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ATTORNEY–CLIENT RELATIONSHIPS AFTER *CARTER AND JOHNSON*

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1. Introduction

In recent years in the United States the relationship between the attorney and the corporate client, and the obligations that govern counsel's behavior in that relationship, have come under increased scrutiny. In large measure, that scrutiny has been prompted by the United States Securities and Exchange Commission (the "SEC" or the "Commission"), which has brought various actions against lawyers on the basis of a claim that may fairly be characterized as an assertion that counsel was overly zealous in protecting the client, and insufficiently attentive to other, broader duties that – at least in the view of the Commission – such lawyers owed to the public interest. The most notable of those cases, of which there are a number, is *SEC v. National Student Marketing Corp.* [1]. More recently, the decision of the Commission in *In the Matter of Carter and Johnson* [2] makes clear the importance of examining the relationship that the corporate lawyer is expected to have with his client.

It may be appropriate to dwell for a moment upon the practical role played by corporate counsel in the United States in 1980. For that role is markedly different from traditional notions of the lawyer's position; yet it is affected significantly by those traditional notions. The historical role, of course, is that of the litigator. The lawyer existed to represent the client before a court. From that beginning the ambit of the lawyer first expanded into an advisory capacity when he became a drafter of documents – primarily deeds, trusts, wills, mortgage documents, and contracts. In all of these activities, the lawyer served in a planning capacity and, to some extent, a negotiating capacity. But with the growth of private commercial activity, and the delayed, but corresponding, growth of governmental regulation, the lawyer – or at least some lawyers – came more and more to represent clients in a relatively adversary relationship with their government. Thus far, in this rather abbreviated analysis of the lawyer's function, all remains relatively simple. The lawyer represents a discrete client, and his duties are only to that client. Concern with conflicts of interest may generally be limited to ensuring that one does not have two (or more)

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clients with opposing interests. There are, to be sure, some perplexing questions of duty – what is the lawyer to do when the client commits perjury in the presence of counsel, or advises counsel of an intention to do so? These questions have never been completely resolved to the satisfaction of all commentators. But even these questions involve more clearly defined interests than those that securities lawyers currently face.

The function designed by the Securities Act of 1933 and subsequent securities laws for what is now the Securities and Exchange Commission was subtly different from that played by most regulatory agencies. While most such agencies regulate directly, the Commission's role is indirect (at least as regards its jurisdiction over the issuers of securities). Its role is not to determine what is fair or unfair, proper or improper, but rather is to ensure that there is full exposition of the pertinent data, so that the investing public can itself appraise fairness and propriety.

In establishing that role for the Commission, the Congress planted the seed that has grown into the present quandary. For it developed that corporate issuers turned to their lawyers to prepare the documents by which the SEC would judge whether the issuers adequately disclosed all salient information regarding the corporate entity. While the Commission's staff could certainly review the information submitted for examination, it could not verify that information or begin to consider what additional information, not hinted at in the disclosure documents, might be material to investors. In this framework, it is hardly surprising that over the years the SEC came to view the private bar as having some duty beyond allegiance to client interests – an obligation to serve as investigator of the first resort, to identify items of materiality regarding the entity, and to ensure their disclosure. Given the gradual evolution of the role – here telescoped into a few paragraphs – it is only slightly more surprising that the private bar accepted this mantle.

By 1980 the sometimes (but still infrequently) conflicting expectations of the protagonists – corporate issuers and the Commission – have begun to come into clear focus. The corporation typically clings to the traditional notion, viewing its lawyers as *its* lawyer, beholden and obligated to no one else. The Commission has a much more public view of the lawyer, viewing counsel's function as ensuring that the client discloses all and, to that extent, serving a very public interest. The lawyer, recognizing the conflicting demands of the client he must serve and the agency before which he must practice, sometimes leads a relatively schizophrenic existence.

The reality, of course, is less stark than this brief synopsis would suggest. The Commission does recognize the lawyer's client orientation; lawyers have always recognized some public limits on the zealous representation of client interests; clients have never viewed lawyers as captives and do acknowledge elements of independence. But it is fair to suggest that the conflicting pressures on the lawyer who serves as a corporate adviser are greater today than they have ever been in the past. And while that role may be seen as a gradual evolution, it is nonetheless recognizably different from the historical role of the lawyer.

In some of the modern cases, but clearly not in all of them, the SEC has been

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able to make a colorable argument that the "client", in a traditional sense, is in fact the public that the Commission seeks to protect. For example, in *National Student Marketing* it was at least arguable that counsel was disregarding the interests of the corporate shareholders, and that shareholders – who owned the corporation – were the "client". If shareholders may be considered the external voice of the corporation, the view of the SEC may be characterized as an insistence that counsel heed that external voice, and not be satisfied with only the internal voice of the corporation – *i.e.* the voice of those elected to speak for the entity.

For a variety of reasons, examined in greater detail below, that argument is erroneous: the corporate entity itself is the client and the shareholders cannot be a part of the attorney–client relationship [3]. The "external" owners of the corporation cannot sensibly be viewed as entitled to a part in the attorney–client relationship. As a consequence, the view taken by the SEC can be sustained, if at all, only on a theory that the lawyers breached some duty to the general public interest. In large measure the hostility that has been directed at these SEC proceedings is the result of concern by lawyers that they are being asked to violate traditional norms of the attorney–client relationship, and to honor a duty that has not been defined or specified in any authoritative analysis of lawyers' responsibilities.

In one recent administrative proceeding, however, the SEC has adopted a different focus for its criticism and has fairly raised a wholly new and intriguing question. In *In the Matter of Carter and Johnson* [4] the SEC raises the subtly, but critically different question of what internal voices within the corporate entity are entitled to direct the activities of counsel. Stated more specifically, attention has been directed to the circumstances under which corporate counsel may be required to appeal decisions of corporate officers to the board of directors.

Although the operative facts of the *Carter and Johnson* case are in some dispute, for the present analysis it may be characterized as a case in which counsel's proper advice to corporate officers was disregarded. Counsel did not then insist that the advice be considered by the board of directors, but instead allowed the officers to conduct corporate activities in disregard of the legal advice. The position urged by the staff of the Commission is that the lawyers had a legally enforceable duty at least to ensure that the highest internal voice of the corporation, the board of directors, had the opportunity to consider the propriety of the officers' decisions.

This most recent challenge cannot be considered as going beyond the bounds of the attorney–client relationship, for both officers and directors fall within any sensible definition of "client". As will be seen, however, to recognize that the question is different in a fundamentally important way, is not to say that it admits of any easy answer. Any final decision regarding the specific question raised in that case will, of course, bear upon a related question: when must corporate counsel appeal decisions of lower – or intermediate – corporate officers to their superiors?

The earlier cases, exemplified by *National Student Marketing*, were primarily concerned with the right of persons who were relative "outsiders" – shareholders of the corporation, or creditors or potential investors – to obtain information from

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the corporate lawyer, or the duty of lawyers to provide information to such persons. In *Carter and Johnson,* however, the SEC's staff challenged counsel not for failing to protect such "outsiders" but rather for failing adequately to advise insiders, the board of directors of the corporation, that corporate officers were not heeding counsel's advice. Thus, the SEC has for the first time injected itself fully into the corporate decision-making process and sought to establish rules for corporate counsel's relationships within the corporate client.

In *Carter and Johnson,* the Commission reversed the prior decision of an administrative law judge, and held that the lawyers whose behavior was at issue were not subject to discipline [5]. To some degree, the SEC's decision was based on the absence of any definitive standards by which to determine the propriety of counsel's actions, in the circumstances faced by counsel, for purposes of the Commission's Rule 2(e) [6] relating to persons authorized to practice before the Commission. That basis for the decision, together with the Commission's discussion in rather broad terms of the obligations of counsel, highlight the importance of examining the question which the case raises – the obligation of counsel to respond to different levels of authority within the corporate client.

2. Background: The troubled relationship between the lawyer and the corporate client

The *Carter and Johnson* decision, and the question which it addresses, cannot properly be considered without an awareness of the somewhat confusing standards that presently define the proper role of the lawyer in relation to the corporate client.

In general, the duties of lawyers are matters relegated to the authority of the several states, and are not affected by federal law. The rules of professional behavior presently in effect in the states all derive from the same source, the first canons of ethics established in 1887 in Alabama. Those canons themselves followed closely the principles enunciated by Judge George Sharswood before the students of the University of Pennsylvania in 1854. Some twenty years after the Alabama canons, in 1908, the American Bar Association (the "ABA") promulgated the first set of canons of ethics designed for nationwide application [7].

However, when Judge Sharswood delivered his lectures in 1854, and when the states adopted codes of ethics thereafter, the lawyer was a person primarily concerned with matters of litigation, of trusts and estates and of contracts; while the corporate form existed, it was not nearly so pervasive an influence as it is today. In the three-quarters of a century following the Alabama promulgation of a code of ethics, various revisions of codes of ethics and responsibilities have invariably built upon, and been substantially limited by, their earlier models. There has not yet been any code that definitively examines the duties of the lawyer with respect to the corporate client.

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For several decades this absence of guidance went relatively unnoticed. In 1969, the ABA examined its code of professional ethics and, as a result of that process, adopted the current Code of Professional Responsibility ("ABA Code"), which revised the prior standards to the relatively minimal extent (insofar as is pertinent here) of recognizing that in the case of the corporate client it is the corporation itself and not the officers, directors, shareholders, or any other group, that is the client.

The relatively limited guidance provided by the other provisions of the ABA Code to the lawyer who serves as an adviser to corporations has been examined in detail by the author elsewhere [8], and will not be repeated here. However, it is useful to summarize those provisions of the ABA Code that may be seen as having some bearing upon the issues here under inquiry.

First, the lawyer properly owes the client his undivided loyalty [9]. He is not to put himself in a position where his loyalty to the client may be compromised. His role must be unquestionably that of the representative of and spokesman for his client. He is not to allow himself to be influenced by factors other than his client's interest.

Second, the lawyer is under the strongest of obligations to keep sacred the confidences and secrets of his client [10]. This duty goes beyond the evidentiary privilege that precludes disclosure by the lawyer, even under oath, of certain information without the consent of the client: it demands that, absent a recognized and sufficient reason in furtherance of an important public good, the lawyer refrain from any public disclosure of information that the client does not want disclosed, or that would potentially operate to the client's detriment.

Third, the lawyer is to make his own wishes, and his subjective evaluation of the public weal, subservient to the client's desires. Absent compelling and clear public need, the client's needs and goals, as evaluated by the client, are paramount. The lawyer is enjoined by the ABA Code to heed the client's dictates.

Fourth, the lawyer is, nonetheless, to be cognizant of the public good, and is not to engage or participate in a fraud upon others, nor is he idly to stand by while his client commits a significant wrong. Notwithstanding the other duties of the lawyer, he is not to ignore a broader sense of the public need. He is called upon to exercise judgment, and to recognize that upon occasion the clear public need will outweigh the normal client orientation. That public need is not to be used as an excuse for dereliction of duty, but it is to be recognized and given priority where (but only where) that is clearly required by a sensible view of the circumstances.

In this context of rather ambiguous, if not conflicting, guidance, it is not surprising that there are substantial, unresolved questions as to the nature of the attorney–corporate client relationship. For example, such fundamental questions as whether counsel may properly be a director or a shareholder of the client remain unanswered and only recently addressed. The question suggested by *National Student Marketing* – whether shareholders are to be considered a part of the corporate client – remains unresolved in any definitive context (even though the impossibility

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of confidential communications with a group of public shareholders should demand an immediate negative answer). And the question raised by *Carter and Johnson*, relating to the proper relationship between counsel and the various voices of corporate authority, has not even been addressed authoritatively.

3. The role of the SEC

It is clear that the SEC does not have the authority in the first instance to establish standards that must be met by lawyers who would practice before it [12]. Nonetheless, it appears equally true that the SEC is entitled to discipline for improper behavior those lawyers who do practice before it [13]. Although the jurisdiction of the SEC over lawyers is relatively limited, the impact of an SEC disqualification can be far-reaching [14].

Given that the historical relationship between the SEC and the bar is a fairly close one, in which both the bar and the SEC recognize that the cooperation of the former is essential to the effectiveness of the latter [15], it is perhaps not surprising that the SEC has felt called upon to police the bar in order to protect its own domain. The SEC, for better or worse, is in large measure dependent upon the private bar for effectiveness, and the bar has generally accepted (if not embraced) that importance. It is only natural, then, that the Commission has sensed a need to protect that unusual relationship.

Thus, the SEC has come to view the private bar as owing some allegiance to the regulatory agency, and its constituency the public, in addition to the allegiance the bar owes to its clients, the regulated. While that may easily be considered an inappropriate relationship, and certainly one not sanctioned by any legislative imprimatur, it exists [16]. It cannot be surprising, then, that the Commission chooses to challenge an intruder, however legitimate by traditional notions, that would interfere with the rapport that has been established. In this way, the SEC may be seen as protecting its mistress, the bar, even against the advance of the bar's natural spouse, the client.

4. Securities and Exchange Commission versus National Student Marketing Corporation

Without question, the most important case in which the SEC has sought to establish its views of proper attorney–client relations, and the "public good" limitations upon those relations, is *SEC vs. National Student Marketing Corp.* That case involved a marger between Interstate National Corporation ("Interstate") and National Student Marketing Corporation ("National"): Interstate was to be merged into National and the shareholders of Interstate were to receive common stock of National. The parties prepared and submitted proxy statements to their share-

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holders. The shareholders of the corporations approved the transaction and the parties were prepared to consummate it. However, immediately prior to the closing it came to the attention of the parties and their counsel that the financial statements of National included in the proxy statements were misleading to a degree that might be considered material. (In retrospect it appears that the errors in the financial statements were clearly material, but it might reasonably be argued that the facts known to the parties and their counsel at the time of the closing were not sufficient to compel a conclusion of materiality.) After some analysis, the parties decided to close the transaction notwithstanding the misleading information. Thereafter, it was discovered that National had been on the verge of its subsequent collapse, and the SEC initiated its proceedings.

In its complaint the SEC argued that counsel to National and Interstate had an obligation to prevent the closing and, if necessary, to advise the SEC itself in order to attain that objective. To some substantial degree the SEC's views have been supported on a theory that the corporation's shareholders are the client and are entitled to speak for the client, since they must properly be characterized as the owners of the client.

However, that view cannot sustain the position advanced by the SEC. First, if one attaches any importance to notions of confidentiality between attorney and client, the shareholders of a publicly held corporate client cannot be viewed as the client, since confidential communications with that group are impossible. Furthermore, a large number of cases under state corporate law establish that the rights of shareholders to obtain corporate information are properly quite limited. By itself, that fact suggests strongly the existence of a meaningful distinction between the corporate client and its shareholders. Moreover, the SEC has made arguments similar to those it made in *National Student Marketing* in cases involving persons in other than a shareholder relationship, such as persons acquiring bonds issued by the lawyer's client. In one of the most important cases, the persons to whom counsel assertedly owed duties were neither the owners of the client nor even prospective owners; they were merely prospective creditors of the client [17]. The existence of such other cases may not invalidate the theory suggested in *National Student Marketing*. It does, however, suggest strongly that in all of these cases the SEC is seeking something quite different from a mere recognition that lawyers owe a client-type duty to corporate shareholders.

The position actually taken by the Commission in *National Student Marketing* can be sensible and consistent with prior SEC positions only if one abandons the notion that the case deals with the definition of "who constitutes the corporate client". Rather, the SEC's position involves solely the question of the extent to which the lawyer's duty to the client should be subordinate to some other, as yet only vaguely defined, asserted duties to the investing public or to the SEC. While that may be a difficult question in itself, it is not useful to give it greater complexity by unfairly asserting that it is part of the client definition problem.

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5. In the matter of Carter and Johnson

Carter and Johnson goes beyond *National Student Marketing* in the sense that it does wrestle with difficult aspects of the client definition question. While the Commission did ultimately hold that no Rule 21(e) discipline should be imposed, it also served notice that in future cases lawyers might be held responsible for not advising the board of directors of their corporate client, or resigning or taking other, comparable actions if the corporation's officers consistently disregard the proper and carefully given advice of counsel. Thus, this raises the question that is suggested, but is not really at issue, in *National Student Marketing*: given that the corporate entity is the client, who shall be heard to speak on behalf of this mute client?

The case involved National Telephone Company, which was in the business of leasing telephone equipment to customers. As is true in any leasing operation, the corporation needed substantial initial capital, since it acquired telephone equipment, installed it, and only then derived revenues from leasing the equipment to customers. The more business it had, the more capital it needed. Not surprisingly, the corporation ran into cash-flow difficulties and there came a time when its lenders were not willing to lend additional funds for capital purchases. After a while, the corporation's creditor banks insisted that the corporation cease new capital purchases.

Although the facts are not entirely clear, let it be assumed here that corporate counsel advised the chief executive officer that the position of the banks should be fully disclosed to the public shareholders and potential investors. However, public disclosure of these restrictions would certainly have had adverse business consequences – dampening employee morale and creating a lack of confidence on the part of existing and potential customers, to name two. Consequently, the chief executive officer refused to make the disclosures that counsel had urged. If those facts are assumed, then the basic position of the SEC staff in the case was that corporate counsel failed to perform its duty to advise the board of directors that it had given such advice and that the corporate officers had failed to heed it. This, then, presents the crux of the present inquiry: to what extent must corporate counsel seek higher authority within the corporation when advice is not initially followed?

6. Seeking a proper relationship

There is no clearly correct answer to this query. On one level one might well assert that if the corporation is the client then the board of directors is properly empowered to speak for the client, and any dispute such as that under consideration must be taken to that board of directors. However, to adopt that position on its face, without deeper inquiry, is too facile. It disregards the realities of corporate representation.

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The corporate client is not a monolith, and to address it as though it were is almost certain to lead to serious error. In some corporations the relationship between counsel and the board is long-standing and relatively close. Whether formally or informally, counsel can easily make the board aware when counsel's advice is disregarded. In many other corporations, however, a corporate officer arranges the employment of counsel. In that case, counsel may have neither a relationship with the directors of the corporation nor the ability to consult them with ease. In the former situation there is no practical difficulty in obligating the counsel, under appropriate circumstances, to consult with the board. In the latter, however, that endeavor can be most difficult. In some corporations, quite probably the vast majority, officers desire to adhere closely to the law (when it can be ascertained), recognize the proper role of counsel, and are willing to have matters of significance taken to the board if counsel requests. In some few others, however, officers may take a relatively hostile view toward counsel, and will allow counsel to bring a matter before the board only under the most extreme pressure. If, then, we are to establish some rule for the lawyer's obligation to proceed to the corporation's board of directors, we must do so carefully and in a manner that is sufficiently flexible to be susceptible to application in all instances.

It must be emphasized that we are not presented here with some of the concerns that existed in the *National Student Marketing* context. The questions of that case are relevant in that they indicate the context within which the present question must be answered. But there is no concern here with going to some widely dispersed group with whom confidential relationships are impossible. Rather, we are faced with the difficult and sensitive question as to when counsel for the corporation has some obligation to go beyond the persons with whom he customarily communicates and to insist that his concerns be brought to the attention of the board, and the related issue of how that duty is to be discharged.

In the abstract it may not be too difficult to suggest the norms that might govern corporate counsel in resolving such issues. However, those norms will periodically conflict, and their application in most real situations will be difficult. Furthermore, to identify norms in an article such as this is quite a different matter from determining that lawyers should be subject to some form of discipline for failure to heed them. As the Commission itself noted in the *Carter and Johnson* decision, at the present, there is no authoritative body that has adopted these (or any other) norms, and the imposition of discipline should therefore be subject to a finding of relatively clear and indefensible lawyer behavior.

It is suggested that the following two standards should govern the relationship of the lawyer with corporate officers.

1. Counsel should not, and should not be expected to, countenance behavior that is clearly wrongful, and is likely to have significant consequences, at least unless it has been specifically approved by the Board of Directors.

2. Counsel should not normally or readily interfere with the due and proper delegation of authority within the corporation.

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It is fairly obvious that both of the foregoing norms, if they are accepted, cannot be understood without elaboration, and that they will come into some degree of conflict in most of the difficult cases. The resolution of that conflict will call for the careful exercise of judgment by the lawyer.

6.1. Wrongful behavior

The genesis for this norm may be found in the present ABA Code. Various provisions of that code, although directed toward the lawyer who serves as litigator, indicate clearly that the lawyer should not be a participant in fraud or other illegal behavior [18]. In the modern corporate environment, however, it is not useful to speak generally of illegal behavior, or even of fraud. Too many activities are subject to too many regulations to make "illegality" a meaningful standard, and the expansion of fraud concepts in modern times has been too extensive for the notion of fraud to carry the importance that it once did.

For example, many governmental authorities have established street or highway regulations concerning weight limits, limiting the amount of weight that trucks may haul over roads. In some areas, enforcement of those regulations is infrequent, and the fines that must periodically be paid are commonly treated by companies as no more than a toll charge for the use of the roads. Under those circumstances, a lawyer could hardly be charged with some obligation to put an end to the client's clearly illegal behavior; the social significance of the regulation is not sufficient to mandate any such extraordinary activity by the lawyer. Rather, we must be willing to allow the lawyer considerable discretion, and must admonish only that he not countenance wrongful behavior that has truly significant potential consequences.

The intricate pattern of laws governing the modern corporation must also be acknowledged. A consequence of that situation is that what is "wrongful" is itself often far from clear. For example, it might easily be agreed that tax fraud is the sort of wrongful behavior that counsel should not permit. However, the dictates of the Internal Revenue Code, and of the regulations adopted pursuant to it, are complex, and many corporate transactions are of such a nature that it may reasonably be argued either that they do or that they do not generate adverse tax consequences. Under such circumstances, in a borderline case, we should not demand that counsel insist that the corporation file a tax return accepting the adverse consequences even if counsel believes that those consequences are the result of the better or more likely view of the applicable law.

Thus, the duty to prevent wrongful behavior must be seen to refer to more than behavior that is merely violative of law or within some extended definition of fraud. Rather, it must be accepted that the duty of counsel not to sanction antisocial behavior extends only to wrongful activities that are both clearly wrongful and of a significant nature. That does not, however, end the inquiry. For the notion of wrongful behavior, even when it is both clearly wrongful and significant in nature, embraces a rather broad spectrum and the potential responses of counsel

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must be equally broad. At some extreme level it can probably be accepted that counsel has a duty of public disclosure. Even if only a small minority would accept the position asserted in the SEC's *National Student Marketing* complaint, most legal analysts would probably agree that in a major corporate fraud (under traditional notions), such as that present in the case of *Equity Funding Corporation* [19], counsel would have an obligation of public disclosure if he were unable to put an end to the activity by other means.

The primary focus of this article is not on those extreme cases, but rather on the more frequent cases in which counsel's advice is not being followed, and counsel questions whether the matter must be taken to a higher authority within the corporation. To a significant extent, that determination must be made by reference to the other norm suggested above – the duty of counsel normally to observe the corporate delegation of authority.

6.2. Delegation

Delegation of authority is essential to operation of the modern corporation [20]. It is the practice of the board of directors in the modern corporation to meet relatively infrequently, and certainly no more frequently than monthly. Boards are typically composed of a number of non-management directors, who must look elsewhere for their livelihoods, and corporations are encouraged to expand the number of non-management directors. Such a board cannot "manage" directly – it must delegate. Furthermore, in the large, diversified corporation, even officiers must give to various subordinate officers a fairly broad grant of authority. The Chief Executive Officer of the $ 8 billion (sales) conglomerate simply cannot make all executive decision for the $ 500 million division headquartered 3,000 miles away. Rather, it is reasonable and necessary under such circumstances that executive authority be delegated, and the delegation may be more a matter of custom and informal delegation than the result of any written policy.

It is neither efficient nor desirable for counsel to frustrate the delegation process. Decisions that involve matters of law are not inherently more important to the corporation or to society than decisions involving investments, acquisitions, pollution control equipment, employment, marketing, or any one of a number of other areas of business involvement that may properly be delegated.

Thus, the proper role of corporate counsel in relation to the client must be seen as including, and accepting, this notion of delegation of authority. If a corporate vice president in Tulsa, Oklahoma, seeks the advice of local counsel, counsel should routinely assume that the vice president is the appropriate person with whom to communicate, and should not generally insist – even if it were practicable – on communicating with corporate headquarters in New York.

But in some instances this presumption of regularity is not warranted. It may properly be proposed that the apparent authority of an officer to make decisions

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within the formal or informal grant of his customary jurisdiction should be disregarded by counsel in two types of circumstances.

First, if the corporate officer in question has a personal conflict of interests, his authority should be questioned. For example, there has recently been some considerable attention given to the disclosure in proxy materials of the total remuneration paid to corporate officers. If, then, the corporate secretary to whom responsibility has generally been delegated for the preparation of proxy materials disagrees with counsel's advice, and refuses to include disclosure about an arguably material portion of his personal compensation, counsel should properly insist on review of the matter by a higher, disinterested officer of the corporation.

Second, counsel should always be alert to clearly wrongful activities that are significant. When there occurs such behavior, counsel should not lightly rely upon the delegation of authority. While recognizing that the delegation of authority is normally important, the exercise of sensitive judgment is an attribute of any true professional. Consequently, the lawyer must at all times be prepared to acknowledge that a particular state of facts may sometimes preclude reliance upon the normal delegation of authority.

6.3. Synthesizing the norms

There is a certain rather obvious conflict and circularity in the above proposed norms. They would suggest that corporate counsel should not allow wrongs to be perpetrated, but should observe due delegation of authority unless wrongs are threatened (or the delegate is in a position of conflict). Viewed as two rules for behavior, then, they would have to be considered unsatisfactory. But viewed as guiding principles, they may be useful.

The fundamental principle is that counsel should seek to dissuade clients from engaging in wrongful behavior. But in choosing a response to any particular proposed action that may be wrongful, counsel should consider how clearly it is wrong and how socially significant the wrong is (both part of the first norm) and should then consider the authority that has been delegated to the officer with whom counsel is dealing (the second norm). In the truly extreme case – the *Equity Funding* case – counsel may properly have a duty to go to any length, including public disclosure, to prevent the wrong. In the trivial case – such as that of periodically overloaded trucks – counsel may well be satisfied with the decision of a responsible, albeit subordinate, officer. Between these cases, counsel will have to use sensible judgment, considering the factors outlined above, in deciding how far within the corporate hierarchy a matter must be appealed when counsel's advice is not taken.

In fact, of course, counsel's decisions in any case must also be made against the background of counsel's relationship with the particular client. The guiding principles outlined above may appear satisfactory in the sterile world of abstraction, but their application in any given case must be, and should properly be, affected to

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a substantial degree by the human element of the relationship between the lawyer and the client. Each corporation–attorney relationship is different.

In one case, counsel may have been selected by the Board of Directors after a very thorough examination. In another, the selection of counsel for a particular matter may have been delegated to a corporate officer who is far removed from corporate headquarters and who has relatively little direct input into the corporate decision-making process. In the typical case, corporate counsel is probably chosen as a result of some relationship with the corporation, the chief executive officer or (where one exists) the internal general counsel. In each of those situations, and in the numerous others that are possible, the case in which counsel may seek a higher-level decision will be different. Where the primary personal relationship is with directors of the corporation, or where a clear relationship with the board exists, it may be relatively simple to insist that a particular matter be considered by the board. Where the relationship is with a relatively distant officer, it may be extremely difficult to bring a decision to the attention of higher-ranking officers, much less the board.

Yet the ability of counsel to function effectively is dependent in large measure upon maintaining these complex personal relationships. Accordingly, application of the abstract guides to particular cases, and any decision as to how they are properly to be applied, should vary depending upon the nature of the particular relationship.

For example, assume that a corporation with headquarters in New Jersey proposes to acquire, in exchange for shares of its common stock, a corporation in Arkansas. The acquisition is relatively small in relation to the New Jersey corporation, and the matter is delegated to a corporate vice-president located in Arkansas for final negotiation and consummation. He, with headquarters' approval, hires Little Rock counsel to assist in negotiation and documentation, including preparation of a proxy statement for the shareholders of the Arkansas corporation. Now suppose that in preparing the proxy statement, Little Rock counsel discovers that the New Jersey corporation has for several years been engaged in an antitrust violation, but that the vice-president insists that there be no disclosure of it in the proxy statement. What, here, are the obligations of counsel?

It may be useful at this point to elaborate upon the factors discussed above. If the antitrust violation is relatively unclear (as in a potentially illegal allocation of sales territories), and the consequences relatively slight (as in potential damages, even trebled, being a miniscule part of sales, earnings and net worth of the New Jersey corporation), counsel should not be criticized for acceding to the vice-president's views, especially in light of the difficulty of communicating with the officer's superiors at corporate headquarters. On the other hand, if the violation were clear (*e.g.* a written agreement to fix prices) and the risk substantial (*e.g.* equal to the preceding year's corporate earnings) there would be little excuse for failing to insist on a higher-level review. That conclusion would be even more clear if counsel had been selected by the chief executive in New Jersey, and there were a pre-existing relationship between the two.

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Between those extremes lies the area in which judgment is required. It is by no means an easy path to walk, and counsel should not be too lightly criticized for inadvertently missing a step along the way. Certainly, significant departures from established norms should be disciplined. But to put too much pressure upon counsel, as the initial decision of the administrative law judge in *Carter and Johnson* may be perceived as doing, is not beneficial. The Commission itself clearly recognized that concern in the decision which it finally rendered.

7. Some conclusions

The relationship of attorney and client is one of trust and restraint. The historical ABA Code has always recognized that counsel should try to conform client behavior to social norms, that counsel should not countenance wrongful behavior, but that counsel should follow the client's ultimate desires and not his own. Those dictates, albeit in modified form, should be as applicable to the modern-day lawyer advising the corporation as to the traditional litigation attorney for whom they were written. But those dictates mandate a delicate balance between the client-oriented duty of the lawyer and his public duty.

The recent emphasis on the public duty of the lawyer is no doubt useful. It will serve to make all lawyers more cognizant of the duties that are theirs by being members of what is properly called a profession. But the balance between duty to public and duty to client is important. The SEC clearly recognized the importance of this balance in *Carter and Johnson,* holding only that when " a lawyer with significant responsibilities in ... compliance with the federal securities laws becomes aware ... [of] substantial and continuing failure to satisfy ... disclosure requirements ... [he must take] prompt steps to end the client's noncompliance" [21]. The SEC was clear that the lawyer is not required to be successful, and that the propriety of the actions taken will be judged according to all the circumstances faced by the lawyer.

In the vast majority of instances in which these questions arise, we are not dealing with clear violations of law or clear social evil. Rather, we are dealing with cases in that ambiguous area that is neither clearly right nor clearly wrong. And in that ambiguous area it is proper, and maximizes social utility in the broad sense, if decisions are made by those who are in a proper position to evaluate risks and benefits, and to bear one and reap the other. Under the guides discussed in this article, counsel should certainly seek, within the limits of practicality, to ensure that decisions are made by the appropriate, responsible personnel. But counsel should not use the pressure of appeal to a higher level as a means of appropriating decision-making authority to himself, and we should not encourage counsel to take that course. To do so will almost certainly result in unduly conservative decisions.

The decision-making process involves weighing potential risks and potential rewards. We can generally assume that society has adopted a pattern of laws that

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provide the proper inputs for decision-making. If an activity is of such a type that it is arguably unlawful, that is one of the risks that must be evaluated. But if the device of sanctioning lawyers is effectively used to make lawyers the decision-makers, then wrong decisions are likely to follow. For the potential rewards to the lawyer from proceeding with an activity will seldom be sufficient, in *his* judgment, to offset the potential risks.

If activity is clearly wrongful (and significant in nature), society has decreed that it shall not be undertaken. The lawyer may properly be commanded to exert great efforts to cause the corporation to observe that decree. But in most cases it is important that the lawyer allow the corporation itself, by its appropriate personnel, to make behavioral decisions, giving due weight (but no more than due weight) to legal advice.

The decision of the Commission in *Carter and Johnson* is carefully crafted, and suggests a reasonable and responsible approach toward the difficult role of counsel in such cases. It also, however, provides only a skeletal framework for analysis, and leaves much open for future decisions. It is hoped that the analysis presented in this paper will provide useful additional guidance for lawyers who find themselves faced with similar situations, and for courts who pass upon the acceptability of their behavior.

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Notes

[1] 457 F. Suppl. 682 (D.D.C. 1978). *See also, e.g., Keating, Muething and Klekamp,* Securities Exchange Act of 1934 Release No. 15982 (July 2, 1979); *Plotkin, Yolles, Siegel and Turner,* Securities Act of 1933 Release No. 5841 (July 5, 1977); *Sitomer,* Securities Exchange Act of 1934 Release No. 12501 (June 1, 1976); *McLaughlin and Stern, Ballen and Miller,* Securities Exchange Act of 1934 Release No. 11553 (July 25, 1975); *Lloyd Feld,* Securities Exchange Act of 1934 Release No. 11775 (Oct. 30, 1975); *Milton Loewe,* Securities Exchange Act of 1934 Release No. 11776 (Oct. 30, 1975); *Sam Clammer,* Securities Act of 1933 Release No. 5518 (Aug. 2, 1974); *Jo M. Ferguson,* Securities Act of 1933 Release No. 5523 (Aug. 21, 1974); *Irvin L. Germaise,* Securities Act of 1933 Release No. 5216 (Dec. 7, 1971).

[2] In the Matter of Carter and Johnson, Administrative Proceeding File No. 3-5464 [1979] 494 Sec. Reg. and L. Rep. (BNA) at F-1, reversed Securities Exchange Act Release No. 17,597 (Feb. 28, 1981).

[3] *See* American Bar Association, Code of Professional Responsibility [hereinafter cited as "ABA Code"], Ethical Consideration 5–18 (1977).

[4] In the Matter of Carter and Johnson, Administrative Proceeding File No. 3–5464 [1979] 494 Sec. Reg. and L. Rep. (BNA) at F-1 *reversed,* Securities Exchange Act Release No. 17,597 (Feb. 28, 1981).

[5] *Id.*

[6] 17 C.F.R. § 201.1(e) (1980).

[7] Although the ABA has no formal authority, and is a voluntary organization, its membership comprises approximately one-half of the practicing lawyers in the United States. It is given substantial credibility by the several states, and its promulgations regarding ethics have either been adopted by or have been an important force in each of the states.

[8] *See* Lorne, *The Corporate and Securities Adviser, The Public Interest, and Professional Ethics,* 76 Mich. L. Rev. 423 (1977–78).

It should be noted that the ABA Code itself, particularly with respect to some of the issues analyzed in this article, is currently being re-examined by the so-called Kutak Commission. *See* American Bar Association Special Commission on Evaluation of Professional Standards, Discussion Draft (Jan. 30, 1980).

[9] ABA Code, *supra* note 3, Ethical Considerations 2–26 through 2–28, 5–14 through 5–16; Disciplinary Rules 5–101(a), 5–105.

[10] ABA Code, *supra* note 3, Canon 4, and Ethical Considerations and Disciplinary Rules thereunder.

[11] *See* ABA Code, *supra* note 3, Ethical Considerations 4–2, 7–10; Disciplinary Rules 1–102(A)(4), 2–110(B)(2), 4–101(C)(2), 4–101(C)(3), 7–102(A)(5), 7–102(A)(7), and 7–102(B).

[12] 5 U.S.C. § 500 (1976); 17 C.F.R. § 201.2 (1980).

[13] *See* Touche Ross & Co. v. S.E.C., 609 F.2d 570 (2d Cir. 1979); Koden v. United States Dept. of Justice, 564 F.2d 228 (7th Cir. 1977).

[14] At least in the view of the SEC, one who is disqualified from practicing before it may not perform many acts that non-lawyers, who have never been authorized to "practice" before it can, and frequently do, perform. *See, e.g., Sitomer,* Securities Exchange Act of 1934 Release No. 12501 (June 1, 1976).

[15] *See, e.g.,* Sommer, *The Commission and the Bar: Forty Good Years,* 30 Bus. Law. 5 (1974) at 8.

[16] *See generally* Freedman, Lawyers' Ethics in an Adversary Society (1975).

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[17] *In the Matter of Jo M. Ferguson*, Securities Act of 1933 Release No. 5523 (Aug. 21, 1974), reported in 5 SEC Docket 37 (1974–75).

[18] *See* text accompanying note 11, *supra*.

[19] In the Matter of Equity Funding Corporation of America, 519 F.2d 1274 (9th Cir. 1975).

[20] Of course the assignment of duties to officers of the corporation may well be more than a "delegation". If the Board's duty is to monitor, *see* Leech and Mundheim, The Outside Director of the Public Corporation (Korn/Ferry International, 1976), rather than to manage, then the grant of authority to officers is more in the nature of an allocation of authority than a delegation.

[21] In the Matter of Carter and Johnson, Securities Exchange Act Release No. 17,597 (Feb. 28, 1981) at text preceding note 76.

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