Ethics &
PROFESSIONAL RESPONSIBILITY

The Role of Lawyers in 'Corporate Responsibility'

By Myrna Schack Latham and Patrick W. Fitzgerald

In 2002, in response to the bankruptcy of Enron and "other Enron-like situations," the president of the American Bar Association (ABA) appointed a task force to examine issues relating to corporate responsibility. The ABA Corporate Responsibility Task Force was asked to examine the legal and ethical framework in which public corporations carry on their activities, including the roles of lawyers, executive officers, directors and other key participants, and to recommend an effective system of checks and balances that would enhance the public trust in corporate integrity and improve corporate responsibility.

The final "Report of the American Bar Association Task Force on Corporate Responsibility," released in April 2003, urges changes in corporate governance policies to create a new culture of corporate responsibility stressing "constructive skepticism" and active independent oversight of corporate executives. The 89-page report, available at www.abanet.org/buslaw/corporateresponsibility/, recommends reforms in two principal areas: (1) internal corporate governance (relating to the composition, conduct and responsibilities of the corporation's board of directors and its committees), and (2) the professional conduct of lawyers who represent corporations.

The report primarily addresses governance of public corporations. However, the ABA task force noted that "many of its recommendations will be relevant to and constructive in the governance of other organizations and entities." (Report, p. 3, n. 5.)

WHAT IS CORPORATE RESPONSIBILITY?

In the view of the ABA task force, the term "corporate responsibility" includes,

> "... at the very least, behavior by the executive officers and directors of the corporation that conforms to law and results from the proper exercise of the fiduciary duties of care and loyalty to the corporation and its shareholders.... **[T]he term 'corporate responsibility' also embraces ethical behavior beyond that demanded by minimum legal requirements."** (Report, p. 4; emphasis supplied.)

The task force report includes recommended corporate governance practices, governance policy recommendations relating to the role of corporate lawyers and recommended changes to the ABA Model Rules of Professional Conduct.

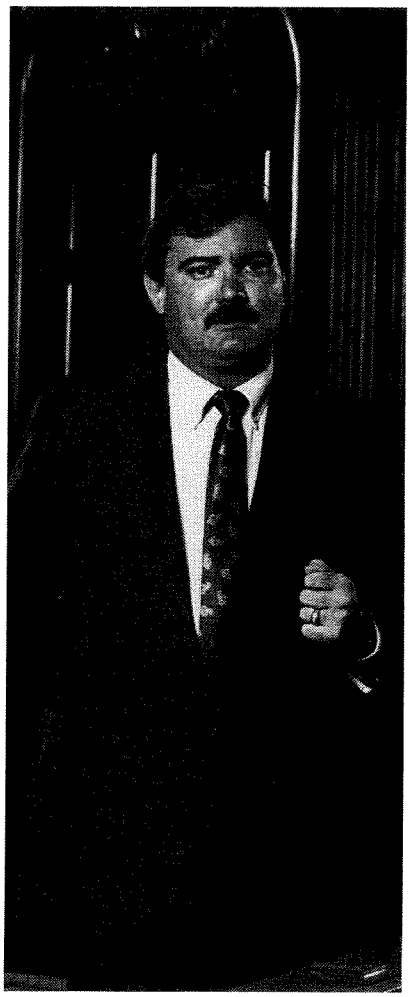
The recommendations in the ABA task force report are intended to complement and supplement reforms that have been proposed or implemented under the Sarbanes-Oxley Act of 2002 (Pub. L. No. 107-204, 116 Stat. 745), which include, among many other things,

- extensive federal regulation of the accounting profession and detailed requirements concerning auditing work, and limitations on the scope of non-auditing services that such firms may supply to public companies
- Securities and Exchange Commission (SEC) rules implementing enhanced and accelerated disclosure requirements
- SEC rules of professional conduct for lawyers that in some circumstances would (1) require lawyers to report to the highest levels of corporate authority material violations of securities laws and other failures of legal compliance, or (2) require a lawyer to withdraw as counsel and to have that withdrawal reported outside the company by the lawyer or by the company (so-called "noisy withdrawal").

The Sarbanes-Oxley requirements concerning "up the ladder" reporting of possible wrongdoing by corporate constituents and "noisy withdrawal" have sparked sharp debate within the legal community. Supporters of the new regulation say it creates a powerful deterrent against corporate wrongdoing by putting executives on notice that they may no longer rely on a lawyer's silence. Opponents say it undermines the principle behind the attorney-client privilege. There were questions whether Section 307 of the Sarbanes-Oxley Act and related regulations are in conflict with existing legal ethics rules.[1]

In its report and recommended revisions to the ABA Model Rules of Professional Conduct, the ABA task force attempted to reconcile these competing points of view in a manner that enables lawyers to serve their clients' best interests while also fulfilling their ethical obligations.

"The ABA task force report includes recommended corporate governance practices."



RECOMMENDED CORPORATE GOVERNANCE PRACTICES

The ABA task force report includes recommended corporate governance practices. (Report, Section VI, pp. 62-73.) Many of the recommendations address the role of directors of a corporation, who are expected to serve an important function in overseeing the conduct of senior executive officers. The recommended practices include the adoption of

"... a corporate code of ethics and conduct that includes the establishment of one or more mechanisms through which information concerning violations of law by the corporation or its management personnel, or breaches of fiduciary duty to the corporation which could have a material effect on the corporation, not appropriately addressed by corporate officers, can be freely transmitted to more senior officers and, if necessary, to a committee consisting solely of independent directors." (Report, p. 69.)

The task force report also suggests, among other things, "establishment and maintenance of a training and education program for all directors, and particularly independent directors, in regard to (A) their

legal and ethical responsibilities as directors...." (Report, p. 72.)

RECOMMENDED POLICIES OF CORPORATE GOVERNANCE

In addition, the ABA task force report includes recommended policies of corporate governance, which are intended to promote compliance with legal and ethical standards. (Report, Section IV, pp. 31-33.) These recommendations were adopted and endorsed by the ABA at its annual meeting in August 2003. (*See* Appendix 1.) Referring to these policies, the task force reiterated that

> "While these recommendations address public corporations, the Task Force believes that many nonpublic organizations and entities would benefit from many of these policies and recommends that all organizations and entities consider whether these policies would promote compliance with law and ethical standards." (Report, p. 31.)

Many of the corporate governance policy recommendations address the development of prudent practices to facilitate communication between the lawyer and the corporate client in relation to legal compliance matters.

However, the task force recognized that even where the recommended practices are applied, corporate officers and employees might take actions that involve the corporation in material violations of law. Consequently, as discussed below, the task force also recommended revisions to existing rules that address the professional responsibility of lawyers when such circumstances arise.

ROLE OF LAWYERS IN CORPORATE RESPONSIBILITY

The ABA task force report addressed the role of lawyers in corporate governance and corporate responsibility:

> "**Lawyers are and should be important participants in corporate governance and important contributors to corporate responsibility.** Lawyers employed by the corporation and outside lawyers retained by the corporation often serve as key advisers to senior management and usually participate in the negotiation, structuring and documentation of the corporation's significant business transactions. Additionally, lawyers often serve as counselors to the board to assist it in performing its oversight function. In such roles, lawyers obviously do and should play a critical role in helping the corporation recognize, understand and comply with applicable laws and regulations, as well as to identify and evaluate business risks associated with legal issues." (Report, p. 21; emphasis supplied.)

In the report, the ABA task force responded to the hotly debated question of whether and, if so, to what extent, lawyers who represent a corporation must confront corporate officers who are contemplating actions that might be illegal or fraudulent:

> "... [T]he Task Force believes that lawyers who represent a corporation have a duty, whenever the situation may present itself, to strongly advise senior executive officers that actions they may be contemplating which violate the law, including the perpetration of a fraud, should not be taken and are always contrary to the legitimate interests of the corporation. Moreover, lawyers representing a corporation are encouraged whenever appropriate to bring a 'public' perspective into their counseling which takes into account not merely specific legal obligations or requirements, but likely reactions of persons outside the corporation such as government officials and even the public at large, especially when those reactions may create legislative, regulatory or litigation risks.

"Lawyers are and should be important participants in corporate governance..."

> The lawyer must have a heightened level of certainty as to the violation of law...

Indeed, lawyers for a corporation, particularly in-house counsel, are frequently expected to provide an ethical, as well as a legal, perspective in their advice to senior executive officers. The Task Force endorses this expectation and urges boards of directors and senior executive officers to invite their counsel to provide such perspective as being in the best interest of the corporation and related to the goal of instilling a culture of legal compliance and corporate responsibility." (Report, p. 61; emphasis supplied.)

REVISIONS TO RULES OF PROFESSIONAL CONDUCT

To further underscore the role of lawyers in corporate responsibility, the task force's report recommended amendments to the ABA Model Rules of Professional Conduct.[2]

In its report, the ABA task force acknowledged that lawyers for a corporation – whether employed by the corporation or specially retained – are not "gatekeepers" of corporate responsibility in the same fashion as public accounting firms. Nevertheless, lawyers for a corporation must bear in mind that their responsibility is to the corporation, and not to the corporate directors, officers or other corporate agents with whom they necessarily communicate in representing the corporation.

According to the report, the task force's recommendations relating to lawyers

"... are intended to enhance the lawyer's ability to exercise and bring to bear independent professional judgment, and thereby enhance the lawyer's ability to promote corporate responsibility without undermining the constructive and collaborative relationship that must exist with the client so that compliance with law can be most effectively promoted." (Report, pp. 24-25).

Specifically, the task force recommended changes to Model Rule 1.6 (Confidentiality of Information), and Model Rule 1.13 (Organization as a Client). The revisions are not limited to lawyers who represent public corporations and would apply to all attorney-client relationships.

Model Rule 1.6 was amended to permit lawyers to reveal information normally protected by client-attorney confidentiality in order to prevent a client from committing financial fraud or to mitigate injury from a financial fraud. Changes to Model Rule 1.13 require lawyers representing organizational clients to report law violations by officers or employees "up the ladder" to higher authorities in the organization in certain circumstances. They further provide that if internal reporting is insufficient to protect the entity client from substantial harm, the lawyer may report wrongdoing to persons outside the organization.

The revisions to these model rules contain strict conditions that must exist before any "reporting out" is allowed. The lawyer must have a heightened level of certainty as to the violation of law, and the actual or threatened violation must be "clear."

At its annual meeting in August 2003, the ABA adopted the task force's recommended changes to the Model Rules of Professional Conduct. However, the ABA's adoption of the revised rules was not without controversy. There were strong differences of opinion between those who believe attorneys should be part of the "enforcement team," and those who believe the changes will cause significant damage to the attorney-client relationship. Opponents of the fraud disclosure amendment argued that the new rule erodes the "core value" of client confidentiality, that the language about what constitutes fraud and to

whom disclosure is allowed is too vague, and that the ABA should not give in to pressure from the SEC and other regulators.

Former ABA President William G. Paul of Crowe & Dunlevy in Oklahoma City expressed concern that the rule changes threaten to turn lawyers into "policemen, prosecutors, judges and regulators."[3] He urged the ABA delegates not to "barter away a piece of our soul to gain public approval." Others argued that the existing rules of professional conduct already give lawyers the means and duty to prevent the occurrence of client fraud.[4]

CONCLUSION

It is unlikely that the debate concerning lawyers' roles as corporate "whistleblowers" will end any time soon. As one author on legal ethics issues has observed,

> "There is no more dramatically difficult decision that lawyers must make than whether to 'blow the whistle' on their client's wrongdoing. If they report a client's wrongdoing when not obligated to (or, especially, when *prohibited* from doing do), they have not only breached their duties of loyalty and confidentiality, they have also unnecessarily condemned their client to punishment. On the other hand, if a lawyer *fails* to reveal information about some client wrongdoing that the ethics rules *requires* to be revealed, the lawyer obviously has assisted in covering up the wrongdoing. This may not violate a lawyer's duties of loyalty or confidentiality, but that would be little consolation to a lawyer whose license has been revoked or who is facing indictment.
>
> Each state has wrestled with this issue. And it is the greatest irony in American legal ethics that the largest variation in states' ethics rules occurs in the precise area where lawyers most need uniform and easy-to-follow guidance – when deciding whether they must 'blow the whistle' on their client's wrongdoing."[5]

Ultimately, it will be up to each state to decide whether and, if so, how to implement the recommended changes to ABA Model Rules 1.6 and 1.13. These revisions have not yet been adopted in Oklahoma, but may be considered soon.[6] Differences between current Oklahoma Rules of Professional Conduct 1.6 and 1.13 and amended ABA Model Rules 1.6 and 1.13 are highlighted in Appendix 2 and Appendix 3.

APPENDIX 1

AMERICAN BAR ASSOCIATION ADOPTED BY THE HOUSE OF DELEGATES Aug. 11-12, 2003

RESOLVED, That the American Bar Association adopts and endorses the following corporate governance practices:

1. The board of directors of a public corporation must engage in active, independent and informed oversight of the corporation's business and affairs, including its senior management.
2. The board of directors of a public corporation should adopt governance principles that (a) establish and preserve the independence and objectivity of directors by eliminating disabling conflicts of interest and undue influence or control by the senior management of the corporation and (b) provide the directors with timely and sufficient information and analysis necessary to the discharge of their oversight responsibilities.
3. The directors should recognize and fulfill an obligation to disclose to the board of directors information and analysis known to them that is relevant to the board's decision making and oversight responsibilities. Senior executive officers should recognize and fulfill an obligation to disclose to a supervising officer, the general counsel, or the board of directors or committees of the board information and analysis relevant to such persons' decision making and oversight responsibilities.
4. Providing information and analysis necessary for the directors to discharge their oversight responsibilities, particularly as they relate to legal compliance matters, requires the active involvement of general counsel for the public corporation.
5. A lawyer representing a public corporation shall serve the interests of the entity, independent of the personal interests of any particular director, officer, employee or shareholder.

6. The general counsel of a public corporation should have primary responsibility for assuring the implementation of an effective legal compliance system under the oversight of the board of directors.

7. Public corporations should adopt practices in which:

   a. The selection, retention and compensation of the corporation's general counsel are approved by the board of directors.

   b. General counsel meets regularly and in executive session with a committee of independent directors to communicate concerns regarding legal compliance matters, including potential or ongoing material violations of law by, and breaches of fiduciary duty to, the corporation.

   c. All reporting relationships of internal and outside lawyers for a public corporation establish at the outset a direct line of communication with general counsel through which these lawyers are to inform the general counsel of material potential or ongoing violations of law by, and breaches of fiduciary duty to, the corporation.

8. The Model Business Corporation Act and the general corporation laws of the states and the courts interpreting and applying the duties of directors should more clearly delineate the oversight responsibility of directors generally and the unique role that independent directors play in discharging that responsibility in public company settings.

9. Engagements of counsel by the board of directors or by a committee of the board for special investigations or independent advice should be structured to assure independence and direct reporting to the board of directors or the committee.

10. The SEC and state attorney disciplinary authorities should cooperate in sharing information in order to promote effective and appropriate enforcement of rules of conduct applicable to counsel to public corporations.

11. The courts, law schools and lawyer professional organizations such as the ABA should promote awareness of and adherence to the professional responsibilities of lawyers in their representation of public corporations.

12. Law firms and law departments should adopt procedures to facilitate and promote compliance with rules of professional conduct governing the representation of public corporations.

APPENDIX 2

RULE 1.6 – CONFIDENTIALITY OF INFORMATION

(a) A lawyer shall not reveal information relating to representation of a client unless the client gives informed consents ~~after consultation, except for~~ the disclosures ~~that are~~ is impliedly authorized in order to carry out the representation, ~~and except as stated in~~ or the disclosure is permitted by paragraphs (b) ~~and (c).~~

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

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

(2) to ~~disclose the intention of~~ prevent the client ~~to~~ from committing a crime or fraud~~and the information necessary to prevent the crime~~ 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;

(~~2~~3) to prevent, mitigate or rectify ~~the consequences of what the lawyer knows to be a client's criminal or fraudulent act in~~ 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 ~~had been used, provided that the lawyer has first made reasonable efforts to contact the client but has been unable to do so, or that the lawyer has contacted and called upon the client to rectify such criminal or fraudulent act but the client has refused or unable to do so.~~

(4) to secure legal advice about the lawyer's compliance with these rules.

(~~3~~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

(46) ~~or as otherwise permitted under these Rules~~.

~~(c) A lawyer shall reveal such information when required by~~ to comply with other law or a court order.

APPENDIX 3

RULE 1.13 – ORGANIZATION AS CLIENT

(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. ~~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 including such matters and any other relevant considerations. Any measures taken shall be designed to minimize disruption for 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 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~~ 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 ~~seriousness of the matter~~ circumstances, ~~referral~~ to the highest authority that can act in 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 ~~likely~~ reasonably certain to result in substantial injury to the organization, the lawyer may ~~resign in accordance with Rule 1.16 [Declining or Terminating Representation]~~.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 the 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 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 [Conflict of Interest]. 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.

1. See Jennifer Wheeler, *Securities Law: Section 307 of the Sarbanes-Oxley Act: Irreconcilable Conflict with the ABA's Model Rules and the Oklahoma Rules of Professional Conduct?* 56 Okla. L. Rev. 461 (Summer 2003); Thomas E. Spahn, *Sarbanes-Oxley and "Whistleblowing" by Corporate Lawyers – the Untold Story"* (McGuire Woods 2003), available at www.findlaw.com.

2. The Oklahoma Rules of Professional Conduct, 5 Okla. Stat. App. 3-A, are based on, but are not identical to, the ABA Model Rules of Professional Conduct. Variations from the ABA rules are noted in the comments to the Oklahoma rules.

3. See BNA Health Law Reporter, Vol. 12, No. 34 (8/21/03), p. 1294.

4. Despite all the recent attention to the topic, this debate is not new. As one legal ethics author noted, "The ABA debate about 'noisy withdrawal' – in which a lawyer whose client is committing or is about to commit some wrongdoing withdraws from the representation and disavows tainted work product (but without explicitly revealing the client's ongoing or intended wrongdoing – has lasted for years. For instance, in a 1992 legal ethics opinion (ABA LEO 366), the ABA Committee described how a "noisy withdrawal" would work in the context of a lawyer who represented a small business in connection with a loan transaction, and later discovered that the company had been fraudulently misstating the company's financial condition (meaning that the opinion was incorrect when the lawyer issued it). The Committee indicated that the lawyer could engage in a 'noisy withdrawal,' disavowing the opinion but without explicitly revealing the client's fraudulent conduct." Spahn, *supra*, note 1.

5. Spahn, *supra*, note 1.

6. The Rules of Professional Conduct Committee of the OBA is responsible for proposing new rules or modifications to the Board of Governors of the OBA. Changes approved by the Board are then recommended to the Oklahoma Supreme Court for adoption.

ABOUT THE AUTHORS

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