Ethical and Professional Issues for Lawyers in the Post-Enron World
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Although most of the blame for the recent financial scandals at Enron, WorldCom, Tyco et al. has been placed on corporate executives, directors and accountants, the corporation’s lawyers have not been immune from public scrutiny and criticism. The principal accusation against the lawyers has been that they turned a blind eye to management’s conflicts of interest or financial misconduct, seeking to avoid any damage to their relationship with management rather than diligently guarding the interests of the corporation as a whole, which is after all their true client. Adding more fuel to the fire is the fact that in many cases the lawyers’ inaction was likely in compliance with minimum standards under existing ethical rules.

Not surprisingly, the public outcry over these events has prompted calls for professional reform, including a renewed focus on the lawyer’s primary responsibility to the corporation and its shareholders. For example, in a recent speech to the Business Law Section of the American Bar Association, SEC Chairman Harvey Pitt commented:

Lawyers for public companies represent the company as a whole and its shareholder-owners, not the managers who hire and fire them.

. . .

[L]awyers . . . must use their legal acumen to pursue only those goals whose sole purpose is to further legitimate corporate interests, not the interests of individual managers — even if management’s individual goals arguably are supportable by a literal reading of the law.2

Various measures have been proposed (and at least one already enacted) requiring lawyers to blow the whistle on miscreant clients by reporting criminal or fraudulent conduct to appropriate authorities within the corporation, and in some circumstances even to third parties outside of the


corporation. Indeed, although lawyers are not being asked to assume quite the adversarial posture of outside auditors, the clear trend is in that direction. In his recent speech to the ABA’s Business Law Section, Harvey Pitt stated that “[a]lthough some lawyers believe the roles of outside auditors and corporate lawyers are vastly different, lawyers representing public companies have responsibilities quite similar to those of outside auditors.” In other words, lawyers are being asked to serve as “watchdogs” over their public company clients in addition to their traditional role as advocates. While these roles may appear at first blush to be inconsistent, they can be reconciled by considering the fundamental duty of the corporate lawyer — the representation of the interests of the organization itself, not the individuals who manage it.

Existing Ethical Rules and Proposed Reforms

What is a lawyer required to do under current ethical rules when confronted with corporate misconduct? Rule 1.13(b) of the Georgia Rules of Professional Conduct provides that if a lawyer representing a corporation “knows” (i.e., has actual knowledge) that an officer, employee or other agent of the corporation is acting or intends to act, with respect to a matter related to the lawyer’s representation, in a manner “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 evaluating what remedial steps to take, the lawyer should consider such factors as the seriousness of the violation, its possible consequences and the scope and nature of the lawyer’s representation. The Rule specifically states that permissible remedial measures may include asking the officer, employee or agent to reconsider the proposed course of action (or inaction), advising that a separate legal opinion should be sought on the matter for presentation to an appropriate authority within the organization, and referring the matter directly to a higher authority in the organization. The Rule cautions the lawyer, however, that “[a]ny measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside of the organization.”

If, despite the lawyer’s efforts under Rule 1.13(b), the highest authority in the organization acts (or refuses to act) in a manner “that is clearly a violation of law and likely to result in substantial injury to the organization,” Rule 1.13(c) provides that the lawyer may withdraw from the representation as provided in Rule 1.16. Furthermore, Rule 1.6(b)(i) permits

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3 Id.

4 See Model Rules Prof’l Conduct R. 1.13; Georgia Rules Prof’l Conduct R. 1.13.

5 See Georgia Rules Prof’l Conduct (Terminology).

6 Although Rule 1.13(c) is written in permissive terms, it would seem that if the lawyer does not withdraw from the representation, he or she may have thereby undertaken a duty to stop the misconduct in order to avoid knowingly assisting the client in criminal or fraudulent conduct, which is prohibited by Rules 1.2(d) and 4.1.
a lawyer to reveal client confidential information to third parties if the lawyer reasonably believes the disclosure is necessary “to avoid or prevent harm or financial loss to another as a result of client criminal conduct or third party criminal conduct clearly in violation of the law.” This is a fairly significant difference between the Georgia Rules of Professional Conduct and the ABA’s Model Rules of Professional Conduct (the “Model Rules”), which currently permit disclosure only to prevent “reasonably certain death or substantial bodily harm.”

Thus, the existing Georgia ethical rules give lawyers some guidance and flexibility in responding to misconduct by corporate management. This very flexibility, however, coupled with the language in the rules cautioning against actions that might disrupt the organization, may discourage lawyers from taking effective remedial action, and could even be used to justify inaction where a lawyer has some evidence, but not actual knowledge, of the illegality or fraud. Indeed, the potential shortcomings in the Georgia Rules are similar to the problems identified in the Model Rules by the ABA’s Task Force on Corporate Responsibility (the “Task Force”), which issued a Preliminary Report on July 16, 2002 (the “Preliminary Report”), recommending several changes to the Model Rules aimed at preventing lawyers from relying on compliance with the Model Rules to excuse this sort of inaction.

First, the Preliminary Report recommends that Model Rule 1.13(b) (which is nearly identical to Georgia’s Rule 1.13(b)) be amended to require, rather than merely suggest, that a lawyer take the remedial steps described in the Rule, and to emphasize that these measures need not be pursued in sequential order if the severity of the misconduct or other circumstances warrant direct referral to a higher authority in the organization. In addition, the Task Force expressed the opinion that the lawyer’s obligation to pursue remedial measures should not be limited to misconduct in connection with matters relating to the lawyer’s representation of the organization, but should also encompass criminal or fraudulent conduct that comes to the lawyer’s attention during the course of the representation (i.e., the lawyer could not dismiss evidence of misconduct simply because it is unrelated to the subject matter of the engagement). The Task Force further expressed the view that the text and comments of Model Rule 1.13(b) should be revised to avoid discouraging lawyers from taking remedial action (e.g., by de-emphasizing the concern with minimizing disruption to the organization, and instead emphasizing the primary goal of preventing harm to the organization).

Second, the Preliminary Report recommends that Model Rule 1.6 (Confidentiality of Information) be amended, along the lines of Georgia’s Rule 1.6 as currently in effect, to permit a lawyer to reveal client confidential information to the extent the lawyer reasonably believes disclosure is necessary in order to prevent a client’s criminal or fraudulent conduct that has resulted in, or is reasonably certain to result in, substantial injury to the financial interests or property of another. More significantly, however, the Task Force felt that disclosure should be mandatory in order to prevent client conduct that the lawyer knows involves felonies or other serious crimes, including violations of the federal securities laws.

See Model Rules Prof’l Conduct R. 1.6(b)(1).
Finally, the Preliminary Report also recommends that Model Rule 1.13(b) be amended to provide that a lawyer’s duty to report misconduct applies if the lawyer knows or reasonably should know of the misconduct, thereby making it more difficult for the lawyer to ignore the context or implications of his or her advice to justify not reporting the matter within the organization. The Task Force also recommended similar changes to Model Rules 1.2(d) and 4.1, each of which currently prohibits lawyers from “knowingly” assisting in a client’s criminal or fraudulent conduct.8

These proposed amendments to the Model Rules would certainly appear to accomplish the Task Force’s objective of increasing the ethical duty on lawyers to investigate and report, rather than overlook or dismiss, evidence of management’s criminal or fraudulent conduct. Although well-intentioned, these proposals also present some serious questions. For example, the prospect of lawyers as corporate policemen raises the concern that lawyers’ communications with corporate employees, including executive officers and other key decision-makers in particular, may be substantially chilled as a result, thereby undermining the ability of lawyers to safeguard the corporation’s interests. Furthermore, requiring lawyers to disclose corporate misconduct to third parties (rather than merely permitting such disclosure) could potentially expose lawyers to the threat of civil liability based on an alleged failure to disclose that information. Similarly, the requirement that lawyers report misconduct unrelated to their representation raises the question whether lawyers will be charged with detailed knowledge of legal matters outside of their areas of expertise (e.g., Will securities lawyers be expected to recognize evidence of a violation of OSHA or environmental regulations? Will labor lawyers be expected to recognize violations of the federal tax laws?).

While these are legitimate concerns and not to be disregarded lightly, it appears that they may be overwhelmed in the current debate by the public’s — and the politicians’ — demands for the profession to “do something” about reform. Indeed, Congress took the first step down that road this summer with the passage of the Sarbanes-Oxley Act of 2002, which is discussed below.

The Sarbanes-Oxley Act of 2002

The first legislative response to the public clamor for reform in the wake of the Enron scandal is the Sarbanes-Oxley Act of 20029 (the “Act”), which was signed by President Bush into law on July 30, 2002 and has received considerable attention over the past two months. Section 307 of the Act directs the SEC to promulgate regulations governing the conduct of attorneys practicing before the SEC:

Not later than 180 days after the date of enactment of this Act, the Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and

8 The Preliminary Report does not recommend similar revisions to Model Rule 1.6, and thus the mandatory disclosure to third parties recommended by the Task Force would seem to apply only where the lawyer has actual knowledge of the misconduct.

practicing before the Commission in any way in the representation of issuers, including a rule—

(1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and

(2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

This provision is quite similar to the proposed amendments to the Model Rules discussed above in that it requires lawyers to report corporate misconduct up the corporate ladder. It also appears, however, that this provision may be broader than the Task Force’s proposed reforms in some respects. For example, the Act requires the lawyer to report “evidence” of a material violation of law or fiduciary duty. It seems likely that this will be a lower reporting threshold than the current “actual knowledge” standard under existing ethical rules, and may even be broader than the “reasonably should know” standard advocated by the Task Force (i.e., because “evidence” of a violation conceivably could be anything from an unsubstantiated allegation by a disgruntled employee to a “smoking gun” email or memorandum). In addition, the Act requires the lawyer to report not only evidence of violations of law, but also possible violations of fiduciary duties and “similar violations”. It is unclear what Congress intended to encompass within the scope of “similar violations”; although current ethical rules do encompass violations of fiduciary duty,\(^{10}\) the SEC may take a broader view in its regulations. Finally, the Act does not address the issue that, although arising infrequently, will likely be far more problematic for lawyers—what must a lawyer do if, after disclosing evidence of misconduct to the board of directors, the board fails to take appropriate remedial action? Although the SEC may address this question in its regulations, it seems equally (if not more) likely that the SEC will avoid this thicket and leave the question of when client confidences may be disclosed to the various state ethical rules.

These points underscore the speculative nature of any discussion of this provision at this time, as the ultimate impact of this provision will be determined by the actual language the SEC adopts in its rulemaking. Furthermore, while the Sarbanes-Oxley Act is unquestionably a significant development for a large segment of the legal profession, its impact on the profession as a whole will be more limited because the new ethical rules will not apply to all lawyers, but

\(^{10}\) See, e.g., Georgia Rules Prof’l Conduct R. 1.13(b) (providing that a lawyer for an organization may take remedial action if, \textit{inter alia}, the lawyer knows that an officer or employee of the organization is acting or intends to act in a manner “that is a violation of a legal obligation to the organization”).
rather only to lawyers who are representing issuers before the SEC. Nevertheless, the Act accurately reflects the current public sentiment that lawyers should do more than the bare minimum required under state ethical rules to protect the interests of the corporation and its shareholders from management’s misconduct.

Moreover, the rapid enactment of the Sarbanes-Oxley Act makes clear that Congress and regulatory authorities will not be bashful about getting into the business of lawyer ethics if they have any concern about the profession’s ability, or willingness, to ensure that lawyers look out for the interests of the organizations they serve rather than the individuals within those organizations who have hired them. As Harvey Pitt recently put it: “Sarbanes-Oxley reflects some skepticism about the degree to which the legal profession can police itself, by making explicit the Commission’s ability, and our obligation, to regulate how lawyers appear and practice before us, including minimum standards of professional conduct for corporate lawyers.”11

In addition, lawyers who are closely involved with public corporations, whether as inside or outside counsel, are increasingly likely to see themselves on the firing line when trouble erupts. The move in the direction of ethical mandates to disclose known, or even suspected, corporate misconduct, including disclosure of such information outside the corporation, combined with the substantial compensation that may be paid to lawyers serving corporations, is a recipe for challenging the lawyer’s exercise of independent professional judgment. For instance, recent lawsuits stemming from the various scandals at Tyco name former general counsel Mark Belnick (in addition to the more notorious former CEO Dennis Kozlowski), and allege that, “through repeated unauthorized grants of stock and benefits,” Mr. Kozlowski bought Mr. Belnick’s “silence.”12 Similar allegations could easily be levied against any lawyer who receives substantial compensation from a client that subsequently becomes the subject of an SEC investigation, enforcement action, or private lawsuit.

**Lawyers as Directors**

Lawyers serving as directors of client corporations have always faced special challenges. While such dual representation is generally not prohibited by ethical rules, it does raise potential conflicts of interest and other concerns. The comments to Rule 1.7 of the Georgia Rules of Professional Conduct presuppose that a lawyer may serve as a director of his or her client and summarize the relevant concerns as follows:

A lawyer for a corporation or other organization who is also a member of its board of directors should determine whether the responsibilities of the two roles may conflict. The lawyer may be called on to advise the corporation in matters

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involving actions of the directors. Consideration should be given to the frequency with which such situations may arise, the potential intensity of the conflict, the effect of the lawyer’s resignation from the board and the possibility of the corporation’s obtaining legal advice from another lawyer in such situations. If there is material risk that the dual role will compromise the lawyer’s independence of professional judgment, the lawyer should not serve as a director.\[^{13}\]

The current focus on corporate governance and professional ethics will likely increase these concerns in a number of ways, as the increased scrutiny placed on corporate decision making and financial reporting, combined with the increased complexity of those obligations, will likely lead to the board of directors seeking more and more guidance on such matters from corporate counsel. This increased reliance on counsel, in turn, will likely increase the opportunities for potential conflicts between the lawyer-director’s dual roles. For example, the lawyer’s independent professional judgment may be clouded by fear of his or her (and, for outside counsel, his or her firm’s) potential liability as a director, as lawyers may be held to a higher standard of care than non-lawyer directors. In addition, increased reliance by the board on the lawyer’s legal advice will likely increase the risk that the lawyer (and his or her firm) may be disqualified from representing the corporation in a legal proceeding challenging a corporate action that was the subject of the lawyer’s advice (i.e., because the lawyer-director may be a necessary witness in the legal proceeding, the other directors may assert reliance on counsel as a defense, or the lawyer, as a defendant-director, may have interests limiting his or her ability to effectively represent the corporation). Indeed, this last point underscores the need for the lawyer-director to maintain carefully the distinction between his or her legal advice and the board’s business deliberations in order to avoid inadvertent waiver of attorney-client privilege.

Additionally, the lawyer could be asked to represent the corporation in a matter that he or she unsuccessfully opposed as a director. The principal question in this situation, as in others, is whether the lawyer’s ability to represent the corporation would be “materially and adversely” affected by the prior opposition.\[^{14}\] The answer to this question should turn on the basis for the lawyer’s opposition to the action—i.e., if the opposition is based on business concerns, the lawyer should be able to represent the corporation effectively notwithstanding his or her prior opposition to the decision; if, however, the lawyer’s opposition stems from concern regarding the legality of the action, the lawyer must undertake an analysis of his or her duties under the Rules of Professional Conduct. That is, if the lawyer believes the board is causing the corporation to act unlawfully, he or she must evaluate whether the action is, or would be, “clearly in violation of law and likely to result in substantial injury to the [corporation]”\[^{15}\] (thereby warranting


\[^{14}\] See Georgia Rules Prof’l Conduct R. 1.7(a).

\[^{15}\] Id. R. 1.13(c).
withdrawal from the representation), and whether disclosure may be necessary “to avoid or prevent harm or financial loss”\textsuperscript{16} to third parties as a result of such action.

Finally, as a practical matter, it seems less likely that lawyers will be asked to serve on the board of directors of their public company clients. For example, both the New York Stock Exchange and The Nasdaq Stock Market have proposed rules requiring at least a majority of a listed company’s board of directors to be independent, which will necessarily leave less room on the board for the corporation’s lawyer. Furthermore, at least one major institutional investor, the California Public Employees’ Retirement System (CalPERS), includes among its “core principles” of corporate governance the recommendation that a person who is a consultant or other service provider to the corporation not also serve as a director.\textsuperscript{17}

On a related note, an interesting question arises in the public company context as a result of the Sarbanes-Oxley Act: If a lawyer-director discovers evidence of corporate misconduct, must the lawyer report the evidence first to the CEO or general counsel before disclosing the matter to the other board members, or should the director instead disclose the evidence directly to the board? While it remains to be seen whether this issue will be addressed in the SEC’s professional responsibility regulations under the Sarbanes-Oxley Act, it seems entirely consistent with the Act to have the lawyer-director disclose misconduct directly to the board, as the Act directed the SEC to promulgate minimum standards rather than rigid procedural rules. Although disclosing evidence of misconduct directly to the board is considered appropriate in certain circumstances under the existing Rules of Professional Conduct, the Rules also caution that a lawyer should have “clear justification” for reporting misconduct over the head of the person normally responsible for the matter. In contrast to other corporate lawyers, however, a lawyer-director may arguably have a fiduciary duty to monitor corporate conduct and ensure that illegal activity is brought to the board’s attention.\textsuperscript{18} Thus, the lawyer-director’s reporting of misconduct directly to the board would be consistent with existing ethical and fiduciary duties, as well as the purpose and intent of the Sarbanes-Oxley Act.

Conclusions

The landscape is changing rapidly for the corporate lawyer. Recent corporate scandals have resulted in a search to assign blame, and neither the accountants nor the lawyers have escaped unscathed. For lawyers, the pendulum is clearly swinging toward ethical requirements — and even legal, regulatory and stock exchange requirements — that will put the corporate lawyer increasingly in the role of watchdog rather than consigliere. While some proposed reforms raise serious concerns with respect to client confidentiality and similar matters, it certainly does no harm for corporate lawyers to be vividly reminded that their primary duty is owed to the corporation and its shareholders, not to the managers who hire and fire them.

\textsuperscript{16} Id. R. 1.6(b)(i).

\textsuperscript{17} California Pub. Employees’ Retirement Sys., \textit{Corporate Governance Core Principles and Guidelines}, at 6 (1998).

\textsuperscript{18} \textit{See In re Caremark Int’l Inc. Derivative Litig.}, 698 A.2d 959, 968-70 (Del. Ch. 1996).
Moreover, if lawyers do not accomplish these changes themselves, the profession may be subject to further attempts to impose reform by legislative and regulatory fiat, as Congress has already done with the Sarbanes-Oxley Act.