What Do I Do Now? A Lawyer's Duty Post-Sarbanes-Oxley

Samantha Ahuja

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Notes

WHAT DO I DO NOW? A LAWYER’S DUTY POST-SARBANES-OXLEY

In our complex society the accountant’s certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar. Of course, Congress did not mean that any mistake of law or misstatement of fact should subject an attorney or an accountant to criminal liability simply because more skillful practitioners would not have made them. But Congress equally could not have intended that men holding themselves out as members of these ancient professions should be able to escape criminal liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen or represented a knowledge they knew they did not possess.¹

I. INTRODUCTION

Fourteen Trillion. That is the amount of money believed lost on the market during the last economic downturn.² In a short time, investor anxiousness turned into uneasiness.³ Sparing no shareholder, Enron, WorldCom, Tyco, and Arthur Anderson became household names and products of “infectious greed.”⁴ Executives of corporations, accountants,

¹ United States v. Benjamin, 328 F.2d 854, 863 (2d Cir. 1964) (holding that a defendant lawyer or attorney who deliberately closed his eyes to fraud had a duty to see that the company was in violation of the Securities Act of 1933).
² William S. Lerach, Plundering America: How American Investors Got Taken for Trillions by Corporate Insiders, 8 STAN. J.L. BUS. & FIN. 69, 91 (2002). Economists blame the dramatic drop in the greatest bull-market in history, beginning in March of 2000, on corporate fraud realizations. Id.
³ Id. at 100-01. The financial reporting and disclosure practices of many public companies started being questioned at the height of the market boom. Id. During the economic boom, Americans invested record levels of monies in pension funds and in individual retirement savings funds. Id. at 95.
investment bankers, and lawyers were all thrust into the glaring spotlight. Investors wanted answers, so Congress responded by enacting the Corporate Accountability Act. With this Act, Congress went one step further than it ever had and mandated "friendly disclosures" as the "right thing" for securities lawyers.

This Note analyzes the new federally promulgated ethics rules, required by the Sarbanes-Oxley Act of 2002, that govern corporate lawyers. To do so, this Note considers the American Bar Association ("ABA") Model Rules, current interpretations of who is governed by the rules, the role of lawyers within an organization, and the interest of protecting the investing public. The purpose of the federal rule is to provide an attorney with clear guidelines that encourage reporting of

Too many corporate executives sought ways to 'harvest' some of those stock market gains ... [t]he incentives they created overcame the good judgment of too many corporate managers. It is not that humans have become any more greedy than in generations past. It is that the avenues to express greed had grown so enormously.

Id.


7 Id. § 307.

[T]he crisis we've been confronting offer[s] unique opportunities as well as difficult responsibilities for corporate lawyers. Recent events underscore what we already knew-confidence in our capital markets cannot be maintained if the public believes that corporate leaders, their advisors or their cohorts, are "gaming" the system and focusing principally, if not exclusively, on their own personal gain. We must reassure investors after the string of recent scandals that such abuses of the system are not, and will not be allowed to become, the norm in American business.

There are least three ways to achieve this goal. First, Congress can legislate new legal standards into law, as it has done in Sarbanes-Oxley. Second, government can impose new regulatory requirements, something we've done with unprecedented vigor over the last year, and something new legislation directs us to expand upon. And finally, those who should be sensitive to their own ethical and moral, as well as legal, responsibilities can voluntarily undertake to ensure that the highest standards prevail for all professionals-managers, directors, accountants and lawyers.

corporate fraud and misrepresentation. A reconcilable standard between the federally promulgated and state bar rules is needed when creating duty for an attorney to report, detect, or prevent instances of corporate fraud. Part II of this Note discusses the initial federal securities legislation and relevant history of the enactment of the Sarbanes-Oxley Act of 2002. This Part also discusses the Rules of Professional Conduct and attorney-client privilege. Part III of this Note analyzes the scope of the body of attorneys subject to the newly enacted federal disclosure rule. Also analyzed are the policy considerations of the proposed "noisy withdrawal" requirement. Additionally, this Part analyzes the conflicts between the Securities and Exchange and state-promulgated confidentiality and attorney-client privilege rules. Part IV then proposes a more defined and narrow interpretation of the scope of the federally promulgated rule and recommendations for state bar associations to better protect investors from corporate fraud.

II. REGULATING CORPORATE AMERICA

In light of recent corporate financial and ethical scandals, legislators were forced to address the question of how best to protect the investing public when regulating securities. In August of 2002, the Sarbanes-Oxley Act ("SOA") was passed by the 107th Congress and signed into law by President George W. Bush. The SOA was an attempt by Congress to protect investors from the fraudulent and hapless acts of management and others that lead to financial fraud or misstatements. SOA swept

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8 See infra Part II.A-C.
9 See infra Part II.D.
10 See infra Part III.A.
11 See infra Part III.B.
12 See infra Part III.B.
13 See infra Part IV.

This bill does hold bad actors accountable for their fraud and deception... The legislation goes much further, and it should because the problem goes much deeper. We are faced with much more than just the wrongdoing of individual executives. We are faced with a crisis in confidence in America's capital markets and in American business... above and beyond hundreds of billions of dollars [have been] wiped out. That is what has happened already. You do not have investor confidence. Without investor confidence, we will not have the economic recovery that we need. Jobs aren't being created. Frankly, this affects all of us.

Id.
more broadly than previous securities acts in its regulations directed
towards corporate attorneys and ethical standards.\(^{16}\)

A. How the Political and Economic Climate of the 1930s Forced the Issue of
Federal Regulation

For more than twenty years before the federal government formed
the Securities and Exchange Commission in 1934, states used “blue sky”
laws to regulate securities that traded within their state borders.\(^{17}\) After
the 1929 stock market crash, it became clear that federal remedies were
needed to regulate securities across the nation.\(^{18}\) The market continued
to slide after making few modest gains during the next three years.\(^{19}\)
Declining productivity, increased floating of margin loans, and short
selling were considered major factors of the economic depression.\(^{20}\) The


\(^{17}\) David P. McCaffrey & David W. Hart, Wall Street Polices Itself 44 (1998). Kansas passed the first “blue sky” law in 1911, and all states, except Nevada, soon passed
similar laws. Id. The term “blue sky” came from the once hotbed of securities trading, Kansas. 1 Louis Loss & Joel Seligman, Securities Regulation 27 (Little, Brown & Co., 3d
ed. 1989) [hereinafter Securities Regulation]. During a discussion regarding the first
state securities trading regulation, a senator of the Kansas State Legislature stood up and
proclaimed that there were crooks who “would sell building lots in the blue sky in fee
simple.” Id. at 34; see also Securities Regulation, supra, at 3-148 (describing the extent of
state securities laws and emergence of federal securities regulation); Louis Loss & Joel
[hereinafter Fundamentals of Securities Regulation] (describing the differences in state
and federal securities regulation).

legislation, disclosure of material insider information was not required. Id. See generally
John Kenneth Galbraith, The Great Crash (3d ed. 1972) (detailing the enormous
growth of manufacturing industries and businesses and the subsequent rapid fall of the
market due to corporate greed).

\(^{19}\) Joel Seligman, The Transformation of Wall Street 3-14 (1982); see also Robert
Sobel, Panic on Wall Street (1968) (describing the rise and fall of the economy and big
business during the Great Depression). See generally Elisabeth Keller & Gregory A.
Gehlmann, A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act
of 1934, 49 Ohio St. L.J. 329, 334-40 (1988) (describing the unethical behavior of securities
dealers which eventually helped to worsen the economy and prompt federal legislation
governing the securities market).

\(^{20}\) Seligman, supra note 19, at 4-14. Before the crash in October of 1929, President
Hoover, in his inaugural address, encouraged the Federal Reserve Board to lower credit
lines for margin loans. Id. at 4. The Federal Reserve Board continued to meet without
issuing any policy statements; this silence softened “speculative fever” which in turn led to
massive trading on March 26th. Id. In complete defiance, the National City Bank
announced it would be borrowing money from the Federal Reserve Bank in order to
business environment was dominated by mismanaged big businesses and monopolies, which contributed to a large division between wealth and poverty. Additionally, with few checks on Wall Street’s “self-regulation,” there was little that could be done without major economic reform and federal legislation to help the market operate effectively.

With political pressure climbing, and after months of delay tactics, the Senate Banking Committee began investigating securities practices taking place in the market. President Hoover initially wanted the managers of the Exchange to “self regulate” to avoid federal regulation. However, after much resistance from the managers, he was forced to prevent liquidation of its margin loans. President Hoover backed down, and the market began to rise throughout the summer of 1929 by nearly 25%. After the crash in October, Hoover did little to urge regulatory reform; he instead held conferences with industrial leaders and spoke of “volunteerism” in maintaining what he called the “fundamental business of the country, that is, production and distribution” of employment and wages. President Hoover was reluctant to regulate banking laws, primarily because he believed there was a lack of constitutional authority to nationalize the laws. Soon after the market crash, several bills were introduced into Congress to regulate corporate financial statements, margin loans, and short selling. The market made a very modest recovery in the months after the crash; however, the economic depression continued. President Hoover blamed the drop in the market on declining productivity while leading critics in the Senate continued to push financial issues into the public eye.

With months of postponing the investigation, President Hoover scheduled an emergency meeting of the Senate Banking Committee due to rumors of new market troubles. This was the beginning of what are known as the Pecora Hearings, which were ultimately responsible for the Securities & Banking Acts of 1933, the Securities Exchange Act of 1934, and the creation of the Securities and Exchange Commission. See generally GALBRAITH, supra note 18 (explaining the effect of the Senate hearings on business practices).
initiate investigations on the practices of the New York Stock Exchange. The Pecora Hearings, named after the Committee’s Counsel, Ferdinand Pecora, lasted over nine months with many widely publicized investigations. The Pecora Hearings brought to light numerous cases of elaborate schemes to manipulate the market. Some of the frauds discovered during the investigation included false reporting of favorable news stories to boost stock prices in exchange for pay-offs, manipulation of purchases, and sell-offs of stocks by high-ranking executives within large companies.

These investigations received much national attention, and Democratic Presidential candidate, Franklin Roosevelt, built a platform advocating federal securities legislation. After Roosevelt was elected to office, the waning Senate hearings received a jolt. Peter Norbeck, the self-proclaimed “Franklin Roosevelt Republican” from South Dakota and an influential member of the Senate Banking Committee, hired Pecora as the Committee’s Counsel. Upon Pecora’s hiring, the Committee conducted many new investigations to uncover the fraud and manipulation of the banking and securities marketplace. Pecora’s relentless investigations and persistent questions led to a public response that in turn led to the passage of the Securities Act of 1933.

The Securities Act of 1933 ("Act") is often referred to as the bill that sought to protect investors by requiring full and fair disclosure of financial information to potential investors.\(^{34}\) The objective of fair disclosure was accomplished by requiring any company offering securities for public sale, except for minor exceptions, to disclose to investors pertinent company information.\(^{35}\) The Act did not require screening of the potential viability of a company, but focused on making the information available to investors so that they would have the necessary information to make informed choices.\(^{36}\) The Act required that corporations disclose relevant corporate information to the public through registration, including a prospectus.\(^{37}\) It also created a right for the investor to recover losses incurred as a result of false or misleading reports filed or reported by the company.\(^{38}\) Finally, it required an independent auditor to certify that the disclosed financial information was reasonably accurate.\(^{39}\)

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\(^{34}\) Securities Act of 1933, 15 U.S.C. §§ 77a-77bbbb (2000); SELIGMAN, supra note 19, at 39-40, 71. The Act required companies to give full disclosure of information regarding the business, capital needs, officers, and securities issuance costs. SELIGMAN, supra note 19, at 70. In addition to other registration requirements, business executives, underwriters, and financial or accounting officers could be held liable if it was proven that they had acted without due diligence and there was an untrue statement or omitted fact in the registration statement. Id.; see, e.g., Dessent, supra note 18, at 1145-46; Steve Thel, The Original Conception of Section 10(b) of the Securities Exchange Act, 42 STAN. L. REV. 385, 414-24 (1990).


\(^{36}\) SKOUSEN, supra note 35, at 20. The SEC uses the reporting requirements to determine if the registration statement and prospectus are deficient, not to judge the merits of an offering. Id.; see also ROBERT E. SHIELDS & ROBERT H. STROUSE, SECURITIES PRACTICE HANDBOOK 17-22 (5th ed. 1987) (describing the process in which the SEC evaluates the registration and other compliance materials in order to assure that the information made available to the investors is complete).

\(^{37}\) SHIELDS & STROUSE, supra note 36, at 17-18.

\(^{38}\) Securities Act of 1933 § 11; SKOUSEN, supra note 35, at 20. Additionally, hefty fines and penalties can be imposed on companies that file false or misleading registration materials. Securities Act of 1933 § 11.

\(^{39}\) Securities Act of 1933 § 11; SKOUSEN, supra note 35, at 20-22. The Act allows for accountants to be held liable for the accuracy of the disclosed information. Securities Act of 1933 § 11.
After the passage of the Securities Act of 1933, the next issue on President Roosevelt's agenda was the regulation of the Securities Exchange. The heated debate over the extent of regulation of the markets often centered on the issue of when and how much governmental interference in economic affairs was justified. Senator Duncan Fletcher introduced a final version of a bill, supported by President Roosevelt, into the Senate the same day that Sam Rayburn, Chairman of the House Banking Committee, introduced it into the House of Representatives. This bill, which came to be known as the Fletcher-Rayburn bill, developed into the Securities Exchange Act of 1934 ("Exchange Act").

Although the bill, in its original form, sought to regulate the exchanges by granting authority to the Federal Trade Commission, the amendments to this bill granted authority to an entirely new body, the Securities and Exchange Commission ("SEC"). Another substantial change to the original bill was an amendment that called for the SEC to specify margin requirements in the legislation, instead of a formula that would allow for adjustments in the market. Additionally, the House dropped the provision prohibiting any sale within six months of insiders' purchases of their own corporation's securities for a profit.

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40 SELIGMAN, supra note 19, at 79-85; see also SOBEL, supra note 19, at 94-121 (recounting the perspective of business insiders to growing federal regulation).

41 SELIGMAN, supra note 19, at 89-92. The New York Stock Exchange President, Richard Whitney, an opponent to the bill, testified that the proposed bill gives the Federal Trade Commission so much power that the commission might not just regulate but might "actually . . . supervise and manage all stock exchanges and establish indirectly a form of nationalization of business and industry which has heretofore been alien to the American theory of Federal Government." Id. at 90; Thel, supra note 34, at 420.

42 Thel, supra note 34, at 425-26. The initial bill encountered intense debate and heavy opposition from multiple parties, leading to numerous amendments that eventually made the enacted version of the bill substantially different from the proposed version. Id. at 424-56.


44 Thel, supra note 34, at 426-34. Ironically, the SEC was the brainchild of one the bill's biggest opponents, Richard Whitney, the New York Stock Exchange President. SELIGMAN, supra note 19, at 97.

45 Id. at 97-98. The elimination of the formula requirement was a result of heavy lobbying from investors and brokers. Id. Without a formula that adjusted for gains and losses in the market, dealers and brokers could engage in increased margin selling as the market grew. Id.

46 Thel, supra note 34, at 428.
With these amendments, the bill passed, but not without great controversy.\(^4^7\)

In the Exchange Act, Congress delegated to the SEC the power to determine the form, content, and rules for all required financial reports that furthered the congressional objectives of preventing stock manipulation and providing investors with reliable financial disclosures and pertinent business information.\(^4^8\) The SEC was granted authority to urge businesses to ensure that investors receive fair and accurate reporting.\(^4^9\) The authority granted by Congress included the SEC's ability to initiate litigation in cases of fraud and to mandate provisions for securities registrations.\(^5^0\)

Congress also granted the SEC the ability to regulate the accounting practices of companies and other business aspects that fall within the reporting and disclosure requirements mandated by the federal securities laws.\(^5^1\) Although Congress explicitly delegated the accounting authority to the SEC, the SEC chose to turn over its powers by reasoning "that it considers those accounting principles, standards, and practices

\(^4^7\) Id. at 426. Representative Rayburn, during a floor debate, accused opponents of coercing and forging letters of opposition. SELIGMAN, supra note 19, at 98. Senator Fletcher successfully stymied several proposed amendments within the Senate. Id. In a quote from the New York Times, he stated, "Not in years, has a bill of such controversial nature been passed by so overwhelming a majority." Id.; see also SECURITIES REGULATION, supra note 17, at 32-37.

\(^4^8\) CHATOV, supra note 21, at 1-2.

\(^4^9\) SKOUSEN, supra note 35, at 7.

\(^5^0\) Id. at 12-14. Many scholars believe that the SEC was not necessarily created to prevent frauds like those taking place when the Securities Acts were enacted but that the SEC's primary role was "to provide information that can be used to make better decisions, which in turn leads to more efficient capital markets." Id. at 7. The securities laws were passed with the purpose of promoting financial disclosure and imposing severe penalties for presenting false and misleading information. Id. at 39. Additionally, the role of the SEC is to determine if the reporting companies have complied with the statute and regulations; any deficiencies or fraudulent acts in the reporting are the responsibility of the company and its management and agents. Id. The ultimate judgment lies with the investor. Id. See generally HAROLD S. BLOOMENTHAL, SECURITIES LAW (1966) (discussing the evolution of the SEC, the regulations, and the extent of the SEC's investigative provisions and duties).

\(^5^1\) SKOUSEN, supra note 35, at 108. Congress felt that in order for the SEC to fulfill its objective of full and fair disclosure, it would need some control of the accounting principles and practices by the companies in their reporting. Id. at 106. Harry A. McDonald, a former commissioner of the SEC stated, "One fact will always be dominant in shaping the course of accounting—the fact that whether directly or through his advisers, whether alone or through the medium of an agency like the SEC, the investor cannot help but look to the accountant." Id. at 108. See generally CHATOV, supra note 21 (discussing the development of the accounting practices and the influence and effect of the SEC's congressional authority).
promulgated by the [Financial Accounting Standards Board] as having substantial authoritative support."52 However, the SEC chose to use the power granted under the Exchange Act to promulgate its Rules of Practice.53 The Rules of Practice cover a wide variety of areas, including the manner and form in which information should be reported.54

Prior to the enactment of the SOA, the SEC invoked Rule 102(e) of its Rules of Practice, to discipline professionals.55 Rule 102(e) allows the SEC to discipline a professional by suspending, limiting, or barring the professional from practicing before it in any way.56 In the past, the SEC has used this power to discipline both accountants and attorneys.57 The rule has been justified as a means of maintaining the integrity of the practice, but not necessarily as a remedy for securities violations.58 Most courts consider the rule a valid exercise of authority under the general rulemaking powers granted by Congress to the SEC.59

52 Skousen, supra note 35, at 108.
54 Securities Regulation, supra note 17, at 2913-23.
56 Id.; see 3 Thomas Lee Hazen, Law Sec. Reg. § 16.2(18) (4th ed. 2002); infra note 57 and accompanying text.
57 3 Hazen, supra note 55, § 16.2(18). Currently, most circuits hold that the SEC is acting within its authority even in the absence of express statutory authority. Id.; see Potts v. SEC, 151 F.3d 810 (8th Cir. 1998) (holding that accountants may be suspended for violating Rule 102(e)); Sheldon v. SEC, 45 F.3d 1515 (11th Cir. 1995) (holding that use of Rule 102(e) against attorneys was constitutional); Touche Ross & Co. v. SEC, 609 F.2d 570 (2d Cir. 1979) (holding that the SEC is within its statutory authority in disciplining professionals in order to maintain integrity of its overall purpose and procedures).
58 In re Carter & Johnson, supra note 53.
59 3 Hazen, supra note 55, § 16.2(18); see supra note 57 and accompanying text.
In 1981, the SEC ruled that scienter must be shown in order to discipline attorneys under Rule 102(e). The SEC, in an administrative proceeding, found that Rule 102(e) addressed the problem of professional misconduct and was limited as such only to protect the investing public. In cases where there is conduct by attorneys that falls short of scienter, the SEC has delegated to its General Counsel the authority to refer the alleged professional misconduct to relevant state bar authorities. The SEC has continued to struggle with balancing the

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60 In re Carter & Johnson, supra note 53 (holding that the Commission failed to prove scienter on the part of the attorneys); Checkosky v. SEC, 23 F.3d 452 (D.C. Cir. 1994) (remanding to the SEC because of failure to distinguish adequately the scienter standards for attorney and accountant liability).

61 In re Carter & Johnson, supra note 53, at 296.

[This rule] is not intended to provide an administrative remedy as an alternative to our power to seek injunctive relief for violations of provisions of the securities laws which do not already provide for an administrative remedy. For example, it does not reach any of the myriad of non-professionals who may have been involved in violations of the securities laws for which an administrative remedy is not available. It is addressed to a different problem—professional misconduct—and its sanction is limited to that necessary to protect the investing public and the Commission from the future impact on its processes of professional misconduct. [The rule] represents a balancing of public benefits. It rests upon the recognition that the privilege of practicing before the Commission is a mechanism that generates great leverage—for good or evil—in the administration of the securities laws. A significant failure to perform properly the professional’s role has implications extending beyond the particular transaction involved, for wrongdoing by a lawyer or an accountant raises the spectre of a replication of the conduct with other clients.

Recognition of the public implications of the securities professional’s role does not mean that the Commission has, by rule, imposed duties to the public on lawyers where such duties would not otherwise exist. . . . [T]he traditional role of the lawyer as a counselor is to advise his client, not the public, about the law. [The Rule] does not change nature of that obligation. Nevertheless, if a lawyer violates ethical or professional standards, or becomes a conscious participant in violations of the securities laws, or performs his professional function without regard to the consequences, it will not do to say that because the lawyer’s duty is to the client alone, this Commission must stand helplessly by while the lawyer carries his privilege of appearing and practicing before the Commission on to the next client.

Id.

62 3 HAZEN, supra note 55, § 16.2(18).
interest of protecting the public against over-regulation of the trading markets.\(^6\)

C. How the Political and Economic Climate Forced Congress to Revisit Federal Securities Legislation: The Passage of the Sarbanes-Oxley Act of 2002

Despite the drastically evolving market, congressional mandates, and judicial interpretation of the Securities Acts, the SEC has been steadfast in its primary goal of full disclosure.\(^6\) However, the evolving market forced Congress to revisit the laws to determine what additional steps were needed to protect the public.

From 1997 to 2000, American companies seemed to be producing at full capacity, growing ten-fold, and increasing profits by unimaginable numbers.\(^6\) Little seemed to dampen the market as the tech boom ran its course.\(^6\) In mid-2000, the market began to slide.\(^6\) Companies restated their earnings in record numbers.\(^6\) Investor confidence waned as

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\(^6\) Thel, supra note 34, at 462. Observers have commented that the SEC has a split personality: the "sunlight" SEC which closely administers the disclosures and anti-fraud elements of the securities acts, verses the "regulatory" SEC which regulates the trading markets. \(\text{Id.}\) The SEC often de-emphasizes its role in the regulation of the trading markets. \(\text{Id.}\)


\(^6\) Kevin Phillips, The New Face of Another Gilded Age, WASH. POST, May 26, 2002, at B02. During the boom, the Dow Jones market set the top ten greatest net one-day point gains, including the record of 499.19 points, a 4.93% change. Dow Jones Average Statistics (Mar. 32, 2004) available at http://wwwindexes.dowjones.com/jsp/avgStatistics.jsp. The market had noticed its greatest percentage change gains during the years of 1929-1932. \(\text{Id.}\) Additionally, the market set eight of the ten days with greatest point net loss records, ranging from 684.81 to 374.47 between 1998 and 2002. \(\text{Id.}\) Seven of the ten record holders for the greatest percentage losses were prior to 1933, ranging from 22.61% to 7.75%. \(\text{Id.}\) Five of the ten best years occurred before 1933, with none occurring after 1975. \(\text{Id.}\) Seven of the ten worst years occurred prior to 1933, with none occurring after 1974. \(\text{Id.}\) The Dow topped 11,722 in January of 2000, mid-7000s in mid-2002, and was trading in the mid-9000s as of September of 2003. Dow Data 2000-2009, available at http://wwwindexes.dowjones.com/jsp/avgDecades.jsp?decade=2000 (last visited Apr. 26, 2004); Dow Jones Indexes, available at http://wwwaverages.dowjones.com/jsp/index.jsp (last visited Apr. 26, 2004).

\(^6\) Charles Stein, In the End, Limited Damage: Initial Blow Keenly Felt but Economy Returned to Growth Late Last Year, BOSTON GLOBE, Sept. 11, 2002, at C1; Phillips, supra note 65, at B02.

\(^6\) Neal St. Anthony & Mike Blahnik, Money Managers: Rolling the Dice, STAR TRIB., Jan. 5, 2003, at 1D; James P. Miller, Crackdown Sparks Rebound, CHI. TRIB., July 25, 2002, at C13; see also supra note 65 (providing stock market data).

\(^6\) ARTHUR LEVITT, TAKE ON WALL STREET 117 (2002). Levitt describes the downhill slide as all encompassing. \(\text{Id.}\)

It wasn't just a case of a few bad apples... [b]lue-chip companies with sterling reputations were manipulating their numbers in misleading
corporate misstatement disclosures, combined with the terrorist attacks of September 11, 2001, helped to send the market further downward.\textsuperscript{69}

Throughout 2001 and 2002, corporate giants like Enron, WorldCom, Qwest, and Tyco collapsed, forcing Congress to address the growing concerns of companies’ financial disclosures and investor losses.\textsuperscript{70} Enron, an energy giant based in Houston, Texas, was forced to disclose its numerous accounting “discrepancies” upon failure to show a profit on numerous off-balance sheet transactions and ultimate default of loan payments resulting from faulty hedge transactions.\textsuperscript{71} Tyco, a manufacturing conglomerate based in Seattle, Washington, was

ways. From 1997 through 2000, 700 companies would find flaws in past financial statements and restate their earnings. By comparison, only three companies restated in 1981. These came at a tremendous cost to investors, who would lose hundreds of billions of dollars in market value.

\textit{Id.}


\textsuperscript{70} Stanley S. Arkin, \textit{Business Crime, Corporate Responsibility Legislation: Conflicts, Uncertainties}, 228 N.Y. L.J. 3 (2002); Lerach, supra note 2, at 73. The Nasdaq fell to 1,139 points from a high of 5,085. Lerach, supra note 2, at 71.

It’s getting to the point where reported earnings in many cases are whatever management wants them to be. If you overstate, no sweat. Just take a writedown later… It takes two to create a deception—deceiver and deceived. Plenty of the latter are around these days. Fifteen years of nearly unbroken bull markets have made people willing, eager to believe in financial miracles…. “Accounting tricks are always going on”…. “[w]hat’s changed is that companies are getting away with more now”…. It’s been a great bull market, but one that’s full of dangers and getting more dangerous all the time.


\textsuperscript{71} Jonathon Weil, \textit{Basic Principle of Accounting Tripped Enron}, \textit{WALL ST. J.}, Nov. 12, 2001, at C1. Enron disclosed that over a 1.2 billion-dollar reduction in shareholder equity was due to improper recording of issued common stock to four “special-purpose” entities. \textit{Id.} In exchange for the Enron stock, Enron received a note receivable from these “special purpose” entities instead of cash. \textit{Id.} Against basic accounting rules, Enron improperly recorded its transactions as cash, which in turn increased shareholder equity on the financial statements. \textit{Id.} Additionally, when the receivables due to Enron and other debtors came due, the “special purpose” entities were unable to pay. \textit{Id.} The entities subsequently defaulted on their loans for which Enron became ultimately responsible as primary or sole shareholders of the entities. \textsc{The Role of the Board of Directors in Enron’s Collapse}, S. REP. NO. 107-78, at 46-50 (2002); see also Jeffrey N. Gordon, \textit{What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections}, 69 U. CHI. L. REV. 1233, 1233-35 (2002) (detailing the rise and fall of the energy giant and the effect on corporate governance models).
ultimately forced to disclose the numerous loans made to its Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") among its other fraudulent accounting schemes.22 WorldCom, a leading telecommunications corporation based in Mississippi, filed for Chapter 11 Bankruptcy when it was forced to disclose and restate its financial statements after reporting that it had inflated profits by more than seven billion dollars.23 WorldCom improperly capitalized expenses, instead of expensing them on the income statement as they were incurred, in order to help meet expected earnings numbers.24 Similarly, Qwest Communications, a leading telecommunications corporation based in Denver, Colorado, restated close to a billion dollars in inflated profits due to the revelation of a sham-swapping agreement.25

Each of these misstatements were caused by manipulative acts of management, improper accounting, and sloppy auditing, which ultimately led to the devaluation of shareholder investments and

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22 Mark Maremont & Laurie P. Cohen, Tyco Probe Expands to Include Auditor Pricewaterhouse Coopers, WALL ST. J., Sept. 30, 2002, at A1. Prosecutors allege that the former Tyco CEO, L. Dennis Kozlowski, and ex-chief financial officer, Mark H. Schwartz, stole $170 million in unauthorized compensation and also participated in an illegal scheme in which they gained another $430 million dollars from stock sales. Id. It is alleged that these payments were improperly withheld from proxy statements and shareholders. Id. Investigations are still being conducted into Tyco's alleged fraudulent accounting which involved illegal gains in the optical-fiber unit's initial public offering, forgiven loans to employees, including the former CEO and CFO, and reported material misstatements in financial and tax reporting. Id. In June of 2003, A New York State Supreme Court judge refused to dismiss criminal indictments against the former executives. Tyco Int'l Ltd: Judge Declines to Dismiss Charges Against Ex-Executives, WALL ST. J., June 24, 2003, at B6.

23 Deborah Solomon, WorldCom's Ex-Controller Pleads Guilty to Fraud, WALL ST. J., Sept. 27, 2002, at A3. David F. Meyers, former CFO of WorldCom, plead guilty to fraud admitting that he was part of a scheme that "helped manufacture profits at the behest of 'senior management' as part of a massive scheme to defraud investors and meet Wall Street expectations." Id. In court, Meyers stated that he was repeatedly "instructed on a quarterly basis by senior management to ensure that entries were made to falsify WorldCom's books, to reduce WorldCom's reported actual costs, and therefore increase WorldCom's reported earnings." Id.

24 Id.

25 Shawn Young, Quest to Restate $950 Million of Revenue Tied to "Swap" Deals, WALL ST. J., Sept. 23, 2002, at A12. The alleged swap deal involved the sale and booked revenue of a network to another carrier while simultaneously purchasing an identical network from another carrier for almost the same amount. Id. These deals were used often by carriers such as Qwest and Global Crossing and served little purpose other than to inflate revenues. Id. The SEC recently ruled that such recorded deals were improperly booked and have opened an investigation into Qwest's accounting. Id.
employee retirement plans. The seemingly continuous stream of fraud and accounting misstatements taking place at the highest levels of corporations, in combination with the sinking stock market, infuriated and disappointed investors. There was a sharp decline in investor

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77 John R. Wilke, President Praises Work of Task Force on Business Crime, WALL ST. J., Sept. 27, 2002, at A4. On July 9, 2002, President Bush signed an executive order forming a Taskforce on Business Crime to help ease interagency conflicts and coordination in multi-jurisdictional cases. President's Ten-Point Plan, available at http://www.whitehouse.gov/infocus/corporateresponsibility/index2.html (last visited Apr. 26, 2004). The President is also focused on improving the quality of corporate disclosure and the accountability of executives and auditors. Id. The Corporate Fraud Conference, sponsored by the President's Corporate Fraud Task Force, released a plan to tackle corporate fraud and investor uneasiness and has brought numerous cases against defendants for civil and criminal wrongdoing. Id. The ten-point plan includes:

1. Each investor should have quarterly access to the information needed to judge a firm's financial performance, condition, and risks.
2. Each investor should have prompt access to critical information.
3. CEOs should personally vouch for the veracity, timeliness, and fairness of their companies' public disclosures, including their financial statements.
4. CEOs or other officers should not be allowed to profit from erroneous financial statements.
5. CEOs or other officers who clearly abuse their power should lose their right to serve in any corporate leadership positions.
6. Corporate leaders should be required to tell the public promptly when they buy or sell company stock for personal gain.
7. Investors should have complete confidence in the independence and the integrity of the companies' auditors.
8. An independent regulatory board should ensure that the accounting profession is held to the highest ethical standards.
9. The authors of accounting standards must be responsive to the needs of investors.
10. Firms' accounting systems should be compared with best practices, not simply against minimum standards.

Id. President Bush continued his effort by emphasizing the importance of stressing ethics in corporate boardrooms at a speaking event. President Bush, Remarks at the Malcolm Baldrige National Quality Award Ceremony (Mar. 7, 2002), at http://www.whitehouse.gov/news/releases/2002/03/20020307-3.html. Additionally, the SEC has added fifty staff members, and the FBI has assigned over 2,000 agents to investigate white-collar crime. Wilke, supra. The FBI's white-collar force nearly equals the amount of agents assigned to battle terrorism. Id. See generally Kerry L. Francis & Albert Lilienfeld, Financial Accounting and Reporting Fraud What Does It Look Like, in CORP. LAW 2002, at 627 (PLI Corp. Law Practice Course, Handbook Series No. 1332, 2002) (describing the various and most frequently used accounting schemes concocted by corporations to inflate profits); John C. Coffee, Understanding Enron: "It's About the Gatekeepers, Stupid," 57
willfulness to trust corporations and the stock markets that seemed to parallel the climate prior to the passage of the 1933 Securities Act.\textsuperscript{78}

Within this climate, Congress responded to the public outcry by passing the SOA just two short weeks after its introduction in the Senate.\textsuperscript{79} The SOA addresses many areas of investor concern, including an extension of the statute of limitations for securities fraud actions,\textsuperscript{80} additional regulation of insider trading,\textsuperscript{81} protection for whistleblowers,\textsuperscript{82} creation of a Public Company Accounting Oversight

BUS. LAW. 1403 (2002) (analyzing the issue of the roles audit firms and law firms play in corporate governance).

\textsuperscript{78} Lerach, supra note 2, at 105.

\textsuperscript{79} Arkin, supra note 70, at 3. The SOA has been described as "legislation as redolent of populist anger as it is of well-intentioned and needed reforms." Id. "The law tries to restore confidence in business through regulation of executives and their advisors—including lawyers." Dwyer, supra note 68, at 74. The SOA included all recommendations made in the "Ten-Point Plan" proposed by the president and gave new and improved tools for prosecutors and regulators to improve corporate responsibility and improve the protection of shareholders and employees. Wilke, supra note 77, at A4.

\textsuperscript{80} Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 804, 116 Stat. 745 (2002). This section amends § 1658 of Title 28 to allow for:

(b) Notwithstanding subsection (a) a private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined . . . [in the Securities Exchange Act of 1934], may be brought not later than the earlier of—

(1) 2 years after the discovery of the facts constituting the violation; or

(2) 5 years after such violation.

Id. This is in comparison to the prior one- and three-year periods that existed under the Securities Exchange Act of 1934.

\textsuperscript{81} Id. § 306. This section creates a new derivative action against officers and directors who trade their company's stock during the blackout period when participants in the company's pension plans can not trade. Id. This section is specifically in response to the alleged sales of Enron executives millions of dollars of stocks just prior to and during the period that all sales of stock owned by non-executive company employees were prohibited from selling. The black-out period under the act is defined as:

any period of more than three consecutive business days during which the ability of not fewer than 50 percent of the participants or beneficiaries . . . to purchase, sell, or otherwise acquire or transfer an interest in any equity . . . held in such an individual account plan is temporarily suspended by the issuer or by a fiduciary of the plan.

Id. In addition, § 306 creates a remedy through an action of recovery of any profits made in violation of § 306. Id.

\textsuperscript{82} Id. § 806. This section creates a remedy for whistleblowers that suffer retaliation. Id. This section is broad in that it also covers acts of an employee that "provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of . . . any rule or regulation of the Securities and Exchange Commission." Id.
Board,\textsuperscript{83} creation of fund accounts to compensate victims of securities laws violations,\textsuperscript{84} regulation of CEO and CFO certification,\textsuperscript{85} elimination

\textsuperscript{83} \textit{Id.} § 101. This section establishes an accounting oversight board:
\[\text{[t]o oversee the audit of public companies that are subject to the securities laws . . . in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors.} \textit{Id.} The Board is not considered a government agency but will be funded by fees on all the publicly traded companies. \textit{Id.} § 109. Additionally, all of the Board’s actions are subject to action and review by the SEC. \textit{Id.} § 101(g).

\textsuperscript{84} \textit{Id.} § 308. This section provides that the SEC, upon a judicial or administrative action, can obtain an order “requiring disgorgement against any person for a violation” for “the benefit of the victims.” \textit{Id.}

\textsuperscript{85} \textit{Id.} § 302. This section requires:

(a) [t]hat the principal executive officer . . . and the principal financial officer . . . certify in each annual or quarterly report . . . that . . .
(1) the signing officer has reviewed the report;
(2) based on the officer’s knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading;
(3) based on such officer’s knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report.

\textit{Id.} Additionally, this section requires that the signing officers be responsible for creating and maintaining internal controls, ensuring that the internal controls are designed to disclose material information to the officers, evaluating the effectiveness of the internal controls within 90 days prior to the report, presenting the conclusions about the effectiveness of the internal controls based on their last review, disclosing to the audit committee and company’s auditors any material deficiencies or detected fraud, and reporting any significant changes in internal control that could affect internal controls subsequent to the date of their evaluation. \textit{Id.}
of personal loans to executives, and creation of a new crime of "securities fraud."

Section 307 of the SOA was initiated and lobbied for by a group of law professors in a letter dated March 7, 2002 to the then SEC Chairman Harvey Pitt. The letter recommended that Enron-like matters and frauds required that special attention be given to the role that lawyers play in public companies. Additionally the professors argued that the

86 Id. § 402.

(1) [In General]—It shall be unlawful for any issuer ... directly or indirectly, including through any subsidiary, to extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit, in the form of a personal loan to or for any director or executive officer (or equivalent thereof) of that issuer. An extension of credit maintained by the issuer on the date of enactment of this subsection shall not be subject to the provisions of this subsection, provided that there is no material modification to any term of any such extension of credit or any renewal of any such extension of credit on or after that date of enactment.

(2) Limitation—Paragraph (1) does not preclude any home improvement and manufactured home loans ... [and] consumer credit, or any extension of credit under an open end credit plan ... or a charge card.

87 Id. § 807.

Whoever knowingly executes, or attempts to execute, a scheme or artifice—

(1) to defraud any person in connection with any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 ... or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 ... or (2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any security of an issuer with a class of securities registered ... or that is required to file reports ... shall be fined under this title, or imprisoned not more than 25 years, or both.


89 Id.

As professors of securities regulation and/or professional responsibility, we are concerned about the role of professionals in the Enron matter and other frauds on investors. While regulation of accountants has been discussed extensively at the SEC, in Congressional hearings and in the press, we believe that attention should also be given to the role of lawyers in representing public
then current ABA Model Rule 1.13 did not adequately protect the investing public because it did not define a specific course of action for a lawyer to take upon detecting fraud and other material violations. The letter urged congressional recognition of the need for the SEC to promulgate ethics standards for corporate attorneys and to grant explicit authority for the federalization of the rules of professional responsibility. On March 28, 2002, the then SEC General Counsel, David M. Becker, responded by recognizing that the role that lawyers played in securities fraud was a matter of public concern. The letter from the SEC explained that the power under Rule 102(e) to discipline lawyers had not been exercised because of strong opposition from the state bar that such proceedings were to be addressed and enforced by the corresponding state court systems.

As a result of the exchange of letters, section 307 was introduced as necessary to assure corporate accountability. It was widely believed

corporations, and in particular to whether lawyers should inform a client corporation's directors about violations of the securities laws. We believe that, if senior management will not rectify a violation, lawyers who are responsible for the corporation's securities compliance work should be required to make such a report.

Id.
90 Id.
91 Id.
93 17 C.F.R. § 201.102(e) (2002); see also Paul Gonson, The 1998 Amendment to SEC Rule 102(e) Will Withstand Judicial Scrutiny, 1999 UTAH L. REV. 609 (discussing the process and the case law behind the SEC use of Rule 102(e) as authority to censure, suspend, or bar professionals from appearing or practicing before it).
94 Strauss, supra note 88, at 5; see Letter from David M. Becker to Richard Painter, supra note 92. Rule 102(e) was premised on the authority that with the SEC's general rule-making power, it also had the inherent authority to protect and enforce the integrity of its processes. GONSON, supra note 93, at 612. Because of the large amount of documents that are required to be filed with the SEC on an annual basis and an inherent limitation on manpower to review all filed documents, the SEC must rely on lawyers and accountants opinions of compliance. Id. To a certain extent the SEC must rely on good faith. Id.
95 Strauss, supra note 88, at 5.

For some time, the SEC actually tried [to ensure that lawyers followed the law] in the late 1970s and early 1980s. They brought legal actions to enforce this basic responsibility of lawyers—the responsibility to take steps to make sure corporate managers didn't break the law and harm shareholders in the process. If you find out that managers are breaking the law, you must tell them to stop. If they won't stop, you go to the board of directors, which represents the shareholders, and tell them what is going on. If they won't act responsibly and in
that lawyers involved with the Enron Corporation did not do enough to alert its top managers of the scandals that eventually led to the collapse of the corporation.\textsuperscript{96} Congress specifically found disturbing the limited compliance with the law, then you go to the board and say something has to be done; there is a violation of the law occurring. It is basically going up the ladder, up the chain of command.

For years, the SEC recognized the principle that lawyers had a legal responsibility to go up the ladder if they saw wrongdoing occurring. But then they stopped. One of the reasons they stopped is because there were a lot of protests coming from the organized bar. With Enron and WorldCom, and all the other corporate misconduct we have seen, it is again clear that corporate lawyers should not be left to regulate themselves no more than accountants should be left to regulate themselves. There has been a lot of debate, rhetoric, and discussion—rightfully so—about the necessity about not “letting the fox guard the chicken coop.” The same is true with lawyers. This has become clear through various acts of misconduct. The lawyers have involvement and responsibility, and they also cannot be left to regulate themselves.

In January, a bipartisan group of top securities lawyers and legal ethics experts in the country wrote a letter to Harvey Pitt telling him it was time for the SEC to enforce the up-the-ladder principle, as in the past. Mr. Pitt’s top lawyer said: We are not going to do anything. If Congress wants something done, Congress should act. Then I wrote a letter to Mr. Pitt in essence saying: We are ready to act here. Will you help us in crafting legislation and working out this problem?

That was 3 weeks ago. As of now, I have not yet received a response. The time has come for Congress to act.

148 CONG. REC. S6524, S6552 (daily ed. July 10, 2002) (statement of Sen. Edwards). “This amendment is designed to assure that attorneys are responsible for fully informing their corporate client of evidence of material violations of Federal securities law. That is what we are talking about through the whole accounting reform.” Id. at S6554 (statement of Sen. Enzi); see also Letter from the American Bar Association to Senator Paul S. Sarbanes (July 19, 2002), at http://www.abanet.org/po/adr/letters/107th/business071902.htm (on file with the Valparaiso University Law Review) (recommending that Congress revisit the definitions and standards proposed in the amendment for regulating attorney conduct).

Attorneys are already subject to strict ethical rules adopted and enforced by the state courts, and the ABA believes that the courts should retain their traditional authority to govern lawyer conduct. All attorneys are licensed by the highest court of the state in which they practice and are subject to the ethical rules adopted by that court. . . . While lawyer disciplinary rules have been, and will continue to be, periodically updated, these changes should be accomplished through the orderly adoption of new state court rules. Regulation of lawyers should remain the province of the judiciary, not the executive, and any attempt to grant the . . . SEC the power to adopt a set of national rules would violate separation of powers principles.

Letter from the American Bar Association to Senator Paul S. Sarbanes, supra.

\textsuperscript{96} Ellen Joan Pollok, Andersen: Called to Account: Enron Lawyers Face Congress Over Their Role, WALL. ST. J., Mar. 15, 2002, at C13.
scope of investigations that took place by in-house and outside counsel upon receiving a letter of concern from an internal senior executive. In response, section 307 of the SOA mandates that the SEC promulgate rules of professional responsibility for corporate lawyers. This sweeping new law required that the SEC promulgate the standards within 180 days from enactment of the legislation. Upon signing of the bill, SEC Chairman Pitt expressed support for the toughening of lawyer reporting requirements and stated that, where the state bars failed to adequately enforce and discipline attorneys, the SEC was ready and now obligated to step in.

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99 Federal Law Requires New Lawyer Rules, 71 U.S. L. Wk. 2079 (2002). A professor of law called the rule "heavy-handed" and "not well thought through." Id. at 2080. This professor, who is also a reporter for the ABA Task Force on Corporate Responsibility, described the rule as:

[N]ot nuanced or sensitive to the circumstances in which lawyers practice before the commission and the relationships they have with their corporate clients. A lawyer's decision to go to the chief legal officer or the CEO should be a much more considered act than an automatic reaction to "evidence" of a violation.

Id. Additionally, the professor of law described the rule as having a standard of a "hair trigger" rather than "a thoughtful predicate for taking such a step." Id.

On November 6, 2002, the SEC voted to release a proposal of the standards of professional conduct in compliance with the SOA. The proposal included a provision for up-the-ladder reporting as mandated by Congress. In addition, the SEC went a step further and included a provision for required disclosure to the SEC and withdrawal if no appropriate response is received by the organization. Comments to the proposed rule were invited and posted on the SEC website. The proposed rules received a flurry of responses, most notably criticizing the SEC's proposed disclosure requirement. On January 23, 2003, the SEC voted to adopt a set of final rules for up-the-ladder reporting which varied from the proposed rules. Additionally, the SEC voted to extend the comment period for the controversial "noisy withdrawal" provision.

The adopted up-the-ladder reporting rule requires that the attorney, upon having credible evidence of a fraud, first report the material violation to the chief legal officer ("CLO") and the CEO. If no

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104 See supra note 101.

105 Tamara Loomis, 77 Big Firms Deliver Objection to Proposed Rules Implementing Sarbanes-Oxley, BROWARD DAILY BUS. REV., Dec. 20, 2002, at A19; Press Release, American Bar Association, ABA Urges SEC Not to Exceed Sarbanes-Oxley Mandate Without Extended Comment Period (Dec. 18, 2002), at http://www.abanews.org/dec02/sec.html; see also Press Release, American Corporate Counsel Association, In-house Counsel Poll on Corporate Scandals (Oct. 21, 2002), at http://www.acca.com/about/pr-archive.php (showing that most in-house counsel define their corporate cultures ethically responsible and half the respondents found Section 307 unnecessary because of self-regulation and the other half found the legislation necessary to assist in preventing and disclosing financial fraud).


107 SEC Adopts Attorney Conduct Rule, supra note 106.

(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 to both the issuer's chief legal officer and its chief executive officer . . . .

(2) The chief legal officer ... 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 ... 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 ... 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 ... a chief legal officer ... may refer a report of evidence of a material violation to a qualified legal compliance committee ... 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 ... reasonably believes that the chief legal officer or the chief executive officer ... has provided an appropriate response within a reasonable time, the attorney shall report the evidence . . . to:

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

(ii) Another committee of the issuer's board of directors . . . who are not . . . "interested persons" . . . or

(iii) The issuer's board of directors . . . .

(8) An attorney who receives what he or she reasonably believes is an appropriate and timely response to a report he or she made . . . 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 . . . [the attorney] shall explain his or her reasons therefor to the chief legal officer . . . , chief executive officer . . . , and directors to whom the attorney reported the evidence of a material violation . . . .

*Id.*
appropriate response is given, then the attorney is to report the evidence
to the audit committee or the qualified legal compliance committee
("QLCC") based on the structure adopted by the corporation.109

The proposed rule for "noisy withdrawal" requires an attorney to
take further action when she does not receive an appropriate response
from the corporation and believes that the material violation is ongoing,
or about to occur, and is likely to result in substantial injury to the
corporation or its shareholders.110 The proposed rule requires the

109 Id. § 205.3(c).
   (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 ... 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 ... 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 .... The chief
   legal officer ... shall inform the reporting attorney that the report has
   been referred to a qualified legal compliance committee. Thereafter,
pursuant to [this rule], the qualified legal compliance committee shall
be responsible for responding to the evidence of a material violation
...

110 SEC Proposed Noisy Withdrawal Rule, supra note 103, § 205.3(d).
   (d) Notice to the Commission where there is no appropriate response
within a reasonable time.
   (I) Where an attorney who has reported evidence of a material
violation ... does not receive an appropriate response, or has not
received a response in a reasonable time, to his or her report, and the
attorney reasonably believes that 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:
   (i) An attorney retained by the issuer shall:
   (A) Withdraw forthwith from representing the issuer, indicating that
the withdrawal is based on professional considerations;
attorney to withdraw from representation, notify the SEC of withdrawal by citing to "professional considerations," and then disaffirm any materially false or misleading documents that were prepared or reviewed by the attorney. The Commission states that such "extreme

(B) Within one business day of withdrawing, give written notice to the Commission of the attorney's withdrawal, indicating that the withdrawal was based on professional considerations; and

(C) Promptly 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 preparing and that the attorney reasonably believes is or may be materially false or misleading;

(ii) An attorney employed by the issuer shall:

(A) Within one business day, notify the Commission in writing that he or she intends to disaffirm some opinion, document, affirmation, representation, characterization, or the like in a document filed or submitted to the Commission, or incorporated into such a document, that the attorney has prepared or assisted in preparing and that the attorney reasonably believes is or may be materially false or misleading; and

(B) Promptly disaffirm to the Commission, in writing, any such opinion, document, affirmation, representation, characterization, or the like; and

(iii) The issuer's chief legal officer... shall inform any attorney retained or employed to replace the attorney who has so withdrawn that the previous attorney's withdrawal was based on professional considerations.

Id. On January 29, the SEC released an additional proposal that called for the corporation to notify the SEC and disaffirm any tainted documents upon a lawyer withdrawing, Securities Exchange Commission, Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys (proposed Jan. 29, 2003), available at http://www.sec.gov/rules/proposed/33-8186.htm (last modified Sept. 26, 2003) (Corporation Notification rule) [hereinafter SEC Proposed Corporation Notification Rule]. This proposed rule still requires the lawyer to notify the corporation and formally withdraw from the engagement and discontinue any attorney-client relationships. Id. However, this proposed rule would not require the attorney to notify the SEC. Id. In the alternative, the proposed section 205.3(e) provides:

(e) Duties of an issuer where an attorney has given notice [to the corporation].

(1) Where an attorney has provided an issuer with a written notice... the issuer shall, within two business days of receipt of such written notice, report such notice and the circumstances related thereto on [specified compliance forms with the SEC], as applicable.

Id. This rule proposal is beyond the scope of this Note, however, more information regarding the scope of the proposed rule and commentary is available at the SEC website.

111 Compare SEC Proposed Noisy Withdrawal Rule, supra note 103, § 205.3(d) (requiring the attorney to notify the SEC directly upon withdrawal of an attorney-client relationship due to professional considerations), with SEC Proposed Corporation Notification Rule,
situations” that mandate disclosure will be rare. An in-house attorney would have the same obligations as outside counsel except the attorney would not have to resign from his position. The attorney would still be required to notify the SEC and disaffirm any tainted documents.

However, the SEC sets up a slightly different procedure for corporations that have established a QLCC. In situations where the corporation has formed a QLCC, the committee would be authorized to require that the corporation take remedial actions to correct a “material violation.” If the corporation does not take remedial action upon

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supra note 110, § 205.3(e) (requiring the corporation to disclose instances where an attorney has ended an attorney-client relationship for professional considerations). The proposed Noisy Withdrawal Rule is similar to the ABA Model Rule 1.6 in that it requires disclosure. However, the ABA Model Rules require disclosure to the court while the SEC “Noisy Withdrawal” Rule requires disclosure to the SEC. For the purposes of this paper, “noisy withdrawal” refers to notifying the SEC and disaffirming relevant documents to the SEC.

SEC Proposed Noisy Withdrawal Rule, supra note 103.

ld.

ld., § 205.2(j).

ld. § 205.2(j)(2)-(4). A QLCC is a committee that:

(2) Has been duly established by the issuer’s board of directors and authorized to investigate any report of evidence of a material violation by the issuer, its officers, directors, employees or agents;

(3) Has established written procedures for the confidential receipt, retention, and consideration of any report of evidence of a material violation . . . ;

(4) Has the authority and responsibility:

(i) To inform the issuer’s chief legal officer and chief executive officer . . . of any report of evidence of a material violation . . . ;

(ii) To decide whether an investigation is necessary to determine whether the material violation described in the report has occurred, is occurring, or is about to occur and, if so, 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 by outside attorneys; and

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

(iii) At the conclusion of any such investigation . . . ;

(A) Direct the issuer to adopt appropriate remedial measures, including appropriate disclosures, and/or to impose appropriate sanctions to stop any material violation that is occurring, prevent any material violation that is about to occur, and/or rectify any material violation that has already occurred; and

(B) Inform the chief legal officer and the chief executive officer . . . and the board of directors of the results of any such investigation . . . and the appropriate remedial measures to be adopted . . .
notification of the QLCC, then each member of the QLCC is required to notify and inform the SEC of any tainted filings and documents.\(^{117}\) Additionally, an outside attorney would not be required to make a "noisy withdrawal" and an in-house attorney would not be required to notify the SEC or disaffirm any tainted filings.\(^{118}\) Both of these provisions, the adopted up-the-ladder reporting rule and the proposed disclosure rules, have been fraught with controversy because of the possible conflict with the already existing body of state law in Professional Conduct.\(^{119}\)

\(^{117}\) *Id.* § 205.2(j)(5).

Each member of which individually, together with the issuer's chief legal officer and the chief executive officer ... individually, has the authority and responsibility, in the event the issuer fails in any material respect to take any of the remedial measures that the qualified legal compliance committee has directed the issuer to take, to notify the Commission that a material violation has occurred, is occurring, or is about to occur and to disaffirm in writing any document submitted to or filed with the Commission by the issuer that the individual member of the qualified legal compliance committee or the chief legal officer or the chief executive officer reasonably believes is false or materially misleading.

\(^{118}\) *Id.* § 205.3(c).

(c) Alternative reporting procedures for attorneys retained or employed by an issuer with a qualified legal compliance committee.

(1) If, in appearing and practicing before the Commission in the representation of an issuer, an attorney 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 [up the ladder] reporting requirements . . . of this section, report such evidence of a material violation to a qualified legal compliance committee, if the issuer has duly formed such a committee . . . . [A]n attorney who reports evidence of a material violation to a qualified legal compliance committee has satisfied his or her obligation to report evidence of a material violation with the issuer, is not required to assess the issuer's response to the reported evidence of a material violation, and is not required to take any action under . . . regarding the evidence of a material violation.

\(^{119}\) See Roberta S. Karmel, *A Bid to Regulate the Entire Bar*, 228 N.Y. L.J. 3 (2002); Fredrick K. Koenen, *Sarbanes-Oxley and the SEC: New Dilemmas for Attorneys*, 3 WHITE-COLLAR CRIME REP. 17 (2002). Many criticize the SEC rule as one that goes to far and is "riddled with numerous faulty judgments." Karmel, *supra*. Additionally, there is a question of how the proposed standards will protect investors from frauds like Enron. *Id.* Others believe that the SEC is forcing attorneys to be governmental actors by reporting information to the SEC, a governmental entity, without permission from the client. *Id.*
D. The State Controlled Area of Attorney Professional Conduct

Historically, the area of regulating lawyer conduct has been vested with the states. The evolution of attorney ethics regulations, in general, reflects a steady increase of requirements and enforcement standards. Initially, several states passed statutes that allowed any registered voter to practice law without any stated regulation on attorney behavior. Then came a tightening of the bar requirements, bar entry, and eventually restrictions on attorney conduct.

Client confidence has been recognized as a crucial part of the evolution of the legal profession and rules governing conduct. Proponents of the confidentiality rule suggest that without such confidence, and even more closely guarded attorney-client privileges, clients' interests would not necessarily be forthcoming and attorneys would not adequately be protected from liability against third parties. Opponents of the broad confidentiality rule suggest that regulations that focus on the attorney-client confidences are to the “detriment of opponents and society at large.” The Supreme Court found that the

120 See David B. Wilkins, How Should We Determine Who Should Regulate Lawyers?: Managing Conflict and Context in Professional Regulation, 65 FORDHAM L. REV. 465, 467-68 (1996). The area of professional regulation has grown to where now a large number of institutions seek to control attorney conduct in some form. Id. at 467. Because of the large amount of tasks that lawyers take part in, the area of regulation will continue to be one of great controversy. Id.

121 Benjamin Hoorn Barton, Why Do We Regulate Lawyers?: An Economic Analysis of the Justifications for Entry and Conduct Regulation, 33 ARIZ. ST. L.J. 429, 429-33 (2001). There are two separate bodies of attorney regulation, entry regulation and conduct regulation. Id. Some states had nominal requirements but they were rarely enforced. Id.

122 Id. Initially the regulations passed to govern lawyers were considered stated ethical norms. Id. at 430. Increasingly, the standards have transformed to minimum standards of allowable attorney conduct. Id. at 431. Additionally, the requirements for practicing law have grown to include extensive educational requirements, a bar exam, and a fitness review. Id.

123 Id. at 467-68.

124 See id. at 470-75. It is argued that the confidentiality rule serves the public interest by encouraging clients to consult attorneys. Id. at 473-75. In doing so, the attorney is able to guide the client into making better, legal decisions and even correct a wrong done by society to the client, i.e., employer negligence. Id. at 478-80.

125 Id. at 473. It is argued that “[l]awyers . . . have considerable latitude in dealing with omissions of material facts or the presentation of questionable or even perjured evidence, and multiple commentators have complained that the regulations undersell candor for the good of the clients.” Id. See generally David S. Caudill, Ethical Guidelines on Attorney-Client Confidentiality: Sympathy for the Devil?: Reflections on the Crime-Fraud Exception to Client Confidentiality, 8 ST. JOHN’S J.L. COMM. 369 (1993) (discussing the clash between client confidentiality and fraud disclosure requirements).
purpose of client confidentiality is to encourage candid communications between the attorney and the client to "thereby promote broader public interests in the observance of the law and administration of justice."127

The balancing of the attorney-client confidentiality against disclosure to avoid frauds, bodily harm, or other illegal activities has been a long-time challenge facing the legal profession.128 Rules on the scope of attorney-client privilege, confidences, and disclosure requirements vary by state.129

ABA Model Rule 1.6 states that a lawyer shall not reveal any information gained during representation unless the client consents.130 The ABA Rule, as amended in August of 2003, allows for, but does not require, attorney disclosure to prevent the client from committing an illegal act that is likely to result in "imminent death or substantial bodily


128 Caudill, supra note 126, at 371. The balance tips in favor of attorney-client privilege because this relationship is "paramount." Id. "[T]he dialectical tension between client confidentiality and disclosure of client fraud is inescapable." Id.; William F. Dietrich, Legal and Ethical Issues for Attorneys Dealing with Financial Data: Heightened Scrutiny After the Enron and Andersen Debacle, in CORP. LAW 2002, at 925, 955-64 (PLI Corp. Law & Practice Course, Handbook Series No. 1325, 2002).

129 Breslin & Dooley, supra note 127, at 722-23; see infra notes 131-35 and accompanying text.

130 MODEL RULES OF PROF'L CONDUCT R. 1.6(a) (2003).

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by [the exceptions noted in this rule].

(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) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests to property of another and in furtherance of which the client has used or is using the lawyer's services;
(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;
(4) to secure legal advice about the lawyer's compliance with these Rules.

Id.
harm" or to prevent a client from committing a fraud that may result in financial injury to others. The ABA Model Rules also require the client fraud to be revealed if committed on a tribunal. Some states require

\[131\] _Id._; Some states had already taken this step to allow for disclosure for future financial harms. See TEX. SUP. CT. R. 1.05.

\(a\) "Confidential information" includes both "privileged information" and "unprivileged client information." "Privileged information" refers to the information of a client protected by the lawyer-client privilege . . . "Unprivileged client information" means all information relating to a client or furnished by the client, other than privileged information, acquired by the lawyer during the course or by reason of the representation of the client.

\(c\) A lawyer may reveal confidential information:

\(1\) When the lawyer has been expressly authorized to do so in order to carry out representation.

\(4\) When the lawyer has reason to believe it is necessary to do so in order to comply with a court order, a Texas Disciplinary Rules of Professional Conduct, or other law.

\(7\) When the lawyer has reason to believe it is necessary to do so in order to prevent the client from committing a criminal of fraudulent act.

\(8\) To the extent revelation reasonably appears necessary to rectify the consequences of a client's criminal or fraudulent act in the commission of which the lawyer's services had been used.

_Id._ Enron was headquartered in Texas, where attorneys are permitted to disclose a financial crime or fraud. In February of 2000, the ABA House of delegates rejected proposed amendments to ABA Model Rule 1.6 that would allow disclosure in instances if criminal or fraudulent acts that are likely to result in substantial financial injury of the interests of another. James H. Cheek & Derek S. Hughey, Emerging Responsibilities and Liabilities of a Corporate Lawyer, in CORP. LAW 2002, 1141, 1150 (PLI Corp. Law & Practice Course, Handbook Series No. 1343, 2002). The ABA House of Delegates eventually approved the revised rule in August of 2003. Press Release, American Bar Association, ABA Adopts New Lawyers Ethics Rules, Urges Fairness in Military Commission Trials (Aug. 12, 2003), at http://www.abanet.org/media/au03/081203_1.html.

\[132\] _MODEL RULES OF PROF'L CONDUCT R. 3.3 (2002)._ A lawyer shall not knowingly:

\(1\) make a false statement of material fact or law to a tribunal . . . ;

\(2\) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel;

\(3\) offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer, has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.
disclosure of client’s acts if a client discloses an intention to commit fraud and the attorney is unable to talk the client out if it.\textsuperscript{133} Other states permit or require disclosure to rectify a substantial loss resulting from a client crime or fraud in which the client used the lawyer’s services.\textsuperscript{134}

\textsuperscript{133} \textit{FLA. SUP. CT. R. 4-1.6.}
(a) Consent Required to Reveal Information. A lawyer shall not reveal information relating to representation of a client except as [follows], unless the client consents after disclosure to the client.
(b) When Lawyer Must Reveal Information. A lawyer shall reveal such information to the extent the lawyer reasonably believes necessary:
(1) to prevent a client from committing a crime . . . .
\textit{id.; N.J. SUP. CT. R. 1.6; VA. SUP. CT. R. 1.6; WIS. SUP. CT. R. 20:1.6; see infra notes 134-35 and accompanying text.}

\textsuperscript{134} \textit{COLO. SUP. CT. R. 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 representation, and except [as follows] . . .
(b) A lawyer may reveal the intention of the lawyer’s client to commit a crime and the information necessary to prevent the crime.
\textit{id.; see also CONN. SUP. CT. R. 1.6.}
(a) A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out representation, and except [as follows];
(b) A lawyer shall reveal such information to the extent the lawyer reasonably believes necessary to prevent the client from committing a criminal act that the lawyer believes is likely to result in death or substantial bodily harm.
(c) A lawyer may reveal such information to the extent the lawyer reasonably believes necessary to:
(1) Prevent the client from committing a criminal act that the lawyer believes is likely to result in substantial injury to the financial interest or property of another;
(2) Rectify the consequences of a client’s criminal or fraudulent act in the commission of which the lawyer’s services had been used.
\textit{CONN. SUP. CT. R. 1.6; see IND. SUP. CT. R. 1.6.}
(a) A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out representation, and except as [follows];
(b) A lawyer may reveal such information to the extent the lawyer reasonably believes necessary:
(1) To prevent the client from committing any criminal act . . . .
\textit{IND. SUP. CT. R. 1.6; see OHIO SUP. CT. R. 4-101.}
(a) “Confidence” refers to information protected by the attorney-client privilege under applicable law, and “secret” refers to other information gained in the professional relationship that the client has
Further, some states have mandatory disclosure requirements for financial crimes.\textsuperscript{135}

requested be held inviolate or the disclosure of which would be embarrassing or would likely to be detrimental to the client.

\ldots

(c) A lawyer may reveal:

(1) Confidences or secrets with the consent of the client or clients affected, but only after full disclosure to them.

\ldots

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


\textsuperscript{135} Tamara Loomis, \textit{New Disclosure Rule, An ABA Proposal Would Have Lawyers "Rat" on Clients}, 228 N.Y. L.J. 5 (2002). A study shows that lawyers in the states that carried the provision ignored the mandatory financial disclosure rule. \textit{Id.; see N.J. Sup. Ct. R. 1.6.}

(a) A lawyer shall not reveal information relating to 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 [follows]:

(b) A lawyer shall reveal such information to the proper authorities, as soon as, and 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.

\textsc{N.J. Sup. Ct. R. 1.6; see Wis. Sup. Ct. R. 20:1.6.}

(a) A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized to carry out the representation, and except as [follows]:

(b) A lawyer shall reveal such information 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 in substantial injury to the financial interest or property of another.

\textsc{Wis. Sup. Ct. R. 20:1.6; see Va. Sup. Ct. R. 1.6.}

(a) A lawyer shall not reveal information protected by the attorney-client privilege under applicable law or other information gained in the professional relationship that the client has requested be held in inviolate or the disclosure of which would be embarrassing or would
Attorney-client privilege, a sub-set of confidentiality, generally does not allow the holder of the privilege to disclose positive or helpful privileged information and then invoke the privilege as to the remaining facts or portions surrounding the previous disclosure. Upon disclosure of privileged information to a third party, privilege is considered waived, regardless of the intent of the communication or intent of the client or attorney. Some courts have recognized a limited waiver approach in situations where a corporation has voluntarily disclosed privileged information to government agencies. This be likely be detrimental to the client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation, and except as [follows].

(b) To the extent a lawyer reasonably believes necessary, the lawyer may reveal:

....

(3) such information which clearly establishes that the client has, in the course of the representation, perpetrated upon a third party a fraud related to the subject matter of the representation;

....

(c) A lawyer shall promptly reveal:

(1) [T]he intention of a client, as stated by the client, to commit a crime and the information necessary to prevent the crime, but before revealing such information, the attorney shall, where feasible, advise the client of possible legal consequences of the action, urge the client not to commit the crime, and advise the client that the attorney must reveal the client's criminal intention unless thereupon abandoned ....


(a) Except when required ... or permitted ... a lawyer shall not, during or after termination of the professional relationship with the client, use or reveal a confidence or secret of the client known to the lawyer unless the client consents after disclosure.

(b) A lawyer shall reveal information about a client to the extent it appears necessary to prevent the client from committing an act that would result in death or serious bodily harm.

(c) A lawyer may use or reveal:

(1) confidences or secrets when permitted under these Rules or required by law or court order;

(2) the intention of a client to commit a crime ....

Id.


Id. Often courts look to fairness in determining the scope and level of the waiver. Id. The level of disclosure, nature of disclosure, when, where, and to whom disclosure was made are all factors, among others, that the court considers. Id.; see also Martin P. Hicks, Limited Waiver of the Attorney-Client Privilege Upon Voluntary Disclosure to the SEC, 50 FORDHAM L. REV. 963, 968-70 (1982).

25A SEC. PRAC. FED. & STATE ENFORCEMENT § 11:18 (2003); COMPLIANCE PROGRAMS & CORP. SENTENCING GUIDELINES § 5:33 (2003). For the purposes of this Note, the attorney-
approach recognizes that voluntary disclosure to the SEC would not constitute a general waiver; therefore, the corporation could still invoke privilege as to other parties.\textsuperscript{139} However, other courts have held that this constitutes a general waiver and attorney-client privilege is waived as to other third parties.\textsuperscript{140}

The premise of confidentiality and privilege extends to organizations as clients. The current ABA Model Rule 1.13(b) provides for an attorney to exercise discretion in how to handle fraud and other criminal wrongdoing in an organization, as long as she is acting reasonably in the best interest of her client.\textsuperscript{141} In addition, the ABA Rule 1.13 allows an

client privilege is used in the context of the required disclosure of confidential information to the SEC that would otherwise be protected as attorney-client privilege in court.\textsuperscript{139} 25A SEC. PRAC. FED. & STATE ENFORCEMENT § 11:18 (2003); see Diversified Indus., Inc. v. Meredith, 572 F.2d 596, 611 (8th Cir. 1977) (en banc) (reasoning that a corporation faced with a general waiver as to privileged information upon disclosure to the SEC would not conduct internal investigations, rectify situations of internal misconduct, or would even invoke privilege towards the SEC thereby frustrating corporate compliance which eventually hurts shareholders and future investors); Byrnes v. IDS Realty Trust, 85 F.R.D. 679, 688 (S.D.N.Y. 1980) (reasoning that voluntary disclosures to governmental agencies should be encouraged rather than discouraged by forcing corporations to fight disclosure in order to protect attorney-client privilege); In re Grand Jury Subpoena Dated July 13, 1979, 478 F. Supp. 368 (E.D. Wis. 1979) (reasoning that to hold voluntary disclosure to the SEC would constitute a general waiver would lead to substantially fewer corporations cooperating with the SEC). See generally Hicks, supra note 137 (discussing the extent of the waiver privilege and court interpretations).

\textsuperscript{140} In re Columbia/HCA Healthcare Corp. Billing Practices Litig. v. Columbia/HCA Healthcare Corp., 293 F.3d 289 (6th Cir. 2002) (holding that a corporation could not selectively waive attorney-client privilege to governmental organizations while trying assert the privilege as to other parties); Permian Corp. v. United States, 665 F.2d 1214 (D.C. Cir. 1981) (finding that disclosure to the SEC resulted in a general waiver); Teachers Ins. & Annuity Ass'n of Am. v. Shamrock Broad. Co., 521 F. Supp. 638 (S.D.N.Y. 1981) (finding that unless reservation of privilege is made, disclosure results in a general waiver); see Hicks, supra, note 137, at 984-85.

\textsuperscript{141} Compare MODEL RULES OF PROF'L CONDUCT R. 1.13 (b) (2003), (b) If a lawyer for an organization knows than 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 a law that 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. 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. ... with, MODEL RULES OF PROF'L CONDUCT R. 1.13 (b) (2002),
attorney to consider the "seriousness of the violation." The ABA Disciplinary Rules provide that attorneys must have information "clearly establishing" that their client's conduct is fraudulent in nature before taking any remedial action.

Congress, in enacting the SOA, granted broad discretion to the SEC in promulgating the standards that trigger reporting, regulating internal disclosure, and enforcing rules of conduct for corporate attorneys. Therefore, corporate attorneys will likely face conflict between the state-imposed ethical regulations and the new SEC promulgated attorney.

(b) 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... 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 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, referred to the highest authority that can act in behalf of the organization...

See also Susanna M. Kim, Dual Identities and Dueling Obligations: Preserving Independence in Corporate Representation, 68 Tenn. L. Rev. 179 (2001). The first Canons of Professional Conduct adopted by the ABA in 1908, had no reference to organizations as clients. Id. at 188. It was not until 1969, when the ABA Model Code was adopted, was there a minor reference to an organization as a client. Id. at 189. It was only once the Model Rules were adopted by the ABA to replace the Model Code did Rule 1.13 offer guidance to lawyers on their ethical duties in representing an organization as a client. Id. at 189-90.

142 MODEL RULES OF PROF'L CONDUCT R. 1.13(b) cmt. 4 (2003); Kim, supra note 141, at 89-90.
143 MODEL CODE OF PROF'L CONDUCT DR 7-102 (2002).

(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 client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal, except when the information is protected as a privileged communication.

Id. Anandarajah, supra note 5, at A3. Some commentators believe this was in reaction to the involvement of the Vinson & Elkins law firm in the Enron debacle and Simpson Thacher & Bartlett in the Global Crossing debacle. Id.; see Arthur D. Burger, Lawyers as Whistleblowers, How Increased SEC Oversight of the Bar Could Change the Client Relationship, 25 Legal Times 22 (2002). The definition of the event that triggers the disclosure is that of a higher standard than the former ABA Rule 1.13. Id. More discretion is allowed to the attorney to consider under the former ABA rules. Id.
conduct standards. A lawyer subject to conflicting ethical duties will not be able to properly guard against corporate fraud; therefore, the state and the SEC standard must be reconcilable to effectuate the public interest of investor protection.\(^{145}\) Additionally, the increased standards for attorney disclosure to prevent corporate fraud provide little protection for management abuses the law was intended to thwart.\(^{146}\) An analysis of the SEC ethical standards, state-imposed ethical duties, and attorney-client confidentiality standards will demonstrate the conflict and impracticalities faced by corporate attorneys and the need for a reconcilable ethical disclosure standard.

III. AN ANALYSIS OF A CORPORATE LAWYER’S CONFLICTING DUTIES

This Part analyzes the scope of the SEC promulgated rules in light of the congressional mandate of SOA. The conflict between the scope of the up-the-ladder reporting scheme, as interpreted by the SEC promulgated ethics rules, and the state bar ethics standards are analyzed first. Next, this Part analyzes the legislative intent and the congressional authority explicitly granted by the SOA to the SEC. Finally, the conflict between the SEC “noisy withdrawal” requirement, the role of lawyers in corporate compliance, and attorney-client privilege are analyzed.

A. Which Lawyers Have a Duty to Report Under the SEC Promulgated Up-the-Ladder Reporting Rule?

For the sake of investors and regular employees, ordinary shareholders, we have to make sure that not only the executives and the accountants do what they are responsible for doing, but also that the lawyers do what they are responsible for doing as members of the bar and as citizens of the country.\(^{147}\)

Up-the-ladder reporting, as currently promulgated by the SEC, places attorneys in a perplexing situation. Criticisms of the SEC rule concern the expansive scope of attorneys that would be considered “to be practicing” within the jurisdiction of the Commission and the standard for material violations that would trigger up-the-ladder

\(^{145}\) See infra Part III.A-B.

\(^{146}\) See infra Part III.A-B.

disclosure. All attorneys, no matter their specialty or client, are faced with dual loyalties, in that they must advocate for their client and abide by the ethics standards laid out by the state bar. The SEC mandated up-the-ladder reporting places an affirmative duty on lawyers and does not properly define triggering standards or to whom the duties will apply. Attorneys must be aware of their duties to better serve the public interest of detecting and preventing fraud within organizations. Finally, the SEC up-the-ladder reporting rule, as currently defined, falls outside the legislative intent and authority of the SOA.

1. Expansive Scope of the SEC Rule Conflicts with Existing State Standards

For a lawyer to serve the public interest, she must know to whom she owes a duty. Generally, the legal profession does not reward attorneys for taking positions adverse to their clients. One view finds that most often, clients will not choose to stay with an attorney who they see as "policing the client's baser instincts." Instead, it is thought that society is better served by preserving client confidentiality by not forcing clients to choose to hide the wrongdoing so as to allow the attorney an opportunity to dissuade them from the wrongdoing. Another view finds that it is possible to strike a balance between allowing a client access to an attorney and protecting others from the harm of their client.

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In my view, the Commission is acting not only under power delegated by Congress, but as a representative of investors. I have no doubt that the overwhelming majority of investors would vote in favor of this rule for an individual company, if it were submitted as a shareholder proposal . . . . Therefore, it is only defects in the corporate governance process that prevent this rule from being in force already.

149 See infra text accompanying notes 153-215.

150 See infra text accompanying notes 178-202.

151 See infra text accompanying notes 153-215.

152 See infra text accompanying notes 219-33.


154 Id.

155 Id.

156 Id. The instrumentalist argument contends that the possibility of an attorney joining in or tolerating the misconduct is more tolerable than forcing clients to not reveal their wrong-doing. Id.
even if the attorney must disclose confidential client information.\textsuperscript{157} This same conflict also is prevalent for business attorneys in a corporate context.

The first issue for a corporate attorney is to clearly identify the client.\textsuperscript{158} Based on the entity theory of representation, ABA Model Rule 1.13 of Professional Conduct states that the client is the corporate entity itself, which is authorized to "[act] through its . . . constituents."\textsuperscript{159} Comment 1 to ABA Model Rule 1.13 defines the organization as a legal entity, which can only act through its constituents, officers, directors, employees, and shareholders.\textsuperscript{160} Generally, a corporate lawyer can look to the senior executive officers to speak for the entity.\textsuperscript{161} A lawyer looking to the corporate executives to speak for the corporate entity usually does not pose a problem until the interests of the officers and the corporation diverge.\textsuperscript{162} An example of where the interests diverge occurs

\textsuperscript{157} \textit{Id.} Often the disclosure rules are enacted to deal with certain specialty predicaments and no serious reevaluation is undertaken to evaluate the effectiveness. \textit{Id.} at 1098. For example, securities field writers encounter a special conflict between preserving confidentiality and an obligation to disclose relevant facts to investors and the SEC. \textit{Id.} at 1099.

\textsuperscript{158} Geoffrey C. Hazard, \textit{Ethical Dilemmas of Corporate Counsel}, 46 \textit{EMORY L.J.} 1011, 1013 (1997); see also John M. Burman, \textit{Representing Organizations Part I}, 25 \textit{WYO. LAW.} 37, 37-41 (2002). There are three critical aspects that a lawyer must consider when representing an organization. \textit{Id.} The lawyer must identify (1) the organization as a client, (2) the persons authorized to speak for the organization, and (3) potential conflicts between individuals representing the company and the company itself. \textit{Id.}

\textsuperscript{159} Kim, \textit{supra} note 141, at 180; see also \textit{MODEL RULES OF PROF'L CONDUCT} R. 1.13 (2003) ("A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.").

\textsuperscript{160} \textit{MODEL RULES OF PROF'L CONDUCT} R. 1.13 cmt. 1 (2003).

[1] An organizational client is a legal entity, but it cannot act except through its officers, directors, employees, shareholders and other constituents. Officers, directors, employees and shareholders are the constituents of the corporate organizational client. The duties defined in this Comment apply equally to unincorporated associations. "Other constituents" as used in this Comment means the positions equivalent to officers, directors, employees and shareholders held by persons acting for organizational clients that are not corporations.

\textit{Id.}

\textsuperscript{161} Kim, \textit{supra} note 141, at 181. For a lawyer to properly fulfill his duties, the lawyer must determine who the client is and who speaks for the client when it is a nonhuman entity, such as a corporation. \textit{Id.} at 180. Supreme Court Justice Potter referred to the issue of dual service as "a vexing problem of professional responsibility." \textit{Id.} at 183.

\textsuperscript{162} \textit{Id.} at 181. See generally John M. Burman, \textit{Representing Organizations Part III}, 25 \textit{WYO. LAW.} 37, 37-41 (2002) (describing the potential conflicts that can arise when interests diverge and the duties a lawyer is obligated to undertake in such a situation). \textit{See also} \textit{MODEL RULES OF PROF'L CONDUCT} R. 1.13 cmt. 2, 3 (2003).
when an executive of a corporation is involved in fraud, which may result in serious financial or property injury to the corporation or its shareholders. At this point the executive can no longer be considered speaking for the entity.

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[2] When one of the constituents of an organizational client communicates with the organization's lawyer in that person's organizational capacity, the communication is protected by Rule 1.6. Thus, by the way of example, if an organizational client requests its lawyer to investigate allegations of wrongdoing, interviews made in the course of that investigation between the lawyer and the client's employees or other constituents are covered by Rule 1.6. This does not mean, however, that constituents of an organizational client are the clients of the lawyer. The lawyer may not disclose to such constituents information relating to the representation except for disclosures explicitly or impliedly authorized by the organizational client in order to carry out the representation or as otherwise permitted by Rule 1.6.

[3] When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful. Decisions concerning policy and operations, including ones entailing serious risk, are not such in the lawyer's province . . . However, that when the lawyer knows that the organization is likely to be substantially injured by the action of an officer or other constituent that violates a legal obligation to the organization or is in violation of law that might be imputed to the organization, the lawyer must proceed as is reasonably necessary in the best interest of the organization. . . . Knowledge can be inferred from circumstances, and a lawyer cannot ignore the obvious.


163 See Hugh P. Gunz & Sally P. Gunz, The Lawyer's Response to Organizational Professional Conflict: An Empirical Study of the Ethical Decision Making of In-House Counsel, 39 AM. BUS. L.J. 241 (2002); see also Kim, supra note 141 (discussing the ethical dilemmas and analysis faced by corporate lawyers).

164 Kim, supra note 141, at 181.

The question every corporate lawyer is taught to ask at the outset of a representation is "Who is my client?" Contrary to popular belief, this is not so they'll know where to send bills. Rather, it is so they'll know whose interests they are sworn to protect. When a corporation hires a lawyer, the lawyer represents the corporation and its shareholders. Being ever mindful of this answer can help protect lawyers from the fate visited upon the accounting profession.

While management has the power to hire or fire lawyers who represent a corporation, lawyers must ask themselves—as well as management—how what they're being asked to do is intended to further the company's and shareholders' interests. Corporate lawyers must be vigilant and protect against conflicts arising between management and shareholders. Most corporate lawyers recognize and fulfill that duty—but the profession, as a whole, must hold this duty paramount.
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In the situation where the lawyer cannot look to the authorized constituents to speak on behalf of the legal entity, the lawyer is given guidance, under ABA Model Rule 1.13, to "proceed as is reasonably necessary in the best interest of the organization."\(^{165}\) Currently, the ABA Model Rules authorize the lawyer to take steps to protect the organizational interests by referring the matter to a higher authority in the organization.\(^{166}\) First, the lawyer must determine if the actions of the constituents will result in substantial injury to the organization and if so, depending on the seriousness of the violation, the lawyer must refer the matter to a higher authority within the organization, including the highest authority determined by law.\(^{167}\) In addition, ABA Model Rule 1.13 makes no distinction in the obligation owed to the corporation by in-house and outside counsel.\(^{168}\) The rule is based on the supposition that the lawyer's duty is to protect the organization and its shareholders rather than the organization's individual officers and employees.\(^{169}\)

SEC Address from Pitt, supra note 7.

166 MODEL RULES OF PROF'L CONDUCT R. 1.13 (2003); see Burman, supra note 162.

It is axiomatic that an attorney must represent every client zealously. Loyalty to the client, therefore, is the touchstone of the attorney-client relationship. That obligation of loyalty is grounded in the law of agency, which applies to every attorney-client relationship since a lawyer is always an agent for each of the lawyer's clients. Agents, of course, owe their principals an unwavering duty of loyalty, including fiduciary and confidentiality obligations. . . . Anything which threatens an attorney's loyalty or a client's confidentiality is, therefore, a conflict of interest, or at least a potential one. To avoid a grievance, a malpractice suit, and/or being disqualified from further representation, a lawyer has three, inter-related duties regarding conflicts of interest. The lawyer must: (1) detect any actual or potential conflict of interest; (2) properly evaluate such conflicts; and (3) react accordingly.

Burman, supra note 162, at 37.

167 Kim, supra note 141, at 181-82; see also Dietrich, supra note 128, at 937-39 (describing the role of attorneys involved with Enron and the concealment of fraud within the organization at all levels).
168 Kim, supra note 141, at 190. In-house lawyers are considered actively involved in establishing the tone of the corporate environment and serve as legal counsel on transactions that may have legal ramifications for the corporation. Id. at 201-04. Additionally, the in-house counsel is conferred with prior to the transaction taking place and not just after the fact. Id. See generally Gunz & Gunz, supra note 163 (discussing the studies conducted on organization-professional conflict in in-house counsel between the requirements of their employer and the ethical requirements of the legal profession).
The SEC reporting rule has prompted a lot of criticism because of the conflicts in standards with current ABA Model Rules and state promulgated and enforced ethics rules.\(^{170}\) All practicing lawyers are subject to the ethics rules promulgated and enforced by their respective state bar, which are most often modeled after the Model Rules adopted by the American Bar Association.\(^{171}\) On July 16, 2002, the ABA released its preliminary report on corporate responsibility ("Preliminary ABA Task Force Report") prior to the passage of the SOA.\(^{172}\) A focus of the Preliminary ABA Task Force Report was the existing tone of Rule 1.13.\(^{173}\) The taskforce found that the current rule discourages action by the lawyer to rectify corporate misconduct by requiring that the lawyer's actions be "designed to minimize" any possible disruption to the organization or disclosure of information regarding the representation to persons outside the organization.\(^{174}\) The Preliminary Report found that the focus was on avoidance of disruption to the organization and not on the minimization of harm resulting from the misconduct.\(^{175}\) The taskforce released its most recent endorsements and adoptions, which included the revised Rule 1.13, which direct a lawyer, who reasonably believes that the officer or employee is acting fraudulently, illegally, or in breach of a duty to the corporation, to take action.\(^{176}\) The most recent revisions to ABA Rule 1.13 finds that a lawyer has the duty to report

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\(^{170}\) Mike France, The SEC's Plan Shouldn't Make Lawyers Squak, Bus Wk., Jan. 24, 2003, at 44; see infra notes 178-84 and accompanying text.

\(^{171}\) See supra notes 158-69 and accompanying text.

\(^{172}\) Preliminary ABA Task Force Report, supra note 169.

\(^{173}\) Id. at 27.

\(^{174}\) Id. at 28.

\(^{175}\) Id.

\(^{176}\) ABA Task Force Endorsements, supra note 169. The taskforce emphasizes that the lawyers play a key role in organizational compliance and that to do so, such issues must be brought to the attention of the appropriate authorities within the organization. Id. To further this role, the taskforce encourages corporations to adopt procedures that would allow needed and critical information to reach the proper organizational authorities. Id.
when a lawyer knows of a violation and her related actions should be prompt and in the interest of protecting the corporation.\footnote{177}{ABA Task Force Report Adopting Rule 1.13 (Aug. 11-12, 2003) [hereinafter ABA Taskforce Report Adopting Rule 1.13], \url{http://www.abanet.org/buslaw/corporateresponsibility/home.html}. "[T]he starting point of the recommended rule is subjective: the obligation to take action would arise only on the basis of facts known to the lawyer." \textit{Id.} The trigger would then be looked at under the objective test, "whether a reasonable lawyer who knows such facts would, in similar circumstances, conclude that the conduct . . . is likely to result in substantial injury to the organization." \textit{Id.}}

In contrast, the adopted up-the-ladder reporting provision of the SEC requires that the attorney, upon becoming "aware" of any evidence of a "material violation" to report the violations in a certain pecking order.\footnote{178}{See SEC Proposed Up-the-Ladder Rule, \textit{supra} note 102; see also Sen. Edwards Miffed by SEC Accounting Ruling, GREENSBORO NEWS & REC., Jan. 26, 2003, at B3; Michael Schroeder, SEC Modifies New Attorney Rules, WALL ST. J., Jan. 24, 2003, at C11.} The SEC justifies the scope of the up-the-ladder reporting rule as one that seeks to deter instances of attorney and issuer misconduct by requiring internal reporting within the corporation.\footnote{179}{See SEC Proposed Up-the-Ladder Rule, \textit{supra} note 102. The SEC also states that the rule is not intended to "impair zealous advocacy" or "discourage issuers from seeking and obtaining effective and creative legal advice." \textit{Id.}} Additionally, in instances where misconduct has occurred, the SEC seeks to minimize damage upon its issuers and shareholders.\footnote{180}{See letter from Alfred P. Carlton, Jr. President, ABA, to Jonathan G. Katz, Secretary, SEC (Apr. 2, 2003), available at \url{http://www.sec.gov/rules/proposed/S74502/aba040203.htm}.} However, in order for the SEC to meet these goals, a lawyer must know that she is subject to the up-the-ladder reporting.\footnote{181}{See letter from Alfred P. Carlton, Jr. President, ABA, to Jonathan G. Katz, Secretary, SEC (Apr. 2, 2003), available at \url{http://www.sec.gov/rules/proposed/S74502/aba040203.htm}.} Normally within an organization, there is one group of attorneys involved in the preparation and submission of documents that are required under the federal securities compliance laws.\footnote{182}{See SEC Proposed Up-the-Ladder Rule, \textit{supra} note 102.} Additionally, there is another group of attorneys that is consulted by an organization regulated by federal securities laws in traditionally non-securities compliance matters.\footnote{183}{See letter from Alfred P. Carlton, Jr. President, ABA, to Jonathan G. Katz, Secretary, SEC (Apr. 2, 2003), available at \url{http://www.sec.gov/rules/proposed/S74502/aba040203.htm}.} An expansive view of attorneys, under the SEC rule, creates uncertainty for all lawyers involved in the corporate arena as to the jurisdiction of the SEC up-the-ladder reporting rule.\footnote{184}{\textit{Id.; Jenny B. Davis, Sorting Out Sarbanes-Oxley, A.B.A. J., Feb. 2003, at 44.}}
a. To Whom Does the Duty Apply?

In addition to the state promulgated ethics rule, the SEC rule triggers an additional affirmative duty to report upon discovering fraud or misconduct for which an attorney may face SEC disciplinary proceedings if in violation. However, lawyers will not be in a position to comply without clearer guidance as to who is subject to this duty. The SEC attempted to narrow and better define the scope of attorneys and to whom the duty would apply in the adopted version of the reporting rule. The adopted rule still retains an expansive view of

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185 See letter from Alfred P. Carlton to Jonathan G. Katz, supra note 181. The ABA takes a position that generally an expansive scope may be acceptable when determining whose conduct may be sanctionable; however, when requiring an SEC mandated affirmative action, it is inappropriate. Id.; see also Mary Jo White, Bruce E. Yannett, & Jonathon R. Tuttle, Lawyers' Roles After Enron and Sarbanes-Oxley: Advocate, Counselors and ... Gatekeepers Too?, in CORP. LAW 2002, at 1295, 1308-10 (PLI Corp. Law and Practice Course Handbook Series No. 1343, 2002). Congress did not specifically address what a lawyer must do if there is no response within a corporation. Id. The SEC has a varied history in bringing enforcement proceeding against attorneys. Id. at 1308-10, 1314. In the past, the SEC has been limited to enforcement actions that involve securities law violations and not that of professional standards. Id.

186 See generally letter from Alfred P. Carlton to Jonathan G. Katz, supra note 181.; letter from Charles E.H. Luedde, Former SEC Chairman, to Jonathan G. Katz, Secretary, SEC (Dec. 2, 2002), available at http://www.sec.gov/rules/proposed/S74502/cehluedde1.htm. [A]s a matter of practicality, I question whether the Commission's attempt to utilize a broad definition—and thereby at least potentially have the capacity to bar a larger portion of the practicing bar from "practice before the Commission"—is reasonably suited to the disciplinary power sought. Given the relative anonymity (vis a vis the Commission) of many attorneys who participate in the disclosure process—and given the fact that much of that role can in fact be performed without status as an attorney—unless there is active corresponding discipline from state bar organizations, Commission sanctions may be illusory.


187 Compare SEC Proposed Up-the-Ladder Rule, supra note 102, § 205.2(a), with Implementation of Standards of Professional Conduct for Attorneys, 17 C.F.R. § 205.2(a) (2003). The proposed rule provided:

(a) Appearing and practicing before the Commission includes, but is not limited to, an attorney's:
(1) Transacting any business with the Commission, including communication with Commissioners, the Commission, or its staff;
(2) Representing any party to, or the subject of, or a witness in a Commission administrative proceeding;
(3) Representing any person in connection with any Commission investigation, inquiry, information request, or subpoena;
(4) Preparing, or participating in the process of preparing, any statement, opinion, or other writing which the attorney has reason to
attorneys and could potentially include those attorneys that prepare and review documents in the ordinary course of business, which are unrelated to the securities filings or practice, but ultimately are used for some related purpose regarding compliance with the SEC. ¹⁸⁸

believe will be filed with or incorporated into any registration statement, notification, application, report, communication or other document filed with or submitted to the Commissioners, the Commission, or its staff; or

(5) Advising any party that:

(i) A statement, opinion, or other writing need not or should not be filed with or incorporated into any registration statement, notification, application, report, communication or other document filed with or submitted to the Commissioners, the Commission, or its staff; or

(ii) The party is not obligated to submit or file a registration statement, notification, application, report, communication or other document with the Commission or its staff.

SEC Proposed Up-the-Ladder Rule, supra note 102, § 205.2(a). The adopted rule provides:

(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.


¹⁸⁸ See letter from Alfred P. Carlton to Jonathan G. Katz, supra note 181.

The following are examples of areas of potential uncertainty:

Lawyer A, who has a limited non-securities specialty, prepares a draft of a section for inclusion in a prospectus (e.g., description of a patent, regulatory requirements or litigation).

https://scholar.valpo.edu/vulr/vol38/iss4/3
Additionally, this rule may also include those attorneys that simply advise that the corporation does not have to file a specific report based on an available exemption under the existing securities laws.\textsuperscript{189}

One consequence of an expansive definition of to be "appearing and practicing before the Commission" is that attorneys will hesitate or will be deterred from reviewing documents or filings for fear of being subject to the rule's disciplinary proceedings.\textsuperscript{190} The scope of the proposed rule encompassed an attorney who was not regularly in the business of securities compliance, for example, a patent attorney, solely because of the manner in which her documents are used. This patent attorney would fall within the broad scope of the rule even if the documents were not originally intended for securities compliance.\textsuperscript{191} This patent attorney is in a better position to serve the public interest by being cognizant of her duty throughout the entire engagement. The duty should be determined on the primary purpose and specialty of her work product rather than a possible use.\textsuperscript{192} An attorney conscious of which entity determines her duty, the SEC or the state bar, is able to appropriately report fraud to the client and in so abiding is able to avoid disciplinary proceedings by either entity.\textsuperscript{193}

In its commentary to the adopted rule, the SEC stated that the proposed rule's scope was narrowed by adding that an attorney must have "notice" from the corporation that the document will be used in

Lawyer A instead reviews a draft of the section prepared by a securities lawyer.
Lawyer B, a litigator, prepares a summary of pending litigation for general use, knowing it may be used as a diligence checklist for future securities offerings.
Lawyer B responds to a routine auditor's request for information on pending litigation in connection with the auditor giving its consent for a registration statement.
Lawyer C, a real estate specialist, drafts a complex lease that will be filed as an exhibit to the company's Form 10-K.

\textit{Id.}

\textsuperscript{189} \textit{Id.} The commentary from the adopted rule provides that "[a]ttorneys who advise that, under the federal securities laws, a particular document need not be incorporated into a filing, registration statement or other submission to the Commission will be covered by the revised definition." Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6298 (Feb. 6, 2003).

\textsuperscript{190} See SEC Comment Letters, supra note 148 (letter from seventy-seven law firms).

\textsuperscript{191} See letter from Alfred P. Carlton to Jonathan G. Katz, supra note 181.

\textsuperscript{192} See id.

\textsuperscript{193} See id.
compliance matters. However, it appears the “notice” requirement does not narrow the scope but instead provides loopholes in enforcement. First, a non-securities attorney must rely on the corporation for “notice” because the documents being prepared may normally be used for daily business purposes and may be used secondarily in compliance matters. Second, the “notice” requirement can serve as an out for an attorney that claims she did not receive proper or timely notice because the rule’s commentary does not make clear when and how “notice” is to be given. Additionally, the adopted rule still retains the proposed rule’s scope problem because the lawyer’s duty can be different based on the use of the document.

For example, a patent attorney can prepare Document A for an organization where she was put on “notice” that it will be used in a compliance matter and then the next day, the same attorney can prepare Document B for an organization that will not be used in a compliance manner. In this situation, the use of the document rather than the primary purpose of her work is still determining the lawyer’s duty.

It appears that the duty of the lawyer can vary based on the use of the document by the client. SEC enforcement of this rule will prove to be

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(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, . . . the Commission, including the provision of such advice in the context of preparing, or participating in the preparation of, any such document.

196 Id.

[A]n attorney must have notice that a document he or she is preparing or assisting in preparing will be submitted to the Commission to be deemed to be “appearing and practicing” under the revised definition. The definition in the final rule thereby also clarifies that an attorney’s preparation of a document . . . which he or she never intended or had notice would be submitted to the Commission, or incorporated into a document submitted to the Commission, but which subsequently is submitted to the Commission as an exhibit to or in connection with a filing, does not constitute “appearing and practicing” before the Commission.

197 See supra text accompanying notes 190-93.

198 See supra text accompanying notes 190-93.
a problem if a lawyer is not held to a single standard at all times. Further, because of the ambiguity in the rule, the SEC would have to show that the corporation gave proper notice to the attorney and that it was timely enough to have put the lawyer in a position to have detected and reported the fraud.

Therefore, the investing public would be better served by imposing the affirmative duty on those attorneys substantially involved in compliance matters and/or practicing securities attorneys. Further, a securities lawyer must be free to give advice to the client without fear of legal liability. However, a securities lawyer must draw a line between advising clients in difficult business judgements and in actions involving fraud. This line may be a difficult one for the SEC and the lawyer to judge, but the public would be better served with an attorney assisting and counseling the client towards compliance instead of immediately engaging in up-the-ladder reporting solely to relieve her liability.

An attorney who falls outside the jurisdiction of the SEC rule, in a narrow interpretation, would be subject to the current ABA Model Rule 1.13 to "proceed as reasonably necessary" to protect her client. An


200 In re Carter & Johnson, supra note 53, at 320.

Significant public benefits flow from effective performance of the securities lawyer's role. The exercise of independent, careful and informed legal judgement on difficult issues is critical to the flow of material information to the securities markets. Moreover, we are aware of the difficulties and limitations attendant upon that role. In the course of rendering securities law advice, the lawyer is called upon to make difficult judgements, often under great pressure and in areas where the legal signposts are far apart and only faintly discernible.

If a securities lawyer is to bring his best independent judgement to bear on a disclosure problem, he must have the freedom to make innocent—or even, in certain cases, careless—mistakes without fear of legal liability or loss of the ability to practice before the Commission. Concern about his own liability may alter the balance of his judgement in one direction as surely as an unseemly obeisance to the wishes of his client can do so in the other. While one imbalance results in disclosure rather than concealment, neither is, in the end, truly in the public interest. Lawyers who are seen by their clients as being motivated by fears for their personal liability will not be consulted on difficult issues.

Id.

201 Id.

202 See generally In re Carter & Johnson, supra note 53.

203 MODEL RULES OF PROF'L CONDUCT R. 1.13 (2003); see supra notes 141-44 and accompanying text.
attorney, subject to ABA Rule 1.13, is also required to consider reporting up-the-ladder internally in order to best serve the interests of the organization.204 The ABA Taskforce Report Adopting Rule 1.13, emphasizes that the ABA Model Rule should actively encourage attorneys to take action rather than discourage reporting to higher authorities within an organization.205 Therefore, with a narrow SEC interpretation, each attorney involved in the corporate arena would be aware of her duty and able to comply to best serve the needs of the investing public while avoiding personal disciplinary proceedings.

b. Ambiguity in Triggering Standard

A second possible consequence of an expansive scope is that an objective standard would hold a non-securities lawyer to the level of a securities lawyer in determining what would constitute the triggering of an up-the-ladder report.206 In its commentary, the SEC interprets that the attorney’s reporting obligation is triggered when (1) an attorney has credible evidence of a material violation, (2) where it would be unreasonable, under the circumstances for a prudent competent attorney not to conclude, (3) that a material violation has occurred, is occurring, or is about to occur.207 The obligation to report would be triggered by any

204 See supra notes 165-69 and accompanying text.
205 ABA Taskforce Report Adopting Rule 1.13, supra note 177. The committee emphasizes in their report that this rule provides guidance “in the extraordinary circumstance of a significant failure of governance that puts or threatens to cause substantial injury.” Id.
206 See supra notes 141-46 and accompanying text.
207 Implementation of Standards of Professional Conduct for Attorneys, 17 C.F.R. § 205.2 (e), (i), (f)-(m) (2003).

(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.

(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.

(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.
attorney considered to be "appearing and practicing before the commission." In drafting this rule, the SEC commented that the reporting rule covers all written and oral communication with the SEC and related filings. The proposed SEC rule required reporting when there was "evidence of a material violation." The triggering standard was narrowed in the adopted version but it is still problematic because the rule requires the lawyer to take action when "it would be unreasonable, for a prudent and competent lawyer not to conclude that it is reasonably likely" that a fraud may be taking place.

An attorney would then be in a position to not only second-guess whether the rule would apply to her but also what is considered not to be acting reasonably. The SEC commentary in the adopted rule precludes the beliefs of the lawyer and instead focuses on what information would be considered unreasonable not to report. With this standard, an

Id. The commentary found in the adopted rule provides:

[The] revised definition of "evidence of a material violation" clarifies aspects of the objective standard that the Commission sought to achieve in the definition originally proposed . . . . Some commentors, including some practicing attorneys, found the proposed reporting triggers too high. Many legal scholars endorsed the framework of increasingly higher triggers for reporting proposed by the Commission at successive stages in the reporting process but considered the Commission's attempt at articulating an objective standard unworkable and suggested changes to the language in the proposed rule. Nearly all practicing lawyers who commented found the reporting trigger in the rule too low and called instead for a subjective standard, requiring "actual belief" that a material violation has occurred, is ongoing, or is about to occur before the attorney would be obligated to make an initial report within the client issuer. The revised definition incorporates suggested changes into an objective standard that is designed to facilitate the effective operation of the rule and to encourage the reporting of evidence of material violations.


211 Id.

212 Compare Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6302 (Feb. 6, 2003), with SEC Proposed Up-the-Ladder Rule, supra note 148. The comments to the adopted rule provide:
attorney would have to report any information that may be a material violation so as to avoid liability because of the possibility of a broad interpretation of "unreasonable." The adopted rule's commentary recognizes that there is an acceptable range of conduct that would be unreasonable by considering the circumstances of the lawyer.

Under the Commission's rule, evidence of a material violation must be reported in all circumstances in which it would be unreasonable 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. To be "reasonably likely" a material violation must be more than a mere possibility, but it need not be "more likely than not." If a material violation is reasonably likely, attorney must report evidence of this violation. The term "reasonably likely" qualifies each of the three instances when a report must be made. Thus, a report is required when it is reasonably likely a violation has occurred, when it is reasonably likely a violation is ongoing or when reasonably likely a violation is about to occur.

Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6302 (Feb. 6, 2003). The proposed rules provided:

The objective standard is intended to preclude reports based on mere suspicion of a material violation while providing reasonable flexibility to attorneys when evaluating their reporting obligations under the proposed rule. An individual attorney is not excused from reporting evidence of a material violation on the grounds that he or she does not personally believe that a material violation has occurred, is occurring, or is about to occur. Under the definition of "reasonably believes"... any information that would lead an attorney, acting reasonably, to believe that a material violation has occurred, is occurring, or is about to occur must be reported—whether or not the reporting attorney subjectively believes it. An individual attorney is not, however, required to report within the issuer evidence of a material violation that the attorney thinks is insufficient to lead an attorney, acting reasonably, to believe that a material violation has occurred, is occurring, or is about to occur. The definition does not prescribe a process by which an attorney must evaluate evidence he or she learns about.


We believe the Commission's attempt to create an objective standard is flawed in several respects... Assuming that the lawyer is, in fact, aware of evidence of a possible violation and is not obligated to investigate, the issue then becomes the nature of the required assessment of the information that the lawyer has actually acquired. That assessment should be evaluated in the context of what the lawyer has actually come to know and believes, not what some hypothetical objectively reasonable lawyer might conclude.

Letter from seventy-seven law firms to Jonathan G. Katz, supra note 199.

However, as in the proposed rule, a non-securities lawyer would not be in a position necessarily to be aware of any fraud, and therefore, it would difficult for the attorney to act in compliance with the adopted rule.  

The "circumstances" that would be considered would leave a great amount of wiggle room for when an attorney has to engage in up-the-ladder reporting. A securities compliance attorney could argue that in light of the surrounding circumstances, a reasonable attorney would have either not detected the fraud or, if so, thought it best not to engage in up-the-ladder reporting. Additionally, a patent lawyer could argue that a prudent patent lawyer would not have detected the securities violation. However, if the rule was narrowed further to apply to securities compliance attorneys only, then a single reasonableness standard could be used by an attorney and the SEC. The interest of the investing public is best served when all attorneys are subject to rules that are clearly defined. Clearly defined rules will allow an attorney to promote legal compliance within an organization and fulfil her duties as promulgated by both the SEC and the state bar.

2. SEC’s Broad Scope Is Outside of Legislative Intent

In adopting an expansive view of required disclosure, the SEC reporting rule falls beyond the scope of the legislative intent of the SOA’s

[The Rule’s] formulation, while intended to adopt an objective standard, also recognizes that there is a range of conduct in which an attorney may engage without being unreasonable. The "circumstances" are the circumstances at the time the attorney decides whether he or she is obligated to report the information. These circumstances may include, among others, the attorney’s professional skills, background and experience, the time constraints under which the attorney is acting, the attorney’s previous experience and familiarity with the client, and the availability of other lawyers with whom the lawyer may consult. Under the revised definition, an attorney is not required (or expected) to report "gossip, hearsay, or innuendo." Nor is the rule’s reporting obligation triggered by "a combination of circumstances from which the attorney, in retrospect, should have drawn an inference," as one commentator feared.

215 See letter from Alfred P. Carlton to Jonathan G. Katz, supra note 181.
217 Id.
218 Id.
section 307, which mandates the promulgation of up-the-ladder reporting. The overarching legislative intent of the SOA was to increase corporate responsibility, transparency and disclosure of reporting statements, as well as to increase resources and oversight for the SEC. Section 307 of the SOA furthered the overall goal of corporate accountability by emphasizing that a lawyer owed her duty to the organization and the shareholders as the clients, and not the officers and directors of the organization. Additionally, section 307 was enacted to ensure that when a lawyer sees that an illegal or fraudulent act is about to occur or is occurring, the lawyer will act in the interest of the shareholders.


220 148 CONG. REC. S6524 (daily ed. July 10, 2002) (statement read by legislative clerk). "[This is] a bill to improve quality and transparency in financial reporting and independent audits and accounting services for public companies . . . to increase corporate responsibility and the usefulness of corporate financial disclosure . . . to improve Securities and Exchange Commission resources and oversight . . . ." Id. The Senate wanted to help frustrated investors:

As we have seen over the past few months, the continued lapses of our corporate leaders, whether they are ethical, criminal or just plain ignorant, have a significant, sometimes crippling, effect on the welfare of our nation. We must make some fundamental changes in the current system of corporate oversight to protect Americans from avarice, greed, ignorance and criminal behavior. Now is the time for Congress to restore investor confidence and take the necessary action to protect the interests of the public shareholders and place those interests above the personal interests of those entrusted with managing and advising those companies. The deterioration of the checks and balances that safeguard the public against corporate abuses must be reversed.

Id. at S6528 (statement of Sen. McCain).

221 Id. at S6551 (statement of Sen. Edwards).

One of the problems we have seen occurring with this sort of crisis in corporate misconduct is that some lawyers have forgotten their responsibility . . . . If you are a lawyer for a corporation, your client is the corporation and you work for the corporation and you work for the shareholders, the investors in that corporation; that is to whom you owe your responsibility and loyalty. And you have a responsibility to zealously advocate for the shareholders and investors in that corporation.

Id.

222 Id. at S6552 (statement of Sen. Edwards).

One of the most critical responsibilities that those lawyers have is, when they see something occurring or about to occur that violates that law, breaks the law, they must act as an advocate for the shareholders, for the company itself, for the investors. They are there and they can

https://scholar.valpo.edu/vulr/vol38/iss4/3
The debate on the Senate floor focused on the responsibility of lawyers to assist management of corporations in complying with securities laws to better protect the investing public.\textsuperscript{223} Congress, in focusing its debate on securities compliance, limited the authority of the agency to promulgate a rule with jurisdiction confined to the furtherance of securities compliance as required by the Securities Acts.\textsuperscript{224} The SEC, in adopting such an expansive view, exceeded this express limited authority granted by Congress. In addition, the overall purpose of the SEC is to provide full and fair disclosure to investors,\textsuperscript{225} and any rulemaking must be limited to furthering the agency's goals.\textsuperscript{226} In adopting expansive jurisdiction, the SEC rule seeks to regulate all corporate lawyers involved in a public organization, and not solely the ones that further its interest of compliance with federal securities laws,

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see what is happening. They know the law and their responsibility is to do something about it if they see the law being broken or about to be broken.

This amendment is about making sure that those lawyers, in addition to the accountants and executives in the company, don't violate the law and, in fact, more importantly, ensure that the law is being followed.

\textit{Id. at S6554-55} (statement of Sen. Enzi).

\textit{Id.}\textsuperscript{223} It has become clear that the role of attorneys who counseled these corporations and their accountants must be scrutinized as well. Just like accountants, these lawyers are expected to represent the corporation in the best interests of the shareholders. In doing so, these attorneys are hired to aid the corporation and its accountants in adhering to Federal securities law.

When their counsel and advice is sought, attorneys should have an explicit, not just an implied, duty to advise the primary officer and then, if necessary, the auditing committee or the board of directors of any serious legal violation of the law by a corporate agent. Currently, there is no explicit mandate requiring this standard of conduct. It is clearly in the best interest of their client to disclose this kind of information to the board, rather than just upper management \ldots. This amendment is simple. It requires the attorney to contact specific persons who are part of the management hierarchy and explain the problem. If that fails to correct the problem, the attorney must contact the audit committee or the board of directors.

\textit{Id. at S6554-55} (statement of Sen. Enzi).

\textit{Id.}\textsuperscript{224} See Karmel, supra note 119, at 3; Strauss, supra note 88, at 5.

\textit{Id.}\textsuperscript{225} See supra text accompanying notes 34-54 (discussing the intent of Congress in enacting federal securities laws).

\textit{Id.}\textsuperscript{226} See supra notes 51-63 and accompanying text (discussing the authority granted to the SEC in the securities laws).

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thereby exceeding its jurisdiction and infringing on the state bar’s jurisdiction.227

Currently, ABA Model Rule 1.13 allows attorneys more discretion in balancing their obligation to engage in “friendly disclosures” based on the seriousness of the violation, whereas the SEC rule mandates affirmative up-the-ladder reporting without attorney discretion.228 Therefore, the required affirmative reporting duty and the resulting overbreadth of attorneys subject to enforcement proceedings by the SEC will defeat the purpose of effectuating the up-the-ladder reporting requirement that was intended to serve the public interest of preventing fraud.229 In addition, the legislative history shows the intent was to encourage those who counsel in SEC compliance matters to comply with full and fair disclosure.230 However, by adopting a broad view of attorneys that fall within the requirement of the SEC rule, public interest will not be served when lawyers who are non-securities specialists are subject to SEC enforcement.231 By limiting the scope of attorneys subject

227 See supra notes 186-202 and accompanying text.
228 See Karmel, supra note 119, at 3; Strauss, supra note 88, at 5. The recent revision of Model Code Rule 1.13 still allows the attorney to determine the likeliness of the substantial injury that may result from the constituent’s actions before reporting to a higher authority. MODEL RULES OF PROF’L CONDUCT R. 1.13 (2003).
229 Arthur D. Burger, How Increased SEC Oversight of the Bar Could Change the Client Relationship, LEGAL TIMES, Aug. 12, 2002, at 1. The increased obligations under the Act are likely to create a “worry factor” that will lead to attorneys to err on the side of over reporting. Id.; see letter from Alfred P. Carlton to Jonathan G. Katz, supra note 181.
230 See letter from Alfred P. Carlton to Jonathan G. Katz, supra note 181. “The breadth of coverage of the proposals will have a counterproductive impact of discouraging broad participation in assuring quality disclosure and providing expert transactional planning.” Id.
231 Id.

Notwithstanding the proposed rule’s elaborate “up-the-line” procedures, I believe that it does little to address the core issue of whether there has been adequate disclosure of all material facts required to be disclosed or necessary to make the disclosures made not misleading. By focusing on a remote and improbable scenario it constructs an [sic] hypothetical straw man. By ignoring the real world the proposed rule risks becoming just so much window dressing without any real benefit to existing or prospective investors or to the restoration of confidence in the marketplace. This does not mean that the proposed rule is toothless and therein lies its danger. The zealous and overreaching nature of certain portions of the proposed rule results in the inclusion of provisions which threaten—by tacitly placing attorneys in the unwarranted role of expertizing the entire content of clients disclosure documents—to make attorneys guarantors of those disclosures.
to up-the-ladder reporting to those whose overall responsibilities are to advise on SEC and registration compliance, the affirmative duty is limited to those who are in the best position to know the rules and comply with them.\textsuperscript{232} In addition, public interest will still be served by limiting the scope of the SEC rule because all other non-securities attorneys would fall under the ABA Model Rule 1.13 requirement and similar state ethics rules.\textsuperscript{233}

B. Withdraw and Snitch to the SEC – The "Noisy Withdrawal" Proposal

The SEC is taking a statutory assignment that requires a scalpel and going after it with a meat cleaver.\textsuperscript{234}

"Noisy withdrawal," as proposed by the SEC, does not protect the public from corporate fraud but instead alters the attorney-client relationship and may lead to less candid communications between the attorney and the client.\textsuperscript{235} The proposed SEC rule, which mandates withdrawal and notice to the SEC, is problematic because it alters the confidence that corporations place in their corporate counsel.\textsuperscript{236} With increased market demands, the role of the corporate counsel has expanded from just incident-related activities to more of an influence over the shape of major corporate transactions while identifying and


\textsuperscript{232} Letter from Alfred P. Carlton to Jonathan G. Katz, supra note 181. Additionally, the ABA recommends that SEC enforcement of this reporting requirement be limited to U.S. law. Id. The ABA also discusses how a broad view of attorneys that are considered to be practicing before the Commission could lead to confusion as to what triggers the "reasonably know or should know" obligation. Id. If the rule is limited to the conduct of those attorneys that have significant responsibility in securities compliance within an organization then an objective standard would be easier to apply. Id. However, with a broad view, non-security lawyers could not be held to the standard of securities lawyers and the objective standard would be much more difficult to apply. Id.

\textsuperscript{233} Id.; see supra text accompanying notes 141-43 (discussing ABA Model Rule 1.13).

\textsuperscript{234} Tamara Loomis, 75 Law Firms Weigh in with Letter to SEC on Disclosures, 228 N.Y. L.J. 1 (Dec. 18, 2002) (quoting Edward Fleischman, former SEC Chairman); see also letter from Edward Fleischman to Jonathan G. Katz, supra note 210.

\textsuperscript{235} See infra text accompanying notes 248-66. In 1978, the SEC argued that the attorney had a duty to "blow the whistle." SEC v. Nat'l Student Mktg. Corp., 457 F. Supp. 682, 701 (D.C. Cir. 1978). The court found that the attorneys should have disclosed the information and should have not "lent the appearance of legitimacy" of the transaction. Id. at 713. However the court did not find that the attorney had a duty to tell third parties of the fraud, but they did have a duty to take steps within the corporation to try and rectify the fraud. Id.

\textsuperscript{236} See letter from Alfred P. Carlton to Jonathan G. Katz, supra note 181.
reducing key legal liabilities of on-going corporate activities. Additionally, corporate counsel is expected to be proficient in recommending different organizational management techniques to help minimize legal liabilities. Corporate counsel is also often consulted by corporate managers for advice on ways to implement processes that will minimize risks of fraud, illegal conduct, and corporate liability. The opportunity for fraud and illegal conduct is minimized by encouraging internal corporate compliance, addressing problems as they are detected or reported, and considering new approaches to different business decisions as societal and economic demands change.

Lawyers possess special skills and qualifications, including their inquisitive and probative nature. In retaining diverse job responsibilities within an organization, they are able to compile many aspects of the corporate decision-making process and to incorporate and encourage legal compliance. Shareholders must rely on the


The practice of law is not limited to the conduct of cases in court. It embraces the preparation of pleadings and other papers incident to actions and special proceedings and the management of such actions and proceedings on behalf of clients before judges and courts, and in addition conveyancing, the preparation of legal instruments of all kinds, and in general all advice to clients and all action taken for them in matters connected with the law.

Id. (quoting Cuyahoga Abstract Title & Trust Co. v. Dworken, 129 Ohio St. 23 (1934)); see also WILLIAM J. CARNEY, THE CHANGING ROLE OF THE CORPORATE ATTORNEY 34-46 (1982) (discussing the fluctuation in attorneys employed by corporations to help protect against legal liabilities); Richard S. Gruner, The Role of the General Counsel: Perspective: General Counsel in an Era of Compliance Programs, 46 EMORY L.J. 1113 (1997) (discussing how attorneys play key roles in various types of organizations).

238 Gruner, supra note 237, at 1114. The increased functions of corporate counsel, as a result of the growing risks at stake, include helping to shape corporate compliance systems.

Id.

239 Id. at 1152. Corporate compliance includes internal procedures to test operational procedures, compilation and analysis of collected data to improve internal systems, and incentives or disincentives for employees to encourage lawful corporate activities. Id. at 1153-63. Additionally, corporations are encouraged to maintain some form of whistleblower reporting system and protection that encourages self-reporting at the earliest possible moment. Id. at 1160.

240 See infra text accompanying notes 241-45; see also Joseph E. Murphy, Can the Scandals Teach Us Anything?, 12 BUS. L. TODAY 11 (2003) (discussing the surge in recent corporate self-governance in the past decade due to the enactment of Organizational Sentencing Guidelines).

241 CARNEY, supra note 237, at 3; see Gruner, supra note 237, at 1141-64.

242 Kim, supra note 141, at 202-03. With this unique role, comes the possibility for conflicts of interests. Id. at 204-18. For example, when a lawyer serves as a legal advisor to the Board and is also a director of the same corporation, the director, in making business
information provided to them from the corporation. Corporate counsel’s duty is to ensure that management is being provided with accurate assessments of legal liabilities and requirements. Corporate counsel can only properly fulfill this duty if actively involved in the strategic business planning, daily management activities, and other daily and long-term corporate decision-making processes.

Further, corporate counsel is not considered to be independent from the client, but instead owes a duty and obligation to zealously advocate for the client. When corporate counsel is required to provide notice to the SEC of violations, the corporation’s constituents may consider the possibility of consulting counsel on difficult or close issues too large of a risk. If the lawyer had an opportunity to spend time and consult with management instead of immediately reporting the possible violation, then the corporation would less likely become involved in costly decisions, is relying on the very same advice that the director as a lawyer has given. Id. at 183-84. This conflict is not in violation of current ethics rules. Id.; see also CHARLES R. HANN, HOW CORPORATIONS AND THEIR LEGAL DEPARTMENTS FUNCTION (1992) (listing and describing the various areas lawyers play a role within organizations and their respective responsibilities); Ronald C. Minkoff, A Leak in the Dike: Expanding the Doctrine of Waiver of the Attorney-Client Privilege, in N.Y. LAW 2002, at 195 (PLI N.Y. Law Practice Course, Handbook Series No. 126, 2002) (discussing the roles that lawyers play in encouraging legal compliance through interaction with many departments within a corporation); John H. McGuckin, Vice Chairman of American Corporate Counsel Association, Written Testimony at the ABA Taskforce on Corporate Responsibility (Nov. 11, 2002), at http://www.abanet.org/buslaw/corporateresponsibility/home.html (testifying to the importance of lawyers within a corporation; over 55% executives that were surveyed by the Association found that the legal department was in the top five most critical departments of their corporation).

243 Gruner, supra note 237, at 1120.
244 CARNEY, supra note 237, at 37-41; Gruner, supra note 237, at 1145. With the growing securities regulations and required public disclosures, lawyers need to be able to access information from various areas within a corporation. CARNEY, supra note 237, at 39.
245 Kim, supra note 141, at 202.
247 See letter from Alfred P. Carlton to Jonathan G. Katz, supra note 181; Subin, supra note 153, at 1096-97. The lawyer’s duty is to the client and the client can best be served if the lawyer is able to protect confidences when guiding individuals, clients through the legal maze. Subin, supra note 153, at 1096-97. In situations where the attorney is an intricate part of the fraud, ethics rules will do little to guide him or her, however, in situations where the lawyer learns of fraud in which he or she plays no part, the lawyers guidance can be key to protecting the shareholders’ interests. Id. at 1112.
investigatory proceedings before the SEC, which may ultimately damage the shareholder.

Corporate counsel must have access to the facts from the client/organization in order to protect the investing public by encouraging legal compliance and disclosure by the corporation. If a client fears public disclosure of facts and subsequent prosecution because of consulting or disclosing information to the attorney, then the client may be dissuaded from coming forth to either prevent or rectify a harmful situation for the shareholders. The lack of candor from the client or its constituents could ultimately harm the public instead of protecting it. A consequence of the required disclosure mandate will lead to corporations not consulting attorneys when considering issues that may require management to make close business judgements and thereby reduce the information that an attorney has access to.

A second prevailing consequence of the "noisy withdrawal" rule is that the communications between the corporate counsel and client are fundamentally changed because a lawyer may be forced to disclose confidential communications to the SEC. The varying disclosure requirement theories are often based on the assumptions about how lawyers and clients will behave when communications between them are

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248 See letter from seventy-seven law firms to Jonathan G. Katz, supra note 199. Confidentiality and related attorney-client privileges have been misused by some clients and abused by some lawyers who are complicit in their client's wrongdoings. But such abuse takes place in an extraordinarily small number of cases, and we should not make rules and set norms for the standards of the bar on a miniscule deviation from what otherwise is effective counseling.


249 Letter from seventy-seven law firms to Jonathan G. Katz, supra note 199. The public is best protected by a lawyer-client relationship in which clients are encouraged to discuss their activities openly with their lawyers in order to gain legal advice and ensure that corporate objectives are accomplished within the law. While there may be some short-term benefit to the public in prosecuting a guilty company by means of forcing the company's lawyer to report corporate misdeeds or disgorge confidential documents, in the long term, the detriments associated with such actions are greater.

Letter from Barry Nagler et al. to Jonathan G. Katz, supra note 248.

250 See infra text accompanying notes 251-72.
treated as confidential. The attorney-client privilege, as defined in the Professional Rules of Conduct, help to facilitate communications in three ways. First, clients will be encouraged to hire attorneys because of their special and unique training as a lawyer. Second, it furthers the duty of the lawyer by helping to ensure that the clients will share truthful information with the lawyer. Third, it helps to ensure that the civil and criminal justice systems work as effectively as possible. The public policy of the privilege rule recognizes that there is an interest in maintaining confidentiality in certain relationships and circumstances.

The communications between the corporate counsel and the constituents of the organization fall within the context of attorney-client confidentiality if counsel is rendering legal advice, assessing grounds for corporate liability, handling whistle-blower reports, and conducting internal investigations and evaluations of an organization's risk. An

251 Leslie C. Levin, Testing the Radical Experiment: A Study of Lawyer Response to Clients Who Intend to Harm Others, 47 RUTGERS L. REV. 81-85 (1994). The Codes of professional conduct and other laws have attempted to address the issue facing attorneys when lawyers must deal clients and their conscience. Id. The "solutions" vary greatly from allowing attorneys wide discretion in deciding whether to disclose to requiring disclosure. Id. at 83.

252 Minkoff, supra note 242, at 197-98.

253 Id. The observance of the ethical obligation of a lawyer to hold inviolate confidential information of the client encourages people to seek early representation and facilitates that full development of the facts essential to proper representation of the client. MODEL CODE OF PROF'L CONDUCT R. 1.6 cmt. 2 (2003).

254 Minkoff, supra note 242, at 198. A fundamental principle in the lawyer client relationship is that the lawyer maintains confidentiality of information relating to the representation. Id. at 197. The client is thereby encouraged to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter. MODEL CODE OF PROF'L CONDUCT R. 1.6 cmt. 4 (2003).

255 Minkoff, supra note 242, at 198. "Almost without exception, clients come to lawyers in order to determine what their rights and what is, in the complex of laws and regulations, deemed to be legal and correct." Id. Lawyers, from experience, know that the majority of clients follow the advice given, and therefore the law is most likely upheld. MODEL CODE OF PROF'L CONDUCT R. 1.6 cmt. 3 (2003).

256 CARNEY, supra note 237, at 37-40; 3 WHARTON'S CRIMINAL EVIDENCE § 11:1 (2002). The attorney must make an effort in verifying the information from the corporation's constituents and then be able to rely on the information disclosed by the client. CARNEY, supra note 234, at 37-40. If a lawyer is forced to disclose information to the SEC, then the incentive for the corporation can diminish even though such consultation may have avoided a liability. Id. With the growing regulation of corporations, the lawyer's opinion can be even more valuable. Id.

257 Gruner, supra note 237, at 1176-82; see also RESTATEMENT (THIRD) OF THE L. GOVERNING LAW. § 59 (2000). "Confidential client information consists of information relating to representation of a client, other than information that is generally known." RESTATEMENT (THIRD) OF THE L. GOVERNING LAW. § 59.
attorney that is required to disclose possible violations to the SEC obtained through attorney-client confidentiality may place an attorney at odds with state rules that would consider such disclosure a violation of client confidences. Additionally, such disclosure would spur a SEC investigation and even civil lawsuits.

Currently the ABA Model Rules allow for an attorney to reveal client confidences when an attorney "reasonably believes" that the attorney must do so to prevent a client from committing a criminal act that is likely to result in substantial bodily harm or injury to the financial interests of another. Some states, like New Jersey, Wisconsin, Texas, and Virginia go a step further and require an attorney to disclose information to prevent "substantial injury to the financial interest or property of another." The difference in theory of the rules lies in the

This definition covers all information relating to representation of a client ... It covers information gathered from any source, including sources such as third persons whose communications are not protected by the attorney-client privilege. It includes work product that the lawyer develops in representing the client, such as the lawyer's notes to a personal file, whether or not the information is immune from discovery as lawyer work product. It includes information acquired by a lawyer in all client-lawyer relationships, including functioning as inside or outside legal counsel . . .

Id. § 59 cmt. B (citations omitted); Minkoff, supra note 242, at 214-17. Currently there is a circuit split regarding the test for what is considered to fall within the privilege claims of in-house counsel. Minkoff, supra note 242, at 205, 214-15. In-house counsel may be subject to greater scrutiny and only allowed if the lawyer makes clear that he is rendering legal advice and not just business advice. Id.

See letter from Alfred P. Carlton to Jonathan G. Katz, supra note 181..

See id.

MODEL RULES OF PROF'L CONDUCT R. 1.6 (2003).

WIS. SUP. CT. R. 20:1.6; see supra notes 128-35 and accompanying text; see also RESTATEMENT (THIRD) OF THE L. GOVERNING LAW. § 67.

(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 being 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.
duties of a lawyer. The SEC argues that there is a special duty owed to the investing public. The ABA, however, takes the position that, although the ethics rules can provide some standards by which to guide an attorney, routine corporate practices to enhance communications between corporate counsel and management better improve the corporate counsel's role in enhancing corporate accountability. The

(3) Before using or disclosing information under this Section, the lawyer must, if feasible, make a good faith effort to persuade client not to act. If the client, or other 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.

RESTATEMENT (THIRD) OF THE L. GOVERNING LAW. § 67. The rule and the corresponding exemptions seek to balance the interests of client confidentiality and lawyer loyalty with the interests of the public and protecting innocent persons from financial fraud. Id. § 67 cmt. b.

See Cheek & Hughey, supra note 131.

SEC Proposed Noisy Withdrawal Rule, supra note 103.

Preliminary ABA Task Force Report, supra note 169.

5. The Corporate Governance Committee . . . should recommend for adoption by the full Board of Directors a corporate code of ethics and conduct that includes the establishment of a mechanism (such as a hot line, an ombudsman or compliance certification) through which information concerning violations of law by the corporation or its management personnel, or breaches of 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 the Audit or Corporate Governance Committee. In any investigation by the Board of Directors (or any committee) of such a violation or breach of duty, the Board (or committee) should have the authority to retain independent legal counsel. . . .

7. The Corporate Governance Committee and the Audit Committee should establish procedures for regular meetings with the corporate officers responsible for implementing the corporation's internal controls, codes of ethics and compliance policies—such as general counsel, the chief internal auditor and the chief compliance officer. At least a portion of such meetings should routinely be outside the presence of any other executive officer or director who is not independent. At such meetings, the responsible officer should report on legal and compliance affairs of the corporation as directed by the committee. The scope and content of such reports should be designed to elicit, at a minimum, information about violations or potential violations of law and breaches of duty by an executive officer or director that could have a material adverse effect on the corporation.

Id. (footnote omitted). The ABA recommends a similar line of communication between outside counsel and a corporation's in-house counsel. Id.
ethics rules that govern attorneys should provide guidance to attorneys on how to proceed internally and externally to prevent or rectify corporate fraud. At the same time, they should be balanced against a lawyer's duty to the client and the public.

The conflict in state and SEC proposed rules could consequentially impair the communications and confidences that lawyers need from their clients to better serve the public. In addition, the required disclosure rule forces an attorney to have divided loyalties, which in turn jeopardizes the attorney-client relationship.

The SEC's position mandates the lawyer to disregard any conflicting state rule requiring the lawyer to maintain confidentiality. It requires disclosure to the SEC of communications that are protected by state rules as confidential. The balancing act of encouraging candid

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265 See infra text accompanying notes 267-91.
266 See infra text accompanying notes 267-91.
267 See letter from seventy-seven law firms to Jonathan G. Katz, supra note 199; 2 ATT'Y-CLIENT PRIVILEGE IN THE U.S. § 9:27 (2003). Some argue that public interest is better served with a rule requiring disclosure because it would limit the possibility of abuse by the client in an attorney-client relationship. Breslin & Dooley, supra note 127, at 728-30. If the client is aware that the lawyer has a duty to disclose facts learned through client communications, the client may be less likely to engage in an illegal activity or fraud. Id. Additionally, it is argued that a client who has a lawyer that has chosen to withdraw noisily will encounter problems hiring a subsequent attorney and thereby be hindered in furthering illegal conduct. Id.

We believe the extension of the proposal beyond the mandate of Section 307 could trigger profound changes in the relationship between companies and their legal counsel. Specifically, we are concerned that, contrary to the Commission's expressed intent, the proposal could deter officers, directors and employees from seeking advice from counsel on sensitive matters. Although we agree that an attorney employed or retained by a company represents the company as an organization—not the company's officers, directors or employees—counsel cannot effectively represent an organization without open communication with the people who make up that organization. . . .

268 See letter from Alfred P. Carlton to Jonathan G. Katz, supra note 181.
269 See letter from seventy-seven law firms to Jonathan G. Katz, supra note 199.
270 See letter from seventy-seven law firms to Jonathan G. Katz, supra note 199; see also Richard M. Phillips, Client Fraud and the Securities Lawyer's Duty of Confidentiality, 49 WASH. & LEE L. REV. 823, 826-27 (1992); Subin, supra note 153, at 1161. A view that does not allow for any revelations of a fraud is justified by the notion that if a client is to be able to access the legal system they must be able to do so without any possibility of incrimination,
communications between lawyers and clients and protecting the investing public from frauds perpetrated by the client or corporation is made more difficult if a lawyer and the public are unsure of when and where information may be used or disclosed.271 At one end of the spectrum are states that do not allow a lawyer to disclose any information in situations of a fraud involving a corporation, while at the other end is the SEC rule requiring disclosure.272 Neither of these rules properly take into consideration the fact that a lawyer often provides services that are critical and essential in the complex, intricate matters of financial and securities law, and that the corporation often relies on attorneys to assure compliance.

The SEC distinguishes between past frauds and those that are on-going or about to occur.273 The SEC does not require withdrawal in cases of past frauds, but permits it.274 The SEC defines an on-going fraud as a filing with the SEC that an investor may rely on.275 An on-going fraud includes misstatements that an attorney may have had an unwitting part in assisting with and any potential reliance on that past fraud.276 For an attorney to avoid personal liability, the attorney will be forced to disclose a past fraud for the fear that there may be an investor relying on the misstatement or fraud. The SEC justifies the proposed rule by explaining that with threatened disclosure, CEOs, CFOs, and QLCCs are more likely

However the opposite side views the access the legal system as a right, but not a “power to subvert the process.” Subin, supra note 153, at 1162. Confidentiality is an expectation and limits as to use of the lawyer-client relationship must be set. Id. For example, a client must know up front that the attorney’s services can not be used to perpetrate a fraud. Id.

271 See letter from seventy-seven law firms to Jonathan G. Katz, supra note 199.
272 See supra notes 110-18, 124-35 and accompanying text.
273 SEC Proposed Noisy Withdrawal Rule, supra note 103.
274 Id.
275 Id.
276 Id.

If the past material violation at issue has already occurred and is not on-going and is likely to have resulted in substantial financial injury to the issuer, [this] proposed rule would allow, but not require, the reporting attorney to withdraw, notify the Commission, and disaffirm false or misleading filings or submissions that the attorney prepared or assisted in preparing. The attorney’s silence, under those circumstances, would not assist the violation. To the extent that the investors may continue to rely upon false or misleading statements in earlier filings or submissions, which have not been disaffirmed, the material violation would be on-going and [the required disclosure rule] would apply.

Id. (emphasis in original).
to rectify reported improprieties and frauds.\textsuperscript{277} However, the SEC does not consider the downside of corporations not consulting specialized attorneys nor the lack of candor that may result from attorneys being forced to snitch.

The SEC also states that disclosure would not be a breach of attorney-client privilege.\textsuperscript{278} The SEC, in requiring disclosure, takes the decision out of the state court’s domain and forces a waiver of privilege in place of the corporation making the decision.\textsuperscript{279} The lack of discretion for the attorney in making a decision on whether to disclose information makes the disclosure mandatory.\textsuperscript{280} Therefore, the information disclosed to the SEC by the attorney may be subject to a limited waiver.\textsuperscript{281} Since

\textsuperscript{277} Id.; see letter from seventy-seven law firms to Jonathan G. Katz, \textit{supra} note 199; letter from Arthur P. Carlton to Jonathan G. Katz, \textit{supra} note 181. It is argued that a noisy withdrawal serves the purpose of alerting third parties that the lawyer will no longer be responsible for the documents prepared by her and that any further inferences of client misconduct are of the third party, not the lawyer’s withdrawal. Breslin & Dooley, \textit{supra} note 127, at 733. However, it is more than likely, with such a disclosure to the SEC, that an investigation into the practices of the corporation would be launched, as is the duty of the SEC. See letter from Arthur P. Caplan to Jonathan G. Katz, \textit{supra} note 181. For the SEC to not take any action would not serve public interest of deterring fraud, therefore an attorney notifying the SEC and disaffirming any documents would be considered evidence of misconduct by the corporation. Letter from seventy-seven law firms to Jonathan G. Katz, \textit{supra} note 199; letter from Arthur P. Carlton to Jonathan G. Katz, \textit{supra} note 181. The SEC, in 2001, announced a major shift in its enforcement programs. 3 LAW SEC. & REG. § 16.2(19)(B) (4th ed. 2002). The SEC sought to encourage more self-policing by reporting corporations by announcing that in determining whether to bring enforcement actions against corporations, several factors would be considered. \textit{Id.} The SEC will consider, among others, whether the internal control processes provide effective self-policing mechanisms, the extent of the company’s cooperation with the SEC, the extent of cooperation with other law enforcement agencies, and whether the company disciplined the persons responsible and compensated the victims. \textit{Id.; Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and the Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 34-44969, [2001-2002 Transfer Binder] (Oct. 23, 2001), available at http://www.sec.gov/reports/34-44969.htm.} This approach is similar to the one announced by the SEC in the 1970s and will likely result in the vigilant enforcement of securities laws violations. 3 LAW SEC. & REG. § 16.2(19)(B) (4th ed. 2002). This is especially so after Enron and similar type revelations. \textit{Id.}

\textsuperscript{278} SEC Proposed Noisy Withdrawal Rule, \textit{supra} note 103, § 205.3(d)(3). The proposed rule provides, “The notification to the Commission prescribed by this [rule] does not breach the attorney-client privilege.” \textit{Id.}

\textsuperscript{279} See letter from seventy-seven law firms to Jonathan G. Katz, \textit{supra} note 199.

\textsuperscript{280} \textit{Other Conduct That May Waive Privilege}, COMPLIANCE PROGRAMS & CORP. SENTENCING GUIDELINES § 5:28 (2003) [hereinafter \textit{Other Conduct That May Waive Privilege}].

\textsuperscript{281} \textit{Id.} There is currently controversy as to what constitutes voluntary and involuntary disclosure. \textit{Id.}
the purpose of the disclosure rule is to protect investors, it is assumed that the SEC will be able to pursue any necessary investigation and rectify the fraud prior to shareholder or investor harm. In doing so, the SEC would have to honor the limited waiver and not disclose the privileged information to the public or the shareholders.

However, if a lawyer has discretion, the lawyer has the ability to work internally to the best of her ability to solve the problem and encourage necessary compliance. In addition, the information gained by the disclosure would not be available to directly protect the public. Subject to the limited waiver rule, the shareholders and investors will not be able to access the information. Although the SEC acknowledges that required disclosure would be rare, an attorney would be forced to decide whether or not to disclose in order to protect herself from the SEC or to violate the state ethics rules.

State rules that permit disclosure, instead of requiring disclosure, allow an attorney to take into consideration the response of the notified parties, the materiality of the situation, and the possible ramifications of either reporting or not reporting. A rule that allows an attorney to use her discretion in revealing corporate frauds in which her services were used protects the lawyer and the investing public by encouraging the

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282 Gruner, supra note 237, at 1152; see also Russell B. Stevenson, Jr., Corporations and Information 85-100 (1980) (discussing the volume, importance, and the need for security and secrecy in corporation documents).

283 Phillips, supra note 270, at 829. There are often two stages to a SEC investigation. 3 Law Sec. Reg. § 16.2(7) (4th ed. 2002). First, there is an informal investigation where the target corporation is not required to have notice regarding the SEC investigation. Id. Frequently, the first stage of an investigation will lead to a second-stage formal investigation. Id. The decision of the SEC to conduct an investigation is not up for judicial review. Id. The SEC only needs to believe there is a “likelihood” of a securities violation to initiate an investigation. Id. Upon launching a formal investigation, the SEC obtains subpoena power that can only be challenged if the corporation refuses to comply and the SEC brings an enforcement action. Id. Generally, as long as there is good faith shown, a court will uphold the subpoena and the corporation will be forced to comply. Id. Additionally, the SEC conducts interviews to gain information about the corporation and its practices. Id. Upon completion of the investigation, the SEC will notify the corporation of its findings, giving the corporation an opportunity to contest the determination. Id. If the SEC finds a wrong-doing, a suit authorization is issued. Id. If the SEC chooses to pursue the suit, an injunctive action may be brought in federal court or the case can be referred to the Department of Justice to determine if criminal sanctions are appropriate. Id. Parallel proceedings are appropriate and do not constitute double jeopardy. Id. § 16.2(8)

284 Id. § 16.2(7); see Hicks, supra note 137, at 965-66.

285 SEC Proposed Noisy Withdrawal Rule, supra note 103.

286 See supra notes 130-40 and accompanying text.
organization to rectify the situation rather than risk disclosure. The required affirmative actions set out by the SEC create a situation where the attorney is required to disclose in order not to breach a duty. Lawyers are often sued for assisting in their client’s frauds based on 20-20 hindsight, on the notion that they should have known of the criminal conduct taking place within the organization. The affirmative duty created by the SEC places the attorney in a situation where her decision to withdraw can lead to the possibility of breaching a state ethical rule, suspension or disbarment proceedings from practicing before the SEC, or a prolonged and damaging investigation by the SEC. The attorney is in a position where being wrong can be very damaging to her practice, the law firm, and possibly the organization which she represents.

Further, the rule of mandatory disclosure to the SEC is outside the legislative intent of Congress. The SEC, in its commentary, states that the proposed rules would be incomplete without requiring notification to the Commission in extreme situations. Further, the agency has the authority to take actions against professionals in order to protect the integrity of its processes. However, in the Senate floor debate, Senator Michael Enzi from Wyoming stated that the amendment would support internal disclosure and not any external reporting. In the entire

287 Carney, supra note 237, at 38; Phillips, supra note 270, at 829; see also Charles W. Wolfram, Modern Legal Ethics 160-67 (1986) (discussing the necessity of candid client communications and lawyer discretion in dealing with misconduct).
288 See Phillips, supra note 270. An affirmative duty must be clear and subject to little interpretation in order for an attorney to respond. See letter from Arthur P. Carlton to Jonathan G. Katz, supra note 181. If the rule is vague and too broad, attorneys will likely not take the action intended in enacting the rule, thereby, defeating the public interest aspect of the duty. Id.
290 See Phillips, supra note 270; letter from seventy-seven law firms to Jonathan G. Katz, supra note 199.
291 See letter from Arthur P. Carlton to Jonathan G. Katz, supra note 181.
293 See supra notes 110-18 and accompanying text (discussing the procedure for “noisy withdrawal” outlined in the proposed provision); SEC Proposed Noisy Withdrawal Rule, supra note 103.
294 See supra notes 110-18 and accompanying text (discussing the procedure for “noisy withdrawal” outlined in the proposed provision); SEC Proposed Noisy Withdrawal Rule, supra note 103.
legislative history, there is no evidence that Congress intended a "noisy withdrawal" rule.\textsuperscript{296}

The SEC's proposed "noisy withdrawal" requirement threatens to alter the confidences that corporate clients place in their attorneys.\textsuperscript{297} The critical role that attorneys play within the corporate arena can serve

[An internal reporting obligation] is still less onerous than that imposed on accountants under section 10A of the 1934 Securities Exchange Act, which requires an auditor to report, both to the client's directors and simultaneously to the SEC, an [sic] illegal act if management fails to take remedial action.

The amendment I am supporting would not require the attorneys to report violations to the SEC, only to corporate legal counsel or the CEO, and ultimately, to the board of directors .... This amendment also does not empower the SEC to cause attorneys to breach their attorney/client privilege. Instead, as is the case now, attorneys and clients can assert this privilege in court.

\textit{Id.} Senator Corzine states:
The bottom line is this. Lawyers can and should play an important role in preventing and addressing corporate fraud. Our amendment seeks to ensure that. It seeks to go back to the old way: When lawyers know of illegal actions by a corporate agent, they should be required to report the violation to the corporation.

\textit{Id.} at S5556 (statement of Sen. Corzine). An exchange regarding the purpose of the amendment provides:

Senator Sarbanes: Mr. President ... It is my understanding that this amendment, which places responsibility upon the lawyer for the corporation to report up-the-ladder only involves going up within the corporate structure. He doesn't go outside of the corporate structure. So the lawyer would first go to the chief legal officer, or the chief executive officer, and if he didn't get an appropriate response, he would go to the board of directors. Is that correct?

Senator Edwards: Mr. President, my response to the question is the only obligation that this amendment creates is the obligation to report to the client, which begins with the chief legal officer, and, if that is unsuccessful, then to the board of the corporation. There is no obligation to report anything outside the client-the corporation.

Senator Sarbanes: I think that is an important point.

\textit{Id.} at S6557 (statements of Sen. Edwards & Sen. Sarbanes); see also letter from Joseph A. Grundfest et al. to Jonathan G. Katz, Secretary, SEC (Dec. 23, 2002), available at http://www.sec.gov/rules/proposed/S74502/jagrandfest1.htm (arguing that if Congress wanted to create a requirement for lawyers to report to the SEC, they would have done so explicitly as they had in Section 10A of the Securities Exchange Act of 1934, requiring auditors to report violations not resolved internally within a corporation).


\textsuperscript{297} See \textit{supra} text accompanying notes 246-72.
to encourage corporate compliance. A rule that would require an attorney to disclose information to the SEC would force an attorney to reveal confidences to avoid potential personal liability. Congress, in granting authority to the SEC to promulgate an up-the-ladder rule, never intended to force lawyers to snitch to the SEC and jeopardize the confidentiality between an attorney and a client.

Therefore, the investing public would be better served if rules and regulations that encourage legal compliance and candid communications between attorney and client were proscribed. This Note advocates a clearly defined scope of the SEC promulgated up-the-ladder reporting rule. Additionally, this Note recommends that the ABA and state bars emphasize the attorney’s role in encouraging legal compliance within a corporation. Finally, the Note urges the ABA and state bars to adopt similar permissive notification provisions to necessary third parties in situations where fraud can be prevented and the attorney has exhausted all other recommended remedies, thus, reasonably believing external reporting to be necessary and in the best interest of the client/organization.

IV. PROPOSED RECONCILIATION OF CONFLICTING PROFESSIONAL CONDUCT STANDARDS

A. An Attorney’s Duty to Report Up-the-Ladder

The SOA was intended to protect the investing public. Section 307 seeks to protect the public by granting authority to the SEC to create a reporting procedure for attorneys in cases of fraud or improprieties discovered by the attorney. Because regulation of lawyers has been traditionally left to the state bars, the SEC must promulgate attorney conduct rules that do not force the attorney to violate one law in order to follow another.

A broad interpretation of the scope of lawyers that fall under the up-the-ladder reporting requirement will lead to confusion as to whom the duty applies. Additionally, the SEC must stay within the legislative

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298 See supra text accompanying notes 237-47.
299 See supra text accompanying notes 267-91.
300 See supra text accompanying notes 292-96.
301 See supra Part II.B.
302 See supra Part II.B.
303 See supra Part III.A-B.
304 See supra text accompanying notes 153-205.
intent of the SOA when promulgating the up-the-ladder reporting rule.\textsuperscript{305} The scope of the rule must be narrowed. The rule must limit the definition of “appearing and practicing before the Commission” to attorneys who play a significant role in securities compliance.\textsuperscript{306} Only then will the attorney be cognizant of her duty from the onset of her representation of the client.\textsuperscript{307} An attorney preparing a document for a corporation should not have to rely on the corporation to notify her of the possible use in a securities compliance matter.\textsuperscript{308} This places the burden on the corporation and places the attorney in a position where she may be subject to liability for lack of notice.\textsuperscript{309} Instead, an attorney who takes a significant part in securities compliance would be aware that she is subject to the affirmative duty and be able to comply without exposing herself to liability. Additionally, the legislative history shows that Congress intended for the SEC to regulate only attorneys who are responsible for securities compliance.\textsuperscript{310}

A narrow interpretation would also allow an objective triggering standard of a "reasonably prudent securities compliance attorney."\textsuperscript{311} With an expansive scope, as enacted by the SEC, a non-securities lawyer would be held to the same standard as a securities compliance attorney, which will not further the congressional objective of protecting investors.\textsuperscript{312} The narrow definition proposed by this Note allows the SEC to focus on attorneys who are in a position to identify, detect, and prevent corporate fraud in securities compliance areas.

**B. Proposed Definition to Narrow the Scope of Attorneys Subject to the SEC Promulgated Rule**

\textsection{205.2(a) Definition of Appearing and Practicing Before the Commission:}

(a) Appearing and practicing before the Commission includes, but is not limited to, an attorney who significantly takes part, advises, or whose main responsibility is:

\textsuperscript{305} See supra text accompanying notes 219-33.  
\textsuperscript{306} See supra text accompanying notes 190-97.  
\textsuperscript{307} See supra text accompanying notes 190-97.  
\textsuperscript{308} See supra text accompanying notes 193-97.  
\textsuperscript{309} See supra text accompanying notes 190-205.  
\textsuperscript{310} See supra text accompanying notes 219-27.  
\textsuperscript{311} See supra text accompanying notes 206-18.  
\textsuperscript{312} See supra text accompanying notes 206-18.
Transacting business with the Commission on behalf of and as requested by and in the interests of the client;

Representing an issuer to, or the subject of, or a witness in a Commission administrative proceeding;

Representing any person in connection with any Commission investigation, inquiry, information request, or subpoena;

Preparing, or participating in the process of preparing any material statement, opinion, or other writing which the attorney has reason to believe will be filed with or incorporated into a required registration statement, notification, application, report, communication, or other document filed with or submitted to the Commissioners, or its staff, on behalf of a client.

Comments:

The scope of this definition is limited to attorneys who materially participate in the Federal securities compliance of the client. Attorneys that take part in reviewing or preparing documents that are not for the sole or primary purpose of securities compliance and the documents are reviewed or prepared in good faith, fall outside the scope of this definition.

An attorney who advises that a statement, opinion, or other writing does not need to be incorporated into any registration statement, notification, application, report, communication, or other document filed with or submitted with the Commission and who has done so in good faith is not considered to be Appearing and Practicing Before the Commission.

An attorney who advises that a client is obligated to submit or file a registration statement, notification, application, report, communication, or other document and who has done so in good faith is not considered to be Appearing and Practicing Before the Commission.

Communication includes all oral and written statements made to the Commission or its staff.
C. Additional Recommendations That Will Ultimately Serve the Public Interest

The up-the-ladder reporting serves the public interest by detailing the reporting procedure an attorney is required to engage in upon detecting fraud.\textsuperscript{313} This procedure informs management and simultaneously allows management an opportunity to respond.\textsuperscript{314} An attorney is able to serve in the best interests of the shareholders by encouraging corporate compliance.\textsuperscript{315} However, if the attorney is forced to disclose information to the SEC, the attorney becomes a risk factor to the corporation. By forcing disclosure, a client is less likely to disclose information, thereby, inhibiting corporate compliance instead of encouraging it.

The public interest would be better served if the SEC withdrew its proposal for "noisy withdrawal" and instead strongly encouraged the ABA and the state bars to adopt a similar up-the-ladder reporting requirement for all practicing attorneys.\textsuperscript{316} A state promulgated up-the-ladder reporting requirement would provide substantiated guidance to attorneys and corporations and help to promote the confidence of shareholders in the legal profession. The ABA and state promulgated rules should encourage an attorney that has knowledge of fraud to take action that will minimize harm to the corporation.\textsuperscript{317} A rule that promotes minimization of disruption to the corporation does not serve the public interest, because it discourages an attorney to take prompt action to protect the client/organization.

\begin{itemize}
  \item See supra text accompanying notes 88-109.
  \item See supra text accompanying notes 108-09.
  \item See supra text accompanying notes 237-300.
  \item See supra Part III.B.
\end{itemize}

In complex fields like securities regulation, the regulatory process provides critical texture to legislative enactments. But, even an agency as wonderful as the SEC has, and should have, limitations on the problems we can solve, as well as on the solutions we can put forth. In my view, government's best role is to define what is illegal, and work with the private sector to help it define what is unethical or incompetent. If all institutions play their proper role, Congress will articulate broad standards, the SEC will define legal requirements under those standards, and the private sector will augment those legal requirements with additional ethical and moral prescriptions and proscriptions.

SEC Address from Pitt, supra note 7.

\textsuperscript{317} See supra text accompanying notes 203-05.
Additionally, as the ABA has recently done, all state bars should adopt rules that permit disclosure in situations where an attorney has evidence that a client will commit an illegal or fraudulent act that may result in substantial financial harm to others.\textsuperscript{318} A rule that permits disclosure allows an attorney to consider the materiality of the situation and take appropriate actions.\textsuperscript{319} An attorney that has attempted internal disclosures in compliance with either the state or SEC promulgated rule can then consider the surrounding circumstances and disclose the information to the necessary third party without fear of disciplinary proceedings. Legal compliance within corporations is promoted when balancing the interests of preserving confidential client communications and serving the interests of the public in preventing corporate fraud.

V. CONCLUSION

Lawyers are an essential part of an organization. They serve in many capacities within an organization and can be a very critical and vital resource. Corporations must be able to look to attorneys to provide sound legal advice. Shareholders must feel confident that the attorney is acting in the best interests of the corporation. The problem of corporate giants “cooking the books” and thinking they can get away with it is not a new problem, but one revisited time and time again. As society progresses, manipulation progresses as well. The problem is not one of the legal profession or the accounting profession alone.

Corporate greed is an ever-evolving art form. One that Congress tried to stay ahead of, but failed. Congress has been trying to protect the investing public since the enactment of the Securities Act of 1933. There have been many countless rules and regulations put in place to deter, detect, and prevent corporate fraud since 1933. Investors wonder why

\textsuperscript{318} See supra text accompanying notes 282-91.

No set of legal rules or guidelines can guarantee that such active care will be achieved in practice . . . . And certainly, no reasonable amount of active care will invariably prevent fraud or other misconduct by corporate management. The Task Force nonetheless believes that its recommendations would significantly enhance corporate governance practices and ethical principles to make it more likely that the system of checks and balances involving . . . corporate counsel will work effectively to help ensure that the corporation is ethically and legally responsible and managed in the long run best interests of the corporation and its shareholders.

Preliminary ABA Task Force Report, supra note 169.

\textsuperscript{319} See supra text accompanying notes 260-68.
none of these rules deterred, detected, or prevented the recent round of corporate greed. The answer from Congress was more laws and regulations so that, maybe, there will not be a next time. There probably will be a next time, with new methods, thereby requiring new laws. The legal profession must also evolve and adapt as the times and methods change, so that maybe there will not be a next time. Or at the least, we can say the lawyer was not to blame.

Samantha Ahuja