The Limits of Confidentiality: Recent Developments in the United States Relating to a Lawyer's Right to Disclose Confidences to Prevent Property Damage and Fraud[1)]

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I. Statement of the Problem (Two Hypothetical Cases)

The purpose of this paper is to examine recent developments in the United States regarding a lawyer's duty to maintain client confidences in cases such as the following:

Case 1.

Suppose you are working for a company as a lawyer (either as "outside" counsel or as "inside" counsel working in the company's "legal division.") You advise the company on compliance with the securities laws. In the course of reviewing documents over several years, you have come to realize that the company filed false and materially misleading documents with the Securities Exchange Commission (SEC) in the previous two years. You are aware that this violated United States criminal law and exposes your corporate client to criminal liability for securities fraud. It also exposes your client to civil liability to shareholders who purchased shares in ignorance of this materially misleading information. You talk to your superior in the legal division and he or she instructs you that he/she will bring what you have discovered to the attention of the corporate client and explain that the company should obey the law in the future. But he/she instructs you to keep this quiet, since it is confidential client information whose disclosure would be very damaging to your client. What are your ethical responsibilities? Does it matter whether you are "outside" or "inside" counsel?

Case 2.

Suppose, as a variation of Case 1, you continue your work without disclosing what you have discovered (except to your superior), but then a draft corporate document comes

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to you for review prior to filing with the SEC. You read it more carefully than ever given what you have discovered about past documents, and you conclude that the proposed document is also materially misleading. You go to your superior again, point this out, and object to the filing of the document in this form. Your superior says : "Thank you for calling this to my attention. You have done your job. We will handle this from here. Remember this is confidential information which you may not, under any circumstances, disclose." You know (or learn later) that the false document will be filed with the SEC and provided to the public in connection with the client's stock offerings. What are your ethical responsibilities now ? Does it matter whether you are "outside" or "inside" counsel ?

The Enron debacle has shown the relevance and importance of "hypothetical" cases such as these. We do not know, indeed we may never know, what lawyers for Enron and the accounting firm Andersen, knew or when they knew it. Nor do we know what advice they gave to their clients when (and if) they clearly understood the extent of the accounting irregularities that Enron was committing. The uncertainty that we possess may reflect a level of uncertainty and ignorance on the part of the lawyers who were actually involved in the Enron affair. Human ignorance and uncertainty are a very important part of ethical decision-making in the real world and we should not ignore or minimize this fact of life. In order to pass judgment on what legal ethics would have required in such a case, we would need to know what the lawyers knew, what they suspected, and what they feared. Lacking this essential information, however, we can still begin the discussion. We can postulate our own facts and imagine that there was full knowledge of the wrongdoing at a time when the lawyers involved still had time to do something about it. When we do that, and ask what was required of the lawyers, we discover that a lot of attention has been paid to this issue in the United States for over three decades.

II. Principal Rules of Conduct to be Considered

Before embarking on a description of the evolution of the confidentiality rules that pertain to these cases in the United States, it is necessary first to simplify the landscape considerably. As is probably well known, legal ethics in the United States is principally a creature of state law. Each of the fifty states (plus the District of Columbia) licenses and regulates lawyers separately. Each has its own legal ethics code. Historically, state regulation of lawyers has been the norm. But there are areas in which federal law has something to say about lawyer behavior, and where federal law speaks, it is generally supreme under our constitution. Thus, we have federal courts which have the power to adopt legal ethics rules for lawyers appearing before them ; and Congress has the right to specify ethics rules for lawyers who practice before federal agencies, such as the Securities

Exchange Commission ("SEC"). One of the interesting developments that I will address below has been the recent interest of the federal government in imposing ethical requirements regarding confidentiality on lawyers practicing securities law before the SEC. Before we get there, however, we need to narrow our focus.

It would be far too time consuming to consider separately the rules for all fifty states plus the District of Columbia. So simplification is necessary. In order to accomplish this, it is customary in the United States to use the American Bar Association ("ABA") model legal ethics codes as our principal reference points. There have been only three of these codes, strictly speaking. In 1908, the ABA adopted its first legal ethics code, called the Canons of Professional Ethics ("Canons"). These very general Canons provided what guidance there was until 1969, when the ABA adopted a new code. The new code, called the Model Code of Professional Responsibility ("MCPR"), included nine general ethical canons which set apart nine sections or chapters, but the important content consisted of the "disciplinary rules" ("DR"), which were designed to be used directly to discipline lawyers who do not conform to minimum expectations, and the "ethical considerations" ("EC"), which were supposed to be of help in interpreting the DRs but which were not themselves to be enforceable rules. One of the principal reasons for the 1969 code was that the 1908 Canons had proven themselves too general to enforce. The 1969 CPR was very well received by the states. Most adopted it without change and its clearer DRs provided a much needed set of tools for bar associations to regulate lawyers. Nonetheless, compared to the 1908 Canons, the 1969 CPR was relatively short lived. By the early 1980s, the ABA became convinced of the need to reexamine and revise many of the rules in the CPR, and in 1983, the ABA promulgated a wholly new code, called the Model Rules of Professional Conduct ("MRPC" or "Model Rules"). The Model Rules were given a new format. Black letter rules (intended for enforcement) were followed by extensive comments, which were intended (as with the ECs of the prior code) to help interpretation of the Model Rules. The structure of the MRPC has been more successful and has survived. But this did not stop the ABA from undertaking a major revision of the Model Rules in 2000. As a result of this "Ethics 2000" review, major changes to the Model Rules were adopted in 2002. And as this paper was being finalized, the ABA adopted still another major change to the Model Rules that is directly pertinent to our topic, in 2003. In this paper, I will principally focus on the Model Rules in their original (1983) and their revised (2002) and (2003) versions. But it will be necessary to review the treatment of confidentiality in the 1969 code to give a clear picture of the tenacity of the issues being examined here.

It is important to note at this point, however, that none of the ABA model codes is legally authoritative. The ABA is a non-governmental organization that has no power to regulate any lawyer. The ABA model codes are only recommendations to the states. That said, the ABA codes have been quite influential. The ABA 1908 Canons and 1969 MCPR were followed, almost verbatim, by almost all states. While still influential, the

1983 Model Rules have been less influential than the prior two codes. Many of the states that had adopted the 1969 MCPR decided to retain it or many of its provisions instead of adopting the 1983 MRPC. As a consequence, there is probably more diversity among the 50 American states on matters of legal ethics than ever in our history. Moreover, another major player walked on to the legal ethics stage in 1998, with the promulgation by the American Law Institute of the Restatement of the Law Governing Lawyers ("Restatement" or "RLGL"). The Restatement, like the ABA Model Rules, is a set of recommended legal ethics rules. While it is similar in many places to the ABA Model Rules, many of its most important rules are quite different than the ABA Model Rules. It will be necessary, therefore, to consider also the Restatement position on confidentiality. Finally, a summary of the state of the law in the fifty states is provided for comparison with the prevailing models.

Once the evolution and acceptance of these recommended rules has been described, we will be in a position to consider the most recent development on confidentiality in the aftermath of the Enron debacle. For the SEC has now entered the scene and adopted rules that will govern lawyers engaged in securities practice. This step by the SEC has been welcomed by some, criticized by others. But either way, it represents a new stage, perhaps a new era, in the regulation of lawyers in the United States. Indeed, as we will see, it has already provoked the ABA to accept a major change to its Model Rules.

III. Summary of Principal Codes From 1969-2002

In the discussion that follows, I will often refer to provisions of the recommended codes referenced above without quoting them. I have set out the major provisions discussed in this paper in an appendix so that readers may consult the full language of the rules as they wish.

A. ABA Code of Professional Responsibility (1969)

The ABA CPR (1969), as originally adopted, <u>permitted</u> a lawyer to disclose "[t]he intention of his client to commit a crime and the information necessary to prevent the crime." (DR 4-101 (C) (3).) Furthermore, if the lawyer learned, after the fact, that his client had used the lawyer's services to perpetrate a fraud on a person, the original CPR <u>required</u> the lawyer to disclose this to the affected person. DR 7-102 (B) (1). This section (DR 7-102 (B) (1)) of the CPR, however, was crucially amended in 1974 with the addition of the words "except when the information is protected as a privileged communication." To understand the relevance of the words "privileged communication" and the debate that followed the adoption of this amendment, one needs to consider the technical details of the confidentiality rule found in the 1969 CPR. Under that Code, a lawyer was prohibited from revealing client "confidences" or "secrets" unless an exception applied. DR 4-101

(B). The CPR defined a "confidence" as "information protected by the attorney-client privilege under applicable law" and a "secret" as "other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client." DR 4-101 (A). When DR 7-102 (B) (1) was amended in 1974, the use of the phrase "privileged communication" made it unclear whether the new exception from mandatory disclosure applied only to "confidences" or to both "confidences" and "secrets" since, technically, only the definition of "confidence" utilized the term "privilege." This uncertainty, however, was resolved in 1975, when the ABA Ethics Committee interpreted the words "privileged communication" to mean both confidences and secrets. ABA Formal Ethics Opinion 341 (1975). So as amended and then interpreted, a lawyer "surprised" by his client's use of the lawyer's services to perpetrate a fraud could not disclose this to the affected person so long as this was a "confidence" or a "secret," which it usually would be.

B. ABA Model Rules (1983)

The ABA Model Rules, as adopted in 1983, did not permit a lawyer to disclose client confidences[2] to prevent future property or financial crimes or to rectify past ones, even if the lawyer's services have been used to commit them. Model Rule 1.6 (b) (1) ; Model Rule 4.1. The Model Rules eliminated a lawyer's discretion to disclose to prevent future property crimes by restricting the discretion given a lawyer to "criminal acts . . . likely to result in imminent death or substantial bodily harm." MRPC 1.6 (b) (1) (1983). The rules denied lawyers the discretion (or duty) to disclose to rectify past property crimes in which the client had used the lawyer's services by carrying over language clearer than, but similar to, that found in the previous code provision DR 7-102 (B) (1). Model Rule 4.1 stated that "lawyer shall not knowingly : . . . (b) Fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by rule 1.6." But disclosure of past crimes by a client would ordinarily be prohibited by rule 1.6. The Kutak Commission, which drafted the 1983 model rules, had recommended a provision which would have permitted disclosure of client confidences "to rectify the consequences of a client's criminal or fraudulent act in the furtherance of which the lawyer's services had been used," but that proposal was rejected by the ABA House of Delegates.[3] Again in 1991, the ABA Ethics Committee recommended a similar amendment to Rule 1.6 but this was again rejected.[4] As a result,

2) The Model Rules replaced the use of the terms "confidences" and "secrets" found in the 1969 CPR with a unitary concept of "confidential information" which is broad enough to cover everything protected by the duty of confidentiality in the prior code, and probably more. MRPC 1.6.

3) Proposed Model Rule 1.6 (b) (2), Final Draft of the Proposed Model Rules of Professional Conduct, May 30, 1981.

4) See ABA Formal Opinion 92-366n.11. The Kutak Commission also proposed a version of Rule ↗

under the ABA Model Rules, as adopted in 1983, a lawyer who found his or her client was using his/her services to commit a crime or fraud was not permitted to disclose client confidences to prevent or rectify such misconduct by the client.

As a result of other provisions of the Model Rules, a lawyer who got into this situation almost certainly needed to resign or withdraw. Under Model Rule 1.16 (a) a lawyer must withdraw from a representation if continuing will cause him or her to violate a rule of professional conduct. Under Model Rule 1.2 (d), a lawyer may not assist a client to commit a criminal or fraudulent act. Continuing to represent a client who you know is about to commit a crime or fraud would be assisting the client in that endeavor and would violate Rule 1.2 (d). So withdrawal is clearly mandatory under Rule 1.16 (a).[5] Alternatively, continuing to represent a client in the face of knowledge that the client has used the lawyer's services to commit a crime or fraud in the past may not have been active "assistance" if the lawyer did not know that it was happening at the time. But if, after the lawyer learns of the misuse, the client continues to use the documents the lawyer produced, and the lawyer allows that continued use, then this could be considered "assistance." Withdrawal would then be mandatory.[6]Absent continued use of the lawyer's work product, if fraudulent "effects" in the future continue to flow from the client's "past" crime, commentators disagree as to whether withdrawal is mandatory, or only permissive. The ABA says withdrawal in this situation is only permissive.[7] But if consequences of past fraud are still playing out in future, it can be argued that lawyer's past work is still "assisting" if he/she continues, knowing this. Whether mandatory or not, however, withdrawal in this situation is at least permissive under Rule 1.16 (b). Most would counsel such a lawyer to withdraw if he or she cannot persuade client to rectify the crime or fraud.

Notwithstanding the prohibitions against disclosing client confidences in the 1983 Model Rules, the official comments to the confidentiality rule (MRPC 1.6) contained a very important caveat. "[Nothing] prevents the lawyer from giving notice of the fact of withdrawal, and the lawyer may also withdraw or disaffirm any opinion, document, affirmation, or the like." ABA Model Rule 1.6 (1983), comment [15]. Many consider the "disaffirmance" (which has come to be called "noisy withdrawal") contemplated by this comment to be a form of disclosure of confidences, even if indirectly so. This seems a reasonable conclusion to draw. If a lawyer "disaffirms" work that he or she has done for the client, those who learn of the disaffirmance are likely to conclude (correctly) that there is a problem with the documents and that there is something "wrong" or "tainted" or "illegal" going on which the lawyer wants to disown. While the details of the problem are not revealed by the disaffirmance, tipping third persons off to the existence of a problem

↘1.13 which would have permitted disclosure outside of the corporation. (Proposed Rule 1.13 (c)).

5) ABA Formal Opinion 92-366.

6) ABA Formal Opinion 92-366.

7) ABA Formal Opinion 92-366.

(something the lawyer knows only because of confidences) is, to that extent, a disclosure of confidences and may be quite damaging to the client. Nonetheless, the “noisy withdrawal" comment was reaffirmed by the ABA Ethics Committee in 1992. The Committee stated (among other things) that :

> “A lawyer may disavow any of her work product to prevent its use in the client’s continuing or intended future fraud, even though this may have the collateral effect of disclosing inferentially client confidences obtained during the representation. In some circumstances, such a disavowal of work product (commonly referred to as a “noisy" withdrawal) may be necessary in order to effectuate the lawyer’s withdrawal from representation of the client. . . . and . . . if the fraud is completed, and the lawyer does not know or reasonably believe that the client intends to continue the fraud or commit a future fraud by use of the lawyer’s services or work product, the lawyer may withdraw from representation of the client but may not disavow any work product."[8)]

Thus, according to the ABA Ethics Committee, noisy withdrawal may not only be permitted, but required in some situations.

C. Restatement of the Law Governing Lawyers (1998)

The ABA Model Rules went through a major reexamination and revision from 2000-2002, and debate continues in the ABA about the proper balance between the duty of confidentiality and disclosure to prevent or rectify client property crimes. But before examining those developments, we need to take account of a competing set of standards that were completed in 1998. The Restatement of the Law Governing Lawyers was promulgated by an organization called the American Law Institute (“ALI"). The ALI has promulgated many Restatements over the years and the restatements on contracts, torts, and property (to name only a few) may be familiar to many Japanese scholars of American law. These Restatements aspire to “restate" the general law among the fifty states in an effort to show that on matters of state law, the United States does not really have fifty different legal rules on every legal issue, but really displays considerable uniformity. Where there is no real uniformity, or where the American Law Institute concludes that the generally accepted rule is misguided, the ALI adopts what it considers the “better rule." Sometimes this is a rule followed only in a minority of jurisdictions. The Restatement of the Law Governing Lawyers is the first attempt by the ALI to lay out the legal rules governing the practice of law in the United States. One of the things that characterizes the American law of lawyering is considerable division among the states as to many of the most important legal rules. As a consequence, the ALI concluded that it should recommend a number of rules (“better rules") that are not generally accepted yet.

The confidentiality rules appearing in the Restatement are a case in point. The

8) ABA Formal Opinion 92-366.

Restatement contains a rule that says a lawyer may disclose client confidences if the lawyer reasonably believes it necessary to prevent a crime or fraud, provided that

"(a) the crime or fraud threatens substantial financial loss;

"(b) the loss has not yet occurred;

"(c) the lawyer's client intends to commit the crime or fraud either personally or through a third person; and

"(d) the client has employed or is employing the lawyer's services in the matter in which the crime or fraud is committed." (RLGL § 67 (1))

The rule goes on, however, to authorize disclosure of confidences "prevent, rectify, or mitigate" losses that would occur from such crimes or frauds that have already occurred. RLGL § 67 (2). As we shall see, the first part of this rule (§ 67 (1)) is a fairly accurate reflection of American law as to prevention of future crimes. But § 67 (2) of the Restatement goes beyond most states in giving permission to disclose to rectify losses from past crimes. Finally, the Restatement (like ABA Model Rule 1.6) includes a "noisy withdrawal" comment: "The lawyer may withdraw any support that the lawyer may earlier have provided the intended act, such as by withdrawing an opinion letter or draft transaction documents prepared by the lawyer." (RLGL § 96, comment e).

There is a nice question whether section 67 of the Restatement would typically permit disclosure of client confidences where the client is a corporation and the lawyer has concluded that corporate constituents are threatening to act or have acted illegally. The constituents, strictly, are not the lawyer's clients. The Restatement does include a section (96) dealing with organizational clients. The Reporter's note to section 96 says that only four states permit disclosure outside the corporation in such a situation. (Reporter's Note to RLGL 96, comment f.) Comment f to Restatement section 96 states:

"Whether the lawyer may disclose a constituent's breach of legal duty to persons outside the organization is determined primarily under §§ 66-67 (see also §§ 61-64). In limited circumstances, it may clearly appear that limited disclosure to prevent or limit harm would be in the interests of the organizational client and that constituents who purport to forbid disclosure are not authorized to act for the organization. Whether disclosure in such circumstances is warranted is a difficult and rarely encountered issue, on which this Restatement does not take a position."

But "[a] crime or fraud committed by a constituent of the organization on behalf of the organization that will result in substantial financial loss to a third party will almost certainly create corresponding liability for the organization."[9] Insofar as the constituent's crime is imputable to the entity, disclosure would seem to be permitted under section 67. The precise wording of section 67 seems to reinforce this conclusion, since the predicate for disclosure is

9) Harris, George C.,* Taking Entity Theory Seriously: Lawyer Liability for Failure to Prevent Harm to Organizational Clients Through Disclosure of Constituent Wrongdoing, 11 Geo. J. Legal Ethics 597 (1998).

that "(c) the lawyer's client intends to commit the crime or fraud either directly or through a third person."

D. The ABA Model Rules (2002)

As already mentioned, the ABA Model Rules went through a major reexamination and revision between 2000 and 2002. Once again, the ABA Commission charged with recommending changes to the Model Rules ("Ethics 2000" Commission) proposed revising the confidentiality rule to permit disclosure of confidences to prevent and/or rectify the consequences of property and financial crimes.[10] Indeed, the Ethics 2000 Commission recommended a provision substantially the same as section 67 of the Restatement.[11] But in August 2001, the ABA House of Delegates once again rejected this proposal.[12] No change was made to the Model Rules on this matter. At the same time, the ABA did not delete the noisy withdrawal comment contained in the comments to the confidentiality rule, so noisy withdrawal was still permitted. (Model Rule 1.6, comment [14].)

E. Confidentiality Rules in force in the United States.

As noted earlier, neither the ABA nor the ALI is a governmental actor and so the codes that they have promulgated are only recommendations. For that reason, it is of some importance to give a general sense of how far the states have followed those models.

Over half of the states permit disclosure to prevent any client crime.[13] Others more narrowly permit disclosure only to prevent a client from committing criminal fraud likely to result in injury to the financial interest or property of another, bringing the total of states that permit such disclosure to forty-one.[14] Of states permitting such disclosure, four actually mandate it.[15] Finally, eighteen states permit lawyers to disclose client confidences to rectify the consequences of past client crimes or frauds which threaten injury to the financial interest or property of another if the lawyer's services were used in furtherance of

10) Love, "The Revised ABA Model Rules of Professional Conduct : Summary of the Work of Ethics 2000," 15 Geo. J. Legal Ethics 441, 450 (2002).

11) Id.

12) Id. at 451. ABA/BNA LAWYERS MANUAL OF PROFESSIONAL CONDUCT, 17 Current Reports 492-3 (Aug. 15, 2001)..

13) E.g. Washington RPC 1.6 (b) (1). This was the rule under the 1969 ABA CPR 4-101 (C) (3) which was retained by a majority of the states. One leading source identifies twenty-eight states which currently have such a broad "future crimes" provision. T. MORGAN & R. ROTUNDA, SELECTED STANDARDS ON PROFESSIONAL RESPONSIBILITY (2003) (Appendix A, following reprinting of ABA Model Rules of Professional Conduct

14) Morgan & Rotunda, supra, identify 41 such states. This is the language of the Restatement and that proposed by the Ethics 2000 Commission. It has been adopted, most recently, by Delaware, effective July 1, 2003. Delaware Rules of Professional Conduct 1.6 (2003), accessed at http://courts.state.de.us/supreme/pdf/FinalDLRPCclean.pdf. See also Reporter's Notes to RLGL §67, comment b.

15) Morgan and Rotunda, supra.

the misconduct.[16] Two of these states actually mandate disclosure in such cases.[17] Thus, prior to the Enron scandal, more than half the states permitted disclosure of client confidences to prevent any future client crimes (well beyond what the ABA and the ALI had recommended), and at least forty-one states permitted disclosure to prevent criminal fraud likely to result in injury to property. On the other hand, only a minority (but a significant minority) permitted disclosure to rectify past crimes threatening injury which had used the lawyer's services (the Restatement position).

IV. Enron and its Aftermath

In the fall of 2001, the seventh biggest company in the United States, Enron, acknowledged that it had overstated profits by more than $580 million since 1997.[18] By December 2001, Enron had filed for bankruptcy protection — the biggest corporate bankruptcy in U.S. history. Soon after, Enron's principal outside accounting firm, Arthur Andersen LLP revealed that it had destroyed documents related to Enron. Its accounting practices came under scrutiny, as did the role of lawyers for Enron and Andersen. In the wake of Enron's collapse, a number of other major U.S. companies (Worldcom, Adelphia Communications, Tyco International, Global Crossing Ltd.) announced that they, too, had overstated earnings or had engaged in other corporate irresponsibility.[19] These events precipitated a crisis in investor confidence. In an effort to shore up public confidence, Congress and regulatory agencies opened investigations and began to focus on the practices of corporate executives and those of their accounting and legal advisers. One of the principal questions asked was whether lawyers for these corporations should have disclosed information to the public, or at least to regulatory agencies.

A. Sarbanes-Oxley Act & SEC Regulations

On July 30, 2002, the U.S. Congress enacted the "Sarbanes-Oxley Act" to address the problems that were disclosed as a result of the collapse of Enron and similar giant corporate accounting scandals.[20] Prior to this, the SEC had asserted its right to discipline professionals found "(ii) To be lacking in character or integrity or to have engaged in unethical or improper professional conduct ; or (iii) To have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules

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16) Id.
17) Id.
18) "Explaining the Enron Bankruptcy," CNN.COM (Jan. 12, 2002) accessed at http://www.cnn.com/2002/US/01/12/enron.qanda.focus/ on August 8, 2003.
19) "Preliminary report of the American Bar Association Task Force on Corporate Responsibility July 16, 2002," 58 Bus. Law. 189 and note 3 (2002).
20) Pub. L. 107-204 codified at 15 U.S.C. 7201-7266 (2003)..

and regulations thereunder"[21] but it had refrained from issuing general standards of conduct for securities lawyers.

The Sarbanes-Oxley Act changed that. Section 307 mandated that the SEC issue regulations, within six months, setting forth "minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers."[22] Congress specified that the rules should include one which requires attorneys to report evidence of a material violation of securities law or breach of fiduciary duty, if necessary, to an "independent" Board of Directors.[23] On November 21, 2002, the SEC proposed regulations to implement section 307 of the Sarbanes-Oxley Act and on January 29, 2003, the SEC adopted some of the proposed regulations to implement section 307, but extended the comment period for another portion.[24]

The regulations adopted to date by the SEC require (or in some cases permit) various kinds of reporting of perceived corporate securities violations by attorneys representing "issuers" of securities who practice before the SEC.[25] Attorneys who become "aware of evidence of a material violation by the issuer" are required first to report this to appropriate authorities within the client organization, working their way up, if necessary to the highest authority within the organization (so-called "up the ladder" reporting). One alternative allows the attorney to report the evidence to a Qualified Legal Compliance Committee (QLCC), if there is one. If this is done, the report relieves the attorney of further responsibility and transfers the "up the ladder" obligations to the QLCC. 17 CFR 205.3 (c). Alternatively, the attorney must report to the Chief Legal Officer ("CLO") or to the CLO and the Chief Executive Officer ("CEO"). Under this alternative, unless the attorney reasonably believes the CLO or CLO/CEO has (have) made an appropriate and timely response, the attorney must continue up the ladder to an audit committee, a committee of independent Board members, or to the whole Board of Directors, depending

21) 17 CFR 201.102 (e).

22) Pub. L. 107-204, section 307, codified at 15 U.S.C. 7245.

23) Pub. L. 107-204, section 307 (1) and (2).

24) SEC Final Rule : Implementation of Standards of Professional Conduct for Attorneys Securities and Exchange Commission, 17 CFR Part 205 [Release Nos. 33-8185 ; 34-47276 ; IC-25919 ; File No. S7-45-02] (Jan. 29, 2003) ("Final Rules") ; SEC Proposed Rule : Implementation of Standards of Professional Conduct for Attorneys 17 CFR Parts 205, 240 and 249 [Release Nos. 33-8186 ; 34-47282 ; IC-25920 ; File No. S7-45-02] (Jan. 29, 2003) ("Proposed Rules").

25) In response to comments from foreign lawyers and legal professions, the SEC exempted a foreign lawyer from the duties created by the rules, provided that he/she : "does not hold himself or herself out as practicing, and does not give legal advice regarding, United States federal or state securities or other laws (except as provided in paragraph (j) (3) (ii) of this section) ; and (3) Who : (i) Conducts activities that would constitute appearing and practicing before the Commission only incidentally to, and in the ordinary course of, the practice of law in a jurisdiction outside the United States ; or (ii) Is appearing and practicing before the Commission only in consultation with counsel, other than a non-appearing foreign attorney, admitted or licensed to practice in a state or other United States jurisdiction." 17 C.F.R. 205.2 (j).

on the structure of the company. 17 CFR 205.3 (b). If the reporting attorney does not receive an “appropriate response" from the highest appropriate authority within the corporate client, the attorney must explain to this authority why he/she does not believe the response is appropriate. 17 CFR 205.3 (b) (9). If there is still no appropriate response, the regulations adopted so far permit, but do not require, the attorney to disclose corporate client confidences (without client consent) to the SEC. 17 CFR 205.3 (d). The detail is important enough to set out here so that it can be compared with what the Restatement and the ABA would permit. Under the SEC regulations now in force :[26]

> “An attorney appearing and practicing before the Commission in the representation of an issuer may reveal to the Commission, without the issuer’s consent, confidential information related to the representation to the extent the attorney reasonably believes necessary :
>
> “(i) To prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors ;
>
> “(ii) To prevent the issuer, in a Commission investigation or administrative proceeding from committing perjury, proscribed in 18 U.S.C. 1621 ; suborning perjury, proscribed in 18 U.S.C. 1622 ; or committing any act proscribed in 18 U.S.C. 1001 that is likely to perpetrate a fraud upon the Commission ; or
>
> “(iii) To rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney’s services were used."[27]

A further rule proposed in November 2002, but still under consideration, would have mandated “noisy withdrawal" for some securities lawyers. In January 2003, the SEC proposed an alternative to this original proposal on noisy withdrawal. (For clarity, I will refer to these two alternatives as “original proposal" and “alternative proposal.") The original proposal is somewhat complicated and lays out various reporting scenarios, depending on whether the perceived violation is past or prospective, and depending on whether the attorney is an “outside" lawyer retained by the issuer, or an “inside" lawyer employed by the company.

i. *Prospective Violation/Outside Lawyer.* Where “a material violation is ongoing or is about to occur and is likely to result in substantial injury to the financial interest or property of the issuer or of investors" an outside lawyer is required to withdraw from the representation, indicate that the withdrawal is based on “professional considerations," notify the Commission of the withdrawal within one business day, and “[p]romptly disaffirm to the Commission any opinion, document, affirmation, representation, characterization, or the like in a document filed with or submitted to the Commission, or incorporated into such a document, that the attorney has prepared or assisted in

26) The regulations went into effect on August 1, 2003 (180 days after publication in the Federal Register).
27) 17 C.F.R. § 205.3 (d) (2).

preparing and that the attorney reasonably believes is or may be materially false or misleading." Original Proposal 17 CFR 205.3 (d) (1) (i) (2002).

ii. *Prospective Violation/Inside Lawyer.* An inside (employed) lawyer faced with the same situation is not required to resign but is required to notify the Commission within one business day of the intent to disaffirm documents the attorney has prepared or assisted in preparing and that the attorney reasonably believes may be materially misleading. to the Commission. The inside lawyer must then promptly disaffirm those documents. Original Proposal 17 C.F.R. 205.3 (d) (1) (ii) (2002).[28)]

iii. *Past Violation.* Where a reporting attorney has not received an appropriate response and reasonably believes "that a material violation has occurred and is likely to have resulted in substantial injury to the financial interest or property of the issuer or of investors but is not ongoing" both outside and inside lawyers are permitted (but not required) to take the steps that are mandated for each in the case of prospective violations. Original Proposal 17 CFR 205.3 (d) (2) (2002).

The alternative proposal would eliminate the original proposed duty on counsel to notify the SEC of his/her withdrawal and disaffirmance of documents prepared for the client, and shift the duty of notification to the client. The proposal would continue to require outside counsel who has not received an appropriate response to withdraw from representing the client and to notify the client that withdrawal is for "professional considerations." It would require inside counsel to "cease forthwith any participation or assistance in any matter concerning the violation and [to] . . . notify the issuer, in writing, that he or she believes that the issuer has not provided an appropriate response in a reasonable time to his or her report of evidence of a material violation." Alternative Proposal 17 C.F.R. 205.3 (d) (1) (2003). In either case, the client would have the duty (within two days) to notify the SEC of the notice received from counsel and "the circumstances related thereto." Alternative Proposed 17 C.F.R. 205.3 (e) (2003). If the client fails to carry out this duty, the reporting lawyer is permitted, but not required, to notify the SEC of the notices given the client. Alternative Proposal 17 C.F.R. 205.3 (f) (2003).

In both the original and the alternative proposals, the SEC has also dealt with the possibility that a client might discharge a lawyer for complying with the SEC "up the ladder reporting" rules. The original proposal would permit the lawyer to notify the SEC of this (original proposal). Original Proposal 17 C.F.R. 205.3 (d) (4) (2002). The alternative would require the lawyer to notify the client of this, who in turn must notify the SEC and, if the client

28) The rationale for this difference of treatment is that forcing inside counsel to withdraw would require them to quit their only job. Presumably this is thought to be too great a sacrifice to demand. But under most ethics codes, inside counsel may have little choice. A lawyer who has disaffirmed past work, against the wishes of the client, has taken a position directly at odds with those within the corporation who direct the lawyer's work. In many cases, that will create a conflict of interest with the client that would mandate withdrawal under Model Rule 1.16 (a).

fails to notify the SEC, the lawyer would be permitted to notify the SEC of the notice given the client. Alternative Proposal 17 C.F.R. 205.3 (d) (3) and (e).

B. Developments at the ABA after Enron

Following the Enron scandal, in 2002, the president of the ABA appointed a "Task Force on Corporate Responsibility" and charged it with examining the "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."[29] The Task Force, chaired by James Cheek ("Cheek Commission"), issued its Final Report in March 2003. Noting the enactment of the Sarbanes-Oxley Act, and the rules adopted and proposed by the SEC to govern securities lawyers, the Cheek Commission recommended that ABA Model Rules 1.6 and 1.13 be amended. At its annual meeting in August, 2003, the ABA House of Delegates voted narrowly to adopt the amendments proposed. Essentially, the amendment to Model Rule 1.6—the confidentiality rule—brings that ABA Model Rule into conformity with the Restatement section 67 and the proposal of the ABA Ethics 2000 Commission.[30] As amended, Model Rule 1.6 (b) now contains the following addition :

> "A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary : . . .
>
> "(2) to prevent the client from committing a crime or fraud that is 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 ; [or]
>
> "(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."

Amended Model Rule 1.6 (b) (2003)[31].

The ABA also adopted an amendment to Model Rule 1.13—governing organizational clients—which actually goes further than the change to Rule 1.6 in the corporation client context.[32] If, a lawyer "knows" that corporate officers are violating the law or duties to the client and, despite a lawyer's report of information "up the ladder" to the highest authority

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29) Report of the ABA Task Force on Corporate Responsibility (2003) (hereinafter "Cheek Commission Report") at page 8-9 and footnote 33 (identifying 42 such states) (accessed at http://www.abanet.org/buslaw/corporateresponsibility/final_report.pdf.) at page 1.

30) The House of Delegates voted 218 to 201 to adopt the amendments to Rule 1.6. Seattle Times (August 12, 2003).

31) The 2003 version of Model Rule 1.6 is set out in full in the Appendix. It may be viewed on-line at http://www.abanet.org/cpr/mrpc/new_rule1_6.pdf.

32) The amendment of Rule 1.13 was approved by a much wider margin : 239 to 147.

within the organization, the client insists on (or fails to address in an appropriate and timely manner) action or inaction that is clearly illegal and

> "the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization, then the lawyer may reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization."

Amended Model Rule 1.13 (c) (2) (2003) (emphasis added).[33] Importantly, as amended, Rule 1.13 (c) (2) makes the pivotal question whether or not illegality will result in substantial injury to the organization client (rather than to the public). But if the lawyer concludes that such injury is reasonably certain, the rule as amended would apparently allow disclosure even if Rule 1.6 (as amended) would not. Thus, for example, disclosure is now permitted under Rule 1.13 even if the client has not used the lawyer's services to further the illegal action. While reasonably certain injury to the organizational client is an important precondition to this permission to disclose, I believe many lawyers could almost always reasonably conclude that illegal action by the constituents of an organization is "reasonably certain to result in substantial injury to the organization."

Thus, to summarize, after the changes made in the summer of 2003, the ABA model rules permit disclosure to prevent (or rectify the consequences of) crimes or fraud in furtherance of which the lawyer's services have been used and which are likely to cause substantial injury to the financial or property interests of others (Rule 1.6). (So they are now consistent with the Restatement as to this.) And they also permit disclosure to prevent reasonably certain and substantial injury to the organizational client flowing from illegal conduct even where the lawyer's services have not been used to further this (Rule 1.13) (So they go beyond the Restatement in this respect.)

C. Analysis

1. Comparing the SEC regulations with prevailing state and model rules.

As noted earlier, the Sarbanes-Oxley Act mandated that the SEC issue regulations setting forth "minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers." In addition, Congress specified that the rules should include one which requires attorneys to report evidence of a material violation of securities law or breach of fiduciary duty, if necessary, to an independent Board of Directors, so-called "up the ladder" internal reporting. The regulations adopted so far by the SEC clearly impose up the ladder internal reporting. But they have also done more. In carrying out the mandate to adopt "minimum standards" for

33) The 2003 version of Model Rule 1.13 is set out, in full, in the Appendix. It may be viewed on-line at http://www.abanet.org/cpr/mrpc/new_rule1_13.pdf.

securities lawyers appearing before the SEC, the SEC has authorized disclosure of client confidences to itself. Some argue that this goes beyond the mandate of Congress, which only required internal reporting.

As the preceding discussion should make clear, however, the SEC regulations are now roughly consistent with what the rules in over eighty percent of American states would allow. They are also roughly consistent with what both the ABA Model Rules and the Restatement now recommend as the baseline for professional conduct by lawyers. But they are not entirely consistent, and the differences should be noted.

First, the SEC provision allows disclosure to prevent a client from committing a material violation likely to cause substantial injury to the financial interests or property of the issuer or investors. Unlike the law of most states, and the ABA and Restatement models, at least in theory this exception to confidentiality is not limited to future crimes. The SEC defines "material violation" to mean "a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law." 17 C.F.R. 205.2 (i). This definition is broad enough to encompass non-criminal violations of federal or state law or breaches of fiduciary duty. As a practical matter, however, before disclosure is permitted under this subsection, the violation must also threaten "substantial injury" to the issuer or investors. Most qualifying violations of federal or state law would also constitute crimes. If there are no qualifying material violations which are not crimes as well, then effectively the exception is limited to criminal violations and is consistent with prevailing law. If there are some qualifying material violations which are not at the same time also criminal violations, then the SEC has gone beyond established law.[34] This issue has already begun to raise controversy at the state level. This controversy, and the justification for the SEC action, will be discussed below under the topic of federalism.

Second, the SEC exception for future material violations does not require that the disclosing lawyer's services have been used to further the prospective violation. As can be seen, section 67 of the Restatement and Model Rule 1.6 (b) (2) permit disclosure only when the lawyer's services threaten to be misused. ABA Model Rule 1.13 (c) (2) would now allow disclosure of confidences to prevent substantial injury to the organizational client regardless of whether disclosure would otherwise be permitted by Rule 1.6 (b) — thus, regardless of whether the lawyer's services have been used in furtherance of the

34) A pending case in Delaware may provide an example of such a non-criminal "material violation." In In re Walt Disney Company Derivative Litigation, 825 A.2d 275 (Del. Ch. 2003), shareholders allege that officers and directors of the company violated their fiduciary duties in hiring and then terminating the President of the company, after only one year of service, with a compensation package of over $ 140 million. The key question, for our purposes, is whether this alleged material violation would also constitute criminal behavior (whether crimes are alleged in the actual case or not).

violation. (The Restatement does not go this far.[35]) But the ABA still does not allow disclosure to prevent injury to investors, if investors can be thought of as having separate interests from the organization. On the other hand, at least twenty-eight states would permit disclosure to prevent future crimes regardless of whether the disclosing lawyer's services were being used in furtherance of the crime. So while the SEC has gone beyond the prevailing models, it is not out of line with what a majority of states would permit.

Third, the SEC permits disclosure to prevent perjury, falsification or concealment of information in an SEC investigation or administrative proceeding. Here again, the disclosure is permitted only to prevent criminal behavior. Neither the ABA nor the Restatement currently permits disclosure to prevent such criminal behavior, but again, the law of twenty-eight states would.

Fourth, the SEC permits disclosure to rectify the consequences of a (past) material violation that "caused, or may cause, substantial injury to the financial interest or property of the issuer or investors." But this time, the exception only applies if the lawyer's services were used in furtherance of the violation. As explained earlier, such a provision for disclosure of past conduct is permitted in a significant minority of states (eighteen). On the other hand, permission to disclose in such circumstances is now recommended by both the ABA and the Restatement. Thus, while the SEC has gone beyond most state law here, it is consistent with the prevailing view of the American bar and commentators.

In addition to the rules already adopted by the SEC, there are proposals still pending. Without question, the proposal that is most important and controversial is that which would mandate "noisy withdrawal" if the client fails to respond in a way that a reporting lawyer concludes is appropriate and a material violation is ongoing or about to occur. Original Proposal 17 C.F.R. 205.3 (d) (1). Actually the proposal would mandate "disaffirmance" of offending documents by both inside and outside counsel, but would require withdrawal only by outside counsel. Id. As noted earlier, the Restatement contains a "noisy withdrawal" comment to section 96 which would permit, but not require, a lawyer to "withdraw any support that the lawyer may earlier have provided the intended act, such as by withdrawing an opinion letter or draft transaction documents prepared by the lawyer."[36] Until 2003, the ABA Model Rules also contained a "noisy withdrawal" comment permitting (and in some circumstances perhaps even requiring) noisy withdrawal in connection with withdrawal as counsel.[37] But when the ABA amended model rules 1.6 and 1.13 in August 2003, it deleted the "noisy withdrawal" comment from the official commentary. Presumably this was because the new permission to disclose confidences to

35) Section 96 of the Restatement does not create any exceptions to confidentiality not already provided in sections 66 and 67.

36) RLGL 96, comment e.

37) ABA Model Rule 1.6 (2002), comment [14]. See ABA Ethics Opinion 92-366.

prevent and/or rectify client crimes was understood to be broader and thus to supercede any need for noisy withdrawal. So neither the Restatement nor the ABA would now require disaffirmance of documents, whether in connection with withdrawal of representation or not. The SEC proposal for mandatory disaffirmance of documents would, therefore, only conform to those very few states (four) that not only permit, but require disclosure of client confidences to prevent clients from committing property crimes.[38] In other words, this proposal by the SEC is radically different from prevailing law in the United States.

Insofar as the SEC has adopted, or proposes to adopt, a rule that differs from the rule in force in any particular state, the action raises an important question of jurisdiction and power under the federal system in force in the United States. Under the federal Constitution, congressional action takes precedence over (is said to "preempt") inconsistent state law, provided that the congressional action is within the powers delegated to the federal government under the Constitution. There are those who will argue that Congress does not have power to regulate lawyers, on the theory that regulation of lawyers has traditionally been a role reserved primarily for the states. But this argument is likely to fail. There can be little question that Congress has the power to regulate the marketing and sale of securities, since Congress has broad power to regulate interstate commerce. The impact of the securities markets on interstate commerce has, perhaps, never been clearer. And it is only in connection with its regulation of securities markets, and the role of lawyers in those markets and before the SEC, that Congress has sought to regulate the legal profession. The Enron collapse has provided strong evidence that lawyers play key

38) Morgan and Rotunda, supra, identify four such states: Florida; New Jersey; Virginia and Wisconsin. Florida RPC 4-1.6 (b) mandates disclosure "to the extent the lawyer reasonably believes necessary (1) to prevent a client from committing a *crime*." Virginia RPC 1.6 (c) mandates disclosure of "(1) the intention of a client, as stated by the client, to commit a *crime* and the information necessary to prevent the crime" after the lawyer has (unsuccessfully) sought to dissuade the client. New Jersey RPC 1.6 (b) mandates disclosure "to the extent the lawyer reasonably believes necessary, to prevent the client: (1) from committing a *criminal, illegal or fraudulent act* that the lawyer reasonably believes is likely to result in death or substantial bodily harm or substantial injury to the financial interest or property of another." Wisconsin SCR 20: 1.6 (b) mandates disclosure "to the extent the lawyer reasonably believes necessary to prevent the client from committing a *criminal or fraudulent act* that the lawyer reasonably believes is likely to result in death or substantial bodily harm or in substantial injury to the financial interest or property of another." Morgan and Rotunda identify two more states that require disclosure to rectify the consequences of past crimes: Hawaii and Ohio. Hawaii RPC 1.6 (b) mandates disclosure of information "which clearly establishes a criminal or fraudulent act of the client in the furtherance of which the lawyer's services had been used, to the extent reasonably necessary to rectify the consequences of such act, where the act has resulted in substantial injury to the financial interests or property of another." Ohio DR 7-102 (B) (1) mandates that "[a] lawyer who receives information clearly establishing that (1) His client has, in the course of the representation, perpetrated a fraud upon a person or tribunal, shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal."

roles in advising (and perhaps misadvising or failing to advise) companies about the legal marketing of securities.

2. Federal Preemption

If Congress (and derivatively the SEC) has the power to regulate the practice of lawyers before the SEC, the question that needs to be examined is what happens if state rules come into conflict with the new SEC regulations. An easy answer is that the SEC regulations will preempt inconsistent law and lawyers will be required to abide by the superior federal law. Thus, if SEC regulations require lawyers to take action (say "noisy withdrawal") and state law forbids such action, then the lawyers is obliged to take the action. A necessary corollary of this conclusion is that a state would not be permitted to discipline a lawyer for complying with a duty under federal law, even if doing so were to violate an inconsistent state rule. The SEC regulations, themselves, make this point when they say that "[a]n attorney who complies in good faith with the provisions of this part shall not be subject to discipline or otherwise liable under inconsistent standards imposed by any state or other United States jurisdiction where the attorney is admitted or practices." 17 C.F.R. 205.6 (c) (2003).

More difficult, however, is determining the interplay between discretion given by federal law but denied by state law. This problem has already surfaced in the state of Washington, whose bar association has published a tentative formal ethics opinion that is intended to give state lawyers advice on how to reconcile the new SEC regulation with their duties under state law.[39] Washington is a state that permits disclosure of confidences to the extent that a lawyer reasonably believes it is necessary to prevent the client from committing any kind of crime.[40] In two respects, the SEC regulations go beyond this state authority. First, they permit disclosure to prevent non-criminal "material violations." Second, they permit disclosure to rectify the consequences of past material violations in furtherance of which the lawyer's services have been used. Nonetheless, the Washington State Bar Board of Governors concluded that there was no conflict between state and federal rules. Since a lawyer is <u>permitted, but not required,</u> to make such disclosures under federal law, the Governors concluded that a state law prohibiting such disclosure could be complied with without violating federal law and that no question of preemption was yet raised by the SEC regulations.[41] As a consequence, it concluded that a lawyer who

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39) WSBA Interim Formal Ethics Opinion : Re : The Effect of the SEC's Sarbanes-Oxley Regulations On Washington Attorneys' Obligations Under the RPCs (As approved and adopted by WSBA Board of Governors on July 26, 2003)("WSBA Ethics Opinion"), available on-line at the WSBA website : http://www.wsba.org/. The opinion says it is "tentative" because the preemptive effect of the federal rules has not yet been determined and Washington state is presently engaged in a review of its rules in light of the 2002 changes made to the ABA Model Rules. Id. at footnote 1. Presumably that review will also take into account the 2003 changes occasioned by Enron and the SEC regulations.

40) Washington RPC 1.6 (b) (1).

41) WSBA Ethics Opinion, sections B.2 and B.3.

made such discretionary disclosure could not assert, as a defense to disciplinary proceedings in Washington, that he or she was complying in good faith with federal law.[42] The Governors, reasoning was that the “good faith" compliance with federal law defense is only applicable where federal law mandated action and does not apply where conduct is discretionary.

The SEC seems to be of a different view. The WSBA Board of Governors transmitted its tentative opinion to the SEC for its comment and the SEC took the unusual step of publishing the reply of its general counsel.[43] In the SEC’s view, the Washington ethics opinion is inconsistent with federal law. In so concluding, the SEC relied on two United States Supreme Court decisions. First, it relied on Sperry v. Florida, which held forty years ago that Florida could not prohibit a non-lawyer from practicing patent law when this was authorized by federal law.[44] (Notice that federal law did not require non-lawyers to engage in patent law, it only permitted it.) Second, it relied on Fidelity Federal Savings & Loan Association v. De La Cuesta, a 1982 decision.[45] In De La Cuesta, the Federal Home Loan Bank Board had adopted a regulation permitting savings and loan associations to include “due on sale" clauses in lending documents.[46] California, however, had ruled that such clauses could not be enforced unless the lender could show that a sale had jeopardized its security interest. The Court held that California’s rule violated federal law and could not be enforced. It made three points critical to the debate between the SEC and Washington. First, it reiterated the rule that “[f]ederal regulations have no less pre-emptive effect than federal statutes."[47] Second, “[a]pre-emptive regulation’s force does not depend on express congressional authorization to displace state law."[48] Third, a conflict between federal and state law “does not evaporate because the [agency]’s regulation simply permits, but does not compel" action which is inconsistent with state requirements.[49] In De La Cuesta, the Court noted that California’s rule had deprived lenders of the “flexibility" that the Board intended that they should have. Due on sale clauses were “an option the Board consider[ed] essential to the economic soundness of the thrift industry" and California had created an obstacle to implementation of that

42) Id. at section B.4.
43) Letter Regarding Washington State Bar Association’s Proposed Opinion on the Effect of the SEC’s Attorney Conduct Rules from Giovanni P. Prezioso (SEC) to J. Richard Manning and David W. Savage (WSBA) (July 23, 2003), available on line at the SEC website at http://www.sec.gov/news/speech/spch072303gpp.htm.
44) 373 U.S. 379 (1963).
45) 458 U.S. 141 (1982).
46) A “due on sale" clause authorizes a lender to require the original borrower to pay off the full outstanding loan balance immediately if the borrower transfers the property on which the lender holds a security interest without the lender’s consent.
47) 458 U.S. at 153.
48) Id. at 154.
49) Id. at 155.

rule.[50] The same could be said about Washington's prohibition of what the SEC has concluded securities lawyers should be permitted to do.

In commenting on Washington's interim ethics opinion, the SEC observed as well that the applicability of the federal "good faith" defense to state disciplinary proceedings would be a federal question, not a state one, and any inconsistent interpretation by Washington would also be preempted. Finally, the SEC took the position that the SEC rules would be frustrated not just by the disciplining of a lawyer who had complied with the regulation, but also by the initiation of proceedings against a lawyer who had done so. "Even if the WSBA proceeding exonerated the attorney, the proceeding itself would thwart the purposes of the Commission's rules by subjecting attorneys to disciplinary proceedings for attempting in good faith to comply with a Commission rule that conflicts with an RPC."

3. An Appraisal of the SEC Rules

The SEC regulations adopted last January represent one of the most aggressive federal attempts to authorize exceptions to the traditional duty of confidentiality in American history, even though they only apply to practice before the SEC. It is not so much that the exceptions are radical. Rather it is that the federal government has entered into territory historically reserved to the states. If the SEC goes on to mandate "noisy withdrawal" in keeping with its original proposal to do so, then the incursion will be even greater. Lawyers who cherish the idea of state regulation of lawyers, and even more those who believe the legal profession should be "self-regulating," view these developments with great apprehension, if not alarm.

As to substance, the SEC rules are superior to what either the ABA or the ALI have done. Moreover, the SEC rules are not all that radical. Insofar as they permit disclosure to prevent crimes likely to cause substantial injury to financial or property interests of others, they are consistent with what eighty percent of the states would allow. But they go beyond what the ABA or ALI allow because as to future property crimes, they do not require that the lawyer's services have been used to further the crime.[51] Insofar as they permit disclosure to permit rectification of past crimes likely to cause such injury in furtherance of which the lawyer's services have been used, they are consistent with what only eighteen states would allow, but they are (now) consistent with what the ABA and the ALI recommend that states should allow.

There are two rationales that have been given for allowing disclosure to prevent or rectify the consequences of property crimes. The first is that the public interest in preventing serious property injury outweighs the public interest in client confidentiality.

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50) Id. at 156.

51) As explained earlier, the Restatement and ABA exceptions are narrower than what the SEC and most states allow for future crimes because those two models require, as a prerequisite for disclosure, that the lawyer's services were used to further the crime. The ABA goes further in its recent change to Model Rule 1.13, but that rule is predicated on injury to the client organization.

As the Restatement puts it :

> "The discretion recognized in this Section may to an unknowable extent lessen some clients' willingness to consult freely with their lawyers. . . . The social benefits of allowing a lawyer to prevent, mitigate, or rectify substantial financial loss to intended victims of criminal or fraudulent client acts under the described circumstances warrant incurring that additional risk."[52]

Or, as the SEC put it:

> "[G]eneralized concerns about impacting the attorney-client relationship must yield to the public interest where an issuer seeks to commit a material violation that will materially damage investors, seek[s] to perpetrate a fraud upon the Commission in enforcement proceedings, or has used the attorney's services to commit a material violation."[53]

The second rationale is that where the client has used the lawyer's services to commit the crime, the client is not entitled to expect confidentiality—indeed, has "forfeited" the protection of the rule.[54] With all respect, if by misusing the lawyer's services a client has forfeited any right to confidentiality, then that, alone, should suffice to permit disclosure (or more). It seems to me that most states have correctly understood that the public interest in protecting innocent victims from substantial financial injury is sufficient to authorize disclosure without requiring that the lawyer's services have been used to accomplish this. That is the position that the SEC and most states have taken with regard to future crimes, and it seems one that is quite justifiable.

But the rationale for drawing the distinction between future and past crimes, where the consequences of a past act are still in the future, is hard to understand if it is the injury to innocent persons which we are trying to prevent. In another context, both the ALI and the ABA have seen that the importance of preventing the injury in question outweighs the interest in confidentiality, regardless of whether the misconduct causing the injury is past or future. Suppose that a client has committed an action (in the past) and as a consequence it is reasonably certain that someone is likely to die or suffer serious bodily injury (in the future). The Restatement and the ABA Model Rules now permit a lawyer to disclose confidences to prevent such injury, regardless of whether the information involves past or future actions by the client.[55] The commentaries to both models state that this exception is based on "the overriding value of life and physical integrity."[56] It is submitted that at some level of injury, the value of financial security is similarly overriding. It should not be necessary to link such injury to death or serious bodily injury to justify disclosure.

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52) RLGL § 67, comment b.
53) SEC Explanation of Final rule 205.3 (d) (2). 17 C.F.R. 205.3 (d) (2003).
54) Comment [7] to ABA Model Rule 1.6 (2003) ; RLGL § 67, comment b.
55) RLGL § 66 (1) ; ABA Model Rule 1.6 (b) (1).
56) RLGL § 66, comment b ; ABA Model Rule 1.6, comment [6].

Suppose, for example, that a client reveals to a lawyer that her employer (Enron ?) has taken actions which, when they play out, will cause investors to lose $ 100 million, or more. The losses can be prevented, but the client strictly forbids the lawyer from disclosing this for fear of losing her job. Alternatively, a client discloses to a lawyer that without using this lawyer's services it has circulated a false and misleading prospectus on which millions of investors have already relied and on which millions are reasonably certain to rely in the future. By hypothesis, the relevant criminal actions are all past ; only the consequences are in the future and it is confidential client information. Wouldn't we say that the lawyer should be entitled to disclose this confidence to protect the potential victims with, or without, client consent ? Quite possibly we could surmise that someone will lose his or her life savings, and perhaps the possibility of life saving health care, if we do not act. But whether such injury is "reasonably certain" is problematic. In any event, we should not really need to link the matter to prevention of death or serious bodily injury to justify disclosure. For this reason, permission to disclose client confidences should be the same regardless of whether it is prevention of future conduct or prevention of the consequences of past action which is at issue.

For the same reasons, the SEC's abandonment of the distinction between criminal and non-criminal "material violations" is justifiable. If it is the injury to innocent persons that we are trying to prevent, and we have concluded that preventing that injury outweighs a client's (and the public's) interest in confidentiality, then whether the injury will result from criminal or non-criminal conduct should not be the pivotal issue. Again, this has now been understood in connection with preventing "reasonably certain death or substantial bodily harm." Both the Restatement and the ABA Model Rules permit disclosure to prevent such harm regardless of whether criminal conduct is the cause.[57] A case that is pending in Delaware against officers and directors of the Walt Disney Company provides one illustration. It is alleged there that the CEO, the compensation committee, and various directors, breached their fiduciary duties to the company and its shareholders by hiring and then terminating a President of the company after only one year of (unsuccessful) service, with a compensation package in excess of $ 140 million.[58] Assuming the allegations are true, if a lawyer for the Walt Disney Company had been aware of these matters at a time when the injury to the Company could still be prevented, I would argue that he or she should be entitled to disclose this information, even if the only "material violation" at issue was a non-criminal breach of a fiduciary duty. That is now the rule adopted by the SEC, and it seems justified. But to be sure, the SEC has gone beyond prevailing state law, and the rules recommended by both the ABA and the Restatement.

There does seem to be general agreement that if a client has used or threatens to use a lawyer's services to accomplish a property crime, this forfeits the right to confidentiality. The

57) ABA Model Rule 1.6 (b) (1) and RLGL § 66 (1).
58) In re Walt Disney Company Derivative Litigation, 825 A.2d 275 (Del. Ch. 2003).

attorney client evidentiary privilege has long been understood not to apply where the attorney/client communications are made for the purpose of committing a crime. And the ABA and ALI are in agreement that the right to confidentiality, as an ethical matter, is forfeited if the lawyer's services are being or have been used to commit a crime.[59] If this is so, what justification can there be for not mandating disclosure, if necessary, to prevent substantial injury to the financial interests or property of others ? This brings us to the SEC proposal to mandate noisy withdrawal. Recall that the proposed duty only required disaffirmance of documents that the lawyer had prepared, and only required this where "a material violation is ongoing or is about to occur and is likely to result in substantial injury to the financial interest or property of the issuer or of investors." Thus, by hypothesis, the lawyer's services have been or will be misused by the client. In such a case, if we believe that the client has forfeited the right to confidentiality and it is likely that substantial injury to the issuer or investors can be prevented, we should mandate disclosure, rather than merely disaffirmance. Whether that should be done by the SEC, however, depends on whether it is somehow improper for the SEC to be engaged in regulation of lawyers.

4. The SEC Rules and Federal Governmental Regulation of Lawyers

Apart from the substantive merit of the SEC regulations and proposed regulations, should we be concerned about the fact that it is the SEC (and the federal government) rather than the states that are promulgating the rules in question ? There are two aspects of this question. One relates to what we in the United States call the issue of "federalism," namely the interplay between federal and state law. The other question relates to the assumption of regulatory authority by the government over the legal profession.

For Japanese observers, the question of federalism is probably not a very interesting question. Japan allows regulation of lawyers to be handled at a local level, and discipline may be imposed at the local level.[60] But lawyers licensed by local jurisdictions are automatically members of the Japanese Federation of Bar Associations and if they are disciplined at the local level, they may appeal this discipline to the JFBA.[61] Moreover, a single code of ethics is applied throughout Japan.[62] Indeed, few countries permit local jurisdictions to operate independent regulatory systems under disparate ethics rules, as does the United States.[63]

These things said, state regulation of lawyers in the United States has both advantages and disadvantages. Its principal advantage is that it permits local admission and regulation of lawyers by the jurisdiction whose law the lawyer will be interpreting and applying for clients. In the United States, state law is dominant in much private law and each state also has a large body of public law, criminal and non-criminal, with which citizens must comply. In such a

59) ABA Model Rule 1.6, comment [7] ; RLGL 67, comment b. See also
60) Japan Practising Attorney Law arts. 31-32 & 56.
61) Articles of Association of the JFBA, arts. 97-5 & 97-6.
62) JFBA Code of Ethics.
63) Canada and Australia seem to do so; but few other countries, so far as I can tell.

system, there is great value to a system of lawyer regulation which is designed to ensure competence in, and compliance, with state law. On the other hand, separate regulatory schemes for lawyers in each of the fifty states (plus the District of Columbia) impose huge burdens on the practice of law across state lines. Given the nature of modern society, most businesses, and many citizens apart from business, have legal affairs that cross state lines. Lawyers, of necessity, find themselves needing to advise clients about matters well beyond the jurisdictional boundary and regulatory sweep of the lawyer's license to practice law. They can do so rather freely, even in the multi-state regulatory regime we have at present. But insofar as lawyers travel out of the state where they are licensed to advise and assist clients, they run the risk of engaging in the unauthorized practice of law outside of their home states.[64] The ABA and many states have recently taken steps to make multijurisdictional practice easier, with the adoption of Model Rule 5.5, which allows a lawyer to engage in temporary practice outside his or her home jurisdiction without fear of charges of unauthorized practice.[65]

Against this backdrop, the action by the SEC to impose a uniform rule for securities lawyers that will apply nationwide is one attempt to move beyond the confusion caused for securities lawyers who constantly must worry about the ethics rules in each jurisdiction. Putting aside any quarrel that lawyers might have with the substance of the SEC rules, I think it is fair to say that many would welcome a uniform rule. Stated differently, many lawyers would say that a uniform, nationwide, set of ethics rules would be a welcome change. What is more interesting, to me, is that the federal government has taken the lead here in trying to introduce such uniformity. Whether this is the beginning of greater involvement in the regulation of lawyers by the federal government is difficult to say. Only a few years ago,

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64) See, e.g., Birbrower, Montalbano, Condon & Frank v. Superior Court, 17 Cal. 4th 119 (1998).

65) Model Rule 5.5, as adopted in August of 2002, provides (in part) that:

(c) A lawyer admitted in another United States jurisdiction, and not disbarred or suspended from practice in any jurisdiction, may provide legal services on a temporary basis in this jurisdiction that:

(1) are undertaken in association with a lawyer who is admitted to practice in this jurisdiction and who actively participates in the matter;

(2) are in or reasonably related to a pending or potential proceeding before a tribunal in this or another jurisdiction, if the lawyer, or a person the lawyer is assisting, is authorized by law or order to appear in such proceeding or reasonably expects to be so authorized;

(3) are in or reasonably related to a pending or potential arbitration, mediation, or other alternative dispute resolution proceeding in this or another jurisdiction, if the services arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice and are not services for which the forum requires pro hac vice admission; or

(4) are not within paragraphs (c)(2) or (c)(3) and arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice.

(d) A lawyer admitted in another United States jurisdiction, and not disbarred or suspended from practice in any jurisdiction, may provide legal services in this jurisdiction that:

(1) are provided to the lawyer's employer or its organizational affiliates and are not services for which the forum requires pro hac vice admission; or

(2) are services that the lawyer is authorized to provide by federal law or other law of this jurisdictio.

Congress moved in the opposite direction. In the 1998 Citizens Protection Act, Congress declared that federal government lawyers (lawyers in the employ of the justice department) were obliged to comply with state ethics rules and could not count on a uniform set of federal rules.[66] The Enron and related corporate scandals have caused Congress to move in quite a different direction as to private lawyers subject to governmental regulation. Only time will tell whether there is more to come.

This brings us to the second aspect of the SEC rule, which is that it is a governmental agency which has moved to establish an ethics rule here, rather than the legal profession itself. Should we be concerned about this “regulatory" overture ? There is a great deal of rhetoric to the effect that the legal profession is “self-regulating." If true, there is reason to be concerned about governmental regulation, because it takes away, to an extent, the independence traditionally enjoyed by the legal profession. But the rhetoric of the “self-regulating" bar association is not really true, at least in the United States. Lawyers in every American jurisdiction are regulated by the courts in that jurisdiction. While the bar association in each state does have a major role in drafting rules of professional conduct, and enforcing them, it is the courts which have the last word in adopting rules to govern the legal profession and in interpreting and enforcing them. The courts are not shy about showing their independence from the proposals brought to them by the legal profession.[67] Moreover, at the state level, lawyers in most states must also comply with rules laid down not only by the courts, but also by legislatures and state agencies.[68] Against this backdrop, it does not seem extraordinary or problematic that a governmental agency set up to regulate the securities industry should have regulatory authority over lawyers who practice before it. In fact, the SEC has for decades had a rule in place that governed lawyers appearing before it, just as has the Internal Revenue Service.[69] What has changed is that the SEC, under a mandate from Congress, has acted to impose more requirements in return for the privilege of practicing before it. I, for one, am not

66) 28 U.S.C. § 530B (1998). See also 28 C.F.R. Part 77 (1999).

67) Two examples of judicial independence from the state of Washington might suffice. (1) On multiple occasions, the Washington state bar Board of Governors submitted a rule to the state Supreme Court to specifically address the problem of lawyers who engaged in sexual relations with their clients. On multiple occasions, the state supreme court rejected the proposals as unneeded. See In re Heard, 136 Wn.2d 405, 419 (1998) ; McQueen, “Regulating Attorney-Client Sex : The Need for an Express Rule," 29 Gonz. L. Rev. 405, 412 (1993/94). (2) On multiple occasions, the Board of Governors recommended that the Court admit to the practice of law an applicant who had been convicted and served prison time for murder, and on multiple occasions the Court refused to do so. In re Jimi Wright, 102 Wn.2d 855 (1984).

68) Again, examples from Washington state. The Washington Supreme Court has held that Washington lawyers must comply with the state consumer protection act with regard to the so-called “entrepreneurial" aspects of the practice of law, such as fees and advertising. Short v. Demopolis, 103 Wn.2d 52 (1984). It has also adopted a rule stating that state agencies may permit non-lawyers to engage in the limited practice of law before those agencies. Washington State Supreme Court General Rule 24 (b) (3).

69) 17 C.F.R 201.102 (e) (SEC) ; 31 C.F.R. 10.31-.34 (Treasury).

troubled by this move. Such increased regulatory activity seems warranted given the apparent failure of the state regulatory system to prevent the kind of misconduct evidenced by the Enron and other recent corporate scandals.

V. Conclusion

Major developments have occurred over the last five years in American thinking about a lawyer's duty to maintain client confidences. It is now fair to say that a wide body of professional opinion has concluded that lawyers should be permitted to disclose client confidences, if necessary, not only to prevent death or substantial personal injury, but also to prevent substantial injury to the financial and/or property interests of innocent victims. The ethics rules of the states generally reflect this conclusion, as do the two major models for professional regulation : the ABA Model Rules and the Restatement of the Law Governing Lawyers. Some members of the legal profession have been brought to this conclusion only after witnessing major financial scandals, such as the collapse of Enron. Others have come to this conclusion only reluctantly, seeing the inclusion of permission for such disclosure in the ethics codes as a bulwark to stave off further regulation by the Securities Exchange Commission or other regulatory agencies. But permit it they now would.

The conclusion of this article is that these developments are healthy ones. Indeed, permission to disclose confidences in these contexts is long overdue. Moreover, where a lawyer's services have been used or are being used by the client to commit crimes that pose substantial injury to the financial security of others, it seems to this author that disclosure can appropriately be required, not just permitted. As with all ethical principles, the ethical duty of confidentiality is not and should not be understood to be absolute. It is justified only insofar as it serves the public interest. The simple truth is that there are occasions when the public interest in disclosure outweighs the public value in protection of client confidences. The exercise of finding the appropriate balance between confidences and exceptions to confidentiality is a difficult and dangerous one. This is because there are extremely important values in play on both sides of the issue. But we should not deceive ourselves into thinking that the interests all rest on only one side of the balance, even if it is in our professional interest to do so.

In all this, the professional consternation about "government regulation" and loss of professional independence and "self-regulation" is largely a red-herring. The legal profession in the United States has never really been self-regulating, nor should it be. Regulation of the legal profession is a business that needs to be undertaken by those governmental bodies before which lawyers practice. Generally, this is the courts ; but it is not always so. Insofar as lawyers wish to appear before legislatures and/or agencies that the legislatures create, it is entirely appropriate for those bodies to regulate the conduct of the lawyers who wish to appear. Who is in a better position to regulate such conduct than the governmental body that will be experiencing it and seeing it first hand, and which is responsible for maintaining orderly and ethical proceedings?

Finally, in the American federal system, there is nothing untoward about the fact that the federal government, in the form of the SEC or any other governmental agency, has decided to step into the business of regulating lawyers. This is an inevitable part of our federal system. If the federal government is to carry on its responsibility for enforcing valid federal laws it needs to ensure that lawyers play their appropriate role in that enterprise. To be sure, federal regulators, just like state regulators and state courts, can make mistakes as to the precise nature of the rules adopted for lawyers. Those inside and outside of the legal profession have a continuing obligation to monitor and critique the rules adopted by government for the legal profession. But we should avoid distracting ourselves from this central task by engaging in unproductive rhetoric.

APPENDIX

A. ABA Model Code of Professional Responsibility (1969-83)

DR 4-101 Preservation of Confidences and Secrets of a Client.

. . . . .

(C) A lawyer may reveal:

. . . . .

(3) The intention of his client to commit a crime and the information necessary to prevent the crime.

DR 7-102 Representing a Client Within the Bounds of the Law.

(A) In his representation of a client, a lawyer shall not . . . (7) Counsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent.

. . . .

(B) A lawyer who receives information clearly establishing that:

(1) His client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal <u>except when the information is protected as a privileged [i.e. confidential] communication.</u>[70)]

B. ABA Model Rules of Professional Conduct (1983-2002)

Rule 1.2 (d): A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent. . . . ."

70) Underline language was added in 1974. "Privileged" was interpreted by the ABA ethics committee to encompass all attorney client confidences and secrets a year later.

Rule 1.6

(a) A lawyer shall not reveal information relating to the representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraph (b).

(b) A lawyer may reveal such information to the extent the lawyer reasonably believes necessary :

(1) to prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm ; or

(2) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client.

Rule 1.13 :

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, the lawyer shall proceed as is reasonably necessary in the best interest of the organization. In determining how to proceed, the lawyer shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the lawyer's representation, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters and any other relevant considerations. Any measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization. Such measures may include among others :

(1) asking for reconsideration of the matter ;

(2) advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization ; and

(3) referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act on behalf of the organization as determined by applicable law.

(c) If, despite the lawyer's efforts in accordance with paragraph (b), the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, that is clearly a violation of law and is likely to result in substantial injury to the organization, the lawyer may resign in accordance with Rule 1.16.

(d) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when it is apparent that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

(e) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

Rule 4.1 : In the course of representing a client a lawyer shall not knowingly : (a) make a false statement of material fact or law to a third person ; or (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

C. ABA MODEL RULES OF PROFESSIONAL CONDUCT (2002) (with principal additions/changes underlined)

Rule 1.2 (d) : (Unchanged)

Rule 1.6 (b) : A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary

(1) to prevent <u>reasonably certain death or substantial bodily harm.</u>

(2) <u>to secure legal advice about the lawyer's compliance with these Rules ;</u>

(3) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client ; or

(4) <u>to comply with other law or a court order.</u>

Rule 1.13 : :

(d) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when <u>the lawyer knows or reasonably should know</u> that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

Rule 4.1 : (Unchanged)

D. ABA MODEL RULES OF PROFESSIONAL CONDUCT (August 2003) (with principal additions underlined)

Rule 1.6 (b) : A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary :

(1) to prevent reasonably certain death or substantial bodily harm ;

(2) <u>to prevent the client from committing a crime or fraud that is 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 ;</u>

(3) <u>to prevent, mitigate or rectify substantial injury to the financial interests or property of</u>

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;

(4) to secure legal advice about the lawyer's compliance with these Rules;

(5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or

(6) to comply with other law or a court order.

Rule 1.13.

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer 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 as determined by applicable law.

(c) Except as provided in paragraph (d), if,

(1) despite the lawyer's efforts in accordance with paragraph (b), the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate manner an action or a refusal to act, that is clearly a violation of law, and

(2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization,

then the lawyer may: reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.

(d) Paragraph (c) shall not apply with respect to information relating to a lawyer's representation of an organization to investigate an alleged violation of law, or to defend the organization or an officer, employee or other constituent associated with the organization against a claim arising out of an alleged violation of law.

(e) A lawyer who reasonably believes that he or she has been discharged because of the lawyer's actions taken pursuant to paragraphs (b) or (c), or who withdraws under circumstances that require or permit the lawyer to take action under either of those paragraphs, shall proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal.

(f) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

(g) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

E. Restatement of the Law Governing Lawyers (1998)

§ 67 Using or Disclosing Information to Prevent, Rectify, or Mitigate Substantial Financial Loss

(1) A lawyer may use or disclose confidential client information when the lawyer reasonably believes that its use or disclosure is necessary to prevent a crime or fraud, and :

(a) the crime or fraud threatens substantial financial loss ;

(b) the loss has not yet occurred ;

(c) the lawyer's client intends to commit the crime or fraud either personally or through a third person ; and

(d) the client has employed or is employing the lawyer's services in the matter in which the crime or fraud is committed.

(2) If a crime or fraud described in Subsection (1) has already occurred, a lawyer may use or disclose confidential client information when the lawyer reasonably believes its use or disclosure is necessary to prevent, rectify, or mitigate the loss.

(3) Before using or disclosing information under this Section, the lawyer must, if feasible, make a good-faith effort to persuade the client not to act. If the client or another person has already acted, the lawyer must, if feasible, advise the client to warn the victim or to take other action to prevent, rectify, or mitigate the loss. The lawyer must, if feasible, also advise the client of the lawyer's ability to use or disclose information as provided in this Section and the consequences thereof.

(4) A lawyer who takes action or decides not to take action permitted under this Section is not, solely by reason of such action or inaction, subject to professional discipline, liable for damages to the lawyer's client or any third person, or barred from recovery against a client or third person.

§ 96 Representing an Organization as Client

(1) When a lawyer is employed or retained to represent an organization :

(a) the lawyer represents the interests of the organization as defined by its responsible agents acting pursuant to the organization's decision-making procedures; and

(b) subject to Subsection (2), the lawyer must follow instructions in the representation, as stated in § 21 (2), given by persons authorized so to act on behalf of the organization.

(2) If a lawyer representing an organization knows of circumstances indicating that a constituent of the organization has engaged in action or intends to act in a way that violates a legal obligation to the organization that will likely cause substantial injury to it, or that reasonably can be foreseen to be imputable to the organization and likely to result in

substantial injury to it, the lawyer must proceed in what the lawyer reasonably believes to be the best interests of the organization.

(3) In the circumstances described in Subsection (2), the lawyer may, in circumstances warranting such steps, ask the constituent to reconsider the matter, recommend that a second legal opinion be sought, and seek review by appropriate supervisory authority within the organization, including referring the matter to the highest authority that can act in behalf of the organization.

F. SEC Sarbanes-Oxley Regulations (January 2003) (17 C.F.R. Part 205)

§ 205.1 Purpose and scope.

This part sets forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in the representation of an issuer. These standards supplement applicable standards of any jurisdiction where an attorney is admitted or practices and are not intended to limit the ability of any jurisdiction to impose additional obligations on an attorney not inconsistent with the application of this part. Where the standards of a state or other United States jurisdiction where an attorney is admitted or practices conflict with this part, this part shall govern.

§ 205.2 Definitions.

For purposes of this part, the following definitions apply:

(a) Appearing and practicing before the Commission:

(1) Means:

(i) Transacting any business with the Commission, including communications in any form;

(ii) Representing an issuer in a Commission administrative proceeding or in connection with any Commission investigation, inquiry, information request, or subpoena;

(iii) Providing advice in respect of the United States securities laws or the Commission's rules or regulations thereunder regarding any document that the attorney has notice will be filed with or submitted to, or incorporated into any document that will be filed with or submitted to, the Commission, including the provision of such advice in the context of preparing, or participating in the preparation of, any such document; or

(iv) Advising an issuer as to whether information or a statement, opinion, or other writing is required under the United States securities laws or the Commission's rules or regulations thereunder to be filed with or submitted to, or incorporated into any document that will be filed with or submitted to, the Commission; but

(2) Does not include an attorney who:

(i) Conducts the activities in paragraphs (a) (1) (i) through (a) (1) (iv) of this section other than in the context of providing legal services to an issuer with whom the attorney has an attorney-client relationship; or

(ii) Is a non-appearing foreign attorney.

(b) Appropriate response means a response to an attorney regarding reported evidence of a material violation as a result of which the attorney reasonably believes:

(1) That no material violation, as defined in paragraph (i) of this section, has occurred, is ongoing, or is about to occur ;

(2) That the issuer has, as necessary, adopted appropriate remedial measures, including appropriate steps or sanctions to stop any material violations that are ongoing, to prevent any material violation that has yet to occur, and to remedy or otherwise appropriately address any material violation that has already occurred and to minimize the likelihood of its recurrence ; or

(3) That the issuer, with the consent of the issuer's board of directors, a committee thereof to whom a report could be made pursuant to § 205.3 (b) (3), or a qualified legal compliance committee, has retained or directed an attorney to review the reported evidence of a material violation and either :

(i) Has substantially implemented any remedial recommendations made by such attorney after a reasonable investigation and evaluation of the reported evidence ; or

(ii) Has been advised that such attorney may, consistent with his or her professional obligations, assert a colorable defense on behalf of the issuer (or the issuer's officer, director, employee, or agent, as the case may be) in any investigation or judicial or administrative proceeding relating to the reported evidence of a material violation.

(c) Attorney means any person who is admitted, licensed, or otherwise qualified to practice law in any jurisdiction, domestic or foreign, or who holds himself or herself out as admitted, licensed, or otherwise qualified to practice law.

(d) Breach of fiduciary duty refers to any breach of fiduciary or similar duty to the issuer recognized under an applicable federal or state statute or at common law, including but not limited to misfeasance, nonfeasance, abdication of duty, abuse of trust, and approval of unlawful transactions.

(e) Evidence of a material violation means credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur.

(f) Foreign government issuer means a foreign issuer as defined in 17 CFR 230.405 eligible to register securities on Schedule B of the Securities Act of 1933 (15 U.S.C. 77a et seq., Schedule B).

(g) In the representation of an issuer means providing legal services as an attorney for an issuer, regardless of whether the attorney is employed or retained by the issuer.

(h) Issuer means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15 (d) of that Act (15 U.S.C. 78o (d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn, but does not include a foreign government issuer. For purposes of paragraphs (a) and (g) of this section, the term "issuer" includes any person controlled by an issuer, where an attorney provides legal services to such person on behalf of, or at the behest, or for the benefit of the issuer, regardless of whether the attorney is employed or retained by the issuer.

(i) Material violation means a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law.

(j) Non-appearing foreign attorney means an attorney:

(1) Who is admitted to practice law in a jurisdiction outside the United States;

(2) Who does not hold himself or herself out as practicing, and does not give legal advice regarding, United States federal or state securities or other laws (except as provided in paragraph (j) (3) (ii) of this section); and

(3) Who:

(i) Conducts activities that would constitute appearing and practicing before the Commission only incidentally to, and in the ordinary course of, the practice of law in a jurisdiction outside the United States; or

(ii) Is appearing and practicing before the Commission only in consultation with counsel, other than a non-appearing foreign attorney, admitted or licensed to practice in a state or other United States jurisdiction.

(k) Qualified legal compliance committee means a committee of an issuer (which also may be an audit or other committee of the issuer) that:

(1) Consists of at least one member of the issuer's audit committee (or, if the issuer has no audit committee, one member from an equivalent committee of independent directors) and two or more members of the issuer's board of directors who are not employed, directly or indirectly, by the issuer and who are not, in the case of a registered investment company, "interested persons" as defined in section 2 (a) (19) of the Investment Company Act of 1940 (15 U.S.C. 80a-2 (a) (19));

(2) Has adopted written procedures for the confidential receipt, retention, and consideration of any report of evidence of a material violation under § 205.3;

(3) Has been duly established by the issuer's board of directors, with the authority and responsibility:

(i) To inform the issuer's chief legal officer and chief executive officer (or the equivalents thereof) of any report of evidence of a material violation (except in the circumstances described in § 205.3 (b) (4));

(ii) To determine whether an investigation is necessary regarding any report of evidence of a material violation by the issuer, its officers, directors, employees or agents and, if it determines an investigation is necessary or appropriate, to:

(A) Notify the audit committee or the full board of directors;

(B) Initiate an investigation, which may be conducted either by the chief legal officer (or the equivalent thereof) or by outside attorneys; and

(C) Retain such additional expert personnel as the committee deems necessary; and

(iii) At the conclusion of any such investigation, to:

(A) Recommend, by majority vote, that the issuer implement an appropriate response to evidence of a material violation; and

(B) Inform the chief legal officer and the chief executive officer (or the equivalents thereof) and the board of directors of the results of any such investigation under this section and the appropriate remedial measures to be adopted; and

(4) Has the authority and responsibility, acting by majority vote, to take all other

appropriate action, including the authority to notify the Commission in the event that the issuer fails in any material respect to implement an appropriate response that the qualified legal compliance committee has recommended the issuer to take.

(l) Reasonable or reasonably denotes, with respect to the actions of an attorney, conduct that would not be unreasonable for a prudent and competent attorney.

(m) Reasonably believes means that an attorney believes the matter in question and that the circumstances are such that the belief is not unreasonable.

(n) Report means to make known to directly, either in person, by telephone, by e-mail, electronically, or in writing.

§ 205.3 Issuer as client.

(a) Representing an issuer. An attorney appearing and practicing before the Commission in the representation of an issuer owes his or her professional and ethical duties to the issuer as an organization. That the attorney may work with and advise the issuer's officers, directors, or employees in the course of representing the issuer does not make such individuals the attorney's clients.

(b) Duty to report evidence of a material violation.

(1) If an attorney, appearing and practicing before the Commission in the representation of an issuer, becomes aware of evidence of a material violation by the issuer or by any officer, director, employee, or agent of the issuer, the attorney shall report such evidence to the issuer's chief legal officer (or the equivalent thereof) or to both the issuer's chief legal officer and its chief executive officer (or the equivalents thereof) forthwith. By communicating such information to the issuer's officers or directors, an attorney does not reveal client confidences or secrets or privileged or otherwise protected information related to the attorney's representation of an issuer.

(2) The chief legal officer (or the equivalent thereof) shall cause such inquiry into the evidence of a material violation as he or she reasonably believes is appropriate to determine whether the material violation described in the report has occurred, is ongoing, or is about to occur. If the chief legal officer (or the equivalent thereof) determines no material violation has occurred, is ongoing, or is about to occur, he or she shall notify the reporting attorney and advise the reporting attorney of the basis for such determination. Unless the chief legal officer (or the equivalent thereof) reasonably believes that no material violation has occurred, is ongoing, or is about to occur, he or she shall take all reasonable steps to cause the issuer to adopt an appropriate response, and shall advise the reporting attorney thereof. In lieu of causing an inquiry under this paragraph (b), a chief legal officer (or the equivalent thereof) may refer a report of evidence of a material violation to a qualified legal compliance committee under paragraph (c) (2) of this section if the issuer has duly established a qualified legal compliance committee prior to the report of evidence of a material violation.

(3) Unless an attorney who has made a report under paragraph (b) (1) of this section reasonably believes that the chief legal officer or the chief executive officer of the issuer (or the equivalent thereof) has provided an appropriate response within a reasonable time, the attorney shall report the evidence of a material violation to :

(i) The audit committee of the issuer's board of directors;

(ii) Another committee of the issuer's board of directors consisting solely of directors who are not employed, directly or indirectly, by the issuer and are not, in the case of a registered investment company, "interested persons" as defined in section 2 (a) (19) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a) (19)) (if the issuer's board of directors has no audit committee); or

(iii) The issuer's board of directors (if the issuer's board of directors has no committee consisting solely of directors who are not employed, directly or indirectly, by the issuer and are not, in the case of a registered investment company, "interested persons" as defined in section 2 (a) (19) of the Investment Company Act of 1940 (15 U.S.C. 80a-2 (a) (19))).

(4) If an attorney reasonably believes that it would be futile to report evidence of a material violation to the issuer's chief legal officer and chief executive officer (or the equivalents thereof) under paragraph (b) (1) of this section, the attorney may report such evidence as provided under paragraph (b) (3) of this section.

(5) An attorney retained or directed by an issuer to investigate evidence of a material violation reported under paragraph (b) (1), (b) (3), or (b) (4) of this section shall be deemed to be appearing and practicing before the Commission. Directing or retaining an attorney to investigate reported evidence of a material violation does not relieve an officer or director of the issuer to whom such evidence has been reported under paragraph (b) (1), (b) (3), or (b) (4) of this section from a duty to respond to the reporting attorney.

(6) An attorney shall not have any obligation to report evidence of a material violation under this paragraph (b) if:

(i) The attorney was retained or directed by the issuer's chief legal officer (or the equivalent thereof) to investigate such evidence of a material violation and:

(A) The attorney reports the results of such investigation to the chief legal officer (or the equivalent thereof); and

(B) Except where the attorney and the chief legal officer (or the equivalent thereof) each reasonably believes that no material violation has occurred, is ongoing, or is about to occur, the chief legal officer (or the equivalent thereof) reports the results of the investigation to the issuer's board of directors, a committee thereof to whom a report could be made pursuant to paragraph (b) (3) of this section, or a qualified legal compliance committee; or

(ii) The attorney was retained or directed by the chief legal officer (or the equivalent thereof) to assert, consistent with his or her professional obligations, a colorable defense on behalf of the issuer (or the issuer's officer, director, employee, or agent, as the case may be) in any investigation or judicial or administrative proceeding relating to such evidence of a material violation, and the chief legal officer (or the equivalent thereof) provides reasonable and timely reports on the progress and outcome of such proceeding to the issuer's board of directors, a committee thereof to whom a report could be made pursuant to paragraph (b) (3) of this section, or a qualified legal compliance committee.

(7) An attorney shall not have any obligation to report evidence of a material violation under this paragraph (b) if such attorney was retained or directed by a qualified legal compliance committee :

(i) To investigate such evidence of a material violation ; or

(ii) To assert, consistent with his or her professional obligations, a colorable defense on behalf of the issuer (or the issuer's officer, director, employee, or agent, as the case may be) in any investigation or judicial or administrative proceeding relating to such evidence of a material violation.

(8) An attorney who receives what he or she reasonably believes is an appropriate and timely response to a report he or she has made pursuant to paragraph (b) (1), (b) (3), or (b) (4) of this section need do nothing more under this section with respect to his or her report.

(9) An attorney who does not reasonably believe that the issuer has made an appropriate response within a reasonable time to the report or reports made pursuant to paragraph (b) (1), (b) (3), or (b) (4) of this section shall explain his or her reasons therefor to the chief legal officer (or the equivalent thereof), the chief executive officer (or the equivalent thereof), and directors to whom the attorney reported the evidence of a material violation pursuant to paragraph (b) (1), (b) (3), or (b) (4) of this section.

(10) An attorney formerly employed or retained by an issuer who has reported evidence of a material violation under this part and reasonably believes that he or she has been discharged for so doing may notify the issuer's board of directors or any committee thereof that he or she believes that he or she has been discharged for reporting evidence of a material violation under this section.

(c) Alternative reporting procedures for attorneys retained or employed by an issuer that has established a qualified legal compliance committee. (1) If an attorney, appearing and practicing before the Commission in the representation of an issuer, becomes aware of evidence of a material violation by the issuer or by any officer, director, employee, or agent of the issuer, the attorney may, as an alternative to the reporting requirements of paragraph (b) of this section, report such evidence to a qualified legal compliance committee, if the issuer has previously formed such a committee. An attorney who reports evidence of a material violation to such a qualified legal compliance committee has satisfied his or her obligation to report such evidence and is not required to assess the issuer's response to the reported evidence of a material violation.

(2) A chief legal officer (or the equivalent thereof) may refer a report of evidence of a material violation to a previously established qualified legal compliance committee in lieu of causing an inquiry to be conducted under paragraph (b) (2) of this section. The chief legal officer (or the equivalent thereof) shall inform the reporting attorney that the report has been referred to a qualified legal compliance committee. Thereafter, pursuant to the requirements under § 205.2 (k), the qualified legal compliance committee shall be responsible for responding to the evidence of a material violation reported to it under this paragraph (c).

(d) Issuer confidences. (1) Any report under this section (or the contemporaneous record thereof) or any response thereto (or the contemporaneous record thereof) may be used by an attorney in connection with any investigation, proceeding, or litigation in which the attorney's compliance with this part is in issue.

(2) An attorney appearing and practicing before the Commission in the representation of an issuer may reveal to the Commission, without the issuer's consent, confidential information related to the representation to the extent the attorney reasonably believes necessary:

(i) To prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;

(ii) To prevent the issuer, in a Commission investigation or administrative proceeding from committing perjury, proscribed in 18 U.S.C. 1621; suborning perjury, proscribed in 18 U.S.C. 1622; or committing any act proscribed in 18 U.S.C. 1001 that is likely to perpetrate a fraud upon the Commission; or

(iii) To rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used.

§ 205.4 Responsibilities of supervisory attorneys.

(a) An attorney supervising or directing another attorney who is appearing and practicing before the Commission in the representation of an issuer is a supervisory attorney. An issuer's chief legal officer (or the equivalent thereof) is a supervisory attorney under this section.

(b) A supervisory attorney shall make reasonable efforts to ensure that a subordinate attorney, as defined in § 205.5 (a), that he or she supervises or directs conforms to this part. To the extent a subordinate attorney appears and practices before the Commission in the representation of an issuer, that subordinate attorney's supervisory attorneys also appear and practice before the Commission.

(c) A supervisory attorney is responsible for complying with the reporting requirements in § 205.3 when a subordinate attorney has reported to the supervisory attorney evidence of a material violation.

(d) A supervisory attorney who has received a report of evidence of a material violation from a subordinate attorney under § 205.3 may report such evidence to the issuer's qualified legal compliance committee if the issuer has duly formed such a committee.

§ 205.5 Responsibilities of a subordinate attorney.

(a) An attorney who appears and practices before the Commission in the representation of an issuer on a matter under the supervision or direction of another attorney (other than under the direct supervision or direction of the issuer's chief legal officer (or the equivalent thereof)) is a subordinate attorney.

(b) A subordinate attorney shall comply with this part notwithstanding that the subordinate attorney acted at the direction of or under the supervision of another person.

(c) A subordinate attorney complies with § 205.3 if the subordinate attorney reports to his or her supervising attorney under § 205.3 (b) evidence of a material violation of which the subordinate attorney has become aware in appearing and practicing before the Commission.

(d) A subordinate attorney may take the steps permitted or required by § 205.3 (b) or (c) if the subordinate attorney reasonably believes that a supervisory attorney to whom he or she has reported evidence of a material violation under § 205.3 (b) has failed to comply with § 205.3.

§ 205.6 Sanctions and discipline.

(a) A violation of this part by any attorney appearing and practicing before the Commission in the representation of an issuer shall subject such attorney to the civil penalties and remedies for a violation of the federal securities laws available to the Commission in an action brought by the Commission thereunder.
(b) An attorney appearing and practicing before the Commission who violates any provision of this part is subject to the disciplinary authority of the Commission, regardless of whether the attorney may also be subject to discipline for the same conduct in a jurisdiction where the attorney is admitted or practices. An administrative disciplinary proceeding initiated by the Commission for violation of this part may result in an attorney being censured, or being temporarily or permanently denied the privilege of appearing or practicing before the Commission.
(c) An attorney who complies in good faith with the provisions of this part shall not be subject to discipline or otherwise liable under inconsistent standards imposed by any state or other United States jurisdiction where the attorney is admitted or practices.
(d) An attorney practicing outside the United States shall not be required to comply with the requirements of this part to the extent that such compliance is prohibited by applicable foreign law.

§ 205.7 No private right of action.

(a) Nothing in this part is intended to, or does, create a private right of action against any attorney, law firm, or issuer based upon compliance or noncompliance with its provisions.
(b) Authority to enforce compliance with this part is vested exclusively in the Commission.