

10-1-1996

The Dilemma of Corporate Counsel Faced with Client Misconduct: Disclosure of Client Confidences or Constructive Discharge

H. Lowell Brown
Northrop Grumman

Follow this and additional works at: <https://digitalcommons.law.buffalo.edu/buffalolawreview>



Part of the [Legal Ethics and Professional Responsibility Commons](#)

Recommended Citation

H. L. Brown, *The Dilemma of Corporate Counsel Faced with Client Misconduct: Disclosure of Client Confidences or Constructive Discharge*, 44 Buff. L. Rev. 777 (1996).

Available at: <https://digitalcommons.law.buffalo.edu/buffalolawreview/vol44/iss3/14>

This Article is brought to you for free and open access by the Law Journals at Digital Commons @ University at Buffalo School of Law. It has been accepted for inclusion in Buffalo Law Review by an authorized editor of Digital Commons @ University at Buffalo School of Law. For more information, please contact lawscholar@buffalo.edu.

The Dilemma of Corporate Counsel Faced with Client Misconduct: Disclosure of Client Confidences or Constructive Discharge

H. LOWELL BROWN†

INTRODUCTION

Recent cases upholding in-house counsel's rights to sue former clients for wrongful discharge and other similar causes of action have once again brought into focus the troubling issue of whether, or under what circumstances, corporate counsel, particularly in-house counsel, are ethically obligated to "blow the whistle" on their corporate client's misconduct. Where, in the past, a lawyer's obligation to speak out in the face of client misconduct was typically viewed as one of ethics and professional conduct alone, increasingly, a lawyer's failure to disclose client wrongdoing to the government or to third parties is also being viewed as a basis of personal criminal and civil liability.

In view of the possibility of personal civil and criminal liability if counsel does not "blow the whistle" on the client's unlawful conduct, are there circumstances under which counsel must either breach a client's confidences or resign? And if so, would in-house counsel's resignation under those circumstances constitute an actionable constructive discharge?

Courts are divided on these issues although a growing body of case law suggests that an in-house counsel who must resign for ethical reasons has recourse against the employer/client. In any event, finding the point at which the lawyer's professional responsibility is completely at odds with the lawyer's responsibility to the client requires following a tortured path through the applicable standards of ethics and decisional rules. This article is an attempt to navigate the thicket.¹

† (c) 1995 H. Lowell Brown Assistant General Counsel, Northrop Grumman Corporation; B.A. Syracuse University; J.D. Antioch Law School. The author wishes to express his appreciation to Richard R. Molleur, Corporate Vice President and General Counsel of Northrop Grumman Corporation, for his assistance in the formulation and refinement of this article. The article's faults are the responsibility of the author as are the opinions expressed, which do not necessarily reflect the views of Mr. Molleur or the Northrop Grumman Corporation.

1. Although the ethical standards provide basic guidance for corporate lawyers con-

Part I of the article analyzes the basic framework of who is the client and what confidences are protected, in the context of the representation of a corporation. Part II discusses the alternatives open to corporate counsel who discover corporate misconduct. Part III considers the possible consequences for corporate counsel if counsel remains silent in the face of client illegality. And finally, Part IV presents possible remedies both for the corporate counsel who must disassociate from the client's illegality, and who for that reason, is terminated, either actually or constructively, as well as for the corporate client facing disclosure of its confidences by the corporation's former counsel.

fronting corporate misconduct, both the Code of Professional Responsibility and the Model Rules of Professional Conduct have been criticized for failing to adequately respond to the unique circumstances of a lawyer whose client is an entity rather than an individual. See Jonathan J. Lerner, *Traversing the Legal Ethics Minefield of the 1990's: When Does the Corporate Counsel become a Cop? in THE ATTORNEY-CLIENT RELATIONSHIP AFTER KAYE, SCHOLER*, at 9, 17 (PLI Corp. Law & Practice Course Handbook Series No. 779, 1992). As Lerner observes:

The difficulties presented to counsel faced with this situation are exacerbated by ethical rules that are not definitive. Neither the ABA's Model Rules of Professional Conduct adopted in 1983 . . . or, its predecessor, the Model Code of Professional Responsibility adopted in 1969 . . . and still in force in some states, provide bright-line guidance as to the parameters of a lawyer's obligation when confronted with a client's misconduct.

Id. at 17; George D. Reyecraft, *Conflicts of Interest and Effective Representation: The Dilemma of Corporate Counsel*, 39 HASTINGS L.J. 605, 609 (1988). Reyecraft notes that:

Problems for the corporate and securities lawyer arise because at various times . . . the interests of the organizational client's constituents diverge. The corporate counsel is then placed in the position of determining who commands his primary loyalty and how he can adequately fulfill his duties and responsibilities to each constituent in the face of their conflicting interests. Because the Model Code and the Model Rules fail to explain how a corporate lawyer can determine the 'entity's' interest in such situations, the lawyer must confront competing loyalties and duties of confidences to the various groups with little or no guidance as to how he might resolve the conflicts.

Id. at 609; Maureen H. Burke, *The Duty of Confidentiality and Disclosing Corporate Misconduct*, 36 BUS. LAW. 239, 253 (1981). Burke states that:

Corporate counsel face unique problems. Their clients are abstract legal entities, heavily regulated by the government, and often wield enormous social and economic power. The public increasingly looks to corporate lawyers as guardians of the corporate conscience. Unfortunately, the Code of Professional Responsibility offers even less guidance to corporate lawyers faced with determining the scope of the duty to disclose client misconduct than it does to lawyers with other types of clients.

Id. at 253.

I. WHO IS THE CLIENT AND WHAT CONFIDENCES ARE PROTECTED?

A. *Who Is The Client?*

Every lawyer for a business entity, whether a member of an in-house legal department or an attorney in an outside firm, must be aware of and resolve the issue of who it is that the lawyer represents. Both the Code of Professional Responsibility (the "Code") and the Model Rules of Professional Conduct (the "Model Rules") provide the facile answer that the client is the entity and not the individuals who comprise it. For example, under Canon 5 of the Code, Ethical Consideration 5-18 provides the instruction that:

A lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity. In advising the entity, a lawyer should keep paramount its interests and his professional judgment should not be influenced by the personal desires of any person or organization.²

That the lawyer for the corporation represents the corporation and no one else is a truism bordering on tautology. Worse, because the corporation has no will of its own or capacity to act except through its human constituents: directors, officers, employees and stockholders, corporate counsel's relationship with those who act on behalf of the corporation is fraught with ambiguity.³ On the one hand, corporate counsel must extract information, often of a highly confidential nature, from the individuals associated with the corporation with whom the lawyer regularly deals, while at the same time the lawyer must segregate the interests of those individuals as manifestations of the corporate client (which must be protected) and the individual interests of those same individuals (which the lawyer has no obligation to protect).⁴

2. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-18 (1980).

3. This ambiguity led Louis Brandeis to remark, when asked whom he represented in the face of numerous conflicting interests in United Shoe Machine Trust, "I represent the situation." Brian D. Forrow, *The Corporate Law Department Lawyer: Counsel to the Entity*, 34 BUS. LAW. 1797, 1800 (1979). Brandeis was roundly criticized for this characterization of his role, see John S. Dzienkowski, *Lawyers as Intermediaries: The Representation of Multiple Clients in the Legal Profession*, 1992 U. ILL. L. REV. 741, 742-43 (1992), but nevertheless, the description is an apt one for corporate counsel. Forrow, *supra*, at 742-43.

4. The Code does not appear to have fully contemplated such a schizoid relationship. See Forrow, *supra* note 3, at 1799. As Forrow notes:

The code is keyed to the relationship between a lawyer and a client, but a cor-

An attempt at clarity was made with the adoption of the Model Rules, which are now the prevailing standards of conduct in the majority of states.⁵ Thus, Model Rule 1.13 provides, in part, that "[a] lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents."⁶ And the comment following Model Rule 1.13 explains:

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 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 representation⁷

The distinction between the entity, a legal fiction, and those empowered to act on behalf of the entity remains blurred, however. And as one commentator has observed, the situation is a "perverse" one in which the lawyer is engaged by, advises, and

porate lawyer must deal not with an entity as a client in an abstraction but with individuals having authority to act on behalf of the entity—employees, managers and officers, members of the board of directors and, in some cases, controlling shareholders.

Id.

5. The Model Rules have been adopted by 35 states and the District of Columbia (Arizona, Arkansas, Colorado, Connecticut, Delaware, Florida, Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maryland, Michigan, Minnesota, Mississippi, Missouri, Montana, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Oklahoma, Pennsylvania, Rhode Island, South Carolina, South Dakota, Texas, Utah, Washington, West Virginia, Wisconsin and Wyoming). Four states continue to follow the Code, albeit with modifications (Massachusetts, Oregon, Virginia and New York). See Note, *Inside Fraud, Outside Negligence and the Savings and Loan Crises: When Does Management Wrongdoing Excuse Professional Malpractice?*, 26 LOY. L.A. L. REV. 1165, 1209 nn.332, 333 (1993).

6. See Robert J. Kutak, *Proposed Model Rules of Professional Conduct*, 36 BUS. LAW. 573, 578-79 (1981). Kutak stated that:

As you know, Rule 1.13 ["organization as client"] proceeds from the traditional premise that the lawyer for the corporation represents the corporation as opposed to any of its many constituencies. In other words, our point of departure was the Code's Ethical Consideration 5-18; but we could not stop there because that general premise provides no meaningful guidance to corporate counsel called upon to make a specific decision under particular circumstances. If a code of professional duty is to provide meaningful guidance to those who consult it, the implications of that general premise must be fully explored and clearly stated in the rules.

Id. at 578-79. Robert J. Kutak was the Chairman of the ABA Commission on Evaluation of Professional Standards which proposed the Model Rules.

7. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 cmt. (1995).

can be discharged by, persons who are not the lawyer's clients while the shareholders (the closest human manifestation of the "client") are largely uninvolved and uninformed of the lawyer's representation.⁸

Nevertheless, while the entity-client theory has led to vexing issues in litigation concerning multiple representation⁹ and has been criticized by commentators,¹⁰ the identification of the entity as the client continues to serve as lodestar for the ethics of corporate counsel.¹¹

8. See Ralph Jonas, *Who is the Client?: The Corporate Lawyer's Dilemma*, 39 HASTINGS L.J. 617 (1988). Jonas goes on to state:

[W]e have the perverse situation in which the lawyer who represents a publicly held corporation is selected and retained by, and reports to and may be fired by, the principal officers and directors of the corporation—*who are not his clients*. Moreover, the shareholders of a corporation, who, collectively, are the owners of the mythical beast, typically do not participate in the process by which the lawyer is selected, retained, or fired.

Id.

9. See, e.g., *Wylie v. Marley Co.*, 891 F.2d 1463 (10th Cir. 1989) (exclusion of communications between a corporate employee and the general counsel on the grounds that the employee reasonably believed he was seeking legal advice); *Evans v. Artek*, 715 F.2d 788 (2d Cir. 1983) (remanded in order to determine whether law firm would be disqualified from representing individual parties in suit with acquiring corporation where the issue was whether counsel, who had also served as counsel to the acquired entity, had consulted with plaintiff individually or as president of the entity); *FTC v. Exxon Corp.*, 636 F.2d 1336 (D.C. Cir. 1980) (corporate counsel prohibited from acting as counsel to a wholly-owned subsidiary that was possibly subject to divestiture). As Professor Geoffrey C. Hazard has pointed out, the creation of an attorney-client relationship with an employee of the corporation may result in counsel's inability to represent the corporation:

When the corporate officer begins talking, the lawyer must be mindful that a lawyer-client relationship is in the making. At this point, if the lawyer treats the corporate officer as the client, and if he learns things that may subject the officer to criminal or civil liability, the lawyer is bound by the rule of confidentiality not to disclose these matters to others, for example to the board of directors. But the lawyer's general retainer, if we may call it that, is to the corporation. The board will consider that it "is" the corporate client, and expect the lawyer eventually to advise the board what to do, including advice about the possibility of proceeding against the executive. The lawyer may find himself unable to do that without violating his professional duty to the executive. The board will then feel at least disappointed and very likely betrayed.

GEOFFREY C. HAZARD, JR., *ETHICS IN THE PRACTICE OF LAW* 50 (1978).

10. See, e.g., Roberta S. Karmel, *Duty to the Target: Is an Attorney's Duty to the Corporation a Paradigm for Directors?*, 39 HASTINGS L.J. 677, 681 (1988); Jonas, *supra* note 8, at 622; Reycraft, *supra* note 1, at 610-11; Thomas B. Leary, *Is there a Conflict in Representing a Corporation and its Individual Employees?*, 36 BUS. LAW. 591, 592 (1981).

11. Thus, as Robert Kutak observed, "[n]o matter which way we approach it I think all recognize that an attorney's duty runs to the corporation and this will require that the attorney act to protect the interest of the corporate client apart from the interests of its many constituents." Kutak, *supra* note 6, at 577.

B. *What Confidences Are Protected?*

The privilege from disclosure to third parties of a client's communication with an attorney is a fundamental tenet of the attorney-client relationship. It is the oldest of the common-law privileges¹² and has as its purpose the encouragement of "full and frank communications between attorneys and their clients . . ."¹³ The privilege arises when one communicates with a lawyer in the course of an attorney-client relationship,¹⁴ and protects not only the professional advice that is provided but also the giving of information to the lawyer by the client, upon which the advice is based.¹⁵

In the corporate setting, the United States Supreme Court has made it clear that communications from all levels of the corporation, not solely those who would be considered the "control group," are subject to the privilege.¹⁶ Accordingly, the attorney

12. *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981) ("The attorney-client privilege is the oldest of the privileges for confidential communications known to the common law."). Indeed, the attorney-client privilege has its origins in Roman law and was incorporated in early English law. See Burke, *supra* note 1, at 242; Junius Hoffman, *On Learning of a Corporate Client's Crime or Fraud—the Lawyer's Dilemma*, 33 BUS. LAW. 1389, 1396 (1978).

13. *Upjohn Co.*, 449 U.S. at 389. As one commentator has suggested, the attorney-client privilege creates a "safe house" of non-disclosure. Hoffman, *supra* note 12, at 1395-96. As Hoffman elaborates:

A logical way to insure that [the lawyer's duty to the client] will be done is to constitute the lawyer a safe house of non-disclosure for confidential information received from his client. And of course the particular foundation upon which such safe house has been built is the attorney-client privilege.

Id.

14. Thus, it is said that the privilege applies if:

(1) [T]he asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.

United States v. United Shoe Mach. Corp., 89 F. Supp. 357, 358-59 (D. Mass. 1950).

15. *Upjohn Co.*, 449 U.S. at 390 ("[T]he privilege exists to protect not only the giving of professional advice to those who can act on it but also the giving of information to the lawyer to enable him to give sound and informed advice.").

16. As the Court stated in *Upjohn Co.*:

In the case of the individual client the provider of information and the person who acts on the lawyer's advice are one and the same. In the corporate context, however, it will frequently be employees beyond the control group as defined by the court below—"officers and agents . . . responsible for directing [the com-

client privilege will attach if: (1) the communications were made to corporate counsel, acting as such¹⁷; (2) the communications were made at the direction of management in order to secure legal advice from counsel; (3) the communications concerned matters within the scope of the employees' corporate duties; and (4) at the time the communications were made, the employees were aware that they were being questioned in order that the corporation could obtain legal advice.¹⁸

Although both the attorney-client privilege and the lawyer's ethical obligation to preserve client confidences serve the same end of encouraging communication between lawyer and client, the two are not coextensive. Indeed, the ethical obligation is significantly broader than the privilege. The attorney-client privilege is an evidentiary privilege that prohibits compelled disclosure to third parties of client confidential communications.¹⁹ Thus, the privilege only arises in the context of litigation. Further, because the privilege is a rule of exclusion, the privilege is construed narrowly.²⁰

pany's] actions in response to legal advice"—who will possess the information needed by the corporation's lawyers. Middle-level—and indeed lower-level—employees can, by actions within the scope of their employment, embroil the corporation in serious legal difficulties, and it is only natural that these employees would have the relevant information needed by corporate counsel if he is adequately to advise the client with respect to such actual or potential difficulties.

449 U.S. at 391.

17. The applicability of the privilege to communications with corporate counsel is sometimes difficult to sustain because corporate counsel from time-to-time function as both legal and business advisors. Thus, the privilege has not been recognized when it has been found that corporate counsel's activities were not primarily those of a lawyer, as for example, where counsel served as a business advisor, *see, e.g.*, *United States v. Davis*, 636 F.2d 1028, 1044 (5th Cir. 1981) (receipt and disbursement of funds); *United States v. Huberts*, 637 F.2d 630, 640 (9th Cir. 1980) (sale of equipment); *SEC v. Gulf & Western Industries, Inc.*, 518 F. Supp. 675, 683 (D.D.C. 1981) (acting as a corporate director, member of pension fund investment committee and investment advisor); negotiator, *see, e.g.*, *Attorney General v. Covington & Burling*, 430 F. Supp. 1117, 1121 (D.D.C. 1977) (contract negotiations); or lobbyist, *see, e.g.*, *North Carolina Elec. Membership Corp. v. Carolina Power and Light Co.*, 110 F.R.D. 511, 517 (M.D.N.C. 1986).

18. *Upjohn Co.*, 449 U.S. at 394.

19. *See, e.g.*, *Doe v. A Corporation*, 709 F.2d 1043, 1046 (5th Cir. 1983) ("The attorney-client privilege is evidentiary. A client may invoke it to prevent his lawyer from revealing communications made in confidence to the lawyer while acting in the capacity of professional legal advisor for the purpose of obtaining legal advice.").

20. *See, e.g.*, *Westinghouse Electric Corp. v. Republic of the Philippines*, 951 F.2d 1414, 1423 (3d Cir. 1991) ("Because the attorney-client privilege obstructs the truth-finding process, it is construed narrowly."); *Diversified Industries, Inc. v. Meredith*, 572 F.2d 596, 602 (8th Cir. 1978) ("While the privilege, where it exists, is absolute, the adverse effect of its application on the disclosure of truth may be such that the privilege is

In contrast, a lawyer's ethical obligation of confidentiality is not limited to judicial proceedings, but instead relates to all of the lawyer's activities on behalf of the client.²¹ Unlike the attorney-client privilege that prohibits only disclosure of confidential information,²² the ethical rule prohibits both disclosure and use of client confidences.²³ This is, at least in part, because rather

strictly construed."); *Garner v. Wolfinbarger*, 430 F.2d 1093, 1100-01 (5th Cir. 1970). According to the Fifth Circuit in *Garner*:

[T]he privilege remains an exception to the general duty to disclose. Its benefits are all indirect and speculative; its obstruction is plain and concrete . . . It is worth preserving for the sake of a general policy, but is nonetheless an obstacle to the investigation of the truth. It ought to be strictly confined within the narrowest possible limits, consistent with the logic of its principle.

Id. (quoting 8 WIGMORE, EVIDENCE § 2291 (1940)). See also Samuel H. Gruenbaum, *Clients' Frauds and Their Lawyers' Obligations: A Response to Professor Kramer*, 68 GEO. L.J. 191, 195 (1979) ("[T]he privilege is construed narrowly and strictly because its application detracts from full disclosure and thus is detrimental to the administration of justice. It therefore may be asserted only after careful analysis shows that all of the elements necessary to bring it into existence are present.").

21. See *Burke*, *supra* note 1, at 241 ("The ethical obligation is broader than the attorney-client evidentiary privilege. The evidentiary privilege only arises in a situation involving litigation, whereas the ethical obligation governs an attorney's behavior in all his professional duties.") (footnote omitted). This is also made clear in the comment following Model Rule 1.6 ("Confidentiality of Information") which states:

The attorney-client privilege applies in judicial and other proceedings in which a lawyer may be called as a witness or otherwise required to provide evidence concerning a client. The rule of client-lawyer confidentiality applies in situations other than those where evidence is sought from the lawyer through compulsion of law.

MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 cmt. (1995).

22. In order to be subject to the attorney-client privilege, the communication must be of a confidential nature. Thus, for example, checks drawn to attorneys are not considered confidential communications and accordingly are not protected from disclosure. See *Harris v. United States*, 413 F.2d 316, 319 (9th Cir. 1969) ("[T]he client, by writing the check which the attorney will later cash or deposit at the bank, has set the check afloat on a sea of strangers . . . Thus, the check is not a confidential communication, as is the consultation between attorney and client."); *United States v. Judson*, 322 F.2d 460, 463 (9th Cir. 1963) ("The canceled checks and bank statements are not within the attorney-client privilege. These items were negotiable instruments in commerce and were never confidential from the time of their creation. Their transfer from the client to the attorney did not constitute a confidential communication."). Similarly, information provided to a lawyer for preparation of a document that is intended to be disclosed to third parties may not be subject to the privilege. See, e.g., *In re Grand Jury Proceedings*, 727 F.2d 1352, 1355-56 (4th Cir. 1984) (information provided for the preparation of a prospectus was not privileged); *United States v. Lawless*, 709 F.2d 485, 487 (7th Cir. 1983) (information to be included in tax return was not privileged).

23. So, for example, under the Code, "[a] lawyer shall not knowingly . . . reveal a confidence or secret of his client . . . [u]se a confidence or secret of his client to the disadvantage of the client . . . [u]se a confidence or secret of his client for the advantage of himself or of a third person . . ." MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 4-101(B) (1980) ; see also MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 4-5 (1980) ("A

than being a rule of evidence²⁴ the ethical duty derives from the law of agency.²⁵

Additionally, in order to be subject to the privilege, the communications must be made under circumstances that manifest the corporation's intent that the communications be confidential.²⁶ Disclosure to third parties will waive the protections of the attorney-client privilege.²⁷ Again in contrast to the privilege,

lawyer should not use information acquired in the course of representation of a client to the disadvantage of the client and a lawyer should not use such information . . . for his own purposes.”)

24. Some commentators have suggested that the privilege is of constitutional dimension as being necessary to the vindication of Fifth and Sixth Amendment rights. See Steven Goode, *Identity, Fees, and the Attorney-Client Privilege*, 59 GEO. WASH. L. REV. 307, 313 (1991); Note, *The Sixth Amendment, Attorney-Client Relationship and Government Intrusions: Who Bears the Unbearable Burden of Proving Prejudice?*, 40 J. URB. CONTEMP. L. 109, 123 (1991); Burke, *supra* note 1, at 262-63; Note, *The Attorney-Client Privilege: Fixed Rules, Balancing, and Constitutional Entitlement*, 91 HARVARD L. REV. 464, 486 (1977). Of course, a corporation does not enjoy a Fifth Amendment privilege. See *George Campbell Printing Corp. v. Reid*, 392 U.S. 286, 288-89 (1968); *Hale v. Hinkel*, 201 U.S. 43, 74-75 (1906).

25. See Steven S. Gensler, *Wrongful Discharge for Attorneys? Holding the Line Against Lawyers' Self Interest*, 1992 U. ILL. L. REV. 515, 539 (1992). As Gensler notes:

Whereas the attorney-client privilege was born of the law of evidence, attorney-client confidentiality finds its roots in the law of agency. The professional codes of legal ethics impose on attorneys a fiduciary duty to their clients. The codes recognize this duty as a means of regulating and policing the legal community to ensure that it is the master (the client) and not the servant (the attorney) who is served by the lawyer's endeavors. Although the client is the beneficiary of confidentiality, the codes, and not the client, determine the extent to which these confidences are honored and protected.

Id. (footnote omitted); Kutak, *supra* note 6, at 579 n.12 (“Under general principles of agency law applicable to corporations, communication to an officer or other agent of the corporation acting within the actual or apparent scope of his authority with reference to a matter to which his employment or authority extends is communication with the corporation.”). Thus, under the Code, “[b]oth the fiduciary relationship existing between lawyer and client and the proper functioning of the legal system require the preservation by the lawyer of confidences and secrets of one who has employed or sought to employ him.” MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 4-1 (1980).

26. See, e.g., *Diversified Industries*, 572 F.2d at 609 (the attorney-client privilege is applicable to communications if, *inter alia*, “the communication is not disseminated beyond those persons who, because of the corporate structure, need to know its contents.”); *Pitney Bowes, Inc. v. Mestre*, 86 F.R.D. 444, 448 (S.D. Fla. 1980) (court found that “broad distribution” of document to twelve persons in addition to the addressee reflected a lack of confidentiality); Cf. *James Julian, Inc. v. Raytheon Co.*, 93 F.R.D. 138, 141 (D. Del. 1982) (distribution of legal opinions prepared by company counsel to seven individuals in the company did not defeat the privilege, “the distribution was both reasonable and necessary; the status of each of the seven named individuals was such that it was essential that they know the contents of the memorandum.”).

27. See, e.g., *United States v. El Paso Co.*, 682 F.2d 530, 540 (5th Cir. 1982) (disclosure of tax analysis to independent auditors waived privilege). As one commentator has

the attorney's ethical obligation is not necessarily extinguished as a result of the client's disclosure of confidential information to a third party.²⁸ Indeed, the confidential information need not come from the client in the first instance.²⁹

Further, the attorney-client privilege extends only to communications and does not apply to other information obtained by the lawyer as a result of the attorney-client relationship.³⁰ The ethical obligation is not restricted to communications, but,

noted, "if clients themselves divulge such information to third parties, chances are that they would also have divulged it to their attorneys even without the protection of the privilege. Thus, once a client has revealed privileged information to a third party, the basic justification for the privilege no longer applies . . ." Comment, *Stuffing the Rabbit Back into the Hat: Limited Waiver of the Attorney-Client Privilege in an Administrative Agency Investigation*, 130 U. Penn. L. Rev. 1198, 1207 (1982).

28. Thus, under the Code, "[t]he attorney-client privilege is more limited than the ethical obligation of a lawyer to guard the confidences and secrets of his client. This ethical precept, unlike the evidentiary privilege, exists without regard to the nature or source of information or the fact that others share the knowledge." MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 4-4 (1980). See *Brennan's, Inc. v. Brennan's Restaurants, Inc.*, 590 F.2d 168, 172 (5th Cir. 1979) ("Information so acquired is sheltered from use by the attorney against his client by virtue of the existence of the attorney-client relationship. This is true without regard to whether someone else may be privy to it."); see also *Burke*, *supra* note 1, at 244 ("The lawyer's ethical duty of client confidentiality protects more client communications than the evidentiary privilege. Unlike the evidentiary privilege, the ethical duty is not waived by the presence of a third party when the information is transmitted.")

29. For example, the comment following Model Rule 1.6 states that, "[t]he confidentiality rule applies not merely to matters communicated in confidence by the client but also to all information relating to the representation, whatever its source." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 cmt. (1995).

30. See *Upjohn Co.*, 449 U.S. at 395 ("The privilege only protects disclosure of communications; it does not protect disclosure of the underlying facts by those who communicated with the attorney."); *In re Six Grand Jury Witnesses*, 979 F.2d 939, 944 (2d Cir. 1992). As the court in *In re Six Grand Jury Witnesses* stated:

Where the client is a corporation, as here, the privilege extends to communications between a lawyer and his or her client—both information provided to the lawyer by the client and professional advice given by an attorney that discloses such information . . . Yet, the cloak of the privilege simply protects the communication from discovery, the underlying information contained in the communication is not shielded from discovery.

Id.; *In re Grand Jury Subpoena Duces Tecum* dated September 15, 1983 (Marc Rich & Co., A.G.), 731 F.2d 1032, 1037 (2d Cir. 1984) ("[T]he attorney-client privilege protects communications rather than information; the privilege does not impede disclosure of information except to the extent that the disclosure would reveal confidential communications."); *Doe v. A Corp.*, 709 F.2d at 1046. The court in *Doe v. A Corp.* stated:

[D]uring the course of representing a client, a lawyer may receive information that is not shielded by the privilege but is considered confidential by the client. He may, for example, receive information from some source other than the client or information imparted for a purpose other than obtaining legal advice.

Id.

instead, encompasses all information relating to the representation.³¹ This may include information gained in the course of investigation of a matter³² and may include information obtained in the course of representing the client in other unrelated matters.³³

Thus, notwithstanding the corporate counsel's dealings with other senior managers who conduct the business of the corporation, the client is the corporation itself as distinct from the directors, officers, employees and the stockholders. Nevertheless, communications from any of these individuals may constitute client confidences if the communications are made to corporate counsel, acting as a lawyer, for the purpose of obtaining legal advice for the corporation. Accordingly, documents, and communications and other information that come into corporate counsel's possession in the course of representing the corporation are subject to the ethical prohibitions against disclosure unless counsel otherwise has a duty to disclose the misconduct to others outside the corporation.

II. WHAT ALTERNATIVE COURSES OF ACTION ARE AVAILABLE TO CORPORATE COUNSEL UPON DISCOVERY OF CORPORATE WRONGDOING?

Having determined that counsel's client is the corporation and therefore, that no duties run to the individual employees,³⁴

31. See MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 cmt. (1995) ("The confidentiality rule applies not merely to matters communicated in confidence by the client but also to all information relating to the representation, whatever its source."); *Doe v. A Corp.*, 709 F.2d at 1046 ("The ethical duty extends to shielding the confidentiality of all information acquired in the course of representing a client, preventing the use of any such knowledge to the client's disadvantage."). As one commentator has noted, "[t]he evidentiary privilege only includes communications relating to legal advice; the ethical duty protects any embarrassing or detrimental information." Burke, *supra* note 1, at 244.

32. See L.A. COUNTY B. ASS'N OP. No. 305 (1968) ("Not only are the client's personal confidences to be kept inviolate, but similarly, evidence obtained by the attorney in his investigation on behalf of the client is also to be kept inviolate . . .").

33. See, e.g., *Donohoe v. Consolidated Operating & Prod. Corp.*, 691 F. Supp. 109, 113 (N.D. Ill. 1988) ("Of course an attorney should preserve all of a client's confidences and secrets, not just those obtained for purposes of a specific case or those subject to the attorney-client privilege.").

34. The Supreme Court has recognized that "[t]he administration of the attorney-client privilege in the case of corporations . . . presents special problems. As an inanimate entity, a corporation must act through agents. A corporation cannot speak directly to its lawyers." *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 348 (1985). And when corporate counsel consult with individual employees of the corporate client there is always the risk that counsel may become entangled in issues of whether there was an attorney-client relationship established with an individual (and as a result,

counsel must resolve whether disclosure of corporate wrongdoing is consistent with counsel's ethical obligations to the corporation. Counsel must also consider the courses of action available in the event that the corporation declines to take remedial action.

Counsel may well find that because continued representation of the corporation creates an irreconcilable conflict with

a duty of confidentiality running to the individual) based on the individual employee's expectations at the time the employee communicated information to corporate counsel. See *Wylie v. Marley Co.*, 891 F.2d 1463, 1471 (10th Cir. 1989) ("The professional relationship for purposes of the privilege hinges upon the belief that one is consulting a lawyer and his intention to seek legal advice."); *In re Grand Jury Proceedings*, 434 F. Supp. 648, 650 (E.D. Mich. 1977), *aff'd*, 570 F.2d 562 (6th Cir. 1978) ("[I]f [the employee] makes it clear when he is consulting the company lawyer that he personally is consulting the lawyer and the lawyer sees fit to accept and give communication knowing the possible conflicts that could arise, he may have a privilege."). The employee's subjective belief or intent to consult with company counsel for individual advice is not, alone, dispositive of the establishment of the attorney-client relationship. See *In re Bevill, Bresler & Schulman Asset Management Corp.*, 805 F.2d 120, 123 (3d Cir. 1986) (quoting *In re Grand Jury Investigation*, 575 F. Supp. 777, 780 (N.D. Ga. 1983). According to the court in *In re Bevill, Bresler & Schulman Asset Management Corp.*, corporate employees asserting the privilege must meet the following test:

First, they must show they approached [counsel] for the purpose of seeking legal advice. Second, they must demonstrate that when they approached [counsel] they made it clear that they were seeking legal advice in their individual rather than their representative capacities. Third, they must demonstrate that the [counsel] saw fit to communicate with them in their individual capacities, knowing that a possible conflict could arise. Fourth, they must prove that their conversations with [counsel] were confidential. And, fifth, they must show that the substance of their conversations with [counsel] did not concern matters within the company or the general affairs of the company.

Id. Nevertheless, to avoid possible disqualification of counsel from representing the corporation where the interests of the individual employee conflict, *see, e.g.*, *E.F. Hutton & Co. v. Brown*, 305 F. Supp. 371 (S.D. Tex. 1969), Model Rule 1.13(d) admonishes counsel to "explain the identity of the client when it is apparent that the organization's interests are adverse to those of the [organization's] constituents with whom the lawyer is dealing." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(d) (1995). The commentary following Model Rule 1.13 further states that, "care must be taken to assure that the individual understands that, when there is such adversity of interest, the lawyer for the organization cannot provide legal representation for that constituent individual, and that discussions between the lawyer for the organization and the individual may not be privileged." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(d) cmt. (1995). Accordingly, when seeking information from individual employees in order to provide legal advice to the corporation, corporate counsel should, at a minimum, inform the employee: (1) that counsel represents the corporation; (2) that counsel does not represent the employee and cannot advise the employee as to the employee's individual rights or obligations; (3) that while their discussions are subject to the attorney-client privilege, that privilege belongs to the corporation alone; and (4) that at some future time the corporation may waive the protections of the attorney-client privilege and disclose to the government or another third party the information being provided by the employee.

counsel's ethical responsibilities, there is no alternative but to resign from further representation of the corporation, thus setting the stage for a wrongful termination/constructive discharge claim. However, this will require an analysis of whether counsel has an affirmative obligation to disclose the wrongdoing; what factors must be considered in reaching the decision that disclosure is warranted; and under what circumstances must counsel withdraw from the representation.

A. *Corporate Counsel's Response to the Discovery of Corporate Misconduct*

Obviously, corporate counsel who becomes aware of possible misconduct involving the corporation must inquire into the facts and circumstances in order to properly advise the client of counsel's analysis of the corporation's rights and obligations as well as counsel's recommendations concerning the appropriate response to the problem.³⁵ However, who among the corporation's individual constituents should be advised in the first instance of counsel's views will depend largely on the circumstances of the particular matter.

In this regard, the Model Rules caution counsel to be aware that there are corporate activities which, although they subject the corporation to risk, do not implicate counsel's ethical obligations, even though counsel believes that the decisions being made are not in the best interests of the corporate client. Thus, the comments to Model Rule 1.13 state that, "[w]hen constitu-

35. Neither the Code nor the Model Rules specifically addresses corporate counsel's ethical duties to investigate when confronted with ongoing or contemplated future misconduct. However, counsel's obligation to inquire into possible misconduct can be inferred from counsel's duty of competence under Canon 6 of the Code. See MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 6-4, DR 6-101 (A)(2) (1980); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.1 (1995). Counsel's obligation to communicate with the client is specifically recognized under Canon 7 of the Code. See MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-8 (1980); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.4 (1995). Additionally, the ABA Committee on Ethics and Professional Responsibility addressed the issue of counsel's duty to investigate in Opinion 1479, stating that:

[A] lawyer should not undertake representation in disregard of facts suggesting that the representation might aid the client in perpetrating a fraud or otherwise committing a crime A lawyer must be satisfied, on the facts before him and readily available to him, that he can perform the requested services without abetting fraudulent . . . conduct and without relying on past client . . . fraud to achieve results the client now wants. Otherwise the lawyer has a duty of further inquiry.

ABA Comm. on Ethics and Professional Responsibility, Informal Op. 1479 (1981) quoted in Robert N. Treiman, Comment, *Inter-Lawyer Communication and the Prevention of Client Fraud: A Look Back at O.P.M.*, 34 UCLA L. REV. 925, 934 n.38 (1987).

ents 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."³⁶

On the other hand, "different considerations arise" when the corporation is engaged in illegal conduct or when future illegal conduct is contemplated. In those circumstances, counsel must urge those individuals with control over the conduct to reconsider their actions³⁷ and in the event that those individuals refuse to reconsider, corporate counsel must elevate the matter to "higher authority within the organization."³⁸

Counsel is cautioned that "[c]lear justification should exist for seeking review over the head of the constituent normally responsible for it."³⁹ And in this connection, Model Rule 1.13(b) provides guidance in how to proceed. In determining a course of action, corporate counsel should give "due consideration" to the following: (1) The seriousness of the violation of law and the possible consequences; (2) The scope and nature of the lawyer's representation; (3) The responsibility in the organization and the apparent motivation of the person involved; and (4) The policies of the organization concerning such matters.⁴⁰

Having taken these factors into consideration, the Model Rule suggests three courses of action: (1) Asking reconsideration of the matter; (2) Obtaining a separate, independent legal opinion for presentation to the appropriate authority in the organization; and (3) Referring the matter to higher authority in the organization including the highest authority that can act on behalf of the organization.⁴¹

36. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 cmt. (1995).

37. As Elihu Root observed, "[a]bout half the practice of a decent lawyer . . . [rests upon] telling would-be clients that they are damned fools and should stop." *Quoted in* Geoffrey C. Hazard, *Doing the Right Thing*, 70 WASH. U. H. L. Q. 691, 699 (1992).

38. As stated in the comments to Model Rule 1.13:

[D]ifferent considerations arise when the lawyer knows that the organization may be substantially injured by action of a constituent that is in violation of law. In such circumstances, it may be reasonably necessary for the lawyer to ask the constituent to reconsider the matter. If that fails, or if the matter is of sufficient seriousness and importance to the organization, it may reasonably be necessary for the lawyer to take steps to have the matter reviewed by a higher authority in the organization.

MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 cmt. (1995).

39. *Id.*

40. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b) (1995).

41. *Id.*

Referral of the matter to the corporation's chief executive officer or board of directors is plainly not an action to be taken lightly. The commentary following Model Rule 1.13 states that such review may be required when "the matter is of importance commensurate with their authority" and that review by the board of directors may be necessary in "an extreme case."⁴²

Going over the head of the chief executive to the board of directors would likely bring to a close counsel's relationship with the corporation.⁴³ Involvement in responding to corporate misconduct has consequences for the board of directors, as well. As Professor Geoffrey C. Hazard has observed:

[W]hen [counsel] takes the matter to the board he implicates the board members in the problem, because their responsibility and potential legal liability is affected by the extent of their knowledge. If they then take appropriate remedial action, their very action can alert potential adversaries of something afoot that may be the basis of legal action against the corporation. If they do not act, they may be regarded as having violated their duties to the stockholders and perhaps have become accomplices so far as concerns liability to outsiders.⁴⁴

Thus, upon discovery of ongoing or planned wrongdoing, corporate counsel is obliged to take action to prevent the misconduct from occurring. In the first instance, counsel must attempt to persuade those involved to abandon the proposed action. If that effort fails, and taking into consideration the seriousness of the wrongdoing and the possible consequences for the corporation, counsel may be required to pursue the matter through the management chain of command up to and including the board of directors. Counsel is not obliged to follow such a course if the conduct involved is of a policy or operational nature and is merely ill advised. If, however, the proposed action is likely to result in significant injury to the corporation, counsel must act to remedy the situation and prevent the harm.

The mere threat of disclosure to the board of directors may be sufficient impetus to prevent the wrongdoing from occur-

42. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 cmt. (1995).

43. Corporate counsel's decision to proceed past the chief executive to the board of directors would at best be viewed as an act of disloyalty. Involvement of the board of directors would likely also involve disclosure of information obtained from other senior managers or from the CEO that was considered confidential, if not in the attorney-client sense at least with respect to disclosure to the board. Thus, the trust between corporate counsel and other senior managers, including the CEO, would be irrevocably broken by the disclosure, rendering counsel's ability to continue impossible as a practical matter.

44. HAZARD, *supra* note 9, at 52.

ring.⁴⁵ But when it is not and when the board itself refuses to arrest the pending misconduct, corporate counsel must determine whether to disclose the situation to others outside the corporation (i.e., to a governmental agency or to affected third parties) or whether resignation is appropriate under the circumstances.

B. *Does Counsel Have a Duty to Disclose Corporate Misconduct?*

The lawyer's twin, or at least sibling, obligations of loyalty to the client and of confidentiality of client communications, like their analog, the attorney-client privilege, are deeply rooted in Anglo-American jurisprudence. Lord Brougham's famous credo, that "an advocate, in the discharge of duty, knows but one person in all the world, and that person is his client," stated in 1820,⁴⁶ remains vital today.⁴⁷ Judge George Sharswood's writings and lectures in the late nineteenth century, which served as the basis for the first codification of American legal ethics in 1908,⁴⁸ similarly recognized the lawyer's "moral responsibility" of "[e]ntire devotion to the interest of the client"⁴⁹ from which flowed the lawyer's duty of confidentiality, even if the lawyer learned of the client's guilt.⁵⁰

Canon 37 of the Canons of Ethics adopted by the ABA in 1908 codified the lawyer's obligation to preserve client confidences.⁵¹ Canon 37 provided, in part, that:

45. See James P. Hemmer, *Resignation of Corporate Counsel: Fulfillment or Abdication of Duty*, 39 HASTINGS L.J. 641, 653-57 (1988).

46. Lord Brougham made this statement in his defense of Queen Caroline in the House of Lords proceedings involving charges of adultery brought against the Queen at the instance of King George IV. It has been said that Lord Brougham was suggesting a threat to reveal the King's secret marriage to Mrs. Fitzherbert, a Roman Catholic, a revelation that could have resulted in the King's forfeiture of the crown under the Act of Settlement. The charges against the Queen were not pursued to conclusion. See DAVID MELLINKOFF, *THE CONSCIENCE OF A LAWYER* 188-89 (1973).

47. Professor Geoffrey C. Hazard has described Lord Brougham's credo as "[t]he legal profession's basic narrative . . . sustained over two centuries notwithstanding pervasive changes in American society and in the profession itself." Geoffrey C. Hazard, Jr., *The Future of Legal Ethics*, 100 YALE L.J. 1239, 1244 (1991).

48. See Rusel G. Pearce, *Rediscovering the Republican Origins of the Legal Ethics Codes*, 6 GEO. J. LEGAL ETHICS 241, 259 (1992).

49. *Id.* at 261 (quoting George Sharswood, *An Essay on Professional Ethics*, 32 ABA REP. 1 (5th ed. 1907)).

50. *Id.* at 262.

51. Canon 37 was adopted in 1928 and amended in 1937. HENRY S. DRINKER, *LEGAL ETHICS* 131 n.25 (1953).

It is the duty of a lawyer to preserve his client's confidences. This duty outlasts the lawyer's employment, and extends as well to his employees; and neither of them should accept employment which involves or may involve the disclosure or use of these confidences, either for the private advantage of the lawyer or his employees or to the disadvantage of the client, without his knowledge and consent, and even though there are other available sources of such information. A lawyer should not continue employment when he discovers that this obligation prevents the performance of his full duty to his former or to his new client.⁵²

The ethical obligation was thought to be the same as that of the attorney-client privilege⁵³ and like the privilege, the rationale for the ethical duty was to foster free and candid communication between client and attorney.⁵⁴ Although not stated specifically in the rule, an exception was implied for disclosure of client confidences when essential to the public safety or when necessary to prevent a contemplated crime or fraud.⁵⁵

In 1928, the ABA also adopted Canon 41 to address the "Discovery of Imposition and Deception." Canon 41 provided that:

When a lawyer discovers that some fraud or deception has been practiced, which has unjustly imposed upon the court or a party, he should endeavor to rectify it; at first by advising his client, and if his client refuses to forego the advantage thus unjustly gained, he should promptly inform the injured person or his counsel, so that they may take appropriate steps.⁵⁶

52. *Id.* at 131-32.

53. *Id.* at 132. As Drinker stated in regard to Canon 37:

The rule of this Canon, that confidential communications by or on behalf of a client may not be disclosed without his consent, has long been a rule of the common law, and is in many jurisdictions the subject of statute. As such, its application is usually a question of law rather than of ethics.

Id. (footnote omitted).

54. Drinker cites the following statement by Judge W. H. Taft in *ETHICS IN SERVICE*, as setting forth the purpose of the Rule of Confidentiality in Canon 37:

To require the counsel to disclose the confidential communications of his client to the very court and jury which are to pass on the issue which he is making, would end forever the possibility of any useful relation between lawyer and client. It is essential for the proper presentation of the client's cause that he should be able to talk freely with his counsel without fear of disclosure

The useful function of lawyers is not only to conduct litigation, but to avoid it, where possible, by advising settlement or withholding suit. Thus, any rule that interfered with the complete disclosure of the client's inmost thoughts on the issue he presents would seriously obstruct the peace that is gained for society by the compromises which the counsel is able to advise.

Id. at 132-33 (quoting WILLIAM HOWARD TAFT, *ETHICS IN SERVICE* 31-32 (1915)).

55. *Id.* at 137.

56. Victor H. Kramer, *Clients' Frauds and Their Lawyers' Obligations: A Study in*

Canon 41 represented a significant expansion of the lawyer's duty to disclose over that in Canon 37 by allowing disclosure of client confidences concerning past as well as future acts. Canon 41 also departed from the confidentiality rule of Canon 37 by requiring disclosure of the client's fraud to the victim or the victim's lawyer.⁵⁷ Because the requirements of Canon 41 created obligations that were inconsistent with Canon 37 and the attorney-client privilege, the ABA Committee on Professional Ethics held that the disclosure requirements were subordinate to the duty to maintain confidentiality under Canon 37.⁵⁸ The committee also held that the communications subject to Canon 37 confidentiality were the same as those protected by the attorney-client privilege.⁵⁹ That view changed, however, when the Canons of Ethics were replaced first by the Code and subsequently by the Model Rules.

1. *Disclosure of Client Confidences Under the Code.* The ABA adopted the Code of Professional Responsibility in 1970. Like its predecessor, the Code is organized around a set of canons of ethical principle.⁶⁰ The Code added additional clarification of the ethical norms in the form of "ethical considerations"⁶¹ which were aspirational in nature, and "disciplinary rules,"

Professional Irresponsibility, 67 GEO. L.J. 991, 992 (1979) (quoting 53 A.B.A. REP. 495, 498 (1928)).

57. The purpose of Canon 41 is not entirely clear. The ABA's Special Committee on Supplements to the Canons of Professional Ethics indicated in its report that Canon 41 was intended to address "particular conduct, whose problems experience has demonstrated demand solution." *Id.*

58. *See id.* at 992. The committee did this principally in Opinion No. 287 issued in 1953. Opinion No. 287 concerned two situations. In the first, an attorney representing the husband in a divorce proceeding learned from the client that the client had misrepresented the date of his wife's desertion and the wife now threatened to reveal the true date which would render the divorce action premature. The committee concluded that if the client refused to recant his perjury to the court, the attorney would be bound by the duty of confidentiality and accordingly would have to withdraw from the representation.

In the second situation, an attorney learned that a criminal client had been sentenced based on the court's erroneous belief that the client had no criminal record. The committee concluded that if the attorney's knowledge of the client's criminal record was derived from a client communication, the attorney could not disclose the client's record to the court even in the event the client lied to the court and stated that he had no record. *Id.* at 992-93, n.10.

59. Burke, *supra* note 1, at 247.

60. *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY Preface (1980).

61. "The Ethical Considerations are aspirational in character and represent the objectives toward which every member of the profession should strive. They constitute a body of principles upon which the lawyer can rely for guidance in many specific situations." MODEL CODE OF PROFESSIONAL RESPONSIBILITY Preliminary Statement (1980).

which were mandatory.⁶² Violation of a disciplinary rule could subject a lawyer to sanction by the Bar.⁶³

Ethical Considerations and Disciplinary Rules under several of the Canons touch upon the lawyer's duty to preserve client confidences. The principal statement of the obligation to maintain confidentiality is Canon 4 which states that "a lawyer should preserve the confidences and secrets of a client."⁶⁴ Under Canon 4, Ethical Consideration 4-1 counsels that both the fiduciary duty of the lawyer to the client as well as "the proper functioning of the legal system" require that the client's confidences and secrets be preserved.⁶⁵ Other Ethical Considerations under Canon 4 make clear that the attorney-client privilege is more limited than the ethical obligation⁶⁶ and the obligation re-

62. The Disciplinary Rules, unlike the Ethical Considerations, are mandatory in character. The Disciplinary Rules state the minimum level of conduct below which no lawyer can fall without being subject to disciplinary action. Within the framework of fair trial, the Disciplinary Rules should be uniformly applied to all lawyers, regardless of the nature of their professional activities. The Model Code makes no attempt to prescribe either disciplinary procedures or penalties for violation of a Disciplinary Rule, nor does it undertake to define standards for civil liability of lawyers for professional conduct. The severity of judgment against one found guilty of violating a Disciplinary Rule should be determined by the character of the offense and the attendant circumstances. An enforcing agency, in applying the Disciplinary Rules, may find interpretive guidance in the basic principles embodied in the Canons and in the objectives reflected in the Ethical Considerations.

Id.

63. *Id.*

64. MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 4 (1980).

65. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 4-1 (1980). Ethical Consideration 4-1 provides:

Both the fiduciary relationship existing between lawyer and client and the proper functioning of the legal system require the preservation by the lawyer of confidences and secrets of one who has employed or sought to employ him. A client must feel free to discuss whatever he wishes with his lawyer and a lawyer must be equally free to obtain information beyond that volunteered by his client. A lawyer should be fully informed of all the facts of the matter he is handling in order for his client to obtain the full advantage of our legal system. It is for the lawyer in the exercise of his independent professional judgment to separate the relevant and important from the irrelevant and unimportant. The observance of the ethical obligation of a lawyer to hold inviolate the confidences and secrets of his client not only facilitates the full development of facts essential to proper representation of the client but also encourages laymen to seek early legal assistance.

Id.

66. Ethical Consideration 4-4 provides:

The attorney-client privilege is more limited than the ethical obligation of a lawyer to guard the confidences and secrets of his client. This ethical precept,

mains in effect after the active representation of the client has ceased.⁶⁷

The prohibition against disclosure is set forth in Disciplinary Rule 4-101(B)(1) which states that except as otherwise provided in part C of the Rule, "a lawyer shall not knowingly . . . [r]eveal a confidence or secret of his client . . ."⁶⁸ The Rule defines confidences and secrets to include not only communications covered by the attorney-client privilege but also "information gained in the professional relationship . . ."⁶⁹

However, there are two Disciplinary Rules that address disclosure: Disciplinary Rule 4-101(C) and Disciplinary Rule 7-102(B).⁷⁰ Under Disciplinary Rule 4-101(C), a lawyer *may* reveal

unlike the evidentiary privilege, exists without regard to the nature or source of information or the fact that others share the knowledge. A lawyer should endeavor to act in a manner which preserves the evidentiary privilege; for example, he should avoid professional discussions in the presence of persons to whom the privilege does not extend. A lawyer owes an obligation to advise the client of the attorney-client privilege and timely to assert the privilege unless it is waived by the client.

MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 4.4 (1980).

67. Ethical Consideration 4-6 provides:

The obligation of a lawyer to preserve the confidences and secrets of his client continues after the termination of his employment. Thus, a lawyer should not attempt to sell a law practice as a going business because, among other reasons, to do so would involve the disclosure of confidences and secrets. A lawyer should also provide for the protection of the confidences and secrets of his client following the termination of the practice of the lawyer, whether termination is due to death, disability, or retirement. For example, a lawyer might provide for the personal papers of the client to be returned to him and for the papers of the lawyer to be delivered to another lawyer or to be destroyed. In determining the method of disposition, the instructions and wishes of the client should be a dominant consideration.

MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 4-6 (1980).

68. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 4-101(B)(1) (1980).

69. Disciplinary Rule 4-101(A) defines the subject confidences and secrets as follows: "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 requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.

MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 4-101(A) (1980).

70. A third rule, Disciplinary Rule 1-103(A), provides that a lawyer who possesses "unprivileged knowledge" of a violation of Disciplinary Rule 1-102 "shall report such knowledge to a tribunal or other authority empowered to investigate or act upon such violation." MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 1-103(A) (1980). Disciplinary Rule 1-102 prohibits lawyers from directly or indirectly violating a Disciplinary Rule, engaging in illegal conduct involving moral turpitude, engaging in conduct involving "dishonesty, fraud, deceit or misrepresentation, and engaging in conduct that is either 'prejudicial to the administration of justice' or adversely reflecting on the lawyer's fitness to

a client's confidences and secrets when required by law or court order.⁷¹ Most significantly, a lawyer *may* reveal "[t]he intention of his client to commit a crime and the information necessary to prevent the crime."⁷²

With regard to the client's intention to commit a crime, the drafters relied on a 1965 opinion of the ABA Committee on Professional Ethics to the effect that before disclosure was warranted, the attorney had to be in possession of facts that established "beyond a reasonable doubt" that the client intended to commit a crime.⁷³ In like fashion, the other principal disclosure provision of the Code, Disciplinary Rule 7-102(B) includes as a prerequisite to disclosure that the attorney possess "information clearly establishing" that the client has perpetrated a fraud. The "clearly establishing" standard has posed decisional difficulties

practice law." MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 1-102 (1980).

71. The Code indicates that this rule was derived from opinions of the ABA Committee on Professional Ethics concerning several issues arising in criminal cases. In one situation, an attorney who failed to inform the court of the whereabouts of his absent client risked aiding and abetting his client's escape. The Committee stated, "[i]t is the opinion of the Committee that under such circumstances, the attorney's knowledge of his client's whereabouts is not privileged, and that he may be disciplined for failing to disclose that information to the proper authorities . . ." MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 4 n.15 (quoting ABA Comm. on Professional Ethics and Grievances, Formal Op. 155 (1936)). In the second situation, the Committee ruled that an attorney was obliged to advise "the proper authorities" if after being counseled by the lawyer to comply with the conditions of probation, the client refuses to do so. "Such information, even though coming to the attorney from the client in the course of his professional relations with respect to other matters in which he represents the defendant, is not privileged from disclosure . . ." *Id.*

72. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 4-101(C) (1980).

73. See MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 4 n.16 (1980). The Code indicates that the drafter's relied on a ruling of the Committee on Professional Ethics in Opinion 314 (1965) to the effect that a lawyer must disclose client confidences if "the facts in the attorney's possession indicate beyond reasonable doubt that a crime will be committed." ABA Opinion 314 involved the obligations of an attorney, practicing before the Internal Revenue Service, who "acquires information bearing upon the strength of his client's claim." ABA Comm. on Professional Ethics, Formal Op. 315 (1965). The ABA Committee noted that when negotiating a settlement with the IRS on behalf of a client, counsel, "will always urge . . . the strong points of his case and minimize the weak . . ." *Id.* The Committee concluded, however, that the attorney's duty not to make false assertions does not require the disclosure of weaknesses in the client's case, "unless the facts in the attorney's possession indicate beyond a reasonable doubt that a crime will be committed." *Id.* In this connection, the Committee further observed that a "wrong" or an "unjust" tax result is not a crime. The Committee also noted that an attorney may not mislead or allow the client to mislead the IRS. Upon discovery of a misrepresentation, the lawyer must advise the client to correct the misstatement. If the client refuses to do so, "the lawyer's obligation depends on all the circumstances." See also Marshall L. Small, *Commentary at the Proceedings of the Arlie House Conference on the Ethical Responsibilities of Corporate Lawyers*, 33 BUS. LAW. 1423, 1428 (1978).

because the phrase is not used elsewhere in either the Code or the Canons of Ethics.⁷⁴ Nevertheless, the Rule has been construed as requiring actual knowledge of the client's fraud rather than mere suspicion.⁷⁵

As originally adopted, Disciplinary Rule 7-102(B) provided in pertinent part:

A lawyer who received information clearly establishing that: (1) [h]is client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to

74. As was observed in *Grievance Comm. of the United States District Court, District of Connecticut v. Federal Grievance Comm.*:

Determining whether an attorney has received "information clearly establishing" a fraud on the court—and thus triggering his duty to disclose that information to the affected tribunal—is a "difficult task" Our inquiry into the terms meaning is made even more difficult because it is not used in any other Code provision and was not included in any provision of the Code's predecessor, the Canons of Professional Ethics (1908). Nor is the term included in any provision of the Code's successor, the Model Rules of Professional Conduct (1983), and our exhaustive research has uncovered no court or professional ethics committee decision that has definitively interpreted what the term means.

Grievance Comm. of the United States District Court, District of Connecticut v. Federal Grievance Comm., 847 F.2d 57, 61-62 (2d Cir. 1988).

75. *Id.* at 63. According to the court in *Grievance Comm. of the United States District Court, District of Connecticut v. Federal Grievance Comm.*:

Our experience indicates that if any standard less than actual knowledge was adopted in this context, serious consequences might follow Instead, it seems that the only reasonable conclusion is that the drafters intended disclosure of only that information which the attorney reasonably knows to be a fact and which, when combined with other facts in his knowledge, would clearly establish the existence of a fraud on the tribunal. To interpret the rule to mean otherwise would be to require attorneys to disclose mere suspicions of fraud which are based upon incomplete information or information which may fall short of clearly establishing the existence of a fraud.

Id. In that case, an attorney was told by his client, the plaintiff in an action, that a defense witness told the client that the witness had lied at a deposition on instructions from defense counsel. The attorney did not believe that the perjury had occurred and did not disclose the client's statements to the district court. Despite the bar's grievance committee having exonerated the attorney, the district court concluded that the lawyer had violated Disciplinary Rule 7-102(B)(2) and ordered the attorney suspended from practice. *Id.* at 58-60. The court of appeals reversed the district court, holding that neither the information the attorney had received from his client nor the attorney's independent information concerning the case provided the attorney with the requisite "knowledge" that a fraud had taken place. *Id.* at 63. See also *Quadrozzi v. City of New York*, 127 F.R.D. 63 (S.D.N.Y. 1989) (attorney's failure to make inquiry whether his client's denial of having associated with any organized crime figures was unreasonable in light of a taped intercepted conversation between his client and a prominent member of organized crime. The court appears to suggest that the intercepted conversation was sufficient to "clearly establish" his client's misconduct.).

the affected person or tribunal⁷⁶

However, as written, Disciplinary Rule 7-102(B) puts lawyers at risk of violation of the Code since the lawyer would be forced to choose between disclosure in accordance with Disciplinary Rule 7-102(B) and preserving client confidentiality in accordance with Disciplinary Rule 4-101.⁷⁷ This is particularly true in corporate representation, where, as one commentator has observed, "failure to disclose a past crime or fraud may often constitute an intention to commit a further crime and raise[s] the possibility of conflict between DR4-101(C)(3) and DR7-102(B)(1)."⁷⁸ This ethical and legal ambiguity was further aggravated by references in the Code to the attorney-client privilege which, as a rule of evidence, forecloses inquiry into client communications concerning past criminality⁷⁹ but does not

76. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(B) (1980).

77. See Kramer, *supra* note 56, at 993-94 ("In adopting DR7-102(B)(1), the ABA apparently overlooked the probability that the new rule would often require a lawyer to choose between violating the rule against disclosure of a client's privileged communications and the rule requiring disclosure of the fraud."). Indeed, as the ABA Committee on Ethics and Professional Responsibility pointed out in Opinion 341, when the Code was originally drafted in 1969, there was no disciplinary rule requiring disclosure of client misconduct. The ABA Committee suggested that this was due to the drafter's "consideration of the high fiduciary duty owed by lawyer to client and consideration of the firm support found in the law of evidence for the attorney-client privilege." ABA Comm. on Ethics and Professional Responsibility, Formal Op. 341 (1975).

78. Hoffman, *supra* note 12, at 1402-03. Professor Hazard has made a similar observation that when corporate misconduct comes to the attention of corporate counsel, the counsel has to address the question how to treat the information received from the "client." In that regard, counsel:

must decide whether the situation involves a "past" wrong, so that he must treat its disclosure as confidential, or a wrong continuing into the future, in which event the rule of confidentiality may not apply, particularly if the conduct may be a crime. This problem of classification . . . is difficult in itself, owing to the often illusory character of the distinction between past and future.

HAZARD, *supra* note 9, at 49.

79. As Mr. Justice Kennedy (then Circuit Judge) explained in *United States v. Hodge and Zweig*:

In our legal system the client should make full disclosure to the attorney so that the advice given is sound, so that the attorney can give all appropriate protection to the client's interest, and so that proper defenses are raised if litigation results. The attorney-client privilege promotes such disclosure by promising that communications revealed for these legitimate purposes will be held in strict confidence. The privilege encourages persons to seek advice as to future conduct. But so important is full disclosure that the law recognizes the privilege even if the advice is sought by one who has already committed a bad act But a quid pro quo is exacted for the attorney-client confidence: the client must not abuse the confidential relation by using it to further a fraudulent or criminal scheme, and as a condition to continued representation, the

shield communications in furtherance of ongoing or future crime.⁸⁰

lawyer is required to advise the client to cease any unlawful activities that the lawyer perceives are occurring.

United States v. Hodge and Zweig, 548 F.2d 1347, 1355 (9th Cir. 1977).

Accordingly, the "crime-fraud" exception to the attorney-client privilege is held not to apply in regard to past, completed crimes. See *In Re Grand Jury Proceedings* (FMC Corp.), 604 F.2d 798, 803 (3d Cir. 1979). In that case, the court stated that:

[T]he district court's finding that "a crime *has* been committed by FMC" . . . does not state whether the crime was committed before or after Mr. Kliever and his firm were retained for the work during which the documents at issue were generated. If the crime had been completed before retention of the Cleary firm, then the privilege should be in effect. If, however, the crime was a continuing one, or one that occurred after the firm was consulted, then the *prima facie* showing made by the government would suffice to allow inspection by the grand jury

Id.; *Lockette v. American Broadcasting Companies, Inc.*, 118 F.R.D. 88 (N.D. Ill. 1987) (attorney who believed his client had committed a past crime was bound by Disciplinary Rule 4-101).

80. The crime-fraud exception to the privilege will permit inquiry into communications involving present or future criminality. See, e.g., *Union Camp Corp. v. Lewis*, 385 F.2d 143, 144 (4th Cir. 1967) ("The attorney-client privilege is withdrawn upon a *prima facie* showing that the lawyer's advice was designed to serve his client in commission of a fraud or crime."). The reason for this is that the rationale underlying the privilege does not apply when the lawyer's advice is sought for a criminal purpose. See *In re Grand Jury Subpoena Duces Tecum* dated September 15, 1983 (Marc Rich & Co., A.G.), 731 F.2d 1032, 1038 (2d Cir. 1984) ("Whereas confidentiality of communications and work product facilitates the rendering of sound legal advice, advice in furtherance of a fraudulent or unlawful goal cannot be considered 'sound.' Rather, advice in furtherance of such goals is socially perverse, and the client's communications seeking such advice are not worthy of protection."). Further, it is not necessary that the crime or fraud have been accomplished in order to defeat the privilege so long as there is evidence that the purpose of seeking the lawyer's advice was to further the illegal scheme. See *id.* at 1039 ("The crime or fraud need not have occurred for the exception to be applicable; it need only have been the objective of the client's communication. And the fraudulent nature of the objective need not be established definitively; there need only be presented a reasonable basis for believing that the objective was fraudulent."). So, for example, a corporation was not entitled to assert the attorney-client privilege to prevent disclosure of a report of the findings of an internal investigation conducted by the corporate legal department. See *John Doe Corp. v. United States*, 675 F.2d 482, 491-92 (2d Cir. 1982). As the Court stated in *John Doe Corp.*:

Corporate counsel need not run to the FBI upon the first sign of criminality in an *Upjohn* protected communication. But such communications are protected only for the purpose of the corporate client seeking, and the attorney rendering, legal advice Use of the fact of an investigation to allay the concerns of third parties about possible criminal acts, to create the appearance of compliance with laws requiring disclosure, or to cover up a crime disclosed through a protected communication in the course of the investigation will cause the corporation to lose the privilege.

Id.

The ABA addressed this anomaly in 1974 when the rule was amended by adding the clause "except when the information is protected as a privileged communication."⁸¹ Thus, information clearly establishing that the client committed fraud could not be disclosed if the information otherwise would be privileged. The following year, in an opinion published by the ABA Committee on Ethics and Professional Responsibility, the exception for privileged communications was construed as including "confidences" and "secrets" protected by Disciplinary Rule 4-101.⁸² Thus, the exception virtually swallowed the rule since privileged communications were not restricted to information received by the client for purposes of legal representation,⁸³ but instead included any information received in the course of the professional relationship from whatever source.⁸⁴ It is difficult to conceive of information clearly establishing a client's

81. As the ABA Committee on Ethics and Professional Responsibility subsequently explained in Opinion No. 341, the provision of Disciplinary Rule 4-101(C) permitting a lawyer to reveal client confidences:

[W]hile quite proper in the preliminary draft, had the unacceptable result when combined with new DR 7-102(B)(1) of requiring a lawyer in certain instances to reveal privileged communications which he was also duty-bound not to reveal according to the law of evidence. The amendment of 1974 was necessary in order to relieve lawyers of exposure to such diametrically opposed professional duties.

ABA Comm. on Ethics and Responsibility, Formal Op. 341 (1975). The Committee went on to conclude that in all but the most serious cases, confidentiality took precedence over disclosure. As the Committee stated:

The tradition (which is backed by substantial policy considerations) that permits a lawyer to assure a client that information (whether a confidence or a secret) given to him will not be revealed to third parties is so important that it should take precedence, in all but the most serious cases, over the duty imposed by DR 7-102(B).

Id.

82. *Id.* ("The balancing of the lawyer's duty to preserve confidences and to reveal frauds is best made by interpreting the phrase "privileged communication" in the 1974 amendment to DR 7-102(B) as referring to those confidences and secrets that are required to be preserved by DR 4-101.")

83. In construing the exception to include "confidences" and "secrets", the ABA Committee opined that the Committee's interpretation would not "wipe out DR 7-102(B), because DR 7-102(B) applies to information received from any source, and it is not limited to information gained in the professional relationship as is DR 4-101." *Id.* The Committee went on to suggest in this regard that the duty of disclosure under DR 7-102(B):

[W]ould remain in force if the information clearly establishing a fraud on a person or tribunal and committed by a client in the course of representation were obtained by the lawyer from a third party (but not in connection with his professional relationship with the client), because it would not be a confidence or secret of a client entitled to confidentiality.

Id.

84. See Kramer, *supra* note 56, at 994.

fraud "in the course of the representation" that came into the attorney's possession outside of the professional relationship.⁸⁵

Finally, by rendering the disclosure of client crime or fraud discretionary the attorney was left to make what can only be considered a momentous decision⁸⁶ with no established or consistent standards from which to take guidance.⁸⁷ Instead, the corporate counsel is left to be guided through conflicting legal obligations and ethical loyalties by counsel's own moral lights.⁸⁸

85. *Contra* Farrow, *supra* note 3, at 1802 ("Though [the 1974 amendment] has been the subject of considerable controversy, a client's communication of an intention to commit a crime is not privileged and a lawyer may disclose such an intention.")

86. One commentator likened the decision by corporate counsel to disclose the corporation's misconduct, thereby irrevocably breaking counsel's relationship to the corporation, to Greek tragedy:

Whether resignation of any further representation should also occur is probably academic. That would probably be forced by corporate action with laser-like speed Of course, resignation, usually unpleasant at worst for outside counsel, rises to the level of crucial life choice for inside corporate counsel. To sacrifice the fruits (both present and future) of a career devoted single-mindedly to the affairs of a single client has perhaps even the slight flavor of Greek tragedy.

Hoffman, *supra* note 12, at 1410-11 & n.59.

87. Professor Hoffman has suggested that in the absence of established standards, that counsel balance a variety of factors in determining whether to disclose misconduct. He suggests the following:

Since we cannot prepare a checklist of intended crimes that should be disclosed, it seems fair to suggest that the lawyer's obligation to disclose will turn not only on the nature of the crime, but also on the balancing of other factors: the effect of its disclosure would have on the well-being of the corporate client, the effect its commission or disclosure would have on third parties and whether third parties are reasonably relying on the lawyer to protect their expectations.

Id. at 1409.

88. So, for example, it has been observed that:

In deciding whether to disclose a confidence, a lawyer inevitably will face an ethical conflict. On the one hand, any professional feels loyalty to a client who has placed his trust in the professional's expertise. What was once called "honor", purged of its aristocratic limitations as a code of behavior for gentlemen, will exert a strong moral pull. On the other hand, a lawyer's training commits him to the rule of law, which presupposes the accuracy of the facts to which rules are applied. Although likely to be an agnostic about where ultimate truth lies, the lawyer—perhaps on that very account—is committed to a process untainted by false or incomplete disclosure.

William D. Popkin, *Client-Lawyer Confidentiality*, 59 *TEX. L. REV.* 755, 770-71 (1981). Professor Popkin further observed in this connection that "[d]isclosure depends on the point at which the client has forfeited his claim to loyalty; this in turn depends on what the lawyer defines as central to his ethical role. Once the client asks the lawyer to depart from that role, his claim on the lawyer's fidelity is broken." *Id.* at 771. This dilemma is particularly acute since the decision not to disclose past misconduct may constitute evidence of intent to commit a future crime or, indeed, may constitute an act in

This failure of the Code to provide meaningful guidance with respect to disclosure was first addressed in 1977 by the ABA Commission on Evaluation of Professional Standards, chaired by Robert J. Kutak (also known as the "Kutak Commission"), and then through the adoption in 1983 of the Model Rules.

2. *Disclosure of Client Confidences Under the Model Rules.*

A major impetus to the ABA's re-evaluation of the Code was the failure of the Code to provide meaningful guidance to corporate counsel⁸⁹ who are confronted with corporate criminality, including fraud.⁹⁰ This perceived inadequacy of the Code was underscored by the argument of the Securities and Exchange Commission in the *National Student Marketing* case⁹¹ that a corporation's lawyers had aided and abetted violations of the federal securities laws in connection with a merger by failing to disclose the contents of a "comfort letter" prepared by their client's outside auditors.⁹² As Chairman Kutak explained, the Code no longer responded adequately to the ethical demands on lawyers:

And what does the Code say about the obligations of the advisor and the evaluator, about the special problems of corporate counsel and the impli-

furtherance of a present or future crime, subjecting corporate counsel to personal criminal or civil liability. See Hoffman, *supra* note 12, at 1403; Burke, *supra* note 1, at 255. And it was observed:

The Code provides no guidance. The corporate lawyer must choose between violating the law and facing potential civil and criminal liability or disobeying a disciplinary rule and facing debarment or a damage suit by his client. Corporate counsel is left to his own conscience and analysis of the personal costs and benefits to determine the outcome.

Id.

89. See, e.g., Reycraft, *supra* note 1, at 610 ("The Model Code is not particularly enlightening on the issue of how a corporate or securities lawyer should respond upon discovering that his organizational client's management has committed securities fraud.")

90. The ABA Committee interpreted "fraud" as used in Disciplinary Rule 7-102(B) as meaning "active fraud, with a requirement of scienter or intent to deceive." ABA Comm. on Professional Ethics and Grievances, Formal Op. 341 (1975). As has been observed, such a construction of "fraud" is, in essence, a criminal act. See Hoffman, *supra* note 12, at 1408. As Hoffman states:

In the corporate and securities areas, something actionable as a "fraud" will almost always constitute a "crime" as well. Especially is this so since the interpretations given to the term "fraud" in ABA Opinion 341 . . . require an intent to deceive, manipulate, or defraud. And if such intent is present, some crime will also almost surely be involved.

Id.

91. Securities and Exchange Commission v. National Student Marketing Corp., 457 F. Supp. 682 (D.D.C. 1978).

92. The *Student Marketing* litigation is discussed further *infra* Part III.A.2.

cations of lawyers practicing together? Frankly, either nothing or very little. Thus, a revision of the Code is necessary if for no other reason than to acknowledge the problems facing lawyers in the 1980s and to provide them with some guidance in resolving the questions of professional ethics which they must face today and which will confront them tomorrow.⁹³

Certainly one of the most, if not the most, significant and controversial issues addressed by the Kutak Commission was whether the corporation's lawyer was obliged to reveal the corporation's confidences in order to prevent the commission of a crime or fraud and to avoid injury to others.⁹⁴

In addition to the debate concerning the lawyer's ethical duties to third parties spawned by the *National Student Marketing* litigation,⁹⁵ there was also substantial interest within the profession regarding the duty of withdrawing counsel to inform successor counsel of the corporate client's misconduct, engendered by the O.P.M. leasing affair.⁹⁶ Also, concurrently with the Kutak Commission's deliberations, the Institute for Public Interest Representation of Georgetown University Law Center petitioned

93. Kutak, *supra* note 6, at 576.

94. See James R. McCall, *The Corporation as Client: Problems, Perspectives, and Partial Solutions*, 39 HASTINGS L.J. 623, 632 (1988). As McCall further elaborates:

A significant initial concern of the drafters of Rule 1.13 was whether the entity as client concept should be adjusted to allow or require a corporation attorney to divulge confidential information to persons outside the corporation in order to prevent the client from causing harm through commission of a fraud or crime that would cause injury to third parties.

Id.

95. See, e.g., Ronald D. Rotunda, *Law, Lawyers, and Managers*, in THE ETHICS OF CORPORATE CONDUCT, 127 (Walton ed., 1977); Theodore Sonde, *Continuing Debate on Attorneys' Responsibilities to the Public and Third Parties*, 36 BUS. LAW. 585 (1981).

96. The OPM Leasing Services, Inc. matter is discussed further *infra* Part II.C.3. In essence, during the 1970's, OPM Leasing Services was engaged in the leasing of computer equipment. Many of the leases were with Rockwell International Corp. and were later found to have been procured by OPM Leasing through bribery. OPM Leasing was represented by the law firm of Singer, Hutman, Levine & Seeman who assisted OPM Leasing in closing the leases and in obtaining approximately \$196 million in financing secured by the leases.

In the course of the representation, Singer, Hutman learned from the president of OPM Leasing that the company was engaged in a massive fraud. This revelation led to the eventual resignation of Singer, Hutman as counsel. OPM Leasing then retained another firm, Kaye, Scholer, Fierman, Hays & Handler to represent it. Prior to accepting the representation, lawyers from Kaye, Scholer contacted Singer, Hutman and asked whether there was any reason why Kaye, Scholer should not represent OPM Leasing. Singer, Hutman did not reveal its knowledge of the ongoing fraud but advised Kaye, Scholer merely that the representation had been terminated by mutual agreement. Kaye, Scholer undertook OPM Leasing as a client and subsequently closed \$2.4 million in fraudulent leases. See Treiman, *supra* note 35, at 928-31.

the SEC for rule making requiring a corporation's attorneys to report "probable violations of law" to the board of directors and requiring the board of directors to certify in the corporation's annual report that the board had taken "appropriate action" in response to the attorney's report and that the board had made information concerning the violations available to the corporation's outside auditors.⁹⁷ The Institute's proposal was ultimately rejected by both the SEC⁹⁸ and the Kutak Commission.⁹⁹

The testimony before the Kutak Commission was almost uniformly hostile to the suggestion that an attorney had ethical obligations to anyone but the client.¹⁰⁰ In a 1980 letter to his colleagues, Chairman Kutak signalled the Commission's reluctance to impose additional obligations to third parties.¹⁰¹ After the draft Model Rules were promulgated for consideration by the ABA, Commissioner Kutak again emphasized that the circumstances under which disclosure of client confidences would

97. In June 1978, Professor Victor H. Kramer submitted a petition prepared by the Institute for Public Representation of Georgetown University Law Center requesting the SEC to adopt a rule requiring attorneys to reveal their client's frauds committed during the course of a representation before the SEC, except in circumstances when the knowledge of the fraud was the result of privileged communications. Subsequently, in November 1978, the Institute filed a supplemental petition requesting a rule requiring corporations to certify in their annual reports that: 1) the board of directors had instructed the corporation's attorneys to report any corporate activities that violate or "probably violate" a law and that could either "result in material financial liability" or "call into question the quality and integrity of management" or represent "a pattern or practice of recurring activity;" 2) the corporation's attorneys had indicated their compliance with the board's instructions; 3) the board had considered the reports of the attorneys and had taken appropriate action; and 4) information concerning material violations or probable violations had been provided to the corporation's outside auditors. See Gruenbaum, *supra* note 20, at 204 n.68; Kramer, *supra* note 56, at 991 n.2.

98. The SEC denied the Institute's first petition. However, over the strenuous objection of Commissioner Roberta Karmel, the SEC published the Institute's disclosure proposal and invited public comment. Over 300 mostly negative comments were received and on April 30, 1980, the SEC formally denied the rule making on the grounds that the ABA was also devoting attention to the same issue. See Burke, *supra* note 1, at 274-75.

99. As Commission Chairman Kutak explained:

We carefully evaluated these recommendations and heard from the Institute in the course of our deliberations, but we did not adopt the proposal. We believe that those triggering events would result in activity on the part of corporate counsel beyond the legitimate scope in which they should function, injecting lawyers into matters of judgment concerning business risk that are more appropriately the responsibility of corporate management. Ultimately, such a rule would create a conflict situation for corporate counsel, encouraging them to act from a fear of liability rather than from concern for the corporate client.

Kutak, *supra* note 6, at 578.

100. See Richard L. Abel, *Why Does the ABA Promulgate Ethical Rules?*, 59 *TEX. L. REV.* 639, 674 n.185.

101. *Id.*

be permitted were "very limited."¹⁰² The Model Rules as adopted by the ABA in 1983 reflect this reluctance to moderate a lawyer's duty of loyalty to the client by imposing additional obligations to persons other than the client. So, for example, the Preamble to the Model Rules states:

In reliance on the attorney-client privilege, clients are entitled to expect that communications within the scope of the privilege will be protected against compelled disclosure The fact that in exceptional situations the lawyer under the Rules has a limited discretion to disclose a client confidence does not vitiate the proposition that, as a general matter, the client has a reasonable expectation that information relating to the client will not be voluntarily disclosed and that disclosure of such information may be judicially compelled only in accordance with recognized exceptions to the attorney-client and work product privileges.¹⁰³

The Preamble recognized that the preservation of client confidences served the public interest by encouraging people to seek legal advice.¹⁰⁴ However, the Preamble also recognized that confidentiality was to be maintained "except so far as disclosure is required by the Rules of Professional Conduct or other law."¹⁰⁵

The corporation lawyer considering disclosure finds guidance primarily in two rules: Model Rule 1.6, which sets forth the lawyer's general duty to preserve client confidences; and Model 1.13, which illuminates the lawyer's ethical loyalties when the client is an entity. Under Model Rule 1.6, a lawyer is instructed generally not to reveal "information relating to representation of a client" unless the client consents. The Rule applies regardless of whether the client is an individual or an entity and the commentary following the Rule echoes the Preamble in noting the central importance of confidentiality to the full and frank communication which is "essential to proper representation of the client" and which "encourages people to

102. Kutak, *supra* note 6, at 583 ("[U]nder the proposed Model Rules, the Lawyer has some affirmative obligations to deter or reveal client misconduct, but only in a few, very limited situations.").

103. MODEL RULES OF PROFESSIONAL CONDUCT Preamble (1995).

104. As stated in the Preamble, "[a] lawyer can be sure that preserving client confidences ordinarily serves the public interest because people are more likely to seek legal advice, and thereby heed their legal obligations, when they know their communications will be private." *Id.* The Preamble also suggested that "[t]he lawyer's exercise of discretion not to disclose information . . . should not be subject to re-examination" because "[p]ermitting such re-examination would be incompatible with the general policy of promoting compliance with law through assurances that communications will be protected against disclosure." *Id.*

105. *Id.*

seek early legal assistance."¹⁰⁶

Confidentiality under Model Rule 1.6 is not absolute, however. Instead, the Model Rule provides for several exceptions, one of which is the disclosure of information in order to prevent the commission of a crime.¹⁰⁷ Model Rule 1.6(b)(1) provides, in this regard: "A lawyer may reveal [information relating to the representation of a client] 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 imminent death or substantial bodily harm"¹⁰⁸

The Model Rules recognize in this regard that the lawyer has "professional discretion" whether to reveal the client's confidences even when the lawyer has learned of the client's intention to commit a violent crime.¹⁰⁹ As the commentary to Model Rule 1.6 points out, it is difficult to be certain that the client will carry out that intention because the client "may have a change of mind,"¹¹⁰ particularly after being counseled to conform

106. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 cmt. (1995). With regard to the necessity of lawyer-client confidentiality, the commentary following Model Rule 1.6 explains:

The observance of the ethical obligation of a lawyer to hold inviolate confidential information of the client not only facilitates the full development of facts essential to proper representation of the client but also encourages people to seek early legal assistance.

Almost without exception, clients come to lawyers in order to determine what their rights are and what is, in the maze of laws and regulations, deemed to be legal and correct. The common law recognizes that the client's confidences must be protected from disclosure. Based upon experience, lawyers know that almost all clients follow the advice given, and the law is upheld.

A fundamental principle in the client-lawyer relationship is that the lawyer maintain confidentiality of information relating to the representation. The client is thereby encouraged to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter.

Id.

107. Model Rule 1.6(b)(2) also permits disclosure of client confidences: (a) to establish "a claim or defense" in connection with a dispute with the client; (b) establish a defense to a criminal or civil charge based on conduct in which the client was involved; and (c) to respond to allegations concerning the lawyer's representation of the client. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6(b)(2) (1995).

108. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6(b)(1) (1995).

109. As the commentary to Model Rule 1.6 explains, "the lawyer may learn that a client intends prospective conduct that is criminal and likely to result in imminent death or substantial bodily harm. As stated in paragraph (b)(1), the lawyer has professional discretion to reveal information in order to prevent such consequences." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 cmt. (1995).

110. *Id.* The commentary states, "[i]t is very difficult for a lawyer to 'know' when such a heinous purpose will actually be carried out, for the client may have a change of mind." *Id.*

to legal requirements, as the attorney is ethically required to do.¹¹¹

Thus, Model Rule 1.6 is permissive, not mandatory, and allows disclosure only where the client's proposed conduct is likely to result imminently in a crime involving death or serious injury to persons.¹¹² Interestingly, the rule as originally proposed by the Kutak Commission would have allowed an attorney to disclose client confidential information necessary to prevent "substantial injury to the financial interests of another."¹¹³ The rule was rejected because it was thought that the rule would force the attorney into the role of a policeman.¹¹⁴ The commentary following the rule adds further emphasis to the lawyer's discretion in making the disclosure, in light of the public interest in candid communication between lawyer and client,¹¹⁵ as well as caution-

111. As discussed *supra* Part II.A, under Model Rule 1.13, corporate counsel's response to learning of client misconduct is to seek "reconsideration of the matter." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 (1995). Thus, the commentary to Model Rule 1.6 states, "[w]here the client is an organization, the lawyer may be in doubt whether contemplated conduct will actually be carried out by the organization. Where necessary to guide conduct in connection with this Rule, the lawyer may make inquiry within the organization as indicated in Rule 1.13(b)." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 cmt. (1995).

112. Model Rule 1.6 has not found great acceptance among the states. Only six states have adopted Model Rule 1.6 without modification. Those states are Alabama, Delaware, Louisiana, Montana, Missouri and Rhode Island. Other states have included crimes against financial and property interests as being subject to disclosure. Those states are: Connecticut, Maryland, New Hampshire, New Mexico, North Dakota, Pennsylvania and Utah. While others allow discretionary disclosure of any future crime. Those states are: Arizona, Arkansas, Colorado, Idaho, Illinois, Indiana, Kansas, Michigan, Minnesota, Mississippi, North Carolina, Oklahoma, South Carolina, Washington, West Virginia, and Wyoming. See Lonnie Kocontes, *Client Confidentiality and the Crooked Client: Why Silence is Not Golden*, 6 GEO. J. LEGAL ETHICS 283, 300 (1992).

113. See Lawrence J. Fox, *OTS v. Kaye, Scholer: An Assault on the Citadel*, 48 BUS. LAW. 1521, 1527 n.17 (1993).

114. *Id.* It has been suggested that this represented the ABA's choice to "structure the standards of professional ethics to protect the interests of the client over the interests of third parties." McCall, *supra* note 94, at 638 n.53. As Professor Hazard, who served as Reporter for the Kutak Commission, has observed, "recognizing that an advocate could be held criminally and civilly liable if involved in a client's fraud, the Kutak draft tried to qualify the rules about client confidences to protect an innocent lawyer enmeshed in such a scheme. This violated the fraternal tradition that client confidences were sacrosanct." Hazard, *supra* note 47, at 1258.

115. The commentary states:

In becoming privy to information about a client, a lawyer may foresee that the client intends serious harm to another person. However, to the extent a lawyer is required or permitted to disclose a client's purposes, the client will be inhibited from revealing facts which would enable the lawyer to counsel against a wrongful course of action. The public is better protected if full and open communication by the client is encouraged than if it is inhibited.

ing the lawyer who makes such a disclosure that "a disclosure adverse to the client's interest should be no greater than the lawyer reasonably believes necessary to the purpose." The commentary also counsels the lawyer contemplating disclosure of a client confidence to take into consideration: (1) the lawyer's relationship with the client; (2) the lawyer's relationship with those who might be injured by the client's action; (3) the lawyer's own involvement in the transaction; and (4) circumstances that may extenuate the client's proposed conduct.

However, the attorney must also take guidance from Model Rule 1.13, which governs the attorney-client relationship when the client is an entity rather than an individual. In contrast to Model Rule 1.6, Model Rule 1.13 contemplates the lawyer's response to corporate wrongdoing as elevating disclosure within the corporation up to and including "the highest authority that can act in behalf of the organization as determined by applicable law."¹¹⁶ Model Rule 1.13 does not include disclosure outside of the corporation among the alternatives available to corporate counsel, suggesting instead that resignation may be the appropriate response to the corporation's intransigence.¹¹⁷ Unfortu-

MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 cmt. (1995). The commentary also states that "[a] lawyer's decision not to take preventive action permitted by paragraph (b)(1) does not violate this Rule." *Id.*

116. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b)(3) (1995).

117. Thus, Model Rule 1.13 (c) states:

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

MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 (c) (1995). The text of Model Rule 1.13 underwent a series of significant revisions in this regard. As proposed in the January 1980 draft of the rule, corporate counsel was authorized to disclose client confidences "to the extent necessary . . . if the lawyer reasonably believes such action to be in the best interest of the organization." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 (Jan. 1980 draft) *quoted in* STEPHEN GILLERS & NORMAN DORSEN, *REGULATION OF LAWYERS: PROBLEMS OF LAW AND ETHICS* 593 (1985). The authority to disclose confidential information was limited in the May 1981 draft to situations involving self dealing by senior management, where the lawyer "reasonably believes that . . . the highest authority in the organization has acted to further the personal or financial interests of members of that authority which are in conflict with the interests of the organization . . . and . . . revealing the information is necessary in the best interest of the organization." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 (May 1981 draft) *quoted in* GILLERS & DORSEN, *supra*, at 593. Although this provision was maintained in the June 1982 draft, as adopted, Model Rule 1.13(c) "gives the lawyers no authority to reveal organizational confidences even when necessary to prevent self-dealing by the organization's highest authority." GILLERS & DORSEN, *supra*, at 593.

nately, neither the Model Rules nor the accompanying commentary attempt to harmonize Model Rule 1.6 and Model Rule 1.13.

Moreover, Model Rule 1.13(b) charges the corporation's attorney to "proceed as is reasonably necessary in the best interest of the organization" when a violation of law "is likely to result in substantial injury to the organization." There are circumstances under which disclosure of wrongdoing may benefit the corporation.¹¹⁸ Nevertheless, Model Rule 1.13 does not contemplate disclosure under these circumstances. To the contrary, Model Rule 1.13(b) can be read to forbid such disclosure in the absence of authorization by the corporate client.¹¹⁹ Again, the Model Rules and the accompanying commentary are silent with respect to the corporation attorney's obligation to remain silent when disclosure might otherwise be "in the best interest of the organization."

118. For example, prosecutors take disclosure and the recognition of responsibility into consideration when determining whether to exercise discretion to decline prosecution. Some formal disclosure programs, such as the corporate leniency policy of the Antitrust Division of the U.S. Department of Justice assure that there will be no criminal prosecution if the corporation comes forward voluntarily and discloses wrongdoing. ANTI-TRUST DIVISION, U.S. DEPT OF JUST., CORPORATE LENIENCY POLICY (1993). Other programs, such as the program administered by the Department of Defense and the Department of Justice for the voluntary disclosure of fraud by defense contractors, offer the enhanced likelihood that the corporation will not be prosecuted. U.S. DEPT OF DEF., THE DEPT OF DEF. VOLUNTARY DISCLOSURE PROGRAM—A DESCRIPTION OF THE PROCESS (1990); see also U.S. DEPT OF JUST., *Factors in Decisions on Criminal Prosecutions for Environmental Violations in the Context of Significant Voluntary Compliance or Disclosure Efforts by the Violator*, in DEPT OF JUST. MANUAL, § 5-11.301A (1991). Additionally, under the Federal Sentencing Guidelines for Organizational Defendants, voluntary disclosure of wrongdoing is a significant mitigating factor in the sentence imposed for corporate crime. See UNITED STATES SENTENCING COMMISSION, GUIDELINES MANUAL, § 8C2.5.(g) (1994). Finally, for corporations that contract with the United States, a corporation's voluntary disclosure may be viewed as evidencing a contractor's present responsibility thereby allowing the corporation to avoid, or mitigate, a period of suspension or debarment from government contracting. See 48 C.F.R. § 9.406-1(a)(2) (1994).

119. The Model Rules provide that "[a]ny measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b) (1995) As Professor McCall observed, Model Rule 1.13(b):

[S]pecifically imposes a duty on the corporation lawyer who learns of constituent misconduct to take measures to protect the best interests of the corporation, including referring the matter, if necessary, to the corporation's board of directors. All such measures taken by the attorney must be consistent with the duty of confidentiality, which binds the attorney not to reveal confidential information relating to the representation of the corporation. In practical terms, this means not revealing the information to anyone outside the corporation, and, within the corporation, revealing it only to those persons who necessarily must be informed to protect the corporation's interests.

McCall, *supra* note 94, at 635-36.

However, the paramount importance of client confidentiality is underscored in other provisions of the Model Rules as well. For example, when a lawyer acts as an intermediary between clients, Model Rule 2.2 requires that the confidentiality of all clients be respected and if the "delicate balance" of the interests and confidentiality of each client cannot be maintained, "the common representation is improper."¹²⁰ Likewise, under Model Rule 1.9, the threat of disclosure of client confidence is a basis for disqualification of counsel where there is a conflict of interests between current and former clients.¹²¹ Similarly, where dis-

120. MODEL RULES OF PROFESSIONAL CONDUCT Rule 2.2 cmt. (1995). See generally Dzienkowski, *supra* note 3, at 803-11.

121. Under Model Rule 1.9, a lawyer may be disqualified from representing a client if the lawyer had represented another client in "the same or a substantially related matter" and the interest of the present and former client are "materially adverse." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.9(a) (1995). The lawyer is also forbidden from using "information relating to the representation" to the disadvantage of the former client. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.9(b) (1995). Courts construing Model Rule 1.9, and its predecessor Canon 4 of the Code, have noted in this regard that the lawyer's duty to a client is that of a fiduciary. See, e.g., *Cinema 5, Ltd. v. Cinerama, Inc.*, 528 F.2d 1384, 1386 (2d Cir. 1976); *Elan Transdermal Ltd. v. Cygnus Therapeutic Systems*, 809 F. Supp. 1383, 1386 (N.D. Cal. 1992); *Financial General Bank Shares, Inc. v. Metzger*, 523 F. Supp. 744, 762 (D.D.C. 1981). The likelihood that a lawyer may disclose a former client's confidences to the disadvantage of the former client gives rise to a presumption of a "substantial relationship" between the subject matters of the current and former representation. See, e.g., *Trone v. Smith*, 621 F.2d 994, 998 (9th Cir. 1980) ("If there is a reasonable probability that confidences were disclosed which could be used against the client in a later, adverse representation, a substantial relationship between the two cases is presumed."); *Elan Transdermal*, 809 F. Supp. at 1389; *Hagen-Dazs Co. v. Perche No! Gelato, Inc.*, 639 F. Supp. 282, 285 (N.D. Cal. 1986). Conversely, establishment that the two matters are substantially related will give rise to an irrebuttable presumption that client confidences were disclosed in the course of the former representation. See, e.g., *In Re American Airlines*, 972 F.2d 605, 614 (5th Cir. 1992) ("Once it is established that the prior matters are substantially related to the present case, the court will irrefutably presume that relevant confidential information was disclosed during the former period of representation."); *Smith v. Whatcott*, 757 F.2d 1098, 1100 (10th Cir. 1985); *Elan Transdermal*, 809 F. Supp. at 1389; *T.C. Theater Corp. v. Warner Bros. Pictures*, 113 F. Supp. 265, 268-69 (S.D.N.Y. 1953); see also *Laker Airways, Ltd. v. Pan American World Airways*, 103 F.R.D. 22, 38 (D.D.C. 1984) (When the subject matters of the two representations are substantially related, it is assumed that a genuine threat exists that the confidences revealed to former counsel will be used for the benefit of the present adversary despite the attorney's good faith efforts to avoid such use."). For that reason, courts have adopted a "strict prophylactic rule" of disqualification to prevent disclosure of client confidences. See *Emile Indus., Inc. v. Patents, Inc.*, 478 F.2d 562, 571 (2d Cir. 1973). As the *Emilie Industries* court states:

Even the most rigorous self-discipline might not prevent a lawyer from unconsciously using or manipulating a confidence acquired in the earlier representation and transforming it into a telling advantage in the subsequent litigation. Or, out of an excess of good faith, a lawyer might bend too far in the opposite direction, refraining from seizing a legitimate opportunity for fear that such a

closure is sought by the client's independent auditor, Model Rule 2.3 and long standing ABA policy protect client confidences.¹²²

C. *Does Counsel Have an Ethical Duty to Resign?*

The corporate counsel confronted with ongoing or intended criminal conduct, which the corporation's "highest authority" refuses to abandon, is in a precarious position. Although counsel may not be permitted ethically to disclose the wrongdoing, counsel may nevertheless risk personal involvement in the misconduct, and a serious breach of the attorney's ethical duties, by virtue of the attorney's silence. Under these circumstances, counsel may have no choice but to resign.

tactic might give rise to an appearance of impropriety. In neither event would the litigant's or the public's interest be well served. The dynamics of litigation are far too subtle, the attorney's role in that process is far too critical, and the public's interest in the outcome is far too great to leave room for even the slightest doubt concerning the ethical propriety of a lawyer's representation in a given case. These considerations require application of a strict prophylactic role to prevent any possibility, however slight, that confidential information acquired from a client during a previous relationship may subsequently be used to the client's disadvantage.

Id.; See also *United States Football League v. National Football League*, 605 F. Supp. 1448, 1461 (S.D.N.Y. 1985). The disqualification of one or more attorneys pursuant to Model Rule 1.9 may also result in the disqualification of all of the lawyers practicing with them, pursuant to Model Rule 1.10, there being a presumption of shared information among them. See, e.g., *Smith v. Whatcott*, 757 F.2d at 1101; *Elan Transdermal*, 809 F. Supp. at 1390; *United States Football League*, 605 F. Supp. at 1466.

122. As a result of the criticism of public accountants for failing to uncover fraud in financial statements they had audited, in March 1975, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 5 ("FAS 5") addressing accrual and disclosure of "loss contingencies," defined as: "an existing condition, situation, or set of circumstances involving uncertainty as to possible . . . loss . . . to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur." AUDITOR'S LETTER HANDBOOK, 23 (ABA 1976). Corporate counsel who received requests from auditors seeking information concerning contingent losses risked waiver of the attorney client privilege by responding to the request. To address this problem, following discussions between the ABA and the American Institute of Certified Public Accountants, in December 1975 the ABA issued its Statement of Policy Regarding Lawyer's Responses to Auditors' Requests for Information. The ABA recognized that "[authorizing] lawyers to respond to general inquiries and disclose information to auditors concerning matters which have been communicated in confidence is essentially destructive of free and open communication and early consultation between lawyer and client." *Id.* at 5. The ABA distinguished between litigation (pending litigation and litigation which "a third party has manifested . . . a present intention to commence"), which was considered an appropriate subject for evaluation by counsel (at least with respect to the client's position on the matter and possible exposure), and "other contingencies of a legal nature," which was not considered appropriate for a lawyer's response in view of the public interest in encouraging communication and consultation between clients and attorneys. *Id.* at 6.

Once counsel has sought reconsideration of the current or proposed misconduct through the corporate hierarchy and has been rebuffed, a variety of ethical precepts come into play which bear directly on whether the lawyer can continue to serve as corporate counsel. Both the Code and the Model Rules recognize that there are situations in which counsel must resign, for example, where continued representation will involve counsel in the client's misconduct. Similarly, the Code and Model Rules identify circumstances when counsel's withdrawal is permissive, leaving the decision whether to resign in counsel's discretion. Finally, there is the question of counsel's obligations to the client and to others once the decision to resign has been made. In each instance the ethical rules provide only skeletal guidance.

1. *Mandatory Withdrawal.* The Code requires that a lawyer withdraw from representing a client when the lawyer "knows or it is obvious that his continued employment will result in violation of a Disciplinary Rule."¹²³ The Model Rules contain a similar requirement.¹²⁴ For example, a lawyer may not engage in illegal conduct, or conduct involving dishonesty, fraud or misrepresentation.¹²⁵ Neither may a lawyer counsel a client to violate the law or assist a client in conduct the lawyer knows to be illegal.¹²⁶

123. Disciplinary Rule 2-110(B)(2) states that, "[a] lawyer representing a client . . . shall withdraw from employment, if . . . [h]e knows or it is obvious that his continued employment will result in violation of a Disciplinary Rule". MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-110(B)(2) (1980). So, for example, a lawyer whose client submitted fabricated records to an administrative agency must resign if the client refuses to rectify the fraud. Although the lawyer is prohibited from revealing the fraud absent the client's consent, the lawyer may not, in any event, offer false evidence to a tribunal in violation of Disciplinary Rule 7-102(A)(6). See ABA Comm. on Ethics and Professional Responsibility Op. 90-7 (1990).

124. Model Rule 1.16(a)(1) provides, "a lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if . . . the representation will result in violation of the Rules of Professional Conduct or other law . . ." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.16(a)(1) (1995).

125. See MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 1-102(A)(3) (1980) ("A lawyer shall not . . . [e]ngage in illegal conduct involving moral turpitude."); MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 1-102(A)(4) (1980) ("A lawyer shall not . . . [e]ngage in conduct involving dishonesty, fraud, deceit or misrepresentation."); MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(A)(8) (1980) ("In his representation of a client, a lawyer shall not . . . [k]nowingly engage in other illegal conduct or conduct contrary to a Disciplinary Rule.").

126. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(A)(7) (1980) ("In his representation of a client, a lawyer shall not . . . [c]ounsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent."); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2(d) (1995) ("A lawyer shall not counsel a client to engage, or assist a client,

This is not to say, however, that simply providing advice that the client subsequently uses to commit an unlawful act is an ethical transgression,¹²⁷ or that withdrawal is ethically required when a client suggests that the lawyer engage in illegal activity.¹²⁸ Instead, withdrawal is required when the lawyer's services materially further criminal or fraudulent conduct¹²⁹ such that the lawyer's continued participation in the matter could fairly be characterized as engaging in the illegal conduct.¹³⁰

2. *Permissive Withdrawal.* In keeping with their purpose of providing a framework for the ethical practice of law and a structure for regulating conduct,¹³¹ both the Code and the Model

in conduct that the lawyer knows is criminal or fraudulent").

127. As the comment following Model Rule 1.2 states: "[t]he fact that a client uses advice in a course of action that is criminal or fraudulent does not, of itself, make a lawyer a party to the course of action." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2 cmt. (1995).

128. As the comment to Model Rule 1.16 states, "[t]he lawyer is not obliged to decline or withdraw simply because the client suggests [an illegal or unethical] course of conduct; a client may make such a suggestion in the hope that a lawyer will not be constrained by a professional obligation." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.16 cmt. (1995).

129. Thus, the comment to Model Rule 1.6 states that "[i]f the lawyer's services will be used by the client in materially furthering a course of criminal or fraudulent conduct, the lawyer must withdraw" MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 cmt. (1995). See also MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13 cmt. (1995) ("If the lawyer's services are being used by an organization to further a crime or fraud by the organization, Rule 1.2(d) can be applicable."). As explained in the comment following Model Rule 1.2, "There is a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which a crime or fraud might be committed with impunity." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2 cmt. (1995). The comment notes further that the prohibition against assisting client illegality applies even when the lawyer discovers the illegal conduct after the representation has begun: "[a] lawyer may not continue assisting a client in conduct that the lawyer originally supposes is legally proper but then discovers is criminal or fraudulent. Withdrawal from the representation, therefore, may be required." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2 cmt. (1995).

130. As one commentator has observed in this regard, "if a lawyer is sufficiently involved in a particular matter so that he may be viewed as 'engaging' in the illegal or fraudulent conduct . . . the only way to 'disengage' from the conduct would be withdrawal from representation. This effectively amounts to mandatory withdrawal." Gruenbaum, *supra* note 19, at 199.

131. Both the Code and the Model Rules make this point. The Preliminary Statement to the Code states, "[t]he Model Code is designed to be adopted by appropriate agencies both as an inspirational guide to the members of the profession and as a basis for disciplinary action when the conduct of a lawyer falls below the minimum standards stated in the Disciplinary Rules." MODEL CODE OF PROFESSIONAL RESPONSIBILITY Preliminary Statement (1980). The Preamble to the Model Rules carries the point forward and

Rules allow significant discretion in determining whether withdrawal from representation is appropriate. For that reason, withdrawal under both the Code and the Model Rules tends to be permissive rather than mandatory.

For example, as noted above, Disciplinary Rule 2-110(B)(2) *requires* withdrawal when the lawyer “knows” or when “it is obvious” that continued representation will result in violation of a Disciplinary Rule. In contrast, Disciplinary Rule 2-110(C)(2) provides that a lawyer *may* withdraw when continued representation is “likely” to result in violation of a disciplinary rule. And the ethical considerations under Canon 2 emphasize that a lawyer should withdraw “only on the basis of compelling circumstances”¹³² Consistent with that ethical premise, the Code permits but does not require a lawyer to withdraw from representing a client when the client “seeks to pursue an illegal course of conduct¹³³ or the client “[i]nsists that the lawyer pursue a course of conduct that is illegal,¹³⁴ or when the client insists that the lawyer “engage in conduct that is contrary to the judgment and advice of the lawyer” so long as the conduct does

emphasizes that the rules do not form an independent legal duty or basis for civil liability. In this regard, the Preamble provides:

Violation of a Rule should not give rise to a cause of action nor should it create any presumption that a legal duty has been breached. The Rules are designed to provide guidance to lawyers and to provide a structure for regulating conduct through disciplinary agencies. They are not designed to be a basis for civil liability [N]othing in the rules should be deemed to augment any substantive legal duty of lawyers or the extra-disciplinary consequences of violating such a duty.

MODEL RULES OF PROFESSIONAL CONDUCT Preamble (1995).

132. MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 2-32 (1980). Ethical Consideration 2-32 states:

A decision by a lawyer to withdraw should be made only on the basis of compelling circumstances. . . . A lawyer should not withdraw without considering carefully and endeavoring to minimize the possible adverse effect on the rights of his client and the possibility of prejudice to his client as a result of his withdrawal. Even when he justifiably withdraws, a lawyer should protect the welfare of his client by giving the notice of his withdrawal, suggesting employment of other counsel, delivering to the client all papers and property to which the client is entitled, cooperating with counsel subsequently employed, and otherwise endeavoring to minimize the possibility of harm.

Id.

133. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-110(C)(1)(b) (1980) (“A lawyer . . . may not withdraw . . . unless . . . such withdrawal is because . . . [h]is client . . . [p]ersonally seeks to pursue an illegal course of conduct.”).

134. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-110(C)(1)(c) (1980) (“A lawyer . . . may not withdraw . . . unless . . . such withdrawal is because . . . [h]is client . . . [i]nsists that the lawyer pursue a course of conduct that is illegal or that is prohibited under the Disciplinary Rules.”).

not violate a disciplinary rule.¹³⁵

The Model Rules are similarly permissive with regard to withdrawal by counsel. Although as a general policy, a lawyer is bound to abide by the client's decisions concerning objectives,¹³⁶ if the client pursues a course of action "involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent"¹³⁷ or if the client "has used the lawyer's services to perpetuate a crime or fraud"¹³⁸ or if the lawyer considers the client's objectives otherwise "repugnant or imprudent,"¹³⁹ the lawyer may seek to withdraw from the representation. Withdrawal may be permitted in these circumstances even though the lawyer's representation does not further the unlawful or fraudulent activity.¹⁴⁰ Thus, corporate counsel may seek to withdraw if after

135. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-110(C)(1)(e) (1980) ("A lawyer . . . may not withdraw . . . unless . . . such withdrawal is because . . . [h]is client . . . [i]nsists . . . that the lawyer engage in conduct that is contrary to the judgment and advice of the lawyer but not prohibited under the Disciplinary Rules."). Other ethical considerations also suggest that withdrawal is not precipitated by the client's rejection of the lawyer's advice. Ethical Consideration 7-5 states, a lawyer "may continue in the representation of his client even though his client has elected to pursue a course of conduct contrary to the advice of the lawyer so long as he does not thereby knowingly assist the client to engage in illegal conduct . . ." MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-5 (1980). The ethical considerations recognize that in such circumstances, the legal consequences of a course of conduct may depend entirely on the client's state of mind and the ethical considerations counsel the lawyer to resolve doubts in favor of the client. Thus, Ethical Consideration 7-6 provides:

Whether the proposed action of a lawyer is within the bounds of law may be a perplexing question when his client is contemplating a course of conduct having legal consequences that vary according to the client's intent, motive, or desires at the time of the action In many cases a lawyer may not be certain as to the state of mind of his client, and in those situations he should resolve reasonable doubts in favor of his client.

MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-6 (1980).

136. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2(a) (1995) ("A lawyer shall abide by a client's decisions concerning the objectives of representation . . . and shall consult with the client as to the means by which they are to be pursued.")

137. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.16(b)(1) (1995) ("A lawyer may withdraw from representing a client if . . . the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent.")

138. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.16(b)(2) (1995) ("A lawyer may withdraw from representing a client if . . . the client has used the lawyer's services to perpetrate a crime or fraud.")

139. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.16(b)(3) (1995) ("A lawyer may withdraw from representing a client if . . . a client insists upon pursuing an objective that the lawyer considers repugnant or imprudent.")

140. As the comment following Model Rule 1.16 explains:

Withdrawal is also justified if the client persists in a course of action that the lawyer reasonably believes is criminal or fraudulent, for a lawyer is not required to be associated with such conduct even if the lawyer does not further

seeking reconsideration of a proposed course of action, "the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, that is clearly a violation of law and is likely to result in substantial injury to the organization[.]"¹⁴¹ It has been suggested, however, that as a practical matter violations of law of this sort are rarely "clear."¹⁴²

3. *The Manner of Withdrawal.* Further complicating the withdrawal decision is the manner in which the withdrawal will be effected. That is, should counsel simply resign from the representation or must counsel disclose the reason for the resignation to others (i.e., to successor counsel or to potential victims of future crimes or frauds), sometimes referred to as a "noisy" withdrawal. Obviously, resolution of this issue requires a careful balancing and reconciliation of the obligation of confidentiality and the prohibitions against furthering a crime or fraud.

The Code and the Model Rules clearly favor withdrawal that does not adversely affect the client. Canon 2 of the Code requires that the withdrawing lawyer take "reasonable steps to avoid foreseeable prejudice to the rights of his client . . ."¹⁴³ The

it. Withdrawal is also permitted if the lawyer's services were misused in the past even if that would materially prejudice the client.

MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.16 cmt. (1995). See also ABA Comm. on Ethics and Professional Responsibility, Formal Op. 92-366 (1992) ("When a lawyer's services have been used in the past by a client to perpetrate a fraud, but the fraud has ceased, the lawyer may but is not required to withdraw from further representation of the client . . .").

141. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(c) (1995) ("If, despite the lawyer's efforts . . . the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, that is clearly a violation of law and is likely to result in substantial injury to the organization, the lawyer may resign . . .").

142. See Hemmer, *supra* note 45, at 658 ("The author submits that this professional rule will seldom permit counsel to resign. In practice, potential violations of law typically are not 'clear,' particularly if they involve elements of business judgment beyond the sphere of counsel's expertise.")

143. Disciplinary Rule 2-110(A)(2) provides:

[A] lawyer shall not withdraw from employment until he has taken reasonable steps to avoid foreseeable prejudice to the rights of his client, including giving due notice to his client, allowing time for employment of other counsel, delivering to the client all papers and property to which the client is entitled, and complying with applicable laws and rules.

MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-110(A)(2) (1980). In this regard, Ethical Consideration 2-32 also admonishes that the lawyer:

[N]ot withdraw without considering carefully and endeavoring to minimize the possible adverse effect on the rights of his client and the possibility of prejudice to his client as a result of his withdrawal. Even when he justifiably withdraws, a lawyer should protect the welfare of his client by giving due notice of his withdrawal, suggesting employment of other counsel, delivering to

Model Rules, as well, provide that withdrawal will be permitted "if withdrawal can be accomplished without material adverse effect on the interests of the client . . ." ¹⁴⁴

However, notwithstanding the almost overriding importance of maintaining client confidentiality and the clear obligation to avoid prejudicing the client, the lawyer who withdraws may nevertheless face an equal obligation to disclose confidential information in order "to avoid assisting a criminal or fraudulent act by a client . . ." ¹⁴⁵ Thus, as the comment to the Model Rules observes, "[w]hen the client's course of action has already begun and is continuing, the lawyer's responsibility is especially delicate." ¹⁴⁶ The delicacy of corporate counsel's position in such a sit-

the client all papers and property to which the client is entitled, cooperating with counsel subsequently employed, and otherwise endeavoring to minimize the possibility of harm.

MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 2-32 (1980).

144. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.16(b) (1995). *See also* MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.16 cmt. (1995) ("Even if the lawyer has been unfairly discharged by the client, a lawyer must take all reasonable steps to mitigate the consequences to the client."). As an example of the prejudice to a client that can result from withdrawal, one commentator has observed:

The resignation of counsel, as the legal representative of a large publicly held corporation, can cost many thousands of dollars simply to bring new counsel "up to speed." More importantly, it can involve adverse publicity or "signals" to counter parties, which may in the end be improperly determinative of a client's course of conduct . . . A resignation that jeopardizes the client's chosen course of conduct would be an abdication of that professional responsibility.

Hemmer, *supra* note 45, at 662-63.

145. Thus, Model Rule 4.1 provides:

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

MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1 (1995). Although the comment following Model Rule 4.1 is clear that there is no general duty to inform the opposing party of "relevant facts," a lawyer is nevertheless required "to be truthful in dealing with others on the client's behalf." MODEL RULES OF PROFESSIONAL CONDUCT Rule 4.1 cmt. (1995). In this regard, the comment notes that "[a] misrepresentation can occur if the lawyer incorporates or affirms a statement of another person that the lawyer knows is false." *Id.* Similarly, a misrepresentation "can also occur by failure to act." *Id.* With regard to a client's fraud, the comment also notes that the rule "recognizes that substantive law may require a lawyer to disclose certain information to avoid being deemed to have assisted the client's crime or fraud." *Id.*

146. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2 cmt. (1995). As the commentary further observes:

The lawyer is not permitted to reveal the client's wrongdoing except where permitted by Rule 1.6. However, the lawyer is required to avoid furthering the purpose, for example, by suggesting how it might be concealed. A lawyer may

uation was amply demonstrated in the O.P.M. affair.

O.P.M. Leasing Services, Inc. ("O.P.M.") was a company engaged in leasing computer equipment to businesses. Between 1978 and 1981, O.P.M. (which stood for "Other People's Money") obtained loans of approximately \$225 million to fund the venture. These loans were collateralized with computer leases and equipment. Many of the leases were with Rockwell International Corp. and had been procured by bribing various Rockwell employees. In addition, virtually from the beginning of its operation, O.P.M. had defrauded lenders by using a single piece of computer equipment as collateral for multiple loans without disclosing the other security interests. In some instances, lessees' signatures were forged on leases reflecting exaggerated payments.¹⁴⁷

Between 1970 and 1981, O.P.M. was represented by Singer, Hutner, Levine & Seeman, P.C. ("Singer, Hutner"), which served as general counsel to O.P.M. Eventually during the representation, an attorney from Singer, Hutner served on the O.P.M. Board of Directors and as an O.P.M. officer. Between 1975 and 1981, O.P.M. represented approximately 60% of Singer, Hutner's business.¹⁴⁸

Although there had been warning signs of problems,¹⁴⁹ Singer, Hunter became aware of the magnitude of the fraud on June 12, 1980 when Myron Goodman, a founder and president of O.P.M., admitted to Joseph Hutner that O.P.M. had been engaged in a fraudulent scheme that it was financially unable to

not continue assisting a client in conduct that the lawyer originally supposes is legally proper but then discovers is criminal or fraudulent.

Id.; see also Marc I. Steinberg, *Attorney Liability for Client Fraud*, 1991 COLUM. BUS. L. REV. 1, 18 (1991). As Steinberg observes:

In the client fraud setting, inside counsel is in a particularly troubling dilemma. If outside counsel speaks out or resigns, a lucrative client may be lost. If inside counsel does so, he or she may well have to find another job. Nonetheless, inside counsel's professional obligations are not lessened by the fact of in-house status. As a consequence, inside counsel must be careful not to be co-opted into being a participant in the client's fraud.

Steinberg, *supra*, at 18.

147. See generally Kocontes, *supra* note 112, at 301-09; Treiman, *supra* note 35, at 928.

148. Kocontes, *supra* note 112, at 302.

149. For example, O.P.M. had been convicted in March 1980 of twenty-two felony counts arising from a check-kiting fraud scheme in which O.P.M. had used its controlling interests in a Louisiana bank to obtain interest free loans from other financial institutions. Also, with regard to the Rockwell leases, O.P.M. instructed Singer, Hutner to forward the Rockwell leases to O.P.M. rather than to Rockwell, as was the practice with other non-Rockwell leases. *Id.*

remedy. It appears that Goodman's confession was prompted by a letter sent by an O.P.M. accountant controller to Singer, Hutner just prior to the controller's resignation.¹⁵⁰

Because of the firm's concerns arising from its role in the fraudulent transactions, Singer, Hutner engaged two experts in legal ethics, Joseph McLaughlin, Dean of the Fordham Law School, and Henry Putzel III, a former Fordham Professor of professional responsibility, to advise the firm of its ethical obligations.¹⁵¹ The firm was told that it had no ethical obligation to disclose the fraudulent conduct or withdraw as O.P.M.'s counsel since there was no evidence that the fraud was ongoing. The firm was further advised that there was no obligation to withdraw its opinion letters, now seen to be misleading, because the documents had been prepared in good faith.¹⁵²

However, when further information was disclosed concerning the fraud and the uses to which the firm's services had been put in furtherance of the scheme, Singer, Hutner withdrew as counsel for O.P.M., although on the advice of Professor Putzel, the firm's withdrawal was a gradual one, over several months, so as to avoid prejudicing O.P.M.¹⁵³ The only documentation of the withdrawal prepared by Singer, Hutner was a letter indicating that the termination of the representation was by "mutual agreement."¹⁵⁴

Following Singer, Hutner's resignation, O.P.M. engaged the firm of Kaye, Scholer, Fierman, Hays and Handler ("Kaye, Scholer").¹⁵⁵ Prior to undertaking the representation, Kaye, Scholer inquired of Singer, Hutner whether there was any reason why Kaye, Scholer should not represent O.P.M. Kaye, Scholer was informed by Joseph Hutner that the termination had been by mutual agreement and that Hutner would not disclose the reasons for the termination.¹⁵⁶ A Kaye, Scholer partner told Hutner in this connection that Kaye, Scholer would accept O.P.M. as a client because he assumed that Hutner would alert him if anything was wrong. Kaye, Scholer undertook the representation of O.P.M. and assisted O.P.M. in transactions that proved to be fraudulent which resulted in \$15 million in addi-

150. *Id.*

151. Treiman, *supra* note 35, at 928.

152. Kocontes, *supra* note 112, at 304.

153. *Id.* at 305.

154. Treiman, *supra* note 35, at 930.

155. Kocontes, *supra* note 112, at 305.

156. Treiman, *supra* note 35, at 929-30.

tional losses to lenders.¹⁵⁷

As a matter of legal ethics, Singer, Hutner's failure to disclose O.P.M.'s fraud was defensible. Goodman's confession to Hutner was for the purpose of obtaining legal advice and not, apparently, in furtherance of the fraudulent scheme. Accordingly, the information was subject to the obligation to preserve client confidences under both the Code and the Model Rules. Further, because the opinions expressed by the firm in a good faith belief in their accuracy related to past crimes committed by O.P.M. there does not appear to have been a legal obligation to rectify what was subsequently revealed to have been possible misrepresentations on the part of the firm. Finally, again assuming that Singer, Hutner had no reason to believe that the O.P.M. fraud was ongoing, there was no basis for the firm to disclose O.P.M.'s past acts to Kaye, Scholer, a disclosure which would have violated Singer, Hutner's duty of confidentiality to O.P.M. Thus, even under so egregious a factual setting as the O.P.M. fraud, there was not an ethical basis for a "noisy" withdrawal.

In contrast to the O.P.M. affair is the situation addressed by the ABA Committee on Professional Responsibility concerning an attorney who knows or has reason to believe that her work product and services are being used or will be used by her client to perpetrate a fraud.¹⁵⁸ There, the outside counsel to a small privately held corporation engaged in providing lighting equipment to commercial buildings issued an opinion in support of the closing of a \$5 million unsecured loan, *inter alia*, that the company's installation contracts (the company's principal assets) were enforceable obligations against the company's customers. After the transaction closed, the CEO and Treasurer of the client confessed to counsel that for the preceding three years, they had falsified millions of dollars of contracts by altering existing contracts and forging change orders to inflate receivables. As a result, both the lawyer's opinion and the audited financial statements were materially misleading.¹⁵⁹

The confessing officers informed the lawyer that they were unwilling to issue corrected financial statements. They also informed her that the company intended to engage new counsel who would be called upon to assist with additional loans and to maintain the company's line of credit with the defrauded lender.

157. *Id.*

158. ABA Comm. on Ethics and Professional Responsibility, Formal Op. 92-366 (1992).

159. *Id.*

The officers stated that they would not disclose the fraud to the new counsel.¹⁶⁰

In effecting these transactions, the lender would rely on the lawyer's earlier opinion. The lawyer advised the third member of the company's board of directors, who was not involved in the fraudulent activity, and was informed that the board member intended to take no action "other than to assist the CEO and treasurer in avoiding the company's insolvency."¹⁶¹

With regard to the lawyer's intention to resign from representing the company, while the ABA Committee agreed that the lawyer was required to withdraw from any representation that would have the effect of directly or indirectly assisting the client's fraud, the committee suggested that withdrawal from representation unrelated to the fraudulent activity would not be required.¹⁶² Further, the Committee concluded that to the extent the client's fraud was completed and the lawyer did not know or have reason to believe that the client would use the lawyer's services and work product in a future fraud, the lawyer could withdraw from the representation but could not disavow her work product.¹⁶³ However, the lawyer could disavow her work product to prevent its use in a continuing or future fraud unless the mere fact of her withdrawal would put the lender on notice that something was wrong.¹⁶⁴

160. *Id.*

161. *Id.*

162. *Id.* The Committee stated:

It is not clear from the facts presented to the Committee whether severance of the *entire* relationship is ethically compelled in this case, as the lawyer apparently believes, or whether she is ethically required to withdraw from representation of the client only in matters relating to the fraud. We do not believe that knowledge of a client's ongoing fraud necessarily requires the lawyer's withdrawal from representation wholly unrelated to the fraud, even if the fraud involves the lawyer's past services or work product. On the other hand, complete severance may be the preferred course in these circumstances, in order to avoid any possibility of the lawyer's continued association with the client's fraud. We would simply point out, however, that withdrawal from matters totally unrelated to the fraud is more likely to be permissive, and governed by Rule 1.16(b), than mandatory under Rule 1.16(a)(1).

Id.

163. *Id.* The Committee concluded in this regard:

[I]f the fraud is completed, and the lawyer does not know or reasonably believe that the client intends to continue the fraud or commit a future fraud by use of the lawyer's services or work product, the lawyer may withdraw from representation of the client but may not disavow any work product.

Id.

164. *Id.* As the Committee stated:

[W]e conclude that the instant inquiry presents a situation in which a "noisy"

The Committee took pains to make clear that such a “noisy” withdrawal should be “a last resort” and should be limited to that disclosure necessary to accomplish the purpose and no more. For example, in the context of the underlying facts, the Committee suggested the possibility of notifying successor counsel rather than the lender.¹⁶⁵ Thus, the Committee concluded:

Our present opinion reads the Rules as permitting limited disclosure *only* where the client is determined to continue the fraudulent conduct which the lawyer has unwittingly facilitated, or to make use of the lawyer’s services or work product in a future fraud, and there is no other way for the lawyer to avoid giving assistance to such continuing or future fraud in violation of Rule 1.2(d). In these limited circumstances, where silence would result in a violation of the lawyer’s duty under Model Rule 1.2(d) not to assist a client’s ongoing or intended future fraud, we are persuaded that her duty to keep client confidences must

withdrawal would be proper since the client has declared itself determined to engage in further fraudulent conduct that will implicate the lawyer’s past services, and the lawyer knows it. Withdrawal from further representation of the client is therefore mandated by Rule 1.16(a)(1). And, if the lawyer reasonably believes that her withdrawal in silence will be ineffective to prevent the client from using the lawyer’s work product to accomplish its unlawful purpose, in order to avoid violating Rule 1.2(d), she may take the additional step of disaffirming her work product, with the hope and expectation that this will prevent reliance on that work product by future victims of the client’s continuing fraud. Indeed, disavowal of her opinion may be the only way of making her withdrawal effective.

Id.

165. *Id.* The Committee opined:

[D]isaffirmance should be a last resort, and should in any event go no further than necessary to accomplish its purpose of avoiding the lawyer’s assisting the client’s fraud. Before taking this drastic step, the lawyer should determine whether the circumstances are such that disaffirmance is necessary to disassociate herself from the client’s fraud, or whether measures short of disaffirmance will suffice. We can envision situations in which the lawyer’s simple silent withdrawal from representation would be sufficient to accomplish this end. We can also envision situations in which the lawyer’s intention to disaffirm, announced to the client, would accomplish the same result as actual disaffirmance. And even where disaffirmance is necessary, it may be enough to take measures short of notifying the bank. For example, it may be sufficient for the lawyer to notify the client’s new lawyers that she can no longer stand behind the opinion she gave at the loan closing about the enforceability of the installation contracts. Finally, if the bank must be notified, in disaffirming her work product the lawyer should take only such steps as are reasonably necessary to accomplish the intended purpose of preventing use of her work product in the client’s fraud. The lawyer may and indeed must decline to discuss or otherwise reveal anything about the disaffirmed work product beyond the simple fact that she no longer stands behind it.

Id.

give way to the extent necessary to avoid this result.¹⁶⁶

In addition to the risk of violating the ethical prohibitions against assisting client illegality or fraud, the corporate counsel who elects to remain silent concerning corporate misconduct risks criminal prosecution and civil suit for violating or avoiding and abetting the violation of law. In such situations, corporate counsel's position is indeed "delicate" particularly when counsel represents the corporation in its dealings with federal regulatory authorities.

III. CONSEQUENCES IF CORPORATE COUNSEL REMAINS SILENT IN THE FACE OF CORPORATE ILLEGALITY

In light of the Model Rules' prohibition against knowing assistance of a client's fraud or other illegal conduct, the corporate counsel who remains silent in the face of ongoing or planned illegality risks significant liability on several fronts. Despite the bar's consistent view that disclosure may be made only in limited circumstances,¹⁶⁷ an attorney's failure to disclose client misconduct, particularly violations of regulatory statutes, may result in prosecution by government regulatory authorities and civil suits by third parties who were damaged by the corporate client's misconduct. The Securities and Exchange Commission has sought through civil enforcement actions and administrative

166. *Id.* In a strongly worded dissent, three members of the Committee challenged the fundamental premise of the majority's opinion as well as the Committee majority's interpretation of Model Rules 1.2(d) and 1.16(a)(1) to require post hoc disavowal of the attorney's opinion letter. The Committee minority concluded that because the lawyer's representation with regard to banking matters had been concluded, Model Rule 1.16(a)(1) did not require noisy withdrawal since Model Rule 1.16(a)(1) "clearly contemplates mandatory withdrawal only if future ongoing representational services will be improperly used by the client. Only then would a 'noisy withdrawal' be permissible." *Id.* The Committee minority also found the majority's conclusion that the lender would be "lulled" absent disavowal to be "artificial." Instead, the Committee minority concluded that "disaffirmance is only possible if withdrawal is mandatory" and that "[w]ithdrawal is mandatory only if continued representation will violate Model Rule 1.2(d) by assisting the client in committing a fraud on the bank." *Id.*

167. Recently, in August 1991, the Business Law Section of the ABA proposed an amendment of Model Rule 1.6 that would permit disclosure of client fraud in cases where the lawyer's services were used to perpetrate a fraud. Under the amendment, disclosure would only be permitted when the client had withheld information and thereby had involved an innocent lawyer in the client's fraud. Despite arguments that requiring confidentiality under these circumstances would in effect reward a client's lack of candor, the House of Delegates rejected the proposed amendment. See Richard M. Phillips, *Client Fraud and the Securities Lawyer's Duty of Confidentiality*, 49 WASH. & LEE L. REV. 823, 827-29 (1992).

proceedings to impose on securities lawyers duties of disclosure that exceed the lawyer's ethical duties. So too, in its efforts to recoup federal insurance funds lost through the failures of savings and loan associations, the Office of Thrift Supervision has been successful in aggressively asserting liability on the part of lawyers for the failure to disclose fully the financial condition of their clients to the banking regulators. Regardless of whether one applauds or condemns the regulators' activities in these regards, the complexity of corporate counsel's potentially conflicting duties of confidentiality and disclosure are at least troubling and are a source of grave personal and professional concern for corporate counsel.

A. *The Securities and Exchange Commission*

Following the revelations that Salomon Brothers had on at least three occasions violated SEC and Treasury rules in connection with trading in Treasury notes in 1991, the SEC and its Chairman commented on the responsibility of Salomon's Chief Legal Officer, Donald M. Feuerstein, to bring Salomon's misconduct to the attention of government regulators. Although the SEC's comments were equivocal with respect to the obligation of a lawyer in Feuerstein's position to come forward and report client misconduct, the SEC report regarding Feuerstein's actions (and failure to act) revived issues of professional responsibility that have been the subject of debate by securities law practitioners for the past twenty years.

1. *The Salomon Brothers Case.* In February 1991, Salomon bid for 35% of the five-year Treasury notes then at auction. Salomon's bid was the maximum that any one bidder could lawfully submit. Salomon exceeded this limit by submitting unauthorized bids in the names of two Salomon customers. As a result, Salomon was able to secure 56.7% of the auctioned Treasury notes. Salomon then readjusted its books to make it appear that the customers, in whose names the bids had been made, had sold their positions to Salomon.¹⁶⁸

168. For the facts of the Salomon Brothers case, see the report of the SEC concerning the actions of Salomon Brothers' management in *In Re Gutfreund*, Exchange Act Release No. 31, 554, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,067, at 83,600 (Dec. 3, 1992); James R. Doty, *Regulatory Expectations Regarding the Conduct of Attorneys in the Enforcement of the Federal Securities Laws: Recent Development and Lessons for the Future*, 48 BUS. LAW. 1543, 1556-57 (1993).

Paul Mozer, who was in charge of Salomon's government trading desk, later admitted to his manager, John W. Meriwether, that he had submitted false bids. Meriwether then advised Salomon's President, Thomas W. Strauss and Donald Feuerstein of Mozer's admission. Feuerstein stated that the matter should be disclosed to the government.¹⁶⁹

The following week, Strauss, Meriwether and Feuerstein met with John H. Gutfreund, Chairman and CEO of Salomon. In the course of that meeting, Feuerstein advised that in his opinion the submission of a false bid was a criminal act. Feuerstein reiterated his advice that the matter be disclosed to the government. There was, or there appeared to be, agreement that the false bids would be disclosed to the Federal Reserve Bank of New York, Salomon's regulator in its dealings in Treasury securities.¹⁷⁰

Despite Mozer having been told by his manager Meriwether that his earlier submission of the false bid was "career threatening,"¹⁷¹ Mozer again caused false and unauthorized bids to be submitted at the Treasury actions on April 25, 1991 and May 22, 1991.¹⁷² In the meantime, in mid-May 1991, Feuerstein met with Gutfreund and Strauss concerning Mozer's February trading and again urged that the February false bids be disclosed. Both Gutfreund and Strauss assured Feuerstein that they intended to make the disclosure.¹⁷³

Finally, on June 10, 1991, after rumors of a "squeeze" were reported in the press specifically naming Salomon, Gutfreund met with Treasury representatives. Gutfreund did not disclose, however, the false bids in February but confined his discussion to trading at the May 22 auction. Gutfreund stated that Salomon had acted properly in regard to the auction and that Salomon would cooperate with the Treasury's inquiry.¹⁷⁴

Gutfreund met subsequently with Strauss and Meriwether on June 19 and the decision was made to delay disclosure of the February bids. Feuerstein was not present at the meeting and apparently was not informed of the decision to delay

169. *In Re Gutfreund*, *supra* note 168, at 83,600-83,601.

170. *Id.* at 83,601. The SEC subsequently noted in *In Re Gutfreund*, that "each of the four executives who attended the meetings in late April placed the responsibility for investigating Mozer's conduct and placing limits on his activities on someone else." For his part, Feuerstein claimed he believed that once disclosure was made, the government would instruct Salomon how to investigate the matter. *Id.* at 83,602.

171. *Id.* at 83,600.

172. *Id.* at 83,602.

173. *Id.* at 83,603.

174. *Id.*

disclosure.¹⁷⁵

In early July, after having been contacted by the SEC and other agencies regarding the May auction, Feuerstein engaged outside counsel to investigate Salomon's actions with respect to the May 22 auction. Counsel was not informed of the February bids at that time. Feuerstein informed Salomon's outside counsel of the February bids after the head trader on Salomon's government trading desk declined to answer counsel's question regarding other trading similar to that in the May auction. When counsel expanded the inquiry into these areas, it was learned that false bids had also been submitted in the December 27, 1990 and February 7, 1991 auctions.¹⁷⁶

Counsel reported its findings to Feuerstein on August 6 and to Gutfreund, Strauss and Meriwether on August 7, 1991. On August 9, Salomon issued a press release stating that "irregularities and rule violations" with respect to "submission of bids in certain auctions of Treasury securities" had been uncovered.¹⁷⁷ In telephone conversations with government officials on August 9, Gutfreund and Strauss disclosed that Salomon had known of a false bid since late April 1991. A second press release issued on August 14, 1991 disclosed that Salomon had been informed in late April that "a single unauthorized bid had been submitted in the February 1991 auction . . ."¹⁷⁸ Four days later, on August 18, Gutfreund, Strauss and Meriwether resigned. Feuerstein resigned his position of Chief Legal Officer on August 23, 1991.¹⁷⁹

In light of these events, SEC Chairman Richard C. Breeden, was invited to testify concerning the government's response to the Salomon matter before the House Subcommittee on Telecommunications and Finance. In his testimony, Chairman Breeden opined that when companies become aware of wrongdoing among their employees, they have a duty not only to take prompt corrective action but also to report the wrongdoing to government regulators. Chairman Breeden stated in this regard, "it should be seen as the personal obligation of every chief executive to make an immediate and full investigation of the possible wrongdoing, to report it promptly to the appropriate regulatory bodies and to seek to take corrective action . . ."¹⁸⁰

175. *Id.* at 83,603-83,604.

176. *Id.* at 83,604.

177. *Id.* at 83,605.

178. *Id.*

179. *Id.*

180. *Salomon Brothers and Government Securities: Hearing Before the Subcommittee*

Chairman Breeden concluded that, "prompt and vigorous public accountability for willful, unlawful acts should be seen as the responsibility of the firm itself and not just the government."¹⁸¹

Not surprisingly, Chairman Breeden's views were also reflected in the SEC's decision in *In Re Gutfreund*, which held that Gutfreund, Strauss and Meriwether had breached their duty to supervise under section 780(b)(4)(E) of the Exchange Act.¹⁸² Feuerstein was on a different legal footing, however, and the SEC took some pains to elucidate what it considered to be his duty under the circumstances.

First, because Feuerstein had not been a direct supervisor of Mozer, Feuerstein was not named as a respondent in the *Gutfreund* proceedings. The SEC felt constrained, nevertheless, to examine Feuerstein's actions and issue a report "to amplify [the SEC's] views on the supervisory responsibilities of legal and compliance officers in Feuerstein's position"¹⁸³ The SEC then went on to find that notwithstanding the fact that he did not have direct supervisory authority over Mozer, Feuerstein was nevertheless a supervisor for purposes of section 15 (b)(4)(E) liability because of his responsibilities and position within Salomon Brothers as Chief Legal and Compliance Officer.¹⁸⁴

In this connection, the SEC particularly noted that Feuerstein had been informed of the misconduct by senior management "in order to obtain his advice and guidance, and to involve him as part of management's collective response to the problem."¹⁸⁵ The SEC also noted that on other occasions Feuerstein had directed Salomon's response to misconduct and had made

on Telecommunications and Finance of the Committee on Energy and Commerce House of Representatives, 102nd Cong., 1st Sess. 136, 147 (1991) (statement of Richard C. Breeden, Chairman of the Securities and Exchange Commission) (quoted testimony appears on p. 12 of the document submitted to subcommittee).

181. *Id.*

182. 15 U.S.C. § 780(b)(4)(E) (1994). Under this section, the SEC may impose liability where a broker-dealer has "failed reasonably to supervise, with a view to preventing violations [of the federal securities laws], another person who commits such a violation, if such person is subject to his supervision." *Id.*

183. *In re Gutfreund*, *supra* note 168, at 83,608.

184. The SEC stated, however, that an employee of a brokerage house does not become a supervisor solely because the employee has legal or compliance responsibilities. Instead, "determining if a particular person is a supervisor depends on whether, under the facts and circumstances of a particular case, that person has a requisite degree of responsibility, ability or authority to affect the conduct of the employee whose behavior is at issue." *Id.* at 83,608-83,609.

185. *Id.*

recommendations concerning disciplinary action.¹⁸⁶ The SEC concluded therefore that “given the role and influence within the firm of a person in a position such as Feuerstein’s and the factual circumstances of his case, such a person shares the responsibility to take appropriate action to respond to the misconduct.”¹⁸⁷

According to the SEC, once Feuerstein became involved in formulating management’s response to Mozer’s misconduct, Feuerstein was “obligated to take affirmative steps to ensure that appropriate action was taken to address the misconduct.”¹⁸⁸ The SEC cautioned, however, that the obligations of a person in Feuerstein’s position are not limited to the person’s own actions. The SEC stated that “[i]f such a person takes appropriate steps but management fails to act and that person knows or has reason to know of that failure” he or she should consider additional steps “appropriate to address the matter.”¹⁸⁹ The SEC suggested that such steps include “disclosure of the matter to the entity’s board of directors, resignation from the firm, or disclosure to regulatory authorities.”¹⁹⁰ The SEC recognized, however, that for an attorney, the applicable ethical rules “may bear upon what course of conduct that individual may properly pursue.”¹⁹¹

2. *The National Student Marketing Litigation.* Largely as the result of the Watergate disclosures of illicit, off-book “slush

186. *Id.*

187. *Id.*

188. *Id.* For example, the SEC suggested that Feuerstein could have directed that an investigation be undertaken or that he could have made “appropriate recommendations” for limiting Mozer’s activities or recommended “the institution of appropriate procedures, reasonably designed to prevent and detect future misconduct, and verify that his or her recommendations, or acceptable alternatives are implemented.” *Id.*

189. *Id.* The SEC has also emphasized that persons with supervisory authority have a duty to inquire into possible wrongdoing and to follow up on that inquiry when there are “red flags” indicating irregularities. As the SEC stated in its order in *In Re Joseph*:

The federal securities laws also impose on supervisors the obligation to respond vigorously even to indications of possible wrongdoing. In large organizations it is especially imperative that those in authority exercise particular vigilance when indications of irregularity reach their attention Red flags and suggestions of irregularities demand inquiry as well as adequate follow-up and review. When indications of impropriety reach the attention of those in authority, they must act decisively to detect and prevent violations of the federal securities laws.

In Re Joseph, Exchange Act Release No. 32340, [1992-1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,200, 84,175-84,176 (1993) (citation omitted).

190. *In Re Gutfreund*, *supra* note 168, at 83,609.

191. *Id.* at 83,609 n.26.

funds,¹⁹² as well as the SEC's inquiry into questionable overseas payments by U.S. Companies,¹⁹³ the SEC came to view the role of a corporation's securities lawyers as being more akin to a corporation's outside accountants rather than as advocates for the corporation.¹⁹⁴ Thus, lawyers were considered by the SEC to be direct participants in the enforcement of the securities laws with disclosure obligations running to the corporation's shareholders and to the SEC itself.¹⁹⁵

192. See David P. Doherty, *The SEC's Management Fraud Program*, 31 BUS. LAW. 1279 (1976).

193. See STAFF OF SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 94TH CONG., 2D SESS., REPORT OF THE SECURITIES AND EXCHANGE COMMISSION ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES (Comm. Print 1976).

194. Thus, for example, SEC Chairman Ray Garrett, Jr. observed that although: [T]he lawyers' position in corporate and financial matters is subtler and less obvious [than that of accountants] . . . when it comes to matters affecting public stockholders and investors, we are not prepared to agree that the corporate lawyer's duty is solely, or even primarily, to protect the interests of the individuals constituting corporate management, when he is retained to serve the corporation.

Hoffman, *supra* note 12, at 1400-01. In this same vein, SEC Commissioner, A.A. Sommer, Jr., had also suggested that:

In securities matters (other than those where advocacy is clearly proper) the attorney will have to function in a manner more akin to that of the auditor than to that of the advocate. This means several things. It means he will have to exercise a measure of independence that is perhaps uncomfortable if he is also the close counselor of management in other matters, often including business decisions. It means he will have to be acutely cognizant of his responsibility to the public who engage in securities transactions that would never have come about were it not for his professional presence. It means he will have to adopt the healthy skepticism toward the representations of management which a good auditor must adopt. It means he will have to do the same thing the auditor does when confronted with an intransigent client—resign.

Id.

195. This position was summarized as follows:

The overwhelming responsibility for enforcement of the Securities laws rests with the Securities Bar rather than with the SEC. The SEC is a small agency, with a limited budget and staff and overwhelming responsibilities. Because of the unique position of lawyers in the securities process, the obligation rests with the lawyers to investigate and assure themselves of their clients' compliance with the law. The SEC accepts, on faith in the lawyers' probity and diligence, their clients' registration statements, proxy statements and other vital disclosure documents which the lawyers file. Hence, lawyers who fail to exercise diligence in enforcing and administering the securities laws breach their responsibility to the SEC, the financial community and the public, and violate the Federal Securities Laws.

Donald J. Evans, *Disclosure Obligations of Lawyers Advising in the SEC Area*, 31 BUS. LAW. 468, 469 (1975). This same view was also subsequently expressed by the United States Court of Appeals for the Second Circuit:

By the very nature of its operations, the Commission, with its small staff and

The SEC strenuously asserted this position in its controversial complaint filed in the *National Student Marketing* case in 1972.¹⁹⁶ There, the SEC alleged, among other things, that lawyers in the law firms of White & Case and Lord, Bissell and Brook had engaged in acts and practices in violation of section 10(b) of the Securities Exchange Act of 1934¹⁹⁷ and the Commission's Rule 10b-5¹⁹⁸ in connection with the dissemination of inaccurate financial statements and proxy materials.

The lawyer defendants represented the two parties to the merger of National Student Marketing Corporation ("NSMC") and Interstate National Corporation ("Interstate") in 1969. In essence, the SEC alleged that the financial statements for NSMC's fiscal year ending August 31, 1968 and for the nine month period ending May 31, 1969 were materially inaccurate in that they overstated sales and retained earnings.¹⁹⁹ The SEC alleged that the proxy statement issued by NSMC was similarly inaccurate and misleading.²⁰⁰

At the closing which occurred on October 31, 1969, NSMC's counsel received an unsigned "comfort letter" that had been dictated by NSMC's outside accountants, Peat, Marwick, Mitchell & Co. ("PMM"). The comfort letter showed that various substantial downward adjustments had been made to the unaudited financial statements for the period ending May 31, 1969. Later that same day, PMM informed NSMC's counsel that PMM wished to add a paragraph to the comfort letter to the effect that if the referenced adjustments were made, the statement of earnings would reflect a net loss for the period ending May 31, 1969 rather than net earnings of \$700,000 as reflected in the NSMC financial statements provided to Interstate.²⁰¹ NSMC's lawyers did not provide this information to Interstate and the closing meeting concluded.²⁰² Nor did they provide Interstate

limited resources, cannot possibly examine, with the degree of close scrutiny required for full disclosure, each of the many financial statements which are filed. Recognizing this, the Commission necessarily must rely heavily on both the accounting and legal professions to perform their tasks diligently and responsibly.

Touche Ross & Co. v. SEC, 609 F.2d 570, 580-81 (2d Cir. 1979).

196. SEC v. National Student Mktg. Corp., [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,360 (1972) [hereinafter NSMC Complaint].

197. 15 U.S.C. § 78j(b) (1994).

198. 17 C.F.R. § 240.10b-5 (1995).

199. See NSMC Complaint, *supra* note 196, at 91,913-6 to 91,913-8.

200. *Id.* at 91,913-8.

201. *Id.* at 91,913-16.

202. After the conclusion of the closing meeting, PMM informed NSMC's counsel that an additional paragraph would be added to the comfort letter stating, "[i]n view of

with the comfort letter they received from PMM.²⁰³

The SEC alleged that under these circumstances, NSMC should have notified the SEC of the misleading nature of the financial statements.²⁰⁴ This contention that NSMC's lawyers had a legal duty to inform the SEC of inaccuracies in their client's financial statements engendered substantial concern among the Bar²⁰⁵ and resulted in the adoption in 1975 of the ABA's Statement of Policy Regarding Responsibilities and Liabilities of Lawyers in Advising with Respect to the Compliance by Clients with Laws Administered by the Securities and Exchange Commission.²⁰⁶ As noted above, this debate became part of the formulation of the Model Rules.²⁰⁷

However, when the case was finally decided in the district court,²⁰⁸ the precise boundaries of the attorney's disclosure responsibility remained unresolved. The district court found that the attorneys had aided and abetted in the violation of the securities laws by failing to interfere with the closing of the merger.²⁰⁹ In this connection, the district court held that the attorneys were required to "speak out" regarding the inaccuracies

the above mentioned facts, we believe the companies should consider submitting corrected interim unaudited financial information to the shareholders prior to proceeding with the closing." *Id.* at 91,913-19.

203. *Id.*

204. The SEC stated in this regard that "[a]s part of the fraudulent scheme, [NSMC's lawyers] . . . failed to insist that the financial statements be revised and shareholders be resolicited, and failing that, to cease representing their respective clients and, under the circumstances, notify the plaintiff commission concerning the misleading nature of the nine month financial statements." *Id.* at 91,913-17.

205. See Hoffman, *supra* note 12, at 1404.

206. See ABA Comm. on Counsel Responsibility and Liability, *Statement of Policy Adopted by American Bar Association Regarding Responsibilities and Liabilities of Lawyers in Advising with Respect to the Compliance by Clients with Laws Administered by the Securities and Exchange Commission*, 31 BUS. LAW. 543 (1975) [hereinafter *ABA Statement*]. The ABA statement forcefully reiterated the view that client confidentiality and fiduciary loyalty to the client "are vital to the basic function of the lawyer as legal counselor . . ." *Id.* at 544. For that reason, the SEC position in *National Student Marketing* was forthrightly rejected by the ABA, which noted that:

[The] vital confidentiality of consultation and advice would be destroyed or seriously impaired if it is accepted as a general principle that lawyers must inform the SEC or others regarding confidential information received by lawyers from their clients even though such action would not be permitted or required by the [code] . . . [I]t must be recognized that a lawyer cannot, consistently with his essential role as legal adviser, be regarded as a source of information concerning possible wrong-doing by clients.

Id.

207. See *supra* Part II.B.2.

208. SEC v. National Student Mktg. Corp., 457 F. Supp. 682 (D.D.C. 1978).

209. *Id.* at 712.

in the financial statements.²¹⁰ However, the district court side-stepped the central issue of the attorney's disclosure obligation by concluding that once the merger was completed, the attorneys' subsequent actions did not "substantially assist the violation."²¹¹

210. *Id.* at 713. The district court stated that:

Upon receipt of the unsigned comfort letter, it became clear that the merger had been approved by the Interstate shareholders on the basis of materially misleading information. In view of the obvious materiality of the information, especially to attorneys learned in securities law, the attorneys' responsibilities to their corporate client required them to take steps to ensure that the information would be disclosed to the shareholders. However, it is unnecessary to determine the precise extent of their obligations here, since it is undisputed that they took no steps whatsoever to delay the closing pending disclosure to and resolicitation of the Interstate shareholders. But, at the very least, they were required to speak out at the closing concerning the obvious materiality of the information and the concomitant requirement that the merger not be closed until the adjustments were disclosed and approval of the merger was again obtained from the Interstate shareholders. Their silence was not only a breach of this duty to speak, but in addition lent the appearance of legitimacy to the closing.

Id. This view was reiterated by Samuel Gruenbaum in his response to Professor Kramer. Gruenbaum, *supra* note 20, at 211. According to Gruenbaum:

The lawyer is more than a scrivener or an aid.

Therefore, it is certainly not acceptable to say that a lawyer must, in the name of loyalty and devotion to his client, remain silent when the client has, in the course of the representation, perpetrated a fraud on others. As an adviser, a lawyer must consider the impact of his client's conduct on others. He must be sensitive to his client's responsibility to remain within the strictures of the law, and must not permit himself to become an unwitting participant in the unlawful conduct. If he finds that he has become such a participant, he must take prompt steps to undo the wrong done. This includes speaking out.

Id.

211. *SEC v. National Student Mktg. Corp.*, 457 F. Supp. at 714-15. According to the district court:

The SEC's contention with regard to counsel's alleged acquiescence in the merger transaction raises significant questions concerning the responsibility of counsel. The basis for the charge appears to be counsel's failure, after the merger, to withdraw their opinion, to demand resolicitation of the shareholders, to advise their clients concerning rights of rescission of the merger, and ultimately, to inform the Interstate shareholders or the SEC of the completion of the merger based on materially false and misleading financial statements.

...

... The Commission's charge, however, concerns the period following the transaction. even if the attorneys' fiduciary responsibilities to the Interstate shareholders continued beyond the merger, the breach of such a duty would not have the requisite relationship to a securities transaction, since the merger had already been completed. It is equally obvious that such subsequent action or inaction by the attorneys could not substantially assist the merger.

Id. (citation omitted).

Representatives of the SEC justified the SEC's position that counsel should have disclosed the inaccuracy of the financial statements to the SEC on the grounds that the information was not a privileged communication.²¹² The ABA Statement and other commentators have forcefully argued that putting lawyers in the role of enforcers of the law would radically alter the attorney-client relationship and impair the lawyer's effectiveness as a counselor.²¹³ Nevertheless, the Feuerstein Report and other administrative decisions of the SEC addressing the responsibility of compliance personnel strongly suggests that the SEC continues to regard attorneys, at least those with compliance responsibilities, to be adjuncts to the Commission's enforcement

212. See *Sonde*, *supra* note 95, at 586. *Sonde* emphasizes:

What [the *National Student Marketing*] case points up . . . is the way in which the Bar misread what the Commission was saying in that case. The Commission's concern in that case was not to tamper with privileged communications . . . The Commission was talking about a need to disclose information that could never be considered privileged.

Id.

213. *ABA Statement*, *supra* note 206, at 545. The ABA Statement notes that: Efforts by the government to impose responsibility upon lawyers to assure the quality of their clients' compliance with the law or to compel lawyers to give advice resolving all doubts in favor of regulatory restrictions would evoke serious and far-reaching disruption in the role of the lawyer as counselor, which would be detrimental to the public, clients and the legal profession.

Id.; *Forrow*, *supra* note 3, at 1821 ("The role of counsel as informant would greatly jeopardize the long-accepted confidentiality of the attorney-client relationship. The attorney-client privilege . . . is of fundamental importance and an integral part of our judicial system and should become even more vital as government regulation—ever more complex—permeates the conduct of business."); *Evans*, *supra* note 195, at 470. *Evans* notes that:

Whenever a proposal is made that a lawyer go beyond his fundamental role of advising his client and assume a function that could require him publicly to contradict his client or disclose possible deficiencies, on the basis of information gained in the course of his professional engagement, there is cause for concern on the part of the public as well as the bar, since the attorney-client relationship is of fundamental importance to our legal system.

Id.; *Burke*, *supra* note 1, at 277. According to *Burke*:

Requiring securities counsel to disclose client wrongdoing presumes that the public good is maximized by substituting the public interest for that of the client. However, the effect of the resulting erosion of the attorney-client privilege on corporate compliance with the law is dubious. Extending disclosure obligations to corporate securities counsel is "anomalous . . . at a time when serious commentators are questioning whether the entire disclosure process is working sufficiently well to justify its expense."

Id.; *Hemmer*, *supra* note 45, at 648 ("Most practitioners, including the author, find abhorrent the notion that counsel must inform a governmental regulatory agency of the improper conduct of a client. The notion directly conflicts with the common-law attorney-client privilege and the professional rules of conduct governing lawyer-client confidentiality.").

efforts.²¹⁴

Additionally, the SEC has utilized its administrative proceedings under its Rule 2(e)²¹⁵ to express the view that a lawyer's representation of a client in the face of the client's materially false or misleading disclosures (or omissions) implicates not only the lawyer's professional standards of conduct but also legal responsibility for the consequences of the client's conduct. Thus, a lawyer may be compelled to take action beyond counseling the client to comply with the requirements of the law in order to avoid personal liability for client fraud.

3. *The SEC's Rule 2(e) proceedings: In Re Carter and Johnson.* The SEC has used the vehicle of its Rule 2(e) proceedings, under which the SEC may suspend lawyers from practicing before the Commission because of "unethical or improper professional conduct," to engage in protracted and controversial litigation with lawyers on the question of the lawyer's personal responsibility for client misconduct, arising from the attorney-client relationship. Such was the case in *In Re Carter and Johnson*²¹⁶ which the Commission instituted following the *National Student Marketing* litigation.

William R. Carter and Charles J. Johnson were partners in the firm of Brown, Wood, Ivey, Mitchell & Perry, which represented National Telephone Company, a commercial telephone leasing company, from 1973 until National ceased operations in 1975. During the critical period from 1974 until 1975 when National entered bankruptcy, Carter and Johnson were in "close and continuing contact with the company."²¹⁷

In May and June 1974, Carter and Johnson represented National in the negotiation of an interim credit agreement with five banks resulting in a revolving loan of up to \$15 million. As part of this transaction, National granted the banks a security interest in substantially all of National's assets.²¹⁸

214. See *In re First Albany Corporation*, Exchange Act Release No. 34-30515, 51 SEC Docket 87 (Mar. 25, 1992) (chief legal and compliance officer held liable for failing to supervise a registered representative for failing to conduct an inquiry or establish a procedure to determine whether employees were in compliance with firm's policies and procedures); see generally Richard W. Painter, *The Moral Interdependence of Corporate Lawyers and Their Clients*, 67 S. CAL. L. REV. 507, 560-70 (1994); Doty, *supra* note 168, at 1564-65.

215. 17 C.F.R. § 201.2(e) (1995).

216. Exchange Act Release No. 17, 597 [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847 (Feb. 28, 1981).

217. *Id.* at 84,153.

218. *Id.* at 84,153-84,154.

The transfer of the assets under the agreement required the approval of National's stockholders. The 1974 annual report which accompanied the proxy materials projected that lease installations would double from \$13.3 million in 1974 to \$27 million in 1975. Carter advised National that these projections could only be made if they were accompanied by the assumptions on which they were based. National ignored Carter's advice and the annual report was published without disclosure of the assumptions.²¹⁹

At the board of directors meetings, attended by Johnson, in July, August, and October 1974, National's financial straits were discussed. In July it was revealed that the growth projections in the annual report were dependent on National's securing \$17 million dollars in additional funding. In August, several directors questioned the projected growth rate in view of National's immediate need for funding. Despite these discussions and revelations, letters sent by National's management to the shareholders announcing the declaration of stock dividends did not disclose the company's difficulties in securing necessary financing.²²⁰

At the October board meeting, there were further discussions of National's "tight cash position" and the concern that National's operations would have to be curtailed and sales terminated unless financing was obtained. Two days later, however, National issued a press release reporting a substantial increase in lease installations, net income and earnings per share. No mention was made of National's financial crisis.²²¹

Also in October, during negotiations for an amended credit agreement, in which Carter and Johnson participated, National's management revealed plans to "wind down." National rejected the lawyers' advice to inform the stockholders of National's financial condition.²²²

In December, National issued a press release disclosing the borrowing but not the company's financial condition.²²³ A letter was also sent to shareholders stating that the company was "stronger now than ever before in its history," that the company had "a greater availability of capital, expanding productivity and growing earnings," and that the company was "looking forward

219. *Id.* at 84,154.

220. *Id.* at 84,154-84,155.

221. *Id.* at 84,156.

222. *Id.* at 84,157.

223. *Id.* at 84,159-84,160.

to an outstanding year."²²⁴ Although Carter and Johnson felt the letter did not make adequate disclosure, they concluded that it was not materially false or misleading and accordingly, and that no corrective action was required.²²⁵

In February 1975, a creditor-imposed wind down plan was triggered by National's deteriorating financial condition. In April, Carter and Johnson advised National's management that disclosure of the plan was required but it was not until May, after the independent directors learned of the implementation of the plan, that the public was informed of the plan and National's need for financing.²²⁶ Thereafter, the market for national's stock "became virtually non-existent" and in July, National instituted proceedings in bankruptcy.²²⁷

Despite there being evidence that Carter and Johnson had advised at various times that disclosure be made, an administrative law judge found that Carter and Johnson had engaged in unethical and improper professional conduct by willfully aiding and abetting National's violation of the securities laws.²²⁸ Although finding the matter a "close question", the SEC did not find sufficient evidence of willfulness to sustain the finding of aiding and abetting.²²⁹

With regard to the violation of ethical and professional conduct standards, the SEC was at somewhat greater pains. The SEC noted that practice before the Commission "generates great leverage . . . in the administration of the securities laws."²³⁰ The SEC also noted that the lawyer's traditional role as advisor to a client and not the public does not absolve the lawyer from complying with ethical or professional standards.²³¹ The Commission

224. *Id.* at 84,160.

225. *Id.*

226. *Id.* at 84,164.

227. *Id.*

228. *Id.* at 84,146-84,165.

229. *Id.* at 84,167-84,169. In his dissenting opinion, Commissioner Evans would have found that Carter aided and abetted the violations. *Id.* at 84,176.

230. *Id.* at 84,150. As the Commission explained:

Rule 2(e) 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 . . . raises the specter of a replication of that conduct with other clients.

Id.

231. *Id.* The Commission further explained that:

[T]he traditional role of the lawyer as counselor is to advise his client, not the

recognized, however, that when a lawyer learns that a client has violated the securities laws, a lawyer's ethical and professional responsibilities "have not been so firmly and unambiguously established that . . . all practicing lawyers can be held to an awareness of generally recognized norms."²³² For that reason, the Commission did not make findings of unethical or unprofessional conduct against Carter and Johnson.²³³

The Commission took the opportunity of the *Carter and Johnson* decision to enunciate standards of professional conduct to which lawyers practicing before the Commission would thereafter be held. In essence, the Commission stated that a lawyer who becomes aware of a client's failure to comply with disclosure requirements must take "prompt steps to end the client's noncompliance" or otherwise, the lawyer's continued representation will be considered a violation of professional standards.²³⁴ The Commission also cautioned that "a lawyer is not privileged to unthinkingly permit himself to be co-opted into an ongoing fraud and cast as a dupe or a shield for a wrongdoing client."²³⁵

The Commission enumerated the actions it considered to be consistent with a lawyer's professional responsibility. As an initial matter, the Commission found that "counseling accurate disclosure" would be sufficient even if the lawyer's advice was not followed by the client.²³⁶ However, when the client is engaged in

public, about the law. Rule 2(e) does not change the 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 his 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.

232. *Id.* at 84,170 (footnote omitted).

233. *Id.* at 84,173. Nevertheless, the Commission pointed out that: "[w]hile precise standards have not yet emerged, it is fair to say that there exists considerable acceptance of the proposition that a lawyer must, in order to discharge his professional responsibilities, make all efforts within reason to persuade his client to avoid or terminate proposed illegal action." *Id.* at 84,170.

234. *Id.* at 84,172. The Commission stated in this regard:

When a lawyer with significant responsibilities in the effectuation of a company's compliance with the disclosure requirements of the federal securities laws becomes aware that his client is engaged in substantial and continuing failure to satisfy those disclosure requirements, his continued participation violates professional standards unless he takes prompt steps to end the client's noncompliance.

Id.

235. *Id.*

236. *Id.*

a continuing course of violative conduct such that a reasonable lawyer would conclude that the lawyer's advice "is not being followed, or even sought in good faith" at that "critical juncture" additional "more affirmative steps" must be taken by the lawyer "to avoid the inference that he has been co-opted, willingly or unwillingly, into the scheme of non-disclosure."²³⁷ The Commission suggested that a "direct approach" to members of senior management or members of the board may be appropriate or resignation may be called for.²³⁸ The Commission recognized that the lawyer is in the best position to determine a course of action, but emphasized that "prompt action" demonstrating that the lawyer "is engaged in efforts to correct the underlying problem" is ethically required.²³⁹ Interestingly, despite the position regarding disclosure that the Commission had taken in *National Student Marketing*, the Commission did not include disclosure, either to the public or to the Commission itself, among the specifically enumerated options to be considered by counsel under the circumstances in *Carter and Johnson*.²⁴⁰

The involvement of Carter and Johnson in National's affairs was more extensive than simply providing legal counsel. Carter had advised National's management concerning sources of funding outside the United States²⁴¹ and Johnson became secretary of the corporation, which led one commentator to characterize their relationship with National as one of "interdependent decision making" in which the lawyers had acted as "monitors of

237. *Id.*

238. With respect to resignation, the Commission suggested that:

[T]here may occur situations where the lawyer must conclude that the misconduct is so extreme or irretrievable, or the involvement of his client's management is so thoroughgoing and pervasive that any action short of resignation would be futile. We would anticipate that cases where a lawyer has no choice but to resign would be rare and of an egregious nature.

Id. at 84,173 (footnote omitted).

239. *Id.* As the Commission stated, "[w]hat is required, in short, is some prompt action that leads to the conclusion that the lawyer is engaged in efforts to correct the underlying problem, rather than having capitulated to the desires of a strong-willed but misguided client." *Id.*

240. The Commission explained in this regard that:

This case does not involve, nor do we here deal with, the additional question of when a lawyer, aware of his client's intention to commit fraud or an illegal act, has a professional duty to disclose that fact either publicly or to an affected third party. Our interpretation today does not require such action at any point, although other existing standards of professional conduct might be so interpreted. *See, e.g.,* ABA D.R. 7-102(B).

Id. at 84,173 n.78.

241. *Id.* at 84,157.

management conduct."²⁴² The SEC had earlier held that such a close relationship between lawyer and client gave rise to a duty to assure that filings with the Commission included all material facts of which the lawyers were aware.²⁴³

The other principal administrative action brought by the SEC involving a lawyer's responsibility for client misconduct was the protracted proceedings against George C. Kern, a partner in the firm of Sullivan & Cromwell, arising from the alleged failure of Kern's client, Allied Stores Corporation, to disclose negotiations with a "white knight" when Allied was the subject of a tender offer.²⁴⁴ In the order instituting administrative proceedings (i.e., the Division of Enforcement's complaint), it was alleged that following a hostile tender offer, Allied sought to sell a "material portion" of its assets (i.e., six shopping centers) to a friendly "white knight." It was further alleged that although Kern, who was responsible for preparing Allied's filings with the SEC, knew of the negotiations with the "white knight," Kern decided that an amendment of Allied's Schedule 14D-9 would not be made.²⁴⁵ The order also alleged that after the decision had

242. Painter, *supra* note 214, at 565.

243. *In re Keating, Muething & Klekamp*, Exchange Act Release No. 15982 [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,124 (July 2, 1979). There, members of the law firm were directors of subsidiaries of the client corporation and were involved in transactions with the client. The Commission concluded that because of their close involvement, the lawyers knew or should have known of the material misrepresentations and omissions in their client's financial statements which the law firm had prepared. As the Commission stated:

A law firm has a duty to make sure that disclosure documents filed with the Commission include all material facts about a client of which it has knowledge as a result of its legal representation of that client . . . it is clear that substantial additional procedures were required here, for the Commission concludes that [the firm] failed to carry out its professional responsibilities with regard to the . . . filings of [the client], when despite its extensive representation of [the client] and the knowledge of the members of [the firm] relating to material transactions, it did not have a system which assured that the knowledge of the members of the firm was communicated to the persons responsible for preparing disclosure documents so that adequate disclosure of material information—which was within the firm's knowledge—was made.

Id. at 81,989.

244. *In re Allied Stores Corp. and George C. Kern, Jr.*, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,142 (June 29, 1987) (order instituting administrative proceedings); *In re George C. Kern, Jr.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,342 (Nov. 14, 1988) (initial decision of the administrative law judge); *In re George C. Kern, Jr.*, Exchange Act Release No. 29356, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,815 (June 21, 1991) (order of the SEC affirming the initial decision of the administrative law judge).

245. *In re Allied Stores Corp. and George C. Kern, Jr.*, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,142, at 88,764-88,765.

been made to sell all of Allied to a "white knight," Allied again failed to file an amendment of the Schedule 14D-9.²⁴⁶ Finally, it was alleged that after the Allied board of directors directed management to execute an agreement of merger with the "white knight," Kern, who had attended the board of directors' meeting and who was aware of the board's resolution, decided that disclosure would not be made pending resolution of the "white knight's" financing problems.²⁴⁷ As a result, Allied did not amend its Schedule 14D-9 until after the agreement of merger was executed approximately a week later.²⁴⁸ The order charged that Allied had failed to comply with section 14(d)(4) of the Exchange Act²⁴⁹ and SEC Rule 14d-9²⁵⁰ and that Kern was a cause of Allied's failure to comply.²⁵¹

On November 14, 1988, almost a year and a half after the Commission instituted proceedings against Kern, Administrative Law Judge Warren E. Blair issued his decision.²⁵² He found in regard to the failure to disclose the agreement to sell Allied's shopping centers, that Allied's management "expected and understood that Kern would make legal decisions on disclosure questions without consulting officers of Allied except as Kern saw fit" and that Kern "decided, without consultation with any officer or other director of Allied, that an amendment was not required."²⁵³ Kern was found to have caused Allied's failure to disclose the merger negotiations²⁵⁴ and Allied's failure to timely disclose the agreement in principal to merge.²⁵⁵ In sum, by tak-

246. *Id.* at 88,765-88,766.

247. *Id.* at 88,766.

248. *Id.* at 88,767.

249. 15 U.S.C. § 78n(d)(4) (1994).

250. 17 C.F.R. § 240.14d-9 (1996).

251. *In re Allied Stores Corp. and George C. Kern, Jr.*; [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,142, at 88,767.

252. *In re George C. Kern, Jr.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,342 (Nov. 14, 1988).

253. *Id.* at 89,582.

254. *Id.* at 89,584. The administrative law judge found that:

Continuing to exercise the legal discretion vested in him, . . . Kern, without consultation with any officer or other director of Allied, decided that no amendment to Allied's Schedule 14D-9 disclosing the merger negotiations . . . would be filed. It appears from the record that Kern's decision not to file such amendment was erroneous and that as a result Allied failed to comply with section 14(d)(4) of the Exchange Act and Rule 14d-9 thereunder. It also appears that Kern was a cause of Allied's failure to comply and knew or should have known that the omission to amend Allied's Schedule 14D-9 would contribute to the failure to comply.

Id.

255. *Id.* at 89,587. According to the administrative law judge:

ing on discretionary authority to make the disclosure decisions on behalf of Allied, Kern also accepted responsibility for Allied's compliance with the requirements of the Exchange Act and the SEC's rules.²⁵⁶

Notwithstanding the administrative law judge's imputation of disclosure responsibility on to Kern, the proceedings were inconclusive as to a lawyer's responsibility under the circumstances because the administrative law judge terminated the proceedings on jurisdictional grounds.²⁵⁷ And four years after the commencement of the action, the SEC affirmed the administrative law judge's decision solely on that basis.²⁵⁸

4. *Disclosure to Third Parties Under the Securities Laws.* The *Student Marketing* assertion that lawyers have a duty of disclosure to third parties under the federal securities laws has not gained acceptance in the courts. As a general matter, a duty to disclose is considered to arise from a "fiduciary or other similar relation of trust and confidence."²⁵⁹ For that reason, courts have consistently declined to impose a general duty to disclose even a client's fraud absent a fiduciary duty owed by the attorney to the injured third party.²⁶⁰

Kern was well aware of the developments leading up to and including the reaching of the agreement in principle between Allied and EJDc on the price and terms of their contemplated merger and of the passing of the Allied Board Resolution on October 3. Because he assumed sole responsibility for determining when an amendment to Allied's Schedule 14D-9 would be filed, Kern must be found to have caused Allied's violation.

Id.

256. As the administrative law judge observed:

It appears from the record that during the relevant period Kern found himself in the center of a complex and fast-changing series of negotiations which required him to exercise his authority to have Allied comply with the disclosure requirements of Rule 14d-9 When Kern accepted discretionary authority to make those decisions he also accepted the responsibility the Allied officers had for compliance with Rule 14d-9 and cannot be heard now to complain that his legal judgments are being second-guessed in these proceedings.

Id. at 89,592.

257. The administrative law judge concluded that because Kern had no authority to make or correct Allied's filings going forward, the Commission was not authorized to issue an order directing future compliance by Kern. *Id.* at 85,593.

258. *In re* George C. Kern, Jr., Exchange Act Release No. 29356, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,815 (June 21, 1991).

259. *Chiarella v. United States*, 445 U.S. 222, 228 (1980) (quoting RESTATEMENT (SECOND) OF TORTS § 551(2)(a) (1976)).

260. *See, e.g., Schatz v. Rosenberg*, 943 F.2d 485, 490 (4th Cir. 1991) ("We . . . hold that a lawyer or law firm cannot be held liable for misrepresentation under section 10(b) for failing to disclose information about a client to a third party absent some fiduciary or other confidential relationship with the third party."); *Renovitch v. Kaufman*, 905 F.2d

As suggested by the *Kern* proceedings, however, it is a much closer question when the attorney's representation materially furthers a fraudulent transaction. On the one hand, in cases when the attorney's involvement in the transaction has been viewed as being that of a mere "scrivener," simply preparing the documents necessary to effect the transaction, liability generally has not been imposed.²⁶¹ On the other hand, lawyers have long been regarded as the "passkey" to a securities transaction.²⁶² For that reason, it has been argued that the role of a

1040, 1048-49 (7th Cir. 1990) (attorney was not liable under Section 10(b) for losses resulting from client's fraudulent cattle leasing program because the attorney had no fiduciary duty to the investors and thus had no duty to disclose even if he knew of the fraudulent scheme); *Abell v. Potomac Insurance Co.*, 858 F.2d 1104, 1133 (5th Cir. 1988), *vacated on other grounds*, 492 U.S. 914 (1989) ("Neither lawyers nor accountants are required to tattle on their clients in the absence of some duty to disclose." (quoting *Barker v. Henderson, Franklin, Starnes & Hoalt*, 797 F.2d 490, 497 (7th Cir. 1986)); *Tew v. Arky, Freed, Stearns, Watson, Greer, Weaver & Harris*, 655 F. Supp. 1573, 1574 (S.D. Fla. 1987) (attorney had no general duty of disclosure to client company's auditors and, absent a specific identification of a claim and request for comment, attorney's ethical obligation to preserve client's confidence foreclosed disclosure) *aff'd mem.*, 846 F.2d 753 (11th Cir. 1988); *Bush v. Rewald*, 619 F. Supp. 585, 590 (D. Haw. 1985) ("Clearly, performing corporate legal work does not, by itself, create [a duty of disclosure] to investors in the corporation."); *Van Boeckel v. Weiss*, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,648 (N.D. Ca. 1983) (defendant's position as corporate counsel did not create a duty on his part to disclose information to persons investing in his client company); *see also Quintel Corp. v. Citibank*, 589 F. Supp. 1235, 1242 (S.D.N.Y. 1984) (in the absence of an attorney-client relationship between plaintiff and defendant, plaintiff cannot establish a breach of duty of disclosure).

261. *See, e.g.*, *Camp v. Dema*, 948 F.2d 455, 464 (8th Cir. 1991) (quoting *Schatz v. Rosenberg*, 943 F.2d at 497).

262. Such was the view expressed by SEC Commissioner A. A. Sommer in his 1974 address, *The Emerging Responsibilities of the Securities Lawyer*, in [1973 - 1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,631. Sommer observed that:

In a word . . . the professional judgment of the attorney is often the "passkey" to securities transactions. If he gives an opinion that an exemption is available, securities get sold; if he doesn't give the opinion, they don't get sold. If he judges that certain information must be included in a registration statement, it gets included (unless the client seeks other counsel or the attorney crumbles under the weight of client pressure); if he concludes it need not be included, it doesn't get included.

Id. at 83,869; In Commissioner Sommer's view, the attorney's role in a securities transaction was "more akin to that of [an] auditor" meaning that the attorney would "have to exercise a measure of independence" and would have to be "acutely cognizant of his responsibility to the public who engage in securities transactions that would never have come about if not for his professional presence." *Id.* at 83,689-83,690; *See Simon M. Lorne & W. Hardy Callcott, Administrative Actions Against Lawyers Before the SEC*, 50 *BUS. LAW.* 1293 (1995). Lorne and Callcott note that:

Starting in the late 1960s, the SEC began to bring claims against lawyers who, in the agency's view, participated or assisted in their clients' securities law violations. The actions were based on the premise that lawyers are "gatekeepers"

lawyer in a securities transaction is more akin to a participant than to a traditional adviser.²⁶³ Liability may result from a failure to correct inaccurate or false information, of which the lawyer is aware, in documents which the lawyer prepared knowing they would be relied upon by third parties.²⁶⁴

So for example, a lawyer who prepares an opinion in connection with a securities transaction does not thereby engender a general duty of disclosure to third parties.²⁶⁵ But, in contrast, a lawyer who has been extensively involved in the operations of a company and who is directly involved in the transaction, i.e., through preparation of the offering documents, risks liability²⁶⁶

to the securities markets, and that, in rendering professional services to clients, they may facilitate their clients' securities law violations. By sanctioning lawyers, the SEC sought indirectly to deter misconduct by clients.

Id. at 1297.

263. See Gruenbaum, *supra* note 20, at 201. Gruenbaum states that:

A lawyer acting in the capacity of an advisor may be viewed as having responsibilities that run to the client as well as to others. This responsibility stems from the lawyer's participation and involvement in the client's decision making process concerning the client's contemplated conduct. In many if not most securities transactions, a lawyer's opinion or judgment is the "pass key" to consummation. In addition, lawyers play an almost indispensable role in the disclosure process of the federal securities laws. The lawyer, then, may be viewed as a "participant" in the conduct that takes place upon issuance of the pass key or in the disclosure made by the client.

Id.

264. Thus, it has been observed with regard to the SEC actions in *National Student Marketing*, *Carter and Johnson*, and *In re Kern*, "[t]he thrust of the series of complaints issued by the SEC was to emphasize its view that the attorney in these situations has responsibilities to the public at large, or at least to certain segments of it, as well as to the party paying the fee and that whether the source of that responsibility is statute, common law, or the lawyer's disciplinary rules, liability will follow from its breach." ANDREW KAUFMAN, PROBLEMS IN PROFESSIONAL RESPONSIBILITY 295 (1989).

265. See, e.g., *Fortson v. Winstead, McGuire, Sechrest & Minick*, 961 F.2d 469, 472 (4th Cir. 1992) (lawyers preparing tax opinion did not have duty to discover and disclose misrepresentations by offeror that were unrelated to the tax opinion); *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646, 653-54 (9th Cir. 1988) (lawyers preparing title opinions in oil or gas transactions were not obliged to disclose that the property had been sold to the partnership by an interested party at allegedly inflated prices when such information would not affect the state of the title to the property).

266. See *Molecular Technology Corp. v. Valentine*, 925 F.2d 910, 917-18 (6th Cir. 1991) (attorney who prepared documentation and edited marketing information was obliged to disclose that information in the offering circular was misleading); *Eisenberg v. Gagnon*, 766 F.2d 770, 776 (3d Cir. 1985) ("[A]n opinion that has been issued without a genuine belief or reasonable basis is an 'untrue' statement which, if made knowingly or recklessly, is culpable conduct actionable under § 10(b) and Rule 10b-5."); *SEC v. Coven*, 581 F.2d 1020, 1029 (2d Cir. 1978) (attorney who wrote a letter falsely stating that the required portion of the offering had been purchased, where the attorney had no basis to make the statement, was liable under section 10(b) since under the circumstances, the attorney should have been able to conclude that his letter "was likely to be used in fur-

therance of illegal activity’”); *SEC v. Universal Major Industries Corp.*, 546 F.2d 1044, 1046 (2d Cir. 1976) (attorney aided and abetted sale of unregistered stock by preparing an opinion letter for the transfer agent stating that the transfer of the unregistered stock was legal when the attorney had previously concluded it was not); *SEC v. Management Dynamics*, 515 F.2d 801, 809 (2d Cir. 1975) (lawyer who reviewed and edited press releases and other statements that misrepresented the risk that a real estate venture would not be completed violated the anti-fraud and registration provisions of the securities laws). The court in *Management Dynamics* noted that:

As an experienced securities lawyer, [defendant] surely should have known that contingencies cloud the horizon of almost every business venture, and [defendant] should have asked . . . about potential obstacles to the planned developments. Moreover, and particularly because of his expertise, he should have insisted that these possible impediments be identified in any communication which described the projects.

Id.; *SEC v. Spectrum, Ltd.*, 489 F.2d 535, 542 (2d Cir. 1973) (lawyer who prepared opinion letter in reliance on which unregistered securities were sold, based solely upon an earlier letter prepared by another lawyer, was held to have aided and abetted the unlawful sale). The court in *Spectrum* observed that:

In the distribution of unregistered securities, the preparation of an opinion letter is too essential and the reliance of the public too high to permit due diligence to be cast aside in the name of convenience. The public trust demands more of its legal advisers than “customary” activities which prove to be careless. And, to be sure, where expediency precludes thorough investigation, an attorney can prevent the illicit use of his opinion letter by prohibiting its utilization in the sale of unregistered securities by a statement to that effect clearly appearing on the face of the letter.

Id.; *SEC v. Frank*, 388 F.2d 486, 489 (2d Cir. 1968) (lawyer held liable for preparation of a misleading offering circular. “[A] lawyer, no more than others, can escape liability for fraud by closing his eyes to what he saw and could readily understand.”); *SEC v. Electronics Warehouse, Inc.*, 689 F. Supp. 53, 60 (D. Conn. 1988), *aff’d*, 891 F.2d 457 (2d Cir. 1989) (“Attorneys may be liable as aiders and abettors where, if it is reasonably foreseeable that potential investors will rely on documents they draft, they omit material information or include erroneous information in reckless disregard of the truth.”); *Arden Way v. Boesky*, 664 F. Supp. 855, 857 (S.D.N.Y. 1987) (purchasers of limited partnership interests stated a claim against law firm for violation of the securities laws in connection with misrepresentations in a private placement memorandum); *Andreo v. Friedlander, Gaines, Cohen, Rosenthal & Rosenberg*, 660 F. Supp. 1362, 1367 (D. Conn. 1987). According to the court in *Andreo*:

[A]ttorneys should be held accountable if they draft certain documents for securities offerings with reckless disregard of the truth. This does not mean that attorneys who draft such documents have an affirmative duty to verify all information provided by their clients, or to discover if any pertinent information might have been omitted. Rather, those attorneys have a responsibility to not act in reckless disregard of the truth when using the information provided by clients in performing their professional duties and preparing offering memoranda and tax opinions.

Id.; *Koehler v. Pulvers*, 614 F. Supp. 829, 845 (S.D. Cal. 1985) (“[B]ecause [attorney] lent his name and provided necessary and substantial services to promote and facilitate the sale of securities which he should have known [were] issued in violation of registration and disclosure requirements, he proximately caused the investors’ injuries.”); *Antinore v. Reavis & McGrath (In re Flight Transportation Corp. Securities Litigation)*, 593 F. Supp. 612, 618 (D. Minn. 1984) (law firm could be held liable for preparing allegedly false and

even though the Supreme Court has lessened that risk by eliminating civil aiding and abetting liability under section 10(b) and Rule 10b-5.²⁶⁷

misleading prospectus); *Felts v. National Accounts Systems Ass'n, Inc.*, 469 F. Supp. 54, 68 (N.D. Miss. 1978) (lawyer for issuer of promissory notes liable for misrepresentations in connection with the offering). The court in *Felts* stated that:

Peters, [the attorney for National Account Systems], owed a special duty of diligent investigation and disclosure. Not only was he the lawyer responsible for the issuer's compliance with applicable laws, he also permitted his name (and his office) to be exploited

....

The court concludes that without the active, affirmative assistance of Peters as lawyer for the issuer, including the use and exploitation of his name, the sale would not have been accomplished. Therefore, under applicable law, Peters was a participant in the sale and is jointly liable with the issuer for all damages.

Id.; *SEC v. National Student Marketing Corp.*, 402 F. Supp. 641, 649 (D.D.C. 1975) (lawyer who issued opinions concerning the legality of back dating the effectiveness of a transaction aided and abetted securities laws violations. The defendant "either knew that NSMC planned to issue a false financial statement, or he ignored what should have been evident to him as a lawyer with some expertise in corporate mergers and acquisitions."). *Cf. Friedman v. Arizona World Nurseries Ltd. Partnership*, 730 F. Supp. 521, 531 (S.D.N.Y. 1990). As the *Friedman* court stated:

Where counsel drafted the offering memorandum and were acting on behalf of the general partner, they are not, without more, corporate insiders or affiliates to whom relaxed pleading's standards are applicable. Thus, they are not ordinarily liable for the general statements in the offering memorandum but rather plaintiffs must specifically attribute misstatements or omissions to them.

Id.; *In re National Smelting of New Jersey, Inc. Bondholder's Litigation*, 722 F. Supp. 152, 173 (D.N.J. 1989) (lawyer's opinion concerning the stability of stock to be issued which was not intended to be included in the offering statement but was nevertheless distributed to the trustee for plaintiff bondholders was too tenuous a link to the transaction to impose a duty of disclosure); *Bush v. Rewald*, 619 F. Supp. 585, 596 (D. Haw. 1986). According to the *Bush* court:

Unless a lawyer knew or should have known that his advice would be transmitted to and relied on by investors in the client firm, or unless the investors were intended beneficiaries of the advice, the lawyer has no duty to them, although it is obviously foreseeable that someone may purchase the securities.

Id.; *Morgan v. Prudential Group, Inc.*, 527 F. Supp. 957, 959 (S.D.N.Y. 1981), *aff'd mem.*, 729 F.2d 1443 (2d Cir. 1983) (general counsel of limited partnership was not liable under the securities laws in connection with the issuance of an allegedly false and deceptive prospectus where there was no showing that the general counsel knew that the maximum tax benefits from the transaction were impossible to achieve).

267. *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994). Although holding that there was no civil liability under section 10(b), the Court cautioned that:

[T]he absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer . . . who employs a manipulative device or makes a material misstatement (or omission) on which

B. *The OTS and the Matter of Kaye, Scholer, Fierman, Hays and Handler*

Like the SEC, the Office of Thrift Supervision ("OTS") and other bank regulatory authorities have aggressively pursued lawyers and their firms for alleged misconduct arising from the lawyers' representation of savings institution clients in their dealings with bank regulators. Actions by the OTS and the Resolution Trust Corporation have resulted in settlements in the tens of millions of dollars²⁶⁸ and have riveted the attention of scholars and practitioners on the lawyer's duty to preserve client confidences when dealing with the regulators on the client's behalf.²⁶⁹

Many of these cases arose in connection with the failure of the Lincoln Savings and Loan Association and the criminal wrongdoing of Charles H. Keating, Jr. It was in connection with Keating's attempt to regain control over Lincoln Savings from the receiver appointed by the Federal Home Loan Bank Board²⁷⁰ that Judge Stanley Sporkin strongly criticized the failure of Lincoln's lawyers to speak out or disassociate themselves from the "looting of Lincoln."²⁷¹

a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met.

Id. at 191. Thus, as was earlier explained:

A person undertaking to furnish information which is misleading because of a failure to disclose a material fact is a primary participant. Conversely, a person who does not undertake to furnish any information, and who is not aware of what information has been furnished, is under no duty to disclose material information in his possession.

SEC v. Washington County Util. Dist., 676 F.2d 218, 223 (6th Cir. 1982).

268. For example, Jones, Day, Reavis & Pogue agreed to a settlement of \$50 million, Paul, Weiss, Rifkind, Wharton & Garrison agreed to a \$45 million settlement and Troutman, Sanders, Lockerman & Ashmore agreed to settle claims by the RTC for \$20 million. Painter, *supra* note 214, at 572 n.277.

269. See, e.g., Nancy Amary Combs, *Understanding Kaye, Scholer: The Autonomous Citizen, the Managed Subject and the Role of the Lawyer*, 82 CAL. L. REV. 663, 683 (1994); Fox, *supra* note 113, at 1525; Note, *Inside Fraud, Outside Negligence and the Savings and Loan Crises: When Does Management Wrongdoing Excuse Professional Malpractice?*, *supra* note 5, at 1208.

270. Lincoln Savings and Loan Ass'n v. Wall, 743 F. Supp. 901, 902 (D.D.C. 1990).

271. [T]he Court permitted the parties the widest latitude to develop a full and complete record. What has emerged is not a pretty picture. It is abundantly clear that ACC's [American Continental Corporation, Lincoln's parent] officials abused their positions with respect to Lincoln. Bluntly speaking, their actions amounted to a looting of Lincoln. This was not done crudely. Indeed, it was done with a great deal of sophistication. The transactions were all made to have an aura of legality about them. They even

The seemingly conflicting duties of confidentiality and disclosure of wrongdoing was sharply focused in the action brought by the OTS against the firm of Kaye, Scholer, Fierman, Hays and Handler for its role in representing Lincoln.²⁷² Although joined, the issues raised by the Kaye, Scholer action were not determined because Kaye, Scholer agreed to settle the administrative charges, and to pay \$41 million six days after an order was entered by OTS Director, Timothy Ryan, freezing the firm's assets.²⁷³ Nevertheless, the record in the Kaye, Scholer matter,

entered into a so-called formal tax sharing agreement in order to claim they had the approval of the regulatory authorities for this phase of their illicit activities. While it is clear ACC overreached in its relationship with Lincoln, it is not discernible why ACC's officials acted as they did.

Id. at 919 (footnote omitted).

There are other unanswered questions presented by this case. Keating testified that he was so bent on doing the "right thing" that he surrounded himself with literally scores of accountants and lawyers to make sure all the transactions were legal. The questions that must be asked are:

Where were these professionals, a number of whom are now asserting their rights under the Fifth Amendment, when these clearly improper transactions were being consummated?

Why didn't any of them speak up or disassociate themselves from the transactions?

Where also were the outside accountants and attorneys when these transactions were effected?

What is difficult to understand is that with all the professional talent involved (both accounting and legal) why at least one professional would not have blown the whistle to stop the overreaching that took place in this case.

Id. (footnote omitted).

While we in this nation have been trying to place blame for the savings and loan crisis on the various governmental participants in the crisis and on the government's fostering of deregulation within the thrift industry, this Court believes far too little scrutiny has been focused on the private sector. We are the world's greatest example of the success of the private enterprise system. It would thus seem that the private sector ought to be able to put in place a system that would prevent the kinds of excesses that took place in Lincoln from recurring. Here it is clear the private sector was not willing to cooperate with the public oversight regulators. Indeed, the private sector at times impeded the regulatory authorities from discharging their duties. All too often Keating and those individuals working with him adopted strategies to thwart and frustrate the regulatory process.

Id. at 919-20 (citations omitted).

272. Notice of Charges and of Hearing for Cease and Desist Orders to Direct Restitution and Other Appropriate Relief; Notice of Intention to Remove and Prohibit from Participation in the Conduct of the Affairs of Insured Depository Institutions; and Notice of Intention to Debar From Practice Before the Office of Thrift Supervision, *In re Fishbein*, OTS AP-92-19 (filed March 1, 1992) [hereinafter *Kaye, Scholer Complaint*], in *THE ATTORNEY-CLIENT RELATIONSHIP AFTER KAYE, SCHOLER*, at 239 (PLI Corp. Law and Prac. Course Handbook Series No. 779, 1992).

273. *See* Temporary Order to Cease and Desist, *In re Fishbein*, OTS AP-92-20 (filed

as well as the debate the proceedings have engendered, are further indications of the wearing away of the protection of client confidences.

1. *The Allegations Against Kaye, Scholer.* In the administrative complaint filed against Kaye, Scholer, the OTS alleged that three Kaye, Scholer partners, Peter M. Fishbein (Kaye, Scholer's managing partner), Karen E. Katzman and Lynn Toby Fisher, had "participated in the conduct of the affairs" of Lincoln and its parent and were "institution-affiliated parties" by virtue of their legal representation of Lincoln and ACC.²⁷⁴

According to the complaint, Kaye, Scholer was engaged by ACC in 1984 (the year ACC acquired Lincoln) to develop Lincoln's position in opposition to the limitations on direct investments being proposed by the Federal Home Loan Bank Board (FHLBB).²⁷⁵ After the limitations were imposed in January 1985, Kaye, Scholer was engaged to advise Lincoln on the legal-

Mar. 1, 1992), in *THE ATTORNEY-CLIENT RELATIONSHIP AFTER KAYE, SCHOLER*, at 323 (PLI Corp. Law and Prac. Course Handbook Series No. 779, 1992).

274. Kaye, Scholer Complaint, *supra* note 272, at ¶¶ 9-13. Fishbein was identified as "principal outside counsel" for ACC and Lincoln with supervisory authority over Kaye, Scholer's representation of ACC and Lincoln. *Id.* at ¶ 9. Katzman was identified as having had "significant and continuing responsibilities" for Lincoln's response to the 1986 examination by the Federal Home Loan Bank Board and as having acted as "second-in-command" to Fishbein. *Id.* at ¶ 10. Fisher, according to the Complaint, "had principal responsibility for providing ACC and Lincoln with legal advice and representation on securities matters" as well as having had "significant responsibility for the development of factual materials to be submitted in connection with the 1988 [Federal Home Loan Bank Board] examination." *Id.* at ¶ 11. In this regard, Fishbein, Katzman and Fisher were alleged to have:

a. Provided advice to Lincoln and ACC, represented and acted as agent of Lincoln before the FHLBB, and participated in defining the course of conduct by Lincoln and ACC in conducting their business and in responding to the FHLBB's regulation and examination of Lincoln's operations as a federally-insured depository institution;

b. Represented and acted as agent for Lincoln and ACC before the FHLBB and, in connection therewith, omitted material facts from and made misrepresentations in submissions to the FHLBB that are the subject of this Notice of Charges;

c. Acted as securities counsel to ACC, were intimately familiar with its affairs and operations and those of its subsidiaries and affiliates, including Lincoln, and prepared and/or reviewed security disclosure documents that were filed with the FHLBB and other federal regulatory agencies.

d. Acted as Lincoln's counsel and agent in providing information and otherwise responding to FHLBB in connection with the examination of Lincoln in the 1986-1989 period.

Id. at ¶ 13.

275. *Id.* at ¶¶ 15-16.

ity of its direct investments in light of the limitation.²⁷⁶ Kaye, Scholer undertook an extensive review of Lincoln's direct investments including interviewing Lincoln employees and reviewing documents relevant to the transactions.²⁷⁷ During the course of its review, in September 1985, Kaye, Scholer learned that unanimous consents of the Board of Directors authorizing the investments had been back-dated to appear to have been created prior to December 10, 1984, the date after which the FHLBB's direct investment limitation would apply.²⁷⁸

According to the complaint, notwithstanding its knowledge that material documents had been back-dated, Kaye, Scholer provided Lincoln with a written opinion that in excess of \$750 million of direct investments were legally "grandfathered" under a provision of the direct investment rule.²⁷⁹ Kaye, Scholer also was alleged to have misrepresented the legal status of the direct investments in Lincoln's responses to inquiries from the FHLBB during an examination of Lincoln in 1986.²⁸⁰ Indeed, the crux of the OTS' complaint against Kaye, Scholer was the manner in which Kaye, Scholer represented Lincoln in regard to FHLBB examinations in 1986 and 1988.

In June 1986, Kaye, Scholer was retained to represent Lincoln in connection with an examination being conducted by the FHLBB of San Francisco. On July 16, 1986, Kaye, Scholer sent a letter to the FHLBB demanding that all requests for information from banking examiners be directed to Kaye, Scholer.²⁸¹ In so doing, "Fishbein interposed Kaye Scholer between Lincoln and the FHLBB with respect to all factual matters relating to the 1986 Examination of Lincoln."²⁸² In the view of OTS, Kaye, Scholer thereby became Lincoln's agent and assumed various of Lincoln's regulatory obligations to the FHLBB.²⁸³ By failing to advise Lincoln to disclose and by failing itself to disclose mate-

276. *Id.* at ¶¶ 16, 22-27.

277. *Id.* at ¶ 27.

278. *Id.* at ¶¶ 23, 28.

279. *Id.* at ¶¶ 29-32.

280. *See id.* at ¶¶ 139-52.

281. *Id.* at ¶¶ 17, 45.

282. *Id.* at ¶ 45.

283. According to the OTS, Kaye, Scholer was obligated to maintain accurate and complete records of all business transactions available for inspection; Kaye, Scholer was prohibited from knowingly making any false or misleading statement with regard to a material fact concerning any matter within the jurisdiction of the FHLBB; and Kaye, Scholer was prohibited from "engaging in any dilatory, obstructionist, egregious, contemptuous, or unethical or improper professional conduct before the FHLBB . . ." *Id.* at ¶¶ 46-48.

rial facts "thereby rendering false and misleading many representations that Kaye Scholer made to the FHLBB on behalf of and as agent for Lincoln," Kaye, Scholer was deemed to have participated in and to have aided and abetted Lincoln's concealment of those material facts.²⁸⁴ The complaint detailed a series of those transactions.²⁸⁵

The OTS action against Kaye, Scholer was defended by its then-Chief Counsel, Harris Weinstein, on several grounds.²⁸⁶ According to Weinstein, the OTS' complaint was grounded on legal principles which Weinstein characterized as being "unremarkable and well established."²⁸⁷ These principles were: (1) that a

284. *Id.* at ¶¶ 49-50.

285. The complaint alleged that Kaye, Scholer had misrepresented circumstances under which Lincoln's independent auditor, Arthur Andersen & Co., had resigned by stating that the resignation was not the result of concern with Lincoln's operations or asset/liability management when, in fact, Kaye, Scholer had been advised by Andersen that Lincoln was considered high risk for financial failure and regulatory intervention. *Id.* at ¶¶ 36-44. Kaye, Scholer was also alleged to have omitted material facts concerning Lincoln's income and net worth by failing to disclose its knowledge of "fictitious and contrived" real estate transactions (that Lincoln officials had characterized as "trading dead horses for dead cows") which artificially inflated Lincoln's income and net worth. *Id.* at ¶¶ 58-73. It was also contended that Kaye, Scholer had omitted to disclose material information concerning Lincoln's loan underwriting and documentation including the removal of adverse information from loan files, the creation of misleading loan summaries and other deficiencies in loan underwriting documentation. *Id.* ¶¶ 74-106. Further, Kaye, Scholer was alleged to have represented a real estate transaction as a loan despite information that the transaction was in actuality a joint venture thereby allowing the premature recognition of income. *Id.* at ¶¶ 107-138. Finally, it was alleged that Kaye, Scholer failed to disclose to both the FHLBB and the SEC that loans to a partnership for the acquisition of a hotel violated the prohibition against loans to affiliated persons and entities. *Id.* at ¶¶ 153-171.

Kaye, Scholer was also accused of other acts of misconduct and disloyalty to its client. The complaint charged that Kaye, Scholer had breached its fiduciary duties of care, candor and loyalty by failing to advise Lincoln's board of directors that Keating and other members of management were not acting in the best interests of Lincoln as well as by having "persisted in representing and acting on behalf of and as agent for Lincoln, notwithstanding its conflict of interest in representing both Lincoln and ACC," thereby placing the interests of ACC and Keating ahead of Lincoln. *Id.* at ¶¶ 52-57. Kaye, Scholer partner Lynn Toby Fisher was also alleged to have engaged in self-dealing by obtaining a loan on very favorable terms while acting as Lincoln's securities counsel. *Id.* at ¶¶ 172-81.

286. Weinstein made these remarks in a speech before the Pennsylvania Association of Community Bankers at Harrisburg, Pennsylvania on March 23, 1992. Harris Weinstein, Remarks at the Meeting of the Pennsylvania Association of Community Bankers (Mar. 23, 1992) [hereinafter March 1992 Speech], in *THE ATTORNEY-CLIENT RELATIONSHIP AFTER KAYE, SCHOLER*, at 403 (PLI Corp. Law and Prac. Course Handbook Series No. 779, 1992).

287. *Id.* A slightly different tack was taken by another defender of the OTS action, Stuart M. Gerson, who was the Assistant Attorney General in charge of the Civil Division of the U.S. Department of Justice. In an op-ed piece in the *NEW YORK TIMES*, Gerson

lawyer may not issue an opinion based on assumptions of fact that the lawyer knows, at the time, to be false; (2) that a lawyer must report corporate wrongdoing "up the chain" within the corporation up to and including the board of directors;²⁸⁸ (3) that a lawyer may not knowingly further a client's unlawful activity; (4) that "representatives and agents" of depository institutions are bound to abide by regulatory disclosure regulations;²⁸⁹ and (5) that "when a lawyer goes beyond the role of lawyer and becomes the provider of facts, the lawyer steps into the client's shoes and becomes subject to the institution's disclosure and record keeping obligations."²⁹⁰ While the first three enumerated

also contended that "[n]otwithstanding the alarums and excursions on the status of the attorney-client privilege and ethical rules, the government's approach does not represent any novel theory or radical departure from traditional standards." Stuart M. Gerson, *When Lawyers Must Disclose*, N.Y. TIMES, Apr. 9, 1992, at A25. Gerson went on to argue that with respect to Kaye, Scholer's obligation to disclose matters to the FHLBB, the lawyer's right not to disclose confidential information derives from the client's right not to disclose. *Id.* "Ultimately, the client's position defines the lawyer's. Thus, lawyers can have no independent exemption from disclosure when they substitute for clients having a duty to disclose." *Id.*

288. Indeed, Weinstein has suggested that the lawyer's duty extends beyond reporting suspected wrongdoing up through the corporate hierarchy. Instead, Weinstein has stated that lawyers "have a responsibility to try to keep their clients on the legal high road, not just the technical straight and narrow . . ." Susan Schmidt, *Panel: 'Where Were the Lawyers During S&L Crisis?'*, WASH. POST., May 23, 1991, at B1. It has been pointed out, however, that:

Mr. Weinstein argued that this dates from *Helvering v. Gregory*, which he mistakenly claimed stood for the principle "that while you might have a scheme that technically complies with or accurately drives through an apparent loophole in the law, because of its basic fundamental law avoidance character, it is nonetheless unlawful."

Fox, *supra* note 113, at 1523.

289. In this connection, Weinstein cited the OTS and FHLBB rule prohibiting "any written or oral statement to the [agency] that is false or misleading with respect to any material fact concerning any matter within the jurisdiction of the [agency]." March 1992 Speech, *supra* note 286, at 407. Weinstein noted that the regulation was "virtually the twin" of the SEC's Rule 10b-5 and was construed as broadly. *Id.* Weinstein observed, "[t]he regulation applies to all submissions by any person. Lawyers are as subject to the rule as anyone else." *Id.* Weinstein also noted that the OTS had a rule governing the conduct of attorneys practicing before the agency that was "virtually identical to SEC Rule 2(e)." *Id.* According to Weinstein, "[i]t should come as no surprise to the bar eleven years after the SEC's decision in *In Re Carter* . . . that administrative agencies take these rules seriously." *Id.*

290. *Id.* at 405. As Weinstein explained elsewhere:

Our position in the OTS case against Kaye Scholer was that by taking that step, by interposing itself between the Bank Board and the bank, Kaye Scholer assumed the bank's obligations for making the necessary disclosures required by the statute and by our rule. This point is at the heart of the OTS charges against the firm.

Harris Weinstein, *Attorney Liability in the Savings and Loan Crisis*, 1993 U. ILL. L. REV.

principles seem safely within Weinstein's description, the latter two, which Weinstein said were of special importance to the OTS case,²⁹¹ are neither unremarkable nor well established.²⁹²

2. *The Hazard Opinion.* In fact, the OTS theory that lawyers representing regulated entities who interpose themselves between their clients and the regulators thereby become "agents" of their clients (and thereby succeed to their client's disclosure and record keeping obligations) was the essence of the Kaye, Scholer debate.²⁹³ Not surprisingly, Kaye, Scholer characterized the participation of its attorneys in dealings between Lincoln and the OTS in a very different way.

As reflected in the summary of the expected testimony of Professor Geoffrey C. Hazard, Jr., who was engaged to provide expert testimony concerning the standards of professional and ethical conduct applicable to Kaye, Scholer's representation of Lincoln, Kaye, Scholer took the position that it had been engaged by Lincoln as litigation counsel to defend Lincoln in con-

53, 56-57 (1993).

291. Weinstein made this observation as a panelist at a Prentice Hall Law & Business Conference. Weinstein's comments are summarized in *ABA/BNA Lawyer's Manual on Professional Conduct*, Vol. 8, No. 5, 77-79 (1992).

292. Thus, it has been observed that:

[P]remising legal malpractice liability on violation of federal securities laws is not new. Nor does holding attorneys liable for fraudulent conduct before a regulatory agency signal a departure from the traditional, common law bases of attorney liability. However, the concept that attorneys have a duty to investigate, and indeed even to regulate, their clients' activities and transactions is a departure from the traditional notion of liability. Similarly, the concept that an attorney representing a financial institution owes the governmental agencies regulating such institutions an affirmative duty to disclose any wrongful or questionable conduct by the client is also a marked departure from the traditional bases of attorney liability. Specifically, both of these concepts represent a deviation from common law theories of duty and liability.

J. Randolph Evans & Ida Patterson Dorvee, *Attorney Liability for Assisting Clients with Wrongful Conduct: Established and Emerging Bases of Liability*, 45 S.C. L. REV. 803, 827 (1994); see Fox, *supra* note 113, at 1532 ("The OTS' view of the lawyer's role as client 'watch dog' is a marked departure from the traditional view of a lawyer as staunch defender of client interests within the bounds of law and the ethical rules.").

293. See, e.g., Combs, *supra* note 269, at 683. Combs notes that:

According to Kaye Scholer, OTS brought suit simply because Kaye Scholer advanced arguments on its client's behalf which it believed were supported by the facts and law without going further and disclosing weaknesses in its client's position or contrary arguments available to OTS. The bottom line, says Kaye Scholer (and others), is that OTS is trying to redefine the role of a lawyer.

Id. Of course, another significant issue, not considered here, was the propriety of the administrative order freezing Kaye, Scholer's assets.

nection with the 1986 FHLBB examination.²⁹⁴ In that capacity, Kaye, Scholer lawyers met with regulators, defended Lincoln employees at investigative depositions, moved to disqualify the FHLBB chairman from participating in Lincoln matters, assisted Lincoln in responding to the charges of misconduct in the 1986 report of examination, filed suit against the FHLBB as a result of the disclosure of confidential information concerning Lincoln, negotiated a settlement of the issues raised in the 1986 examination, conducted a series of reviews of Lincoln's real estate loan files and reported the findings to Lincoln's general counsel, and assisted Lincoln in responding to the FHLBB's 1988 report of examination.²⁹⁵ Kaye, Scholer stressed that throughout the period of its involvement with Lincoln, Kaye, Scholer had not served as Lincoln's sole counsel, nor had Kaye, Scholer acted as Lincoln's regulatory counsel.²⁹⁶

In consideration of these factual representations, it was Professor Hazard's opinion that Kaye, Scholer was acting as Lincoln's litigation counsel and accordingly, "its conduct was governed by the standards applicable to an advocate in a matter that has become adversarial and which involves a reasonable anticipation of possible litigation."²⁹⁷ Thus, "[a]s litigation counsel, Kaye, Scholer had a duty to present Lincoln's case in its best light subject to the restriction against frivolous claims and contentions."²⁹⁸ Further, in its role as litigation counsel, "Kaye,

294. The summary of the expert opinion of Geoffrey C. Hazard, Jr. is reprinted in *THE ATTORNEY-CLIENT RELATIONSHIP AFTER KAYE, SCHOLER*, at 381 (PLI Corp. Law and Prac. Course Handbook Series No. 779, 1992).

295. So, for example, rather than interposing itself between Lincoln and the examiners, Kaye, Scholer described its role as that of an intermediary in the 1986 examination. According to Kaye, Scholer:

Pursuant to the agreement reached with the Office of Enforcement, a Kaye, Scholer litigation associate was assigned to be on Lincoln's premises to receive and pass on the examiners' requests for information to the appropriate Lincoln personnel so that responses could be provided, and to inform the examiners when and from which Lincoln personnel and records the responses could be expected.

Id. at 385.

296. Kaye, Scholer identified Jones, Day, Reavis & Pogue as Lincoln's principal regulatory counsel. Kaye, Scholer also stated that Lincoln had obtained regulatory advice from Arnold & Porter; Mariscak, Weeks & MacIntyre; Sidley & Austin; Strook, Strook & Levan; Hill, Wynne, Troop & Meisinger; and Hogan & Hartson. *Id.* at 383, 393.

297. Professor Hazard noted in this regard that the applicable standards were Model Rule 3.1, Disciplinary Rule 7-102 and California Code of Professional Conduct Rule 2-110. *Id.* at 396.

298. *Id.* at 396. In this connection, Professor Hazard's opinion notes that the FHLBB's policy statement at the time its rules governing the conduct of lawyers was promulgated, specifically stated that the FHLBB "does not intend to establish special

Scholer did not have a duty to disclose weaknesses in Lincoln's position."²⁹⁹ Likewise, it was Professor Hazard's opinion that Kaye, Scholer was under no duty "to make affirmative disclosure of confidential information gained through consultation with its client based on the information's materiality to the Bank Board."³⁰⁰

Instead, in Professor Hazard's opinion, the ethical standard applicable to Kaye, Scholer was "whether, given the information available to Kaye, Scholer, there were non-frivolous legal and factual bases for the arguments and assertions in Lincoln's response to the 1986 ROE and the other Lincoln submissions to the Bank Board" Professor Hazard concluded that Kaye, Scholer had not violated applicable ethical standards and, in contrast, would have breached the standards of ethical conduct and professional responsibility had Kaye, Scholer made the disclosures and representations that the OTS contended should have been made.³⁰¹

Professor Hazard also directly disputed the other principal contentions in the OTS complaint. In Professor Hazard's opinion, Kaye, Scholer did not assume a higher or different standard of conduct by virtue of its direct interaction with the FHLBB examiners. Indeed, in Professor Hazard's view such interactions were "integral aspects of the usual and expected functions of litigation counsel."³⁰²

Similarly, Professor Hazard rejected the OTS contention that Kaye, Scholer was required to address conflicts of interest between Lincoln and ACC which were not raised in the 1986 report of examination.³⁰³ Kaye, Scholer was not obliged to advise Lincoln's Board of Directors concerning Lincoln's compliance with FHLBB regulations since Kaye, Scholer had not been engaged to conduct a regulatory review and had not held itself out as having regulatory expertise.³⁰⁴

standards of conduct for attorneys or other professionals appearing before the Board" and that the regulations "are not intended to require attorneys to report to the Board violations of laws and regulations by their clients or to infringe otherwise on the attorney-client privilege." *Id.* at 397 (quoting 49 Fed. Reg. 25,618 (1984)).

299. *Id.* at 397.

300. *Id.* at 398.

301. *Id.* at 398-99.

302. *Id.* at 399. Thus Kaye, Scholer could not have assumed and did not assume Lincoln's record keeping and disclosure responsibilities. *Id.*

303. *Id.* at 396. Professor Hazard noted that when conflict issues were raised in the 1988 report of examination they were addressed directly by Lincoln's board of directors before Kaye, Scholer was engaged to respond. *Id.* at 400.

304. *Id.* at 400. Professor Hazard likewise rejected the specific allegations that

C. *The American Bar Association*

1. *The ABA Working Group On Lawyers' Representation Of Regulated Clients.* A working group of practitioners, scholars and regulators have met for several years to discern the bounds of zealous advocacy in the context of the regulated banking industry. In a draft report issued in January 1993, the working group examined many of the issues raised in the Kaye, Scholer litigation.³⁰⁵

The working group noted that the overriding concern of practitioners representing banking institutions was the need for certainty concerning the standards by which their conduct is to be scrutinized.³⁰⁶ Interestingly in this regard, the working group noted that the regulators did not want to be bound by state ethical rules that might interfere with the accomplishment of what they considered to be statutory mandates and instead favored the Model Rules as a standard of general applicability.³⁰⁷

Kaye, Scholer had failed to advise Lincoln's board that the unanimous consent of the board was subject to challenge and had failed to report to the Board on the findings of the real estate loan review. With regard to the unanimous consent issue, Professor Hazard noted that the validity or invalidity of the consents would not have altered Kaye, Scholer's conclusions concerning Lincoln's compliance with the direct investment regulation. *Id.* at 401. With regard to the loan review findings, Professor Hazard was of the view that because the 1986 report of examination had already put Lincoln's board on notice of the FHLBB's criticism of Lincoln's lending and record keeping practices, it was "reasonable and proper professional conduct for Kaye, Scholer to report the results of the loan file reviews in writings sent to Lincoln's general counsel and to other Lincoln employees with direct responsibility for maintaining the loan files." *Id.*

305. AMERICAN BAR ASSOCIATION WORKING GROUP ON LAWYERS' REPRESENTATION OF REGULATED CLIENTS, LABORERS IN DIFFERENT VINEYARDS? THE BANKING REGULATORS AND THE LEGAL PROFESSION (1993) (discussion draft).

306. *Id.* at 143. As the working group noted:

The recent spate of cases against lawyers by the OTS, FDIC and RTC indicates at a minimum that these agencies are going to enforce vigorously standards of conduct for lawyers. If that is the case, lawyers need to know with some precision what those standards are. Are they traditional professional responsibility, statutory and common law principles with which lawyers are already familiar? Or are they novel duties created by the agencies? Even if they are traditional principles, will they be expanded to apply in contexts where they did not previously apply?

Id.

307. When asked whether the well-established principles of professional responsibility were those of the lawyer's state of practice or licensure, however, the answer of the government lawyers seemed to be that the variations of professional standards found in the different states would be unworkable before federal agencies. They argued that a more uniform set of principles would be needed. At the October meeting, the government lawyers seemed to shift their position to accept applicable state rules as governing. It was recognized that conflict of law rules for applying appropriate

The working group also found that banking agency regulations as applied to counsel for financial institutions also contributed to the lack of clarity with respect to the lawyer's obligations. The working group took exception to the statements by Weinstein and Gerson that the OTS regulations prohibiting false statements imposed the same duties as SEC Rule 10b-5 and found instead, that the OTS regulations were much broader in their prohibitions, particularly in regard to omissions.³⁰⁸ The apparent disparity between the broad language of the rule and the more narrow interpretation ascribed by Weinstein and Gerson was criticized as being a cause of confusion.³⁰⁹

The working group also criticized Weinstein's agency theory of liability under which the lawyer is deemed to "step into the shoes" of the client when the lawyer takes on responsibility for being the sole source of information made available by the client to the regulator. The working group found that the erosion of the distinction between the client's duty to the regulator and the duty of the lawyer was a matter of concern to the bar because there were many instances in which the lawyer acted on behalf

standards to lawyers representing institutions doing business in a number of states were not well developed. In addition, the regulators also did not want to be bound by a bar rule which would prevent the government from accomplishing statutory mandates. As Mr. Weinstein put it, an agency could not accept a state bar rule that permitted conduct that was flatly unacceptable to the agency. Generally, the government lawyers seemed to believe that, in the absence of statutory provisions to the contrary, the Model Rules proved the most reliable common standard.

Id. at 144-45.

308. At the May meeting, Mr. Weinstein and Stuart Gerson analogized [the OTS] regulation to the duties imposed by SEC Rule 10b-5. The regulations as written, however, are not the same. The OTS provision prohibits a broader range of conduct than does the SEC rule. In regard to omissions, for example, the OTS regulation bars omissions of "a material fact concerning any matter within the jurisdiction of the Office." The SEC regulation is more narrowly crafted, prohibiting the omission of "a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading". The SEC regulation further requires a person to come forward with material facts if failure to do so would work a deception. The OTS regulation seems to require a person to come forward whether or not failure to do so would cause a deception. In addition, the OTS regulations applies [sic] to "any matter within the jurisdiction of the Office" which would include a myriad of interactions with the agency.

Id. at 147-48 (citation omitted).

309. "While Mr. Weinstein seems to have said in meetings and speeches that the OTS interprets its regulation to mean what the SEC regulation says, the fact remains that the OTS regulation does not say that. Such a lack of clarity causes confusion." *Id.* at 148.

of the client without thereby assuming the client's responsibility for coming forward with information.³¹⁰

As part of its report, the working group analyzed various hypothetical problems. In one of them, during a regulatory examination, outside counsel to the subject bank discovers a loan that should be aggregated with other loans under the "loan-to-one-borrower" rule. If the loan is aggregated, however, the rule would be violated. Under the hypothetical facts, the examiner has not raised a question concerning this loan. However, the examiner has inquired concerning another loan which the lawyer believes can be shown not to require aggregation.³¹¹ With regard to the lawyer's advice to the client prior to the exit interview, there was general agreement that the lawyer had no obligation to disclose to the regulators the lawyer's opinion that the loans should be consolidated even if the client informs the lawyer that the client intends not to make such a disclosure.³¹²

In the instance in which the client makes misleading statements, concerning the existence of other loans, to the examiner in the lawyer's presence, there was agreement that if the lawyer did not know of the deception beforehand, the lawyer's mere presence during the making of the statement, standing alone, would not subject the lawyer to liability.³¹³ With regard to the lawyer's subsequent actions, there was also agreement that although the lawyer was obliged to elevate the issue through management, the lawyer would not face liability even if the highest corporate authority declined to remedy the deception. Weinstein suggested, nevertheless, that if the lawyer attended subsequent meetings with the examiners at which the existence of other loans was misrepresented, and the lawyer did not act to

310. The Working Group worried that there was no clear identification of the unusual circumstances in which a lawyer would be assumed to have stepped into the shoes of his client Mr. Weinstein suggested that this assumption would occur only where counsel in connection with the examination process had taken on the responsibility for being the sole source of facts made available by the client to the regulator. Narrowing the concept in the way articulated by Mr. Weinstein may make it a less troubling assertion than it first appeared. The bar remains concerned, however, by erosion of the distinction between duty of client and duty of lawyer because there are many instances when the lawyer speaks for the client, and even makes some judgments for the client, but does not believe that doing so imposes on him all the responsibilities of the client for coming forward with information.

Id. at 156 (citation omitted).

311. *Id.* at 169.

312. *Id.* at 171.

313. *Id.* at 172.

correct the misconception, the lawyer could be viewed as having aided and abetted the company's deception.³¹⁴ Although Weinstein's views were not generally accepted, the working group was of the view that the lawyer could not under any circumstances make a false representation to the examiner.³¹⁵

In its analysis of the hypothetical, the working group again commented on the regulator's agency theory of liability. The working group noted that the distinction between agent and advocate in practice was rarely clear-cut in the context of bank examination. In response to the suggestion that the demarcation between agent and advocate lay at the point when the bank is notified of the resolution of the investigation, the working group observed that there are many points at which the lawyer may appropriately advocate the bank's position before the regulators.³¹⁶

2. *The ABA Opinion Concerning Representation During a Bank Examination.* In an opinion issued in 1993, the ABA Committee on Ethics and Professional Conduct also attempted to elucidate the ethical obligations of lawyers representing financial institutions during a regulatory audit.³¹⁷ In that opinion, the committee considered the same loan-to-one-borrower hypothetical situation analyzed by the working group.

In responding to the hypothetical, the committee noted initially that because the lawyer was acting solely in an advisory capacity, "the duty to respond remains that of the client."³¹⁸ The committee cautioned, nevertheless, that the lawyer may succeed to the client's disclosure obligation if the lawyer takes responsibility for responding on behalf of the client and cuts off access to

314. *Id.* at 172-73.

315. *Id.*

316. But the difficulty with the agency/advocacy distinction is that it is rarely clear cut in practice, at least in the context of a bank examination. When asked to identify a dividing line between the two roles, Mr. Weinstein suggested that it lay at the point where the bank receives formal notice of resolution of the investigation. But there are many situations long before this point where a lawyer may be acting perfectly appropriately in advocating a position on behalf of his client. Moreover, examinations are sometimes used as "record laying" exercises by enforcers who have already decided to take action against the client.

Identifying the point at which the lawyer crosses the line between advocacy and agency during an examination is inherently difficult.

Id. at 174-75.

317. ABA Comm. on Ethics and Professional Responsibility, Formal Op. 375 (1993).

318. *Id.*

the client and its employees.³¹⁹ However, in the hypothetical, because the lawyer's involvement is "indirect and attenuated," the lawyer's sole obligation is not to mislead the agency, whether or not such description is considered necessary to protect the client's confidences.³²⁰

The committee recognized that the lawyer's ethical obligation to be forthcoming is "somewhat less clear."³²¹ The committee commented that the duty of disclosure only takes precedence over the duty of confidentiality in adjudicative proceedings before a tribunal.³²² The regulatory agency is not a "tribunal" and in the opinion of the committee the bank examination was not an "adjudicative proceeding" that would engender a duty of candor.³²³ The committee concluded that because of the importance of protecting client confidences, the prohibition against disclosure must be respected under the circumstances of the hypothetical even if the failure to disclose would result in allowing the client to engage in fraud.³²⁴ However, the lawyer may not assist the fraud.³²⁵

319. Thus, the committee observed that:

Where . . . a lawyer is employed simply to advise the client about how the client should respond to the examining agency's inquiries, the duty to respond remains that of the client. Similarly, if the client simply asks the lawyer to represent him before the agency, the client's duty of disclosure does not *ipso facto* become that of the lawyer . . .

However, a lawyer may put herself in a situation where she *has* assumed such obligations. When the lawyer is the only individual to deal directly with the bank examiners during the course of the examination, takes full responsibility for gathering factual information and preparing the client's submissions to the regulators, and cuts off the regulator from access the regulator otherwise might have to employees of the regulated entity, the lawyer may well have taken on the client's own obligation under the regulations to respond.

Id.

320. *Id.*

321. The committee framed the issue as:

[W]hether and to what extent a lawyer representing a client in a bank examination by a government regulatory agency has an affirmative obligation to come forward with information that is material to the purposes of the examination, the disclosure of which would be against the client's interests or otherwise violate her duty of confidentiality.

Id.

322. The committee considered in this connection, Model Rules 3.3, 3.9 and 4.1. *Id.*

323. *Id.*

324. *Id.*

325. As the committee stated:

Because of the importance the profession placed on protecting client confidences, we also believe that the prohibition on disclosure of client confidences expressly stated in Rule 4.1 must be given effect in this context, even if the result is to allow the client to engage in fraud. On the other hand, we also be-

The committee used the vehicle of the hypothetical to provide guidance concerning the lawyer's ethical obligations at various points in the representation. Thus, with respect to counseling the client during the pendency of the examination, the committee opined that if the lawyer determined that the client had a duty to disclose to the examiner the unaggregated loan, the lawyer was obliged to counsel the client to make the disclosure. The committee made it clear, however, that counseling disclosure is all that is required and because the lawyer was not directly involved, the lawyer could continue to represent the client even if the client determined not to make the disclosure.³²⁶

The committee next considered the lawyer's obligations when the lawyer counsels the client to disclose and, in the lawyer's presence, the client falsely represents that there are no loans which should be aggregated, beyond those of which the examiners were aware. In the face of such a false statement in the lawyer's presence, the lawyer must disassociate from the client's decision to commit fraud. The committee noted, however, that if the lawyer was not informed in advance of the client's intentions, a "noisy withdrawal" was not required. Instead, the lawyer should counsel reconsideration and compliance with legal requirements. If the client refuses to correct the misrepresentation, the lawyer should not attend any further meetings with the examiners and should consider terminating the representation.³²⁷

The committee also considered the implications of the lawyer's direct involvement in the misrepresentation. The committee stated that the lawyer may not under any circumstances make a statement that the lawyer knows to be false and misleading. The committee made clear that this prohibition did not vary whether the false statement was made voluntarily by the lawyer or was directed to be made by the client or whether the statement was made in response to a question from the examiner. In the latter case, the committee counseled the lawyer not to answer the examiner's question regardless of the inferences the examiner might draw from the lawyer's refusal to answer.³²⁸

lieve that a lawyer faced with client fraud is required to conduct herself in such a way that she does not assist the fraud.

Id.

326. *Id.*

327. *Id.*

328. In an opinion issued almost thirty years earlier, the committee had expressed essentially the same view with respect to the lawyer's ethical obligation of disclosure, under the Code, in the context of appearances before the Internal Revenue Service. ABA Comm. on Ethics and Professional Conduct, Formal Op. 314 (1965). There the committee

The prohibition against the lawyer making false representations extends to the omission of material facts that the lawyer knows would likely mislead the examiners.³²⁹ The committee stressed that the lawyer's disclosure obligation depends on the lawyer's role in creating the misrepresentation and not on a determination of whether the lawyer was acting as an "agent" or as an "advocate."³³⁰

observed that the service is "neither a true tribunal, nor even a quasi judicial institution," but rather the service "is the representative of one of the parties" and "is not designed and does not purport to be unprejudiced and unbiased in the judicial sense." *Id.* Under those circumstances, the committee concluded that while the lawyer has an absolute duty not to make false assertions of fact when dealing with the service, "the absolute duty not to make false assertions of fact [does not] require the disclosure of weaknesses in the client's case and in no event does it require the disclosure of his confidences, unless the facts in the attorney's possession indicate beyond reasonable doubt that a crime will be committed." *Id.* Further, the lawyer ethically is not permitted to allow the client to mislead the service and, as the committee noted, "[t]he difficult problem arises where the client has in fact misled . . . without the lawyer's knowledge or participation." *Id.* In that case, when the lawyer discovers the misrepresentation, "the lawyer must advise the client to correct the statement." *Id.* If the client refuses to make the correction and if the lawyer believes the service relies on the lawyer's involvement as corroborating the false statements of the client, the lawyer is obliged to disassociate from the statement ("unless it is obvious that the very act of disassociation would have the effect of violating Canon 37") and if a direct question is put to the lawyer by the service, the lawyer "must at least advise the service that he is not in a position to answer." *Id.*

329. As the committee explained in the context of the hypothetical:

[I]f the lawyer knows that the examiners are unaware of [the undisclosed loan] and/or its implications for the [loan-to-one-borrower] rule, and if what she says to them affirmatively leads them to conclude that there is no such loan, or that it need not be aggregated, the lawyer may have violated her ethical obligation under Rule 4.1(a) not to mislead a third party. On the other hand, if the lawyer limits her statements to the question whether [another loan] should be aggregated, and says nothing at all about any other loans, she cannot be faulted for failing to volunteer information about [the undisclosed loan] even if the examiners themselves make statements in the lawyer's presence to the effect that there are no other loans that need be aggregated. If [the other loan] has escaped the examiners' notice through no fault of the lawyer, the lawyer has no ethical obligation to dispel their erroneous impression that no such loan exists, and indeed is precluded from doing so by Rule 1.6.

ABA Comm. on Ethics and Professional Conduct, Formal Op. 375 (1993).

330. In a seemingly direct reference to the Kaye, Scholer controversy, the committee emphasized that:

Our conclusion here does not depend upon a determination that the lawyer is acting as an "advocate" or as an "agent" for the client; rather, it is based on a purely practical analysis of what the lawyer does or says. We do not believe it helpful to make a lawyer's ethical obligation of disclosure depend upon how she or someone else may abstractly characterize her role in representing a client. Most people, including even lawyers themselves, will doubtless find it easier to decide what responsibility a lawyer had for making or reinforcing a mis-

Finally, the committee considered the situation when the lawyer provides a written compliance opinion before learning facts that reveal noncompliance. In those circumstances, the lawyer has an obligation to see that the opinion is not used by the client to assist the client's fraudulent course of conduct. The committee reiterated its earlier view that the lawyer has an affirmative duty to disaffirm the lawyer's work product if failure to do so would lend assistance to a continuing fraud, even if doing so would create the risk of inferential disclosure of client confidences. The committee noted in this regard, however, that before disallowing the work product, the client should be informed of the lawyer's intention to do so and the client should be given the opportunity not to make use of the work product.³³¹ In any event, the lawyer must be guided by what the lawyer independently believes the client's obligations to be and not by what the lawyer believes the regulators' view to be.³³²

IV. HOBSON'S CHOICE AND CONSTRUCTIVE DISCHARGE

The aggressive positions taken by government regulatory authorities to pierce the distinction between the client's obligation to the regulators and the obligations of counsel do not bode well for the practitioner who may be forced to choose between the ethical obligation to preserve client confidences and the risk of administrative disbarment and significant civil liability.³³³ The only safe harbor when faced with such a dilemma may be withdrawal from the representation, either silent or "noisy" depending on the circumstances. For the attorney in private practice, withdrawal will likely result in the loss of a lucrative client and a commensurate loss of income to the firm (and the individual,

representation by simply looking at what the lawyer said and did rather than determining what hat the lawyer was wearing when she said or did it.

Id.

331. *Id.*

332. *Id.*

333. As one scholar has observed:

[I]f recent developments indicate a trend, federal agencies are equivocally abandoning the presumption that there is a sharp distinction between lawyer and client conduct. In securities and banking law, lawyers have been accused of facilitating or causing client conduct so that they are legally responsible for that conduct, or at least responsible for taking affirmative steps to rectify that conduct. This legal responsibility may only mean the threat of administrative sanctions as in *Carter and Johnson* and *In Re Kern*, but may also, as illustrated in the *Kaye*, *Scholer* proceeding, involve hundreds of millions of dollars of potential liability.

Painter, *supra* note 214, at 574.

as well). But although such a loss is not a happy prospect, the lawyer in a law firm will usually have the opportunity to serve other clients.

The in-house counsel, whose practice is tied to the fortunes of one client, is on a very different footing. Indeed, withdrawal for corporate counsel means loss of employment, a precipitous loss of income and the possibility that counsel's career is either at an end or is limited in other opportunities.

When counsel's dilemma is the result of the corporation's intransigence, that is, after having counseled compliance with a legal obligation up through the management, the highest authority in the corporation refuses to abandon the illegal practice, and counsel is faced with the Hobson's choice of violating ethical obligations to the corporate client or suffering personal liability, the corporate counsel who withdraws may fairly be said to have suffered a constructive discharge. However, because the lawyer-client relationship has traditionally been viewed as one terminable at will, at least by the client, corporate counsel have been foreclosed from recovery for wrongful termination or constructive discharge by their corporate employer/clients. A growing body of precedent and legal commentary suggests that this may no longer be the case.

A. *Breach of Implied Contract Claims by Corporate Counsel*

Since the late nineteenth century, private sector employees, who have neither a contract nor a collective bargaining agreement, have been presumed to be "at-will employees." That is, their employment can be terminated at the will of their employer, at any time, for any reason (even a morally reprehensible one) or for no reason at all.³³⁴ Over time, however, several significant exceptions have been implied which ameliorate the harshness of the rule.

One of these exceptions is the "implied-in-fact contract" under which courts have implied promises of continued employment from such sources as employee handbooks, personnel policy manuals, oral statements and the employer's general employment practices.³³⁵ Courts have only lately, and with some

334. Gensler, *supra* note 25, at 518; Stephen Gillers, *Protecting Lawyers Who Just Say No*, 5 GA. ST. U. L. REV. 1, 5 (1988); Sara A. Corello, Note, *In-House Counsel's Right to Sue for Retaliatory Discharge*, 92 COLUM. L. REV. 389, 390 (1992).

335. See Joseph J. Fleischman, et. al, *The Organizational Sentencing Guidelines and the Employment At-Will Rule as Applied to In-House Counsel*, 48 BUS. LAW. 611, 622 (1993).

understandable reluctance, considered implied-in-fact contracts as arising from the attorney-employer relationships.

It is difficult to imagine a clearer example of an at-will employment relationship than that between attorney and client. Indeed, in view of the high degree of trust and confidence that must be reposed in the attorney, the client must be permitted to sever the relationship at any time.³³⁶ Nevertheless, courts have begun to look beyond the mere fact that the claimant is an attorney, to examine whether attorney-employer relationships have given rise to compensable rights in the employee/attorney. In several notable instances, courts have found that they have.

Thus, in *Nordling v. Northern State Power Co.*,³³⁷ in-house counsel who was terminated after objecting to the company's surveillance of employees was permitted to sue his employer on the grounds that the company had failed to follow the multi-step progressive discipline procedure set forth in the company's employee handbook.³³⁸ In another case, *Mourad v. Automobile Club Insurance Co.*,³³⁹ the code of professional conduct was read into the just-cause employment contract implied from statements in the company's policy manual and supplemental pamphlets.³⁴⁰ In a third case, *Weider v. Skala*,³⁴¹ a law firm associate was held to have a cause of action for breach of an implied-in-fact contract where the law firm had presented the associate with a Hobson's choice of violating an ethical duty to report misconduct or face

336. See, e.g., *Fracasse v. Brent*, 494 P.2d 9 (Cal. 1972). In the *Fracasse* case, the client terminated a contingent fee agreement, before any recovery, in order to retain new counsel. *Id.* at 10. The former attorney sought declaratory judgment that he had been discharged without cause in breach of the agreement. *Id.* The court held that "a client should have both the power and the right at any time to discharge his attorney with or without cause." *Id.* at 13.

337. 478 N.W.2d 498 (Minn. 1991).

338. The Minnesota Supreme Court reversed the trial court's summary dismissal of discharge suits by in-house counsel and allowed the suit to proceed so long as there was no "violence to the integrity of the attorney-client relationship," particularly with regard to disclosure of company confidences and secrets. *Id.* at 502-03.

339. 465 N.W.2d 395 (Mich. App. 1991).

340. Mourad claimed to have been demoted to a position, which he subsequently resigned, because he had refused to implement policy decisions that he believed were contrary to the state's code of professional conduct. *Id.* at 397. On appeal from a jury verdict in Mourad's favor, the Michigan Court of Appeals affirmed Mourad's contract claim concluding that because the employer was aware at the time Mourad was hired that as an attorney he was bound by the code of professional conduct, the code was, in essence, incorporated into the employment relationship. *Id.* at 400. The court side-stepped the attorney-client issue, however, by finding that Mourad was in actuality the attorney for the insured's and served only as a manager with respect to the company. *Id.* at 400-01.

341. 80 N.Y.2d 628 (1992).

termination.³⁴²

Recently, in *General Dynamics Corporation v. Superior Court*,³⁴³ an in-house counsel's right to sue his employer for breach of an implied contract was upheld in the face of a prevailing rule that a client has the unilateral power to discharge an attorney at will.³⁴⁴ While specifically affirming the at-will nature of an attorney's engagement, the court noted that simply because plaintiff could be terminated by his employer did not mean that the employer could do so without liability.³⁴⁵ The court concurred in the finding that because the plaintiff had been hired as a "career oriented" employee with the expectation of permanent employment subject to satisfactory performance and because the plaintiff had been promised job security and substantial retirement benefits, there had been a "course of conduct" creating "a reasonable expectation" that plaintiff would not be terminated absent good cause.³⁴⁶ The court concluded that General Dynamics was bound to honor this obligation.³⁴⁷

342. Plaintiff reported to his employer that a fellow associate had been engaged in fraud, deceit and malpractice and should be reported to the disciplinary committee of the bar. *Id.* at 632. In response, although the firm acknowledged the associate's misconduct, plaintiff was forbidden from reporting the matter outside the firm. *Id.* Plaintiff reported the matter to the committee and subsequently was fired. *Id.* The trial and intermediate appellate courts denied plaintiff's claim in reliance on New York's presumption of at-will employment. *Id.* at 633. However, the New York Court of Appeals reversed concluding that because legal service was the "core purpose" for which plaintiff had been hired, there was an implied obligation on the part of his employer not to fire him for complying with the ethical responsibilities of a lawyer and that to force upon plaintiff the Hobson's choice of violating his ethical responsibility to report misconduct or otherwise to face termination prevented plaintiff from performing his part of the employment agreement. *Id.* at 638.

343. 876 P.2d 487 (Cal. 1994) (en banc) (hereinafter *Rose*).

344. *Rose* claimed that after 14 years of commendable service to the company he was fired as part of a "cover-up" of wide spread drug use among the company's work force. *Id.* at 490.

345. *Id.* at 495 ("To the extent that General Dynamics' claim [sic] that its 'unfettered' right to discharge a member of its corporate legal department means that it may do so without liability of any kind under all circumstances, that is not, and never has been, the law of this state."). In this regard, the court noted that even though the client's right to discharge an attorney at will was a well established and long standing rule, "[i]n exercising their common law powers, courts do not kneel in blind obedience to such misguided reliance on precedent." *Id.* at 494. Thus, "[w]hile the 'unfettered' right of the client to discharge his attorney at any time is an important value that should be upheld in most cases, the legal consequences of such an act will vary depending on the strength of competing interests that are present in a particular case." *Id.*

346. *Id.* at 495.

347. *Id.* at 496. The *General Dynamics* court stated:

It is true, as we have just affirmed, that General Dynamics has a right to discharge any member of its general counsel's staff in whom it has lost confi-

B. *Recovery in Tort for Wrongful Termination or Retaliatory Discharge*

In addition to claims grounded on a breach of implied contract, in-house counsel have also pursued actions against their employers under a second exception to the at-will employment rule for terminations that contravene "public policy." Under this exception, employees can recover damages in tort for wrongful termination for the employer's retaliation against the employee refusing to violate the law or insisting upon legal compliance.³⁴⁸

The "public policy" exception had its origins in California³⁴⁹ and has slowly gained acceptance by other jurisdictions.³⁵⁰ The applicability of the cause of action to cases of terminated in-house counsel has not been universally accepted, however, even in circumstances where similarly situated non-attorney employees would be allowed to seek recovery. Indeed, case law is generally to the contrary.

Even in states that have recognized a public policy exception to the at-will employment rule, courts have declined to extend the exception to treat in-house counsel in the same way as their non-attorney counterparts. So, for example, in *Willy v. Coastal Corp.*,³⁵¹ an in-house lawyer who was discharged because he refused to engage in illegal conduct and who counseled compliance with federal environmental and securities laws was held to be bound by the at-will employment rule, the court concluding that in-house counsel's only recourse was withdrawal.³⁵²

dence. That right does not mean, however, that it may do so without honoring antecedent contractual obligations to discharge an attorney-employee only on the occurrence of specified conditions.

Id.

348. See Raymis H.C. Kim, *In-House Counsel's Wrongful Discharge Action Under the Public Policy Exception and Retaliatory Discharge Doctrine*, 67 WASH. L. REV. 893, 894 (1992).

349. *Petermann v. International Brotherhood of Teamsters*, 344 P.2d 25 (Cal. Dist. Ct. App. 1959). There an employee was fired for refusing to give false testimony, before a California legislative committee, favorable to his union. Under these circumstances, it was held that plaintiff had a cause of action for wrongful discharge because "in order to more fully effectuate the state's declared policy against perjury, the civil law, too, must deny the employer his generally unlimited right to discharge an employee whose employment is for an unspecified duration . . ." *Id.* at 27.

350. See Ted Schneyer, *Professionalism and Public Policy: The Case of House Counsel*, 2 GEO. J. LEGAL ETHICS 449, 468-69 (1988).

351. 647 F. Supp. 116 (S.D. Tex. 1986), *rev'd on other grounds*, 855 F.2d 1160 (5th Cir. 1988).

352. Although the Texas Supreme Court had recently recognized the public policy exception to the at-will employment rule, the U.S. District Court and Court of Appeals declined to extend its applicability to in-house counsel. *Willy* was the company's environ-

Similarly, in *Herbster v. North American Co. for Life and Health Insurance*,³⁵³ in-house counsel who refused to destroy documents that were the subject of discovery in pending civil litigation was foreclosed from suing for retaliatory discharge, despite the state having recognized a public policy exception, on the grounds that the attorney-client relationship precluded a wrongful termination claim by an attorney.³⁵⁴ Thus, in that case, as well, withdrawal was considered the only available course of action.³⁵⁵

The sanctity of the attorney-client relationship prevented recovery for wrongful termination in a third case, *Balla v. Gambro, Inc.*,³⁵⁶ in which in-house counsel's employment was terminated after he had objected to the company's sale of defective medical equipment.³⁵⁷ The court was of the view that a cause of action for retaliatory discharge was not necessary to serve the public interest since in-house counsel were bound by the rules of professional conduct to prevent client conduct that could result in death or grave bodily harm.³⁵⁸ The court also concluded that because a fundamental tenet of the attorney-client relationship is that the attorney will maintain the confidentiality of client

mental counsel and claimed that he had been discharged because he had refused to participate in illegal conduct and had counseled the company to comply with federal environmental and securities laws. 647 F. Supp. at 117. Rejecting Willy's claim that his discharge was retaliatory, the district court observed that "[i]f an attorney believes that his client is intent upon pursuing an illegal act, the attorney's option is to voluntarily withdraw from employment. When an attorney elects not to withdraw and not to follow the client's wishes, he should not be surprised that his client no longer desires his services." *Id.* at 118 (citation omitted).

353. 501 N.E.2d 343 (Ill. App. Ct. 1986).

354. *Herbster* was North American's chief legal officer. *Id.* at 344. During the course of litigation involving the company, *Herbster* was directed to remove documents from a file that was to be produced pursuant to a discovery request. *Id.* *Herbster* refused on the grounds that to do so would violate the law and the ethical rules applicable to him as an attorney. *Id.* The court concluded, however, that the attorney-client relationship including the "special obligations" of an attorney to the client "permeates all phases of the relationship, including the contract for employment." *Id.* at 347.

355. *Id.* at 348.

356. 584 N.E.2d 104 (Ill. 1991).

357. *Balla*, in-house counsel for *Gambro*, became aware of a shipment of dialysis machines from *Gambro's* German parent that did not comply with FDA regulations. *Id.* at 106. After advising *Gambro's* president of the situation and being assured that the shipment would not be accepted, *Balla* learned that the equipment had been accepted and was to be sold. *Id.* *Balla* then informed the president that he "would do whatever [was] necessary to stop the sale of the dialyzers." *Id.* Several weeks later, *Balla* was fired and the following day, *Balla* reported the shipment to the FDA which then seized the dialyzers and found them to be defective. *Id.*

358. *Id.* at 109 ("In-house counsel must abide by the Rules of Professional Conduct. [*Balla*] had no choice but to report to the FDA *Gambro's* intention to sell or distribute these dialyzers, and consequently protect the aforementioned public policy.").

confidences and secrets, extending the tort of retaliatory discharge (grounded on those confidences and secrets) to attorneys would impair the communications between clients and attorneys.³⁵⁹ Finally, the court simply declined to recognize a cause of action for attorneys against their clients based on actions the attorneys were ethically bound to take in any event.³⁶⁰

This disparate treatment of in-house counsel from other employees of the same company has been justified on grounds that to allow attorneys a cause of action for wrongful or retaliatory discharge would undermine the sanctity and the efficacy of the attorney-client relationship. First, it is thought that recognition of the cause of action would be directly contrary to the accepted notion that the client can terminate the attorney's representation at will. Second, it is thought that allowing attorneys to sue clients will necessarily impinge on the preservation of client confidentiality and will thereby cause a lack of confidence and trust reposed by the client in the attorney.³⁶¹

359. *Id.* at 110.

360. *Id.* ("[A]ll attorneys know or should know that at certain times in their professional career, they will have to forgo economic gains in order to protect the integrity of the legal profession.")

361. See generally Fleischman et al., *supra* note 335, at 628-29; William L. Kandel & Kearney W. Kilens, *In-House Counsel as Whistle-Blower: At-Will Employment on Trial*, 19 *EMPL. REL. L.J.* 91, 93-94 (1993); Kim, *supra* note 348, at 903; Corella, *supra* note 334, at 406-15. Several commentators have noted in this regard that there are significant practical restraints on an in-house counsel's willingness to sue a former employer which reduce the likelihood that counsel would undertake litigation lightly or otherwise abuse counsel's former position of trust. See Gensler, *supra* note 25, at 551-52. Gensler notes that:

Practical considerations also mitigate against the fear that attorneys will abuse such a cause of action. First, law suits, even for attorneys, are expensive, especially for the attorney who is unemployed. In addition, a law suit presents many opportunity costs. If the attorney is unemployed, the existence of a law suit against the former employer may make the discharged attorney a pariah; surely many corporations would be hesitant to hire a "litigious" individual, especially for their in-house corporate staff. If the attorney is employed, the new employer likely will not appreciate the new attorney's taking days off to vindicate a personal grievance. Thus, although a discharged attorney possesses a potentially damaging arsenal in a discharge suit, concerns of abuse stemming solely from "inside information" probably are mitigated by economic forces.

Id.; Gillers, *supra* note 334, at 21. According to Gillers:

[W]e should be conscious of the practical constraints on lawyers who would make themselves wrongful discharge plaintiffs. They will usually have to hire counsel. By suing, they too go public, an act that may reduce their prospects of future employment. Their action may invite countercharges of incompetence as the true reason for termination. They will likely be less well-funded and less able to sustain a war of attrition than their former employers. If the worry is

In contrast, it has been pointed out that, notwithstanding the ethical requirement that an attorney withdraw rather than violate the standards of professional conduct, an attorney who elects to withdraw rather than engage in criminal conduct has plainly been "discharged."³⁶² To insulate the corporate employer from liability under those circumstances only protects the "scoundrel" employer who directs counsel to violate the law and either actually or effectively terminates counsel for properly refusing to do so.³⁶³ It has also been pointed out that the possibility of a wrongful termination suit (and the threat of disclosure of confidential information) should not affect client trust and candor, at least as to those clients who seek the lawyer's advice in order to comply with the law.³⁶⁴ Additionally, both the standards of professional conduct and the rules of evidence impose lesser requirements of confidentiality where client communications are in connection with an ongoing or future crime.³⁶⁵

This view found support in the decision in *Rose* which, in addition to upholding the right to sue for breach of an implied contract, held that in-house counsel could also pursue a cause of action for wrongful discharge when adherence to counsel's ethical obligations results in the termination of counsel's employ-

about a rash of strike suits, it seems unfounded.

Id.

362. Schneyer, *supra* note 350, at 470 ("[S]urely when a lawyer who refuses to do something illegal for her company is compelled for that reason to withdraw, her departure can be construed as a discharge even when technically she has not been fired but has resigned.").

363. See Kim, *supra* note 348, at 906 ("Denial of in-house counsel's discharge actions under the public policy exception and retaliatory discharge doctrine protects mostly 'scoundrel' employers who discharge a counsel for upholding law and ethics.").

364. See *id.* at 906-07. As one observer has noted:

The principal argument against the recognition of such causes of action is that an employer would be less candid regarding potentially questionable corporate conduct knowing that counsel could use this information in a retaliatory suit. This argument, however, presupposes that an employer would discharge the in-house counsel if the attorney disagrees with the questionable conduct. Normally, corporations seek advice from in-house counsel to avoid, rather than to commit, illegal activities in their business conduct. Corporate employers that seek legal counsel for the purpose of avoiding illegal acts would thus be receptive to the in-house counsel's advice. Companies that seek to gain competitive advantage at any cost by engaging in illegal activities, however, are not likely to heed the in-house counsel's advice, and are far more likely to discharge in-house counsel for upholding the law and ethics.

Id. (citation omitted).

365. See MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 4-101(c)(3) (1980); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6(b) (1995). The attorney-client privilege does not shield from disclosure communications that are in furtherance of an ongoing or future crime. See *supra* notes 72-73.

ment.³⁶⁶ In so concluding, the *Rose* court was particularly critical of the rationale underlying *Willy*, *Herbster* and *Balla* that the fiduciary nature of the attorney-client relationship required that in-house counsel be viewed differently from other employees.³⁶⁷ Indeed, because of what the court recognized as the unique pressures on in-house counsel due to counsel's obligation to conform to ethical norms and dependence on the corporation, the court observed that in-house counsel have a greater claim to judicial protection than other corporate employees.³⁶⁸ The court also found the suggestion in *Willy*, *Herbster* and *Balla* that withdrawal was the only appropriate remedy to be "illusory."³⁶⁹

366. The *Rose* court noted in this regard that unlike implied contract claims, cases of wrongful termination are not affected by whether the terminated employment was at-will or subject to contract. 876 P.2d at 496.

367. See *id.* at 500 ("If their reasoning and conclusions can be faulted, it is because one searches in vain for a principled link between the ethical duties of the in-house attorney and the courts' refusal to grant such an employee a tort remedy under conditions that directly implicate those professional obligations."). The *Rose* court also rejected the suggestion in *Balla*, *Herbster* and *Willy* that "to the extent that the retaliatory discharge tort rests on underpinnings designed to secure fundamental public policies, a tort remedy for in-house counsel is redundant . . ." *Id.* The court observed, in this connection, that:

[I]t is precisely *because of* [the role of the lawyer to receive and protect client confidences] that attorneys should be accorded a retaliatory discharge remedy in those instances in which *mandatory ethical norms* embodied in the Rules of Professional Conduct *collide with illegitimate demands of the employer* and the attorney *insists on adhering to his or her clear professional duty*. It is, after all, the office of the retaliatory discharge tort to vindicate fundamental public policies by encouraging employees to act in ways that advance them. By providing the employee with a remedy in tort damages for resisting socially damaging organizational conduct, the courts mitigate the otherwise considerable economic and cultural pressures on the individual employee to silently conform.

Id. at 501.

368. *Id.* at 498. The court found that:

[T]he distinguishing feature of the in-house attorney is a virtually complete dependence on the good will and confidence of a single employer to provide livelihood and career success.

The case for shielding the in-house attorney—among *all* corporate employees—from retaliation by the employer for either insisting on adhering to mandatory ethical norms of the profession or for refusing to violate them is thus clear. And because their professional work is by definition affected with a public interest, in-house attorneys are even more liable to conflicts between corporate goals and professional norms than their non-attorney colleagues. On this view, then, in-house counsel, forced to choose between the demands of the employer and the requirements of a professional code of ethics have, if anything, an even more powerful claim to judicial protection than their non-professional colleagues.

Id.

369. *Id.* at 502. The *Rose* court also observed that:

[T]he emphasis by the *Balla*, *Herbster* and *Willy* courts on the "remedy" of the

The court noted, however, that whether an attorney has a wrongful termination claim may depend to a great extent on whether termination resulted from the attorney's adherence to a mandatory ethical standard.³⁷⁰ The court recognized that the case of a termination resulting from ethically permissible (but not mandatory) conduct is more complex,³⁷¹ requiring inquiry whether the employer's conduct would ordinarily give rise to a cause of action for retaliatory discharge and then, whether the attorney was justified, by statute or ethical rule, to depart from the usual requirement of confidentiality and to engage in the conduct for which termination resulted.³⁷²

Thus, the court concluded, there are several limitations on the availability of the cause of action to in-house counsel.³⁷³ The first of these, as noted above, is the limitation to claims arising from "explicit" and "unequivocal ethical norms" and to claims which would be actionable by non-lawyer employees and which involve circumstances in which the obligation of confidentiality

in-house attorney's duty of "withdrawal" strikes us as illusory. Courts do not require non-lawyer employees to quietly surrender their jobs rather than "go along with" an employer's unlawful demands. Indeed, the retaliatory discharge tort claim is designed to encourage and support precisely the *opposite* reaction. Why, then, did the courts in these three cases content themselves with the bland announcement that the only "choice" of an attorney confronted with an employer's demand that he violate his professional oath by committing, say, a criminal act, is to voluntarily withdraw from employment, a course fraught with the possibility of economic catastrophe and professional banishment?

Whatever the reason, the withdrawal "remedy" fails to confront seriously the extraordinary high cost that resignation entails.

Id.

370. *Id.* at 502-03.

371. *Id.* at 503.

372. *Id.* The *Rose* court stated that:

Under these circumstances a court must resolve *two* questions: First, whether the employer's conduct is of the kind that would give rise to a retaliatory discharge action by a *non-attorney* employee . . . second, the court must determine whether some statute or ethical rule, such as the statutory exceptions to the attorney-client privilege . . . specifically permits the attorney to depart from the usual requirement of confidentiality with respect to the client employer and engage in the "non-fiduciary" conduct for which he was terminated.

Id.

373. As an initial matter, the *Rose* court also noted that the doctrine of wrongful discharge is subject to three general restraints. *Id.* at 497. First, the public policy at issue must be both "fundamental" and "clearly established" in the constitutional and positive law of the state. *Id.* Second, the policy to be vindicated must be a truly public one which benefits the public at large rather than the particular employee or employer. *Id.* And third, the action must seek to protect the public by protecting the employee who refuses to commit a crime or who reports illegal or unethical conduct to the proper authority. *Id.*

does not apply.³⁷⁴ In this connection, the court emphasized that the requirement of client confidentiality must be strictly observed and where the elements of a wrongful discharge claim cannot be established without breaching the attorney-client privilege, the suit must be dismissed.³⁷⁵ And second, the contours of the statutory attorney-client privilege are to be strictly observed without dilution to accommodate claims of retaliatory discharge.³⁷⁶

The *Rose* court's establishment of a limited wrongful termination cause of action for in-house counsel was adopted in the recent decision, *GTE Products Corp. v. Stewart*.³⁷⁷ The *Stewart* court agreed with *Rose* that the public interest is better served by providing judicial recourse to in-house counsel whose ethical duties irreconcilably conflict with the demands of counsel's corporate employer.³⁷⁸ Nevertheless, the *Stewart* decision emphasized the limited nature of the remedy particularly with respect to the protection of client confidences. Indeed, like *Rose*, *Stewart* holds that the cause of action is only available if the claim can

374. *Id.* at 503. The *Rose* court also went on to state that:

First, those values that underline the professional relationship—the fiduciary qualities of mutual trust and confidence can be protected from the threat of damage by limiting judicial access to claims grounded in *explicit* and *unequivocal ethical norms* embodied in the Roles of Professional Responsibility and statutes, and claims which are maintainable by the *non-attorney* employee . . . under circumstances in which the legislature has manifested a judgment that the principle of professional confidentiality *does not apply*.

Id. (citation omitted).

375. *Id.* According to the *Rose* court:

Except in those rare instances when disclosure is explicitly permitted or mandated by an ethics code provision or statute, it is never the business of the lawyer to disclose publicly the secrets of the client. In any event, where the elements of a wrongful discharge in violation of fundamental public policy claim cannot, for reasons peculiar to the particular case, be fully established without breaching the attorney-client privilege, the suit must be dismissed in the interest of preserving the privilege.

Id. at 503-04.

376. *Id.* at 504.

377. 653 N.E.2d 161 (Mass. 1995).

378. *Id.* at 166. The court in *GTE Products Corp. v. Stewart* stated that:

We would be reluctant to conclude that an employee, solely by reason of his or her status as an attorney, must be denied all protection from wrongful discharge arising from the performance of an action compelled by a clearly defined public policy of the Commonwealth We agree with the Supreme Court of California that public interest is better served if in-house counsel's resolve to comply with ethical and statutorily mandated duties is strengthened by providing judicial recourse when an employer's demands are in direct and unequivocal conflict with those duties.

Id.

be established without violation of the duty to respect client confidences and secrets.³⁷⁹

Although the *Stewart* court recognized a limited wrongful termination cause of action, summary judgment in favor of Stewart's employer was affirmed. The court noted that Stewart had not established that he had been constructively discharged,³⁸⁰ nor had Stewart established that his employer had asked him to engage in or further any criminal or fraudulent acts.³⁸¹

379. *Id.* at 166-67. The court went on to state that:

We stress, however, that a claim for wrongful discharge brought by in-house counsel will be recognized only in narrow and carefully delineated circumstances . . . [T]hat claim will only be recognized if it depends on (1) explicit and unequivocal statutory or ethical norms (2) which embody policies of importance to the public at large in the circumstances of the particular case, and (3) the claim can be proved without any violation of the attorney's obligation to respect client confidences and secrets.

Id.

380. Stewart had served as general counsel of GTE's lighting group. In that capacity, Stewart advocated that GTE take aggressive and costly measures to foster consumer safety in regard to several of its lighting products. *Id.* at 163-64. Stewart also advised the company that its services subsidiary should treat florescent and incandescent light bulbs as hazardous waste. *Id.* at 164. Stewart claimed that his advice was not well received and on some occasions his advice was disregarded. *Id.* Although in the past, Stewart had received high performance ratings and bonuses, in 1991, his promotability rating was lowered and he was counseled to be less confrontational and to cease being the company's "social conscience." *Id.* Stewart believed that these actions were precursors to termination and resigned. *Id.* Thereafter, Stewart's supervisor (GTE's general counsel) attempted to persuade him to return. The court concluded that this single act of his employer was not sufficient to support a wrongful termination claim. The court also found there was insufficient evidence to establish that Stewart's working conditions "were not so intolerable that a reasonable person would have felt compelled to resign as general counsel." *Id.* at 169.

381. *Id.* at 169. Instead, the court characterized Stewart's claims in this regard as follows:

For the most part, Stewart's claims appear to rest on his advice relating to the avoidance of possible legal liability, rather than with compelling issues of product design directly affecting public health and safety. His insistence that GTE conduct its business 'in compliance with the highest ethical business standards,' by doing more than was absolutely required by law, met some resistance from others legitimately concerned about profitability. We would be reluctant to conclude that disagreements over the wording of a product warning label, or the hypothetical risk posed by a product, which are matters committed to the business judgment of a company and do not rise to the requisite level of public concern, could be the basis for a wrongful discharge claim.

Id. at 168.

C. *Whistleblower Protection Statutes*

In-house lawyers who were terminated after they dissented from their client's illegal or unethical instructions have found comfort in state and federal statutes designed to protect "whistleblowers." In *Parker v. M&T Chemicals*,³⁸² for example, an in-house patent counsel was constructively discharged after refusing, in writing, to copy the technology of the company's competitors that had been erroneously released in court proceedings.³⁸³ Parker brought suit against M&T Chemicals for retaliatory discharge under New Jersey's "Conscientious Employee Protection Act."³⁸⁴

M&T Chemicals contended that the protections of the act should not extend to in-house counsel because under the state's rules of professional conduct, Parker was required to withdraw if he believed his client's instructions violated his ethical obligations.³⁸⁵ The court rejected the company's claim that the statute impinged on the attorney-client relationship.³⁸⁶ The court also found no threat to client confidences because, under state law, the attorney-client privilege did not extend to communications in furtherance of a crime or fraud.³⁸⁷

Although unsuccessful in establishing the basis for his claim, an in-house counsel's assertion of a wrongful discharge claim under the whistleblower protection provision of the False Claims Act³⁸⁸ suggests that in-house counsel may avail themselves of a federal cause of action in other factual circumstances.

382. 566 A.2d 215 (N.J. Super. Ct. App. Div. 1989).

383. *Id.* at 217. M&T Chemicals, Parker's employer, had tried unsuccessfully to develop the specialized technology necessary to manufacture methyltin stabilizers. The company learned that transcripts containing the technology had been inadvertently released, despite being subject to a sealing order, in litigation to which the company was not a party. The company arranged to obtain access to the transcripts from a party to the litigation and directed Parker to supervise the copying of the transcripts. Parker refused and thereafter, was demoted. *Id.* at 217-18.

384. N.J. Rev. Stat. §§ 34:19-1 to 34:19-8 (1988 & Supp. 1996).

385. *Parker*, 566 A.2d at 219.

386. The company argued that the statute was unconstitutional as applied to lawyers because it was contrary to the New Jersey Supreme Court's authority to regulate the conduct of attorneys. The court noted, however, that although the client might be answerable in damages, the client was nevertheless free to discharge its attorney/employee and therefore, the attorney-client relationship was unaffected by the statute. *Id.* at 219-20.

387. *Id.* at 221 (citing N.J. STAT. ANN. § 2A: 84A-20(2)(a) (West) (1994)).

388. 31 U.S.C. § 3730(h) (1994) ("Any employee who is discharged . . . because of lawful acts done by the employee . . . or others in furtherance of an action under this section . . . shall be entitled to all relief necessary to make the employee whole.").

In the case of *X Corp. v. Doe*,³⁸⁹ Doe, X Corp.'s former in-house counsel, had initiated an investigation concerning possible violation of the Federal Acquisition Regulation by supplying the government with equipment containing used or remanufactured parts, rather than the equipment called for in X Corp.'s contract, and by failing to provide the government with notice of the discounts X Corp. provided to commercial customers.³⁹⁰ Doe continued to monitor the progress of the investigation after he was transferred from California to Virginia as a result of his failure to gain admission to the California Bar. Doe advised the general counsel of his concerns regarding X Corp.'s compliance with the federal regulations.³⁹¹ Approximately a year and a half later, Doe's employment was terminated. X Corp. characterized the termination as a lay-off as part of a company-wide reduction in personnel. Doe claimed that he had been discharged in retaliation for actions that X Corp. believed he was taking in further-

389. Although originally under seal, the identity of the parties has subsequently been revealed. "X Corp." is Tandem Computers, Inc., a supplier of computer equipment to the United States Government. See *United States ex rel. Doe v. X Corp.*, 862 F. Supp. 1502 (1994). "Doe" is Mark R. Levin, Esq., a former Deputy Attorney General of the United States, who was an in-house counsel at Tandem responsible for compliance. *Id.* The litigation arose when Tandem, after having laid Levin off from its legal staff, received a letter from Levin asserting a state law wrongful termination claim and enclosing a draft complaint. The complaint contained confidential information. Tandem then filed suit against Levin, under seal, seeking a preliminary injunction against disclosure of its confidential information and the return of documents taken by Levin prior to his termination. The district court enjoined disclosure of the confidential information but declined to order the documents returned. *X Corp. v. Doe*, 805 F. Supp. 1298 (E.D. Va. 1992) [hereinafter "Doe I"]. In further proceedings, the district court granted summary judgment in favor of Tandem as to Levin's claim of retaliatory discharge, permanently enjoined Levin from disclosing Tandem's confidences and secrets and ordered Levin to return Tandem's documents. *X Corp. v. Doe*, 816 F. Supp. 1086 (E.D. Va. 1993) [hereinafter "Doe II"]. The award of injunctive relief, including the return of documents, was subsequently affirmed by the U.S. Court of Appeals for the Fourth Circuit. *X Corp. v. Doe*, 17 F.3d 1435 (4th Cir. 1994). In the meantime, Levin filed a *qui tam* action under the False Claims Act, 31 U.S.C. §§ 3729 *et seq.*, which Tandem eventually settled with the government. *United States ex rel. Doe v. X Corp.*, 862 F. Supp. 1502, 1504 (E.D. Va. 1994) [hereinafter "Doe III"]. Tandem then obtained summary judgment in its favor in Levin's *qui tam* action on the grounds that because of the injunction against disclosure, Levin was not qualified to act as a *qui tam* relator. *Id.* at 1509-10. For convenience, the parties will be referred to as "X Corp." and "Doe" rather than by their true names.

390. *Doe II*, 816 F. Supp. at 1087-88.

391. Doe also expressed his opinion to other members of Tandem's legal department that Tandem was vulnerable to a *qui tam* complaint under the False Claims Act and circulated articles concerning *qui tam* litigation. *Id.* at 1090. However, as the court observed, "Doe never told any member of the legal department or any X Corp. employee that he intended, or even contemplated, filing a *qui tam* action against X Corp." *Id.*

ance of a possible *qui tam* suit.³⁹² The court held that Doe was required to establish a causal relationship between his termination and his purported activities in furtherance of a *qui tam* suit,³⁹³ and Doe had failed to demonstrate such a causal relationship.³⁹⁴

Other courts have read the whistleblower provisions of the False Claims Act more expansively, however. For example, in *Neal v. Honeywell, Inc.*,³⁹⁵ False Claims Act whistleblower protection was extended to an employee who had made an internal report of fraud but who had not filed a *qui tam* action (and who claimed that her employer had improperly failed to apprise her of her right to file a *qui tam* action). Neal was employed by Honeywell at the Joliet army arsenal plant administered by Honeywell. Neal reported to Honeywell's legal counsel that test data were being falsified. As a result of Neal's report and the internal investigation that ensued, Honeywell disclosed the fraud to the government and ultimately two Honeywell employees pleaded guilty to criminal fraud charges and Honeywell entered into a \$2.5 million False Claims Act settlement with the United States.³⁹⁶

392. *Id.* Under the False Claims Act, individuals or entities are authorized to bring actions in the name of the United States for damages. 31 U.S.C. § 3730(b) (1994) ("A person may bring a civil action for a violation of § 3729 for the person and for the United States Government."). The Act provides for the recovery of treble damages, and in the case of a recovery, the *qui tam* relator is entitled to between 15% and 25% of the proceeds of the action. 31 U.S.C. §§ 3729(1), 3730(d) (1994). Lawyers and law firms have filed actions as *qui tam* relators. *See, e.g.,* *United States ex rel. Kriendler & Kriendler v. United Technologies Corp.*, 985 F.2d 1148 (2d Cir. 1993); *United States ex rel. John Doe v. John Doe Corp.*, 960 F.2d 318 (2d Cir. 1992); *Houck ex rel. United States v. Folding Carton Admin. Comm.*, 881 F.2d 494 (7th Cir. 1989); *United States ex rel. Stinson v. Provident Life & Accident Ins. Co.*, 721 F. Supp. 1247 (S.D. Fla. 1989).

393. Thus, the court observed that to prevail, "Doe must establish that his acts can be construed as taken in furtherance of a *qui tam* action because no retaliatory discharge is established if Doe's discharge simply resulted from an adverse reaction to persistence in urging compliance." *Doe II*, 816 F. Supp. at 1096.

394. In this regard, the court noted:

[W]hile Doe alleges that he took certain actions that X Corp. could have construed as acts in furtherance of a *qui tam* suit, it appears that Doe, as corporate counsel, did not take these in order to facilitate a *qui tam* suit, but to prod X Corp. to pursue compliance efforts more vigorously.

Id. at 1095. With respect to Doe's comments concerning possible *qui tam* liability and Doe's circulating articles regarding *qui tam* suits, the court concluded that "[t]hese actions . . . represented no more than Doe's efforts to fulfill his responsibility to raise relevant legal issues." *Id.* at 1095-96. The court further concluded that "[t]hese actions do not suggest that Doe had brought a *qui tam* action, nor that he even contemplated bringing such an action." *Id.* at 1096.

395. 33 F.3d 860 (7th Cir. 1994).

396. *Id.* at 861.

In her suit against Honeywell, Neal contended that as a result of her report and the events that followed, she had been harassed and threatened to the point of resignation.³⁹⁷ Honeywell argued that because Neal had never reported her allegations of fraud to the government or filed a *qui tam* action herself, she was ineligible for whistleblower protection, there being no "action" pending.³⁹⁸ Honeywell's construction of the False Claims Act was rejected by both the district court and the court of appeals.³⁹⁹ Instead, it was held that because the whistleblower provisions apply to investigatory activities preceding litigation, Neal's internal report of the fraud was protected by the False Claims Act.⁴⁰⁰ The broad construction of the False Claims Act whistleblower provisions in *Neal* was relied on in two retaliation cases arising in the federal courts of California. In the first, *United States v. Aiello*,⁴⁰¹ the manager of a federally subsidized senior citizen residential complex alleged that the owners of the complex had falsified records in order to make false claims to the Farmer's Home Administration. The manager sued, claiming that she had been fired because she had disclosed the fraud and had testified before the grand jury.⁴⁰² The defendants sought dismissal of the claim because the plaintiff had failed to allege that her termination was in connection with an action "filed or to be filed."⁴⁰³ Citing *Neal*, the district court held that False Claims Act whistleblower protection extends not only to actual *qui tam* plaintiffs but also to those who investigate, testify or who are "otherwise involved" in the filing of an

397. *Id.*

398. *Id.*

399. In this regard, the district court specifically declined to follow *Doe v. X Corp.* Instead, the district court extended whistleblower protection to Neal on public policy grounds:

The False Claims Act is intended to put an end to fraud against the government by encouraging those with knowledge of such fraud to come forward. In order to further that purpose, public policy demands that internal whistleblowers like the Plaintiff in the present case can be protected from retaliation . . . Thus, we hold that the whistleblower protection provision of the False Claims Act forbids discrimination against an employee who has made an intracorporate complaint about fraud against the government.

826 F. Supp. 266, 272-73 (N.D. Ill. 1993).

400. 33 F.3d at 865 ("Neal conducted her own investigation and reported her findings through corporate channels, leading to two additional investigations: one by Honeywell and a second by the Army. The conduct limned in her complaint may reasonably be described as both investigation for and assistance in an action 'to be filed.'").

401. 836 F. Supp. 720 (E.D. Cal. 1993).

402. *Id.* at 722.

403. *Id.* at 723.

action.⁴⁰⁴

In the second, subsequent case, *Clemes v. Del Norte County Unified School District*,⁴⁰⁵ a school teacher who had reported false record keeping in a federally funded program to the school administration and to the government (the district attorney and the U.S. Department of Justice) was entitled to whistleblower protection despite his not having followed the procedural requirements for filing a *qui tam* action.⁴⁰⁶ Again following the *Neal* decision, the district court held that the whistleblower provisions were to be construed broadly,⁴⁰⁷ and found that Clemes' reporting of the fraud would be sufficient to state a whistleblower claim.⁴⁰⁸

In contrast to *Neal*, *Kent* and *Clemes*, whistleblower protection was denied to a terminated employee in *Robertson v. Bell Helicopter Textron, Inc.*,⁴⁰⁹ where there was no evidence that the employee's supervisors knew that the employee was conducting an investigation outside the scope of his normal duties. There, Robertson, a senior contracts administrator, attempted to substantiate a request to the government for additional funds by requesting documents and information from managers in different departments of the company. Robertson also raised cost charging issues with his supervisors on a regular basis. After he was laid off, Robertson claimed that he had been retaliated against because of his "investigation" and reports to management and because he had refused to perform an illegal act requested by the company.⁴¹⁰ Both the district court (which granted defendants'

404. *Id.* at 723-24.

405. 843 F. Supp. 583 (N.D. Cal. 1994).

406. *Id.* at 595.

407. *Id.* at 595-96. The court in *Clemes* noted that:

Whistleblower statutes have traditionally been broadly construed, *see Neal v. Honeywell, Inc.*, . . . and this court sees no reason to break from tradition in this instance in order to read the statute in a manner which its plain language does not support. Other courts to consider the issue have reached the same conclusion that the retaliation provisions of the False Claims Act are available to whistleblowers whether or not they have pursued a *qui tam* action or taken the steps outlined in 31 U.S.C. § 3730(b).

Id. (citation omitted).

408. *Id.* at 596. The court noted that:

Mr. Clemes alleges that he brought evidence of fraud against the government to the attention of his immediate supervisors, as well as to state officials and the Department of Justice. On the basis of these facts, this court is unable to say that Mr. Clemes can prove no set of facts that would entitle him to relief under 31 U.S.C. § 3730(h).

Id.

409. 32 F.3d 948 (5th Cir. 1994).

410. *Id.* at 949-50. Robertson had expressed concerns about requests for funds with-

motion for judgment NOV) and the court of appeals (which affirmed the district court) disagreed that Robertson's activities were protected under the False Claims Act. Unlike *Neal*, *Kent* and *Clemes*, where plaintiffs had expressed their concerns about possible fraud to management, Robertson had offered no evidence that either his supervisors or the company was aware of any activity on Robertson's part in furtherance of a *qui tam* action.⁴¹¹ Accordingly, Robertson's actions were "qualitatively different" from those in *Neal*, *Kent* and *Clemes*, and his reporting did not rise to protected activity under the False Claims Act.⁴¹²

Thus, although whistleblower protection may not be strictly predicated on the actual filing of a *qui tam* action under the False Claims Act (as suggested in *Doe*), there must be a causal relationship between plaintiff's False Claims Act-related activities and the alleged retaliation by the defendant employer. In this regard, as in *Robertson*, when the plaintiff's activities do not put the employer on notice that the plaintiff is engaging in protected activity (i.e., because the plaintiff's actions were all in the ordinary course of the plaintiff's duties or because the plaintiff did not specifically report fraud or illegality to management) there will be insufficient evidence of retaliatory intent and thus, the required causal connection will be missing.

Nevertheless, because in-house counsel plainly can engage in protected False Claims Act activity, including the filing of a *qui tam* complaint, where in-house counsel can establish the required retaliatory intent by demonstrating a causal connection between counsel's termination and protected activity, in-house counsel should be able to avail themselves of the whistleblower protections of the False Claims Act to be made whole for damages resulting from retaliatory termination.

out verification. When he was asked to write a letter requesting an additional \$2 million for unanticipated maintenance and repair in connection with two contracts, Robertson refused. Robertson's performance rating was subsequently lowered (due to tardiness and difficulty in communicating effectively) and he was later laid off as part of a general reduction in the work force. *Id.* at 950.

411. *Id.* at 951.

412. *Id.* The *Robertson* court stated that:

In the cases cited [*Neal*, *Kent* and *Clemes*], the employees did not file *qui tam* actions, but they did express concerns about possible fraud to their employers. By contrast, in this case, Robertson admitted that he never used the terms "illegal," "unlawful," or "*qui tam* action" in characterizing his concerns about Bell's charges. Thus, Robertson's reporting was qualitatively different than the reporting that occurred in the cases he cites. As a result, we conclude that Robertson's reporting did not constitute protected activity under the False Claims Act.

D. *Protecting Confidential Information in the Face of a Wrongful Termination/Retaliatory Discharge Claim*

The disclosure of confidential information in the course of attorney-client litigation has been a matter of significant concern to courts. Some courts have viewed the risk to the attorney-client relationship, resulting from possible disclosure of client confidences, too great and for that reason have denied in-house counsel recourse in the courts for wrongful termination or retaliatory discharge.⁴¹³ Other courts, however, have found the possible disclosure of client confidences not to be a bar to an attorney's ability to vindicate rights through litigation.⁴¹⁴ To a great extent, however, whether disclosure of client confidences will be permitted turns on whether the confidential information is used offensively or defensively by the attorney.

When a former in-house attorney endeavors to support a claim against a former employer, the employer has several remedies available to limit or prevent disclosure of its confidences. Thus, in the *X Corp. v. Doe* litigation discussed above, X Corp. sought and obtained injunctive relief against Doe after X Corp. learned that Doe had provided the government with confidential information in connection with a *qui tam* action Doe was filing against his former employer.⁴¹⁵ The court found that X Corp. had met its burden to show irreparable injury since, "[o]nce confidential attorney-client communications are disclosed, their confidential nature is permanently and irrevocably impaired."⁴¹⁶ The court also concluded that X Corp. would not be required to demonstrate a likelihood of success on the merits because X

413. See, e.g., *Balla v. Gambro, Inc.*, 584 N.E.2d 104 (Ill. 1991).

414. See, e.g., *Doe v. A Corp.*, 709 F.2d 1043, 1050 (5th Cir. 1983). The court in *Doe v. A Corp.* held that:

The district judge granted summary judgment on the basis that Doe's prior representation of A Corporation was a *per se* bar. A lawyer, however, does not forfeit his rights simply because to prove them he must utilize confidential information. Nor does the client gain the right to cheat the lawyer by imparting confidences to him.

Id.

415. At the time he left X Corp., Doe took with him approximately 4,300 pages of documents from X Corp.'s files which he claimed supported his contention that X Corp. had engaged in fraud in connection with its government contracts. Doe based his report to the government in support of his *qui tam* complaint on these documents. Doe also provided the government with a copy of his state law wrongful termination complaint which contained confidential information. X Corp. learned of Doe's intent to disclose its confidences when Doe's counsel sent a letter to X Corp. asserting Doe's state law wrongful termination claim and enclosing a draft of Doe's complaint. *Doe I*, 805 F. Supp. at 1301-02.

416. *Id.* at 1304.

Corp.'s complaint raised "grave or serious questions" concerning "difficult and troubling ethical issues . . ." Accordingly, the court granted an injunction against disclosure of the confidential information.⁴¹⁷

Although X Corp. was unsuccessful initially in obtaining the return of the documents purloined by Doe,⁴¹⁸ in subsequent proceedings Doe was compelled to return the documents to X Corp.⁴¹⁹ In reaching this conclusion the court analyzed what Doe knew (or should have known) at the time of the intended disclosure of the confidential information and whether a reasonable attorney would have found that the information "clearly established" an ongoing or planned fraud.⁴²⁰ Based on that analysis, the court concluded that Doe had failed to show that disclosure was justified in view of the public interest in maintaining client confidentiality.⁴²¹

417. *Id.* Indeed, the court observed, "[f]ew questions are graver or more serious in the practice of law than determining what evidence of crime or fraud justifies a lawyer's disclosure of his client's confidential information." *Id.*

418. *Id.* at 1311-12. The court concluded that because Doe was enjoined from disclosing X Corp.'s confidences, X Corp. was unlikely to suffer irreparable injury if Doe were allowed to retain his copies of the documents. Additionally, the court expressed some question whether X Corp. would prevail on its breach of confidentiality agreement claim upon which X Corp. sought return of the documents. *Id.* Finally, the court also found no "discernable public interest" supporting return of the documents at that stage of the litigation. In the court's view, requiring return of the documents "would merely confer on X Corp. the fruits of victory before they are earned." *Id.* at 1312.

419. *Doe II*, 816 F. Supp. at 1095.

420. *See id.* at 1091-95. As the court had explained in *Doe I*, "X Corp. must show . . . that the communications sought to be protected are 'confidences' or 'secrets' within the meaning of [the] Virginia Code of Professional Responsibility . . .," and once X Corp. met that initial burden of establishing a duty of confidentiality, "the burden then shifts to Doe to show that the material and information he voluntarily disclosed or seeks to disclose 'clearly establish' that during the course of Doe's representation, X Corp. perpetrated a fraud related to the subject matter of the representation upon a third party, namely the federal government." *Doe I*, 805 F. Supp. at 1310. The court emphasized that Doe was required to show "more than mere suspicion of fraud" but rather, Doe had to show that "a reasonable attorney in his position would find the communications at issue to be convincing evidence of the perpetration of a fraud . . ." *Id.* The court in *Doe II* found that X Corp. had met its burden of showing that the communications constituted "confidences" and "secrets" such that the burden shifted to Doe to justify their disclosure. *Doe II*, 816 F. Supp. at 1095. In this respect, the court in *Doe II* stated that:

Initially, the parties disputed whether the documents met the threshold requirement that they represent client "confidences" or "secrets." There is no doubt they do. Many documents reflect information obtained in the context of the attorney-client relationship. Other documents fall within the attorney-client privilege as they relate to advice from attorneys. As a whole, the body of documents clearly constitute and reflect X Corp.'s secrets and confidences.

Id.

421. *Doe II*, 816 F. Supp. at 1095 ("Doe has failed to show that his proposed volun-

An additional consequence of the injunctive relief granted to X Corp., forbidding Doe from disclosing X Corp.'s confidences and compelling Doe to return X Corp.'s documents, was that Doe was foreclosed from being a relator in a *qui tam* action against X Corp.⁴²² The court reasoned in this regard that although Doe's status as an attorney did not prevent him from serving as a relator, he was nevertheless ineligible to do so because he did not possess sufficient information which he could disclose, consistent with his professional duties, to form a sustainable *qui tam* complaint against X Corp.⁴²³

Thus, an employer faced with disclosure of its confidences and secrets by its counsel offensively, whether in support of a wrongful termination/retaliatory discharge suit or a *qui tam* action under the False Claims Act, may seek injunctive relief preventing disclosure and requiring the return of its documents. However, when counsel proposes to disclose confidential information defensively, for example, to defend against allegations of misconduct or lack of competence, the analysis is quite different.

Both the Model Code and the Model Rules allow an attorney to disclose client confidences defensively. Under the Model Code, a lawyer may reveal the secrets and confidences of a client where necessary "to defend himself or his employees or associates against an accusation of wrongful conduct."⁴²⁴ Similarly, the Model Rules allow the disclosure of confidential information "to the extent the lawyer reasonably believes necessary . . . to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client."⁴²⁵ Courts, as well, have upheld disclosures

tary disclosure is justified given the compelling public interest in preserving the integrity of the attorney-client relationship. Given this, the disputed documents must be returned and Doe permanently enjoined from voluntarily disclosing X Corp.'s confidences and secrets.").

422. *Doe III*, 862 F. Supp. at 1510.

423. *Id.* The court in *Doe III* held that:

In sum, neither Doe's status as an attorney, nor his use of a letter referencing the material contained in the complaint as his "written disclosure," bars Doe from serving as a relator in this action. Doe cannot be a relator in this action for the sole reason that he does not possess enough information that he may legally disclose to form the basis of a valid complaint against X Corp.

Id.

424. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 4-101(C)(4) (1980).

425. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6(b)(2) (1995). The Comment to Model Rule 1.6 notes that:

when necessary to defend against suits by former clients.⁴²⁶ Thus, the employer wishing to discharge in-house counsel must exercise care in the manner in which that discharge is justified in order to safeguard against defensive disclosure of its confidences and secrets by its former counsel.

CONCLUSION

The foundation of the attorney-client relationship is the lawyer's duty of loyalty to the client. From that primary duty flow other ethical duties a lawyer owes the client such as avoiding self-dealing and preserving client confidences and secrets. This fundamental ethical obligation (and its progeny) runs to all lawyers whether the lawyer represents multiple clients, each of whom have individual claims to the lawyer's undivided loyalty, or whether the lawyer represents one institutional client, the lawyer's employer.

When, however, the lawyer becomes aware of client misconduct in the course of the lawyer's representation, what once seemed to be a bright line principle of client loyalty and confidentiality becomes much more vague. The lawyer may also be confronted with possible conflicting ethical and legal obligations regarding disclosure of the wrongdoing. The ethical and legal ambiguity is only heightened for the in-house lawyer who may serve as both counsel and manager of the entity.

As a result of that dual role of lawyer and manager, in-house counsel must always be mindful of who the client is. Both the Model Code and the Model Rules are clear and categorical that for in-house counsel, the client is the corporate entity and not the individuals through which the corporation thinks and acts. In practice, however, the distinction between the corporation and its senior management is more theoretical than real, particularly in the eyes of management who do not labor under such a distinction between themselves and the corporate entity

Where a legal claim or disciplinary charge alleges complicity of the lawyer in a client's conduct or other misconduct of the lawyer involving representation of the client, the lawyer may respond to the extent the lawyer reasonably believes necessary to establish a defense. The same is true with respect to a claim involving the conduct or representation of a former client.

MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 cmt. (1995).

426. See, e.g., *Heartbreak Cabaret Corp. v. Cruz & Toledo Restaurant*, 699 F. Supp. 1066, 1070 (S.D.N.Y. 1988) ("As a matter of common sense, when a former client sues his former attorney, the client places the attorney in a position where previously confidential communications must be revealed to trial counsel defending the attorney in the suit.").

and who quite naturally view corporate counsel as one of them. For that reason, in-house counsel must take pains to make it clear in the first instance and to remind their management colleagues thereafter that when functioning as a lawyer, in-house counsel's ethical loyalties and fiduciary obligations run to the corporation and not to them.

The divergence of collegiality and loyalty is most poignant when in-house counsel wrestles with disclosure of misconduct by those acting on behalf of the corporation. Here again, the Model Code and Model Rules propose a course of conduct the practical consequences of which, for in-house counsel, were either not contemplated or were ignored by their authors.

The ethical obligation of in-house counsel who has reason to believe that the corporation is acting illegally is to rectify the situation. Counsel is admonished by the Model Rules to seek reconsideration of the decision resulting in the illegality. Failing in that, counsel is then to evaluate the matter to higher authority in the organization up to the highest authority in the organization, ordinarily the board of directors. In order to do so, however, counsel will disclose information to higher management or to the board that may have been imparted to the lawyer in the belief that the information would be treated confidentially. To avoid such a misperception (and to avoid an inadvertent creation of an attorney-client relationship between in-house counsel and an individual), in-house counsel must make it clear that the counsel represents the corporation and not any individual and for that reason, the information provided to in-house counsel will be disclosed to others in the management of the corporation.

If the Chief executive officer or the board of directors rejects counsel's advice and declines to cease the unlawful practice, counsel must confront several courses of action, none of which are pleasant.

Counsel must resolve whether to disclose the client's illegality to the government (if the corporation engaged in regulated activities) or to private third parties. Although again, the Model Code and the Model Rules address such disclosure under limited circumstances and provide that disclosure of client confidences is permissible, if at all, generally only to prevent death or serious bodily injury. Government agencies and private litigants have viewed counsel's disclosure obligations much less restrictively, however.

Government regulatory agencies, such as the SEC and the OTS, have aggressively sought to impose on corporate counsel an obligation to disclose (or at least not to withhold) information

concerning their clients' violations of the law or the regulations that the agencies enforce. Counsel who remain silent concerning their clients' violations (past, current or future) risk having that silence viewed by these agencies, and private litigants, as being in furtherance of their clients' continuing and future illegality, thereby giving rise to counsel sharing in liability for their clients' misconduct. Additionally, counsel whose involvement in a transaction is considered essential to the transaction's consummation (i.e., the "passkey") also risk being viewed as a direct participant in the transaction and therefore individually liable for improprieties in the transaction. The risk to in-house counsel is even greater in this regard due to in-house counsel's direct involvement in management of the corporation in addition to their role as attorneys. Thus, the in-house counsel faced with client intransigence may have no real alternative but to disclose the client's confidential information in order to avoid personal liability for the client's misconduct, notwithstanding counsel's ethical obligations to the contrary.

Further, when the corporation's executive management declines to abandon the illegal conduct, both the Model Code and the Model Rules direct counsel to withdraw from the representation of the corporation. Compliance with ethical standards of conduct is cold comfort to in-house counsel whose only client is the corporation and who thus faces the prospect of immediate unemployment, and possibly the end of a career, if counsel is ethically obliged to withdraw.

In those circumstances, in-house counsel who must "withdraw" in order to comply with counsel's ethical obligations, as well as to avoid personal culpability, would be justified in the view that rather than being a voluntary act, counsel's resignation was compelled by the corporate employer, in effect, a constructive discharge.

Should in-house counsel have recourse, therefore, against the "scoundrel" client? The prevailing view appears to be that because a lawyer's employment is at the will of the client, in-house counsel can be discharged (actually or constructively) at any time. Courts that have considered wrongful termination and constructive discharge claims by former in-house lawyers have hewed to this traditional view and have denied relief. An emerging line of cases, however, have held that while clients are always free to discharge their in-house counsel, they may nevertheless be held accountable for the consequences of their actions and when the loss of employment is the result of in-house counsel's ethical obligations, counsel have been allowed to recover damages. It remains to be seen whether this view will prevail.