefit for lawyers to raise with corporate decision makers social implications of corporate policy.[374]

Support for this conclusion was found in testimony before the Attorney-Client Task Force from Susan Hackett, Senior Vice President and General Counsel for the Association of Corporate Counsel ("ACC").[375] In the course of her testimony, Hackett described an ACC survey sent to 3,000 corporate counsel to which over 360 responses were received.[376] Notable among the survey results were responses indicating that 30% and 47% of the responding in-house counsel and outside counsel, respectively, had personally experienced "erosion" in their clients' rights under the attorney-client privilege and work product doctrine.[377] Further, over 90% of responding in-house counsel opined that: (1) senior-level employees of their clients are aware of and rely on these confidentiality protections;[378] (2) if the protections no longer existed, candor in communications from clients to lawyers would be impaired and the transmission of information from clients to lawyers would be "chilled"; (3) the protections better enable lawyers to effectively serve clients; (4) the protections increase the likelihood that clients will take the initiative in seeking advice from lawyers; and

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[372] ABA Task Force on the Attorney-Client Privilege, *supra* note 4, at 1049; *see also* Letter from Robert D. Evans, Director, Governmental Affairs Office, Am. Bar Ass'n, to United States Sentencing Commission (Aug. 15, 2005), *available at* http://www.abanet.org/poladv/commentlettertoussc.pdf ("By authorizing routine government demands for waiver of attorney-client and work product protections, the [Commission's waiver-request policy] discourages personnel within companies and other organizations from consulting with their lawyers. This, in turn, seriously impedes the lawyers' ability to effectively counsel compliance with the law.").

[373] ABA Task Force on the Attorney-Client Privilege, *supra* note 4, at 1039.

[374] *Id.*

[375] Testimony from Susan Hackett, Senior Vice President and General Counsel for the Association of Corporate Counsel, to ABA Task Force on the Attorney-Client Privilege Public Hearing (Apr. 21, 2005), *available at* http://www.abanet.org/buslaw/attorneyclient/publichearing20050421/testimony/hackett.pdf [hereinafter Hackett Testimony]. An executive summary of the survey is available at http://www.acca.com/Surveys/ attyclient.pdf (Apr. 6, 2005) [hereinafter ACC Executive Summary].

[376] *See* ACC Executive Summary, *supra* note 375, at 1 n.1.

[377] Hackett Testimony, *supra* note 375, at 4.

[378] Sixty-eight percent of "mid and lower-tier employees" were said to "be aware of and rely on" the confidentiality protections. *Id.*

(5) the protections improve the ability of lawyers to monitor and enforce client compliance initiatives.[379] Although it cannot be assumed that those responding to the ACC survey are representative of the corporate bar as a whole,[380] their responses offer at least general support for the proposition that the confidentiality expectations of clients play a significant role in maintaining the candid and open discourse necessary for the lawyer to assume the role of counselor.[381]

It must be emphasized that the Corporate Responsibility Task Force did not overtly abandon the concept of the corporate lawyer as advisor or counselor. Rather, the Final Report of the Corporate Responsibility Task Force, in proposing the addition of new Model Rules 1.6(b)(2) and (3) to provide further protection for the financial interests of third parties, confirmed that "corporate lawyers are first and foremost counselors to their clients."[382] The Task Force noted, however, that "commentators who emphasized the importance of trust and confidence in the attorney-client relationship have ignored exceptions to the confidentiality principles that have developed to serve other policy purposes."[383] Significantly included among the exceptions to the duty of confidentiality recounted by the Task Force were the existing exceptions in the case of criminal fraud in forty-one jurisdictions and non-criminal fraud in eighteen.[384] The implication apparently drawn by the Task Force from this circumstance was that there was no evidence that the diminution, if any, of client trust resulting from these exceptions was sufficient to impair the ability of the lawyer to assume the counselor's role. The SEC made much the same point in adopting its permissive disclosure rule, by referring to the jurisdictions permitting or mandating such disclosure of confidential information[385] and further noting that the SEC had "seen no evidence that those already-existing disclosure obligations have undermined the attorney–client relationship."[386] The SEC then observed that "generalized concerns about impacting the attorney-client relationship must yield to the public interest" when the client commits a material violation.[387]

In retrospect, it can be seen that the ABA has moved in opposite directions in the "balancing of competing policy interests" in these two situations. In

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[379] *Id.*

[380] *See* ACC Executive Summary, *supra* note 375, at 2 n.1.

[381] More insight might be gained from a study that would determine the extent to which corporate employees are informed and aware of confidentiality rules and whether they believe that the rules will effectively protect the confidentiality of information disclosed to lawyers. *See* Fred C. Zacharias, *Rethinking Confidentiality*, 74 IOWA L. REV. 351, 377-83 (1989) (survey of lawyers and laypersons in Tompkins County, New York indicated, inter alia, that lawyers, significantly more than laypersons, believe that the attorney-client privilege encourages free and full disclosure by clients; about one-half of laypersons predicted that they would withhold information without a guarantee of confidentiality).

[382] Final Report, *supra* note 140, at 156 (emphasis added); *see supra* notes 152-157 and accompanying text.

[383] Final Report, *supra* note 140, at 170 (emphasis added).

[384] *Id.* at 171.

[385] Final Rules Release, *supra* note 91, at 6311.

[386] *Id.*

[387] *Id.*

approving the proposals of the Attorney-Client Task Force, the ABA moved to protect the interest of the corporate client in maintaining confidentiality, thereby diminishing the competing law enforcement interests of the government. On the other hand, in approving the proposals of the Corporate Responsibility Task Force, the ABA moved to protect the financial interests of third parties, thereby diminishing the competing interest of the corporate client in maintaining confidentiality. What is striking is that both Task Forces were dealing with the same basic social concern: the legitimate interests of third parties, be they private investors or public law enforcement agencies, in being informed of corporate crime or fraud. The most likely explanation for their divergence in direction on these two issues is that the task forces were reacting to disparate pressures. The Attorney-Client Task Force, convinced that governmental instrumentalities were negating the confidentiality rules by aggressive law enforcement tactics against corporations, moved to affirm the rules and preserve their effectiveness. On the other hand, the Corporate Responsibility Task Force, reacting to Enron and the other notorious financial scandals and convinced that the confidentiality rules were preventing corporate lawyers from adequately protecting the financial interests of third parties, moved to scale back confidentiality obligations to clients. The ABA's failure to attempt to reconcile these two initiatives is striking. One wonders what would have been the result if the triad of confidentiality rules, namely the duty of confidentiality, the attorney-client privilege, and the work product doctrine, had been re-evaluated by the ABA in one coordinated proceeding.

CONCLUSION: THE CONCEPTUAL FAULTLINE IN THE PROFESSIONAL DUTY OF CONFIDENTIALITY

There is a conceptual fault line running through the professional duty of responsibility with different visions of lawyering on each side of the line. On one side is the vision embodied in the Sarbanes-Oxley Section 307 regulations and the 2003 amendments to Model Rules 1.6 and 1.13. Both of these regulatory regimes, with their mix of permissive and mandatory disclosure of client financial crime or fraud, are based on the implicit premise that even though the lawyer's primary allegiance is to his client, he is accountable to a significant degree to those third parties who have legitimate interests in being protected against the client's misdeeds. On the other side is the vision reflected in the professional responsibility rules of California and the other five jurisdictions that prohibit disclosure in each of the circumstances contemplated by the Section 307 rules and the 2003 amendments. Under these regulatory schemes, the lawyer is unabashedly the client's partisan with a near absolute duty of confidentiality, even in the case of client financial fraud or crime. Straddling the line are the lawyer responsibility rules of the substantial number of jurisdictions that mandate disclosure of the client's intended financial crime, but prohibit disclosure in the cases of intended financial fraud or past crime or fraud. Whether, and to what extent, these jurisdictions adopt the ABA 2003 amendments will depend on their basic vision of the appropriate role of the lawyer in society.

The premise of this article is that the optimum vision of lawyering is that

which engenders the degree of client trust necessary to permit the lawyer to be the client's counselor or advisor in the full sense envisioned in Model Rule 2.1, rather than limiting his role to that of implementer or transaction engineer. Any discussion of the conceptual fault line in the duty of professional responsibility that does not begin and end with the goal of achieving that vision is misguided. In their zeal to protect third parties from client misdeeds, the SEC and the ABA may have not adequately considered that vision in fashioning their reforms. Thus, reconsideration of these measures, with full consideration of the implications of Model Rule 2.1, is in order.