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"There is, perhaps, no profession, after that of the sacred ministry, in which . . . morality is more imperatively necessary than that of the law. There is certainly . . . no profession in which so many temptations beset the path to swerve from the line of strict duty and propriety . . . ."

The Hon. George Sharswood

INTRODUCTION

The modern lawyer can barely be recognized as the descendant of the law students at the University of Pennsylvania to whom Judge Sharswood delivered his lectures in 1854. The lawyer's offices, functions, and clients have been altered fundamentally by rapid developments in transportation, communications, and the law itself. Despite those changes, however, the specific standards that ostensibly govern the modern lawyer's behavior, delineated in the Code of Professional Responsibility (Code), are unquestionably the natural offspring of Judge Sharswood's work. The changes in the world to which it is addressed have had minimal impact on the Code itself.

In the abstract, of course, there may be no reason for change. Our basic notions of morality do not necessarily shift over time. Murder, robbery, and the like remain as criminal today as they were in 1854, and properly so. The Code, however, is not a compilation of abstract principles, but is rather a statement of propriety *as applied* to the practice of the legal profession. That substantial changes have occurred in the nature of that practice should therefore suggest the need for a reappraisal of the Code's precepts. This Article will address one area in which that need is particularly apparent, the emergence of the lawyer who functions primarily as an adviser rather than in the traditional role of advocate. This development, attended by the growth of the corporate client and of the large law firm, has

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outstripped the ability of the present Code to provide meaningful ethical guidance to the modern corporate attorney.

The need for organized reappraisal becomes even more apparent when it is recognized that in its absence the courts, regulatory agencies, and even segments of the bar and other professions have developed, on a relatively haphazard basis, new concepts of the duties and responsibilities of corporate advisers. It is the thesis of this Article that we, as a society, need to make deliberate decisions about the proper role of the corporate adviser, and, when that function has been defined, to develop a structure within which it can be performed. As the Article makes clear, the logical choices involve what might be described as either revolutionary change or reactionary change. That is, the current trends should either be accelerated or reversed; the present situation is intolerable. While the author will contend that the case for shifting into reverse is more persuasive, getting into a gear, and out of the current "neutral drift," is probably more important than the selection of the appropriate gear.

The specific question to which much of this Article is addressed is whether the corporate adviser's present—or at least recently past—role as confidant of management, exercising independent judgment and moral suasion to affect client behavior, should be changed, as it is now changing, to a function autonomous[1] of management, with primary loyalty to the general public. The development of that public function is probably most apparent in the treatment of securities lawyers, and it is upon them that the Article will focus. It should be obvious, however, that the factors influencing the role of the securities law adviser eventually will also affect the tax lawyer, the antitrust adviser, the estate planner, and all other practitioners whose function is advisory rather than adversary in nature. Whatever role it is that we desire corporate advisers to fill, there is a desperate need for a new Code to reflect their appropriate duties; that, too, is given attention in this Article.

The question of proper behavior for the lawyer arises primarily in the context of a conflict between the goals and desires of the lawyer's client, as articulated by its management, and the broader public interest. That is, if the client proposes behavior that may be characterized as antisocial, what is the duty of the lawyer? Does the lawyer

1. The word "independent" would be, in many respects, more appropriate than the word "autonomous" for the purposes of this Article. I use autonomous, however, to avoid confusion with the sense of "independence" that the traditional lawyer is required to maintain. *See* ABA CODE OF PROFESSIONAL RESPONSIBILITY, CANON No. 5 and the Ethical Considerations thereunder (1977) [hereinafter cited as CODE].

have an obligation to assert the public interest, and, if so, under what circumstances is it superseded by responsibilities to the client? Since neither the duty to public nor the duty to client can simply be discarded, the inquiry turns first to identifying the extent to which the duties are irreconcilable, and, second, to identifying the associated costs of preferring one to the other. This issue must certainly be addressed against a background of an increasing societal emphasis on the public nature of the corporate lawyer's responsibilities.

Some aspects of the corporate adviser's changing function already have been the subject of fairly intense debate. To date, however, that debate has not been fruitful, for the parties to it have tended to focus attention on relatively narrow issues, and neither side has been truly responsive to the other. Specifically, the publicity attending the filing of the complaint by the Securities and Exchange Commission (hereinafter referred to as the SEC or the Commission) in the *National Student Marketing*[2] case generated considerable heat, though much less light, concerning the lawyer's obligation to "turn in" or "squeal on" the client. Those supporting the SEC's general position emphasized the need for lawyers to protect the public and the importance of lawyer involvement for the effective operation of the securities laws.[3] The opposition invariably stressed the potential destruction of the client's willingness to impart confidences to attorneys.[4] Neither side confronted the other except to claim that "my concern is more important" or, occasionally, to assert that the two views were not really incompatible and that the argument was not really that important.[5]

Meanwhile, with considerably less attention to the implications for the corporate lawyer, the American Institute of Certified Public Accountants (AICPA) and the American Bar Association (ABA) reached a settlement of a substantial dispute, significant cases and administrative proceedings against lawyers were filed or decided and, recently, one of the major law firm defendants in *National Student Marketing* settled that case through adoption of specified internal procedures. Though each of those developments evidences that

2. Complaint, SEC v. National Student Marketing Corp., [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,360 (D.D.C. 1972).

3. *See, e.g.*, Garrett, *New Directions in Professional Responsibility*, 29 BUS. LAW. 7, 10-12 (1974). *See also* SEC v. Spectrum, Ltd., 489 F.2d 535, 536 (2d Cir. 1973); *Corporate Governance—New Heat on Outside Directors?*, FORBES, Oct. 1, 1977, at 33 (interview with present chairman of the SEC, Harold M. Williams).

4. *See, e.g.*, Daley & Karmel, *Attorneys' Responsibilities: Adversaries at the Bar of the SEC*, 24 EMORY L.J. 747 (1975).

5. *See* Sommer, *Introduction, Symposium: Enforcement of the Federal Securities Laws*, 24 EMORY L.J. 557, 563-66 (1975).

the role of the corporate lawyer is, indeed, shifting, it is clear that they have not emerged from a thoroughgoing consideration of the corporate adviser's social function.

This Article examines these developments with a view to the environment within which the corporate legal adviser works and to the alternative roles such lawyers might logically fill. Building upon that analysis, the Article proposes how best to select the role and to create the environment in which the corporate lawyer can reasonably fulfill societal expectations. Before undertaking that analysis, however, it may be useful, in view of the confusion surrounding many of the issues in this area, to make several preliminary observations.

Liability of Lawyers Is Not the Issue. Many analyses of issues such as those discussed in this Article tend sooner or later to focus on the question "when is the lawyer liable?" That is, of course, a legitimate approach, and the results of such analyses are obviously important to members of the profession. But to focus upon that question creates the danger that historical roles will be viewed as unchangeable, which, of course, they are not. That is, when the lawyer asks for what actions a lawyer should be liable, the unavoidable inclination is to personalize the question: "Should *I* be held liable if I do that?" And the answer, then, tends to assume the lawyer's historical role: "No (or yes), because I have always viewed my role as being __." Thus, notwithstanding the obvious relationship between establishing standards for lawyers and the imposition of liability when they are not met, this Article focuses solely on what should be the role of the corporate adviser, and not on what are the appropriate standards of liability.

There Will Always Be Pressure To Alleviate the Visible Harm. There is an inevitable emotional desire to eliminate that harm which is seen. As a result, if it is determined—as this Article suggests it should be—that confidentiality is of societal value and that the role of the lawyer should not change, the pressure for such change will not simply disappear. If we uphold confidentiality as a value, we also guarantee that there will be future cases in which investors will lose money, or taxes will not be paid, or other social harm will occur that could have been prevented if a lawyer had breached a confidence. But though such losses are, in one sense, the inherent cost of confidentiality, a disclosure obligation will eliminate them only until the requirement becomes generally known and clients stop confiding in their lawyers. Thus, society protects confidentiality in situations such as where the client confesses guilt to the lawyer because of its recognition that a disclosure requirement would have only short-term benefits while the loss of confidentiality would be permanent.

However, as long as there is an emotional environment against confidentiality, there will be courts that in some circumstances will rule with the emotional pressure. Consequently, a statutory mandate is probably the only means by which the confidentiality principle can be effectively safeguarded.

The Individual Lawyer Cannot Act Alone. One of the reasons that this Article rejects the common-law development of the role of the corporate lawyer is that it makes it difficult for the individual lawyer —or firm—to respond to change. No matter how clear it may become that the corporate legal adviser is the equivalent of a "Certified Public Lawyer," with primary obligations to the public, the first lawyer who honestly and openly adopts that mantle would be without clients shortly. The rational client is likely to prefer the lawyer who will preserve confidences to the one who will not. It follows that the bar must respond to the problem with relative uniformity.

The Historical Role of the Lawyer Has Been Beneficial. In any analysis such as this, the cases available for review are typically those in which lawyers have acted poorly or, at the least, have not sufficiently improved the behavior of their clients. Too much attention to those cases tends to create a rather dim picture indeed of the corporate lawyer—particularly when viewed in the light of the general public skepticism directed at lawyers following the Watergate scandal and its related developments. If that picture were accurate, there would be no question that the role of the corporate lawyer should be dramatically altered. But it is not accurate. While there are no reliable data, it is clear that most corporate lawyers try to persuade their clients to operate in a socially desirable manner and, indeed, that most corporate clients naturally tend to so operate. The usual case of antisocial behavior is the result of oversight, not intent, and the lawyer is generally successful in correcting it. Unfortunately, the nature of the lawyer's role is such that its benefits are seldom seen while its failures attain high visibility.

I. Where We Were

A. *The Historical Role of the Lawyer and His Ethics*

It is not the function of this Article to trace the heritage of lawyers in the common-law system or to examine the gradual development of the notions of proper or "ethical" behavior for those engaged in the practice of law. However, since it *is* the purpose of this Article to analyze the role of the lawyer and the lawyer's professional obligations, it is necessary to have at least a minimal understanding of the background of legal ethics, and of how the Code came to be what it is, before analyzing the question of what the role of the lawyer should be for the future, and how a new code might be developed to reflect that role.

It is generally accepted that the progenitor of our notions of legal ethics, at least as a relatively specific compilation of standards, was Judge George Sharswood, who in 1854 made public his lectures given on that topic to the law students at the University of Pennsylvania.[6] A review of that volume is surprisingly useful in isolating the sources of many of our notions of proper behavior for lawyers. Of course, Judge Sharswood's work cannot stand today as a complete authority on legal propriety. The world has changed much in one and one-quarter centuries, and some of the norms accepted by Judge Sharswood have already been rejected. Such, for example, is the case with contingent fees, condemned by Judge Sharswood and now clearly accepted—except in criminal cases—by the Code. Moreover, even to the extent that Judge Sharswood's dictates were accepted as authoritative, their application to many contemporary problems would be unclear. Despite such limitations, however, Judge Sharswood's observations, developed in a much simpler world, remain important to an understanding of our current standards of proper behavior.

Initially, it is noteworthy that Sharswood's volume carries the subtitle "A Compend of Lectures on the Aims and Duties of the Profession of the Law." That subheading itself implies a distinction identified in the Code: that the profession has both aims and duties, that the former are the ideals for which its members should strive, and that the latter are the minimum obligations for the breach of which discipline may be imposed. This analysis suggests—as noted in the introduction to this Article—that it is an error of significance to evaluate the proper, desired role of the lawyer primarily by examining cases concerned with the issue of liability. In the same sense, if the development of the role of the securities lawyer is to take place through the common-law method of case-by-case decision, attention likely will be given only to the minimum level of required behavior, since only behavior tending toward that level will be the subject of litigation.

6. G. SHARSWOOD, PROFESSIONAL ETHICS (1854).

One need go no further than the initial two sentences of Judge Sharswood's lecture to recognize that the problems to which he addressed himself remain in essence those with which we are now confronted: "there is, perhaps, no profession, after that of the sacred ministry, in which a high-toned morality is more imperatively necessary than that of the law. There is certainly, without any exception, no profession in which so many temptations beset the path to swerve from the line of strict duty and propriety; in which so many delicate and difficult questions of casuistry are continually arising."

That quotation, of course, does not answer any of the questions with which we are concerned, for the primary difficulty is in determining exactly what the "line of strict duty and propriety" is and to whom that duty runs. However, Judge Sharswood's suggestion that there is in all of us a natural temptation to avoid the difficult decision and, in context, to leave the decision to the client, is an important one when lawyers are concerned with the ethical standards for lawyers. If we choose to call ourselves a profession, with all that is implied in that word, we cannot avoid the responsibility with which we are faced. As former Commissioner Sommer has observed, the legal profession does not consist merely of highly paid scriveners, but of people called upon to exercise professional judgment.[7] It is equally important, however, to realize that acceptance of that duty does not by itself dictate that all significant questions are to be decided by the lawyer. There are certainly instances in which deferring to the client is not an abdication of duty but an adherence to it. Indeed, the difficult duty may sometimes be to accept the client's decision that runs contrary to the lawyer's judgment. Thus, one of the functions of a code of responsibility is to indicate the circumstances in which deferral to the wishes of the client is required.

Perhaps the most significant legacy left to us by Judge Sharswood is his recognition of the importance—though not exclusive importance—of the lawyer's duty to the client. "[T]he great duty which the counsel owes to his client, is an immovable fidelity."[8] But Judge Sharswood was also aware of the conflicts that plague us today and that have always created public concern with the lawyer's role. That is, the acceptance of confidentiality as a norm inevitably results in cases where a breach of confidence would have furthered justice:

7. Speech by A. Sommer, Emerging Responsibilities of the Securities Lawyer (January 1974), *reprinted in* [1973-1974 Transfer Binder] FED. SEC. L. REP.(CCH) ¶ 79,631, at 83,689.

8. G. SHARSWOOD, *supra* note 6, at 50.

[W]hat are the limits of his duty when the legal demands or interests of his client conflict with his own sense of what is just and right? This is a problem by no means of easy solution.

That lawyers are as often the ministers of injustice as of justice is the common accusation in the mouth of gainsayers against the profession. It is said there must be a right and a wrong side to every lawsuit. In the majority of cases it must be apparent to the advocate, on which side the truth and justice of the cause lie; yet he will maintain, and often with the appearance of warmth and earnestness, that side which he must know to be unjust, and the success of which will be wrong to the opposite party. Is he not then a participator in the injustice?

It may be answered in general:—

Every case is to be decided by the tribunal before which it is brought for adjudication upon the evidence, and upon the principles of law applicable to the facts as they appear upon the evidence. No court or jury are invested with any arbitrary discretion to determine a cause according to their mere notions of justice. Such a discretion vested in any body of men would constitute the most appalling of despotisms. Law, and justice according to law—this is the only secure principle upon which the controversies of men can be decided. It is better on the whole that a few particular cases of hardship and injustice, arising from defect of evidence or the unbending character of some strict rule of law, should be endured, than that general insecurity should pervade the community from the arbitrary discretion of the judge.

Now the lawyer is not merely the agent of the party; he is an officer of the court. The party has a right to have his case decided upon the law and the evidence, and to have every view presented to the minds of his judges, which can legitimately bear upon that question. This is the office which the advocate performs. He is not morally responsible for the act of the party in maintaining an unjust cause, nor for the error of the court, if they fall into error, in deciding it in his favor. . . . The lawyer, who refuses his professional assistance because in his judgment the case is unjust and indefensible, usurps the function of both judge and jury.[9]

Still, Judge Sharswood was careful to enunciate that the lawyer is not solely responsible to the client. He quoted Chief Justice Gibson: "The high and honorable office of a counsel would be degraded to that of a mercenary, were he compelled to do the biddings of his client against the dictates of his conscience." To adopt the contrary view—to "suppose that a lawyer owes no fidelity to anyone except his client, and that the client is the keeper of his professional conscience"—is a "popular but gross mistake."[10] Thus, the conflict is framed: the lawyer owes "immovable fidelity" to the client, but is

9. *Id.* at 24-26.
10. *Id.* at 35-36.

not to let the client be the "keeper of his professional conscience," and must at all times be wary of "temptations . . . to swerve from the line of strict duty and propriety."

By the third edition of his work, Judge Sharswood had added forty-five pages analyzing the duties of the lawyer to the public. He commences that discussion with the following pertinent language: "The dignity and importance of the Profession of the Law in a public point of view, can hardly be over-estimated. It is in its relation to society at large that it is proposed to consider it."[11] Though the extent of Judge Sharswood's recognition of a lawyer's public responsibility may be easily exaggerated, his analysis does provide a historical antecedent for those who would argue the primacy of the public responsibilities of the lawyer. Without question, Judge Sharswood would not have considered the public responsibility of the lawyer to embrace all that some commentators today have suggested. However, he did recognize, even then, that the duties of the lawyer do not begin and end with the client and that it is not sufficient to consider representational interests alone in an analysis of the lawyer's behavior. The "line of strict duty" includes some sense of a public duty.

But the flaw in the Sharswood analysis, when used as a framework from which to extract conclusions about the duties of all lawyers in 1978, is apparent. To Judge Sharswood, for obvious reasons, the lawyer was an advocate in an adversary system whose duties related solely to that function. His entire analysis is developed in the context of litigation, and thus the Judge focused on the lawyer's relationship to the tribunal, to opposing counsel, and to the client who is a plaintiff or defendant. For Judge Sharswood, in 1854, that mode of

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11. G. SHARSWOOD, PROFESSIONAL ETHICS 9 (3d ed. 1869).

The significance of that observation can perhaps be seen from the following exchange, over a century later, concerning the responsibilities of the securities lawyer. That discussion, which took place at the Practising Law Institute's Sixth Annual Institute on Securities Regulation, was between Irving M. Pollack, a Commissioner of the SEC, and Donald J. Evans, a Boston attorney. Commissioner Pollack had previously referred to the lawyer's client as being "the corporation and the public," and Mr. Evans questioned that description:

"MR. EVANS: Did you really mean to say that the public is the lawyer's client? That is far broader than Ray Garrett [then Chairman of the SEC] ever suggested and certainly much broader than what the Code of Professional Responsibility indicates.

"COMMISSIONER POLLACK: [H]is client is the corporation, but he has a public responsibility . . . ."

PRACTISING LAW INSTITUTE, SIXTH ANNUAL INSTITUTE ON SECURITIES REGULATION 218-19 (R. Mundheim, A. Fleischer, Jr., J. Schupper, J. Jewett & J. Thomson eds. 1975) [hereinafter cited as SIXTH ANNUAL INSTITUTE].

Of course, the recognition of Judge Sharswood in one context of a public responsibility and the view of Commissioner Pollack in another does not suggest that Commissioner Pollack must be right, or even that the Judge would agree with the Commissioner.

analysis was unquestionably correct. But to apply it in 1978 to all persons who fit within current perceptions of the function of lawyers demands more than a historical justification. The corporate adviser is not, by and large, part of an adversary system, and frequently is not an advocate.

If, then, the duties and responsibilities of the corporate adviser are to be similar to those of the advocate, it must be for reasons that are sensible in the present environment. That is not to say that we should be surprised if the adviser's duties remain similar to those of the advocate, for the function of the corporate adviser evolved out of the adversary framework, and it may well be that society selected lawyers to serve as advisers because of the traditional adversary-oriented principles that dictated their behavior. But the question is at least open for debate, and even if we conclude that the adviser's duties are similar to those of the advocate, there are compelling reasons why the Code should not apply to the lawyer as adviser. For, as the next section of the Article will make clear, the Code that developed out of Judge Sharswood's analysis does not provide meaningful guidance for the actual conduct of the adviser. Thus, whatever is ultimately concluded about the adviser's role, a new code is needed to govern the adviser's conduct in fulfilling that role.

B. *The Code of Professional Responsibility*

The organized bar's first formal code of ethics, based largely on Judge Sharswood's work, was adopted by the Alabama State Bar Association in 1887. Following in the same mold, the American Bar Association in 1908 promulgated the original thirty-two canons of professional ethics.[12] Those canons, as more clearly delineated by subsequent opinions of the Committee of Professional Ethics and Grievances, remained in force until the House of Delegates of the ABA adopted the present Code of Professional Ethics on August 12, 1969, to become effective on January 1, 1970. Developed over a five-year period by the ABA's Special Committee on Evaluation of Ethical Standards, the present Code, although criticized by some,[13] is a noteworthy updating of the ethical standards embodied in the original canons.

Despite its virtues, however, the present Code remains inade-

12. *See* CODE, *supra* note 1, at i. The Code of Ethics of the Alabama State Bar Association of 1887, as amended in 1899, is reprinted as Appendix F in H. DRINKER, LEGAL ETHICS 352-63 (1953).

13. *See, e.g.*, Morgan, *The Evolving Concept of Professional Responsibility*, 90 HARV. L. REV. 702 (1977).

quate as an ethical guide for the corporate adviser.[14] Though it does to some extent distinguish between the duties of the lawyer as advocate and as adviser, the Code, true to its birthright, focuses primarily upon the lawyer serving in the adversary context. In so doing, it fails satisfactorily to resolve many of the truly complex ethical problems facing the corporate adviser.

Equally significant, the Code represents only the views of the ABA. While those views are clearly entitled to significant weight, they are not binding on the courts—except to the extent they have been adopted by state legislatures—or administrative agencies such as the SEC.[15] And even where the Code has been adopted—as it has been in most states—it is not at all clear that it is applicable to the "practice" of "federal law." Thus, it is entirely possible that some courts or the SEC will dictate standards differing in significant respects from those that might be derived from the Code.[16] That risk is necessarily increased to the extent that the Code's dictates are ambiguous, if not equivocal.

Essential to an understanding of the Code is the recognition that it is divided into three bodies of material of varying length: it consists of 9 canons, 137 ethical considerations (ECs) and 40 disciplinary rules (DRs). The canons establish the general normative principles to be followed. The ECs, some of which are set forth under each of the canons, are defined as aspirational in nature; that is, they identify the goals to which professionals should generally aspire, recognizing that "a man's reach should always exceed his grasp, or what's a heaven for."[17] Finally, the DRs, also set forth under each of the canons, are the minimum standards of appropriate behavior, the violation of which subjects attorneys to discipline.[18]

Unfortunately, the nice distinctions between the ECs and the DRs set forth in the preliminary statement to the Code are not universally followed. The DRs tend to be viewed not simply as what

14. *See also, e.g.*, Paul, *The Lawyer as a Tax Adviser*, 25 ROCKY MTN. L. REV. 412, 412 (1953); Sommer, *supra* note 5, at 563-64; Sommer, *supra* note 7, at 83,688; Thode, *The Ethical Standard for the Advocate*, 39 TEXAS L. REV. 575, 578-79 (1961). *But see* Daley & Karmel, *supra* note 4, at 765; Freedman, *A Civil Libertarian Looks at Securities Regulation*, 35 OHIO ST. L.J. 280, 287 (1974). The Code recognizes the distinction to some extent. *See* Ethical Considerations 7-3, 7-4, & 7-5. *See also* text at notes 105-06 *infra*.

15. D. MELLINKOFF, LAWYERS AND THE SYSTEM OF JUSTICE 637 (1976).

16. *See, e.g.*, Emanuel Fields, Securities Act of 1933 Release No. 5405 [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,407 (June 18, 1973). *Cf.* United States v. Simon, 425 F.2d 796, 805 (2d Cir. 1969) (proof of defendant accountant's compliance with generally accepted auditing standards constitutes persuasive but not conclusive evidence of action in good faith), *cert. denied*, 397 U.S. 1046 (1970).

17. R. BROWNING, *Andrea del Sarto*, in COMPLETE WORKS 346 (1895).

18. *See* The Preliminary Statement of the Code, CODE, *supra* note 1, at 1.

must but also as what *should* be adopted as proper behavior, and the ethical considerations often appear merely as helpful guides in interpreting the disciplinary rules. Indeed, the Code's structure suggests that interpretation—only the DRs are set forth in bold-faced type and they take the form of statutory dictates—as do the several instances where ECs are virtually identical to DRs and where DRs simply state behavior that may be appropriate.

In any event, there are a number of ethical canons, ECs, and DRs ostensibly pertinent to the corporate adviser who perceives a difference between his client's interests and those of the general public. Specifically, five canons, twenty-two ECs and eight DRs are particularly relevant, but only in the sense that *if* the Code is the proper basis for analysis, *then* they are the important provisons of the Code. Thus, they are analyzed here not so much to discern "right" answers to particular ethical questions facing corporate advisers, but rather to present the basic outline of the Code and to consider whether it is actually capable of yielding such answers.

For purposes of examination, it is useful to group the pertinent provisions of the Code into some six categories identifying principles relevant to the conduct of the corporate legal adviser. In discussing those categories it is, of course, important to remember that DR 1-102(a) establishes that it is misconduct, and hence violative of the disciplinary rules, for a lawyer to "violate a disciplinary rule"—an apparent redundancy of unknown implications—and, more important, that it is misconduct for a lawyer to circumvent a disciplinary rule through the actions of another.

1. *The Nature of the Client*

Obviously a critical question in this context—perhaps, depending on the answer, *the* critical question—is "who is the client?" If "the public" can be accepted as the corporate adviser's client, much of this analysis becomes unnecessary. But that view has not yet been formally adopted. EC 5-18 makes clear that in the case of a corporate client it is the corporate entity itself that is the client and not the shareholders, board of directors, management, or any other group. While that concept appears to have been widely accepted, it answers almost no questions. It is not to be supposed that the lawyer for the corporate entity has the right to make decisions for it, and indeed, as discussed below, the lawyer generally has an obligation to defer to the client. How, then, does this "client" make decisions? Probably the answer is that the board of directors represents the client, and that the lawyer should look to the board for guidance. That answer is certainly the one suggested by most state corporate laws. It is also the answer suggested by EC 7-12, which identifies considerations relevant to representation of an incompetent and counsels that the lawyer may look to and rely on the decisions of the incompetent's legal representative. Presumably, the board of directors is the legal representative of the corporation, which is in a meaningful sense "incompetent."

However, while that may provide a general standard, the question raised where the board accepts or approves some level of antisocial behavior is whether the lawyer is entitled to rely blindly on the board of directors or whether, seeing abuse by the board of directors, the lawyer has an obligation to turn to some other source. Could, for example, counsel to the corporation petition a court to mandate a new election of directors? Certainly that novel case has not yet been brought,[19] but, by reference to representation of incompetents, it probably is not improper for the corporate adviser to prompt a change of legal representatives if the legal representative is clearly acting improperly. However, and again by reference both to the law regarding incompetents and to common sense, the standard for determining that the board is so acting must be relatively hard to meet, and the board must be given significant discretion. For the corporate legal adviser acting within the framework outlined above, it probably also follows that, in the case of board misbehavior, no other method of "protecting" the incompetent, such as disregarding the board's directions or taking direct action to protect the incompetent's beneficiaries, can be initiated sua sponte.

If the view is taken that the board of directors *cannot* be accepted as representing the corporation—a view certainly espoused on occasion by some members of the Commission[20]—then we are indeed in a difficult position, for EC 7-18 provides that no communications or advice should be given by counsel to a nonrepresented party, at least if there is any potential conflict, and DR 7-104 (a)(2) sets that forth as a minimal standard of conduct. Thus, if the lawyer cannot rely on the board of directors as representing the client, he probably should not discuss matters with or give advice to the board unless it is represented by separate counsel or makes a knowing waiver. And, while

19. *But cf.* SEC v. Mattel, Inc., [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,807 (D.D.C. 1974) (defendant agreed, under a consent decree, to appoint persons independent of management and satisfactory to the Commission as a majority of its board of directors).

20. *See, e.g.*, Comments of Commissioner Pollack, then Director of the Division of Enforcement, *reprinted in* PRACTISING LAW INSTITUTE, FOURTH ANNUAL INSTITUTE ON SECURITIES REGULATION 192 (R. Mundheim, A. Fleischer, Jr., & J. Schupper eds. 1973) [hereinafter cited as FOURTH ANNUAL INSTITUTE].

such procedures could be adopted to avoid improper communications, it certainly would alarm most corporate boards to learn that they cannot discuss matters directly with corporate counsel, but must retain their own counsel for such purposes.[21]

Furthermore, on what basis can we assume that the entity itself prefers socially beneficial behavior to that which is antisocial? On what basis can we assume that the entity *wants* to disclose anything to anybody? We could construct a presumption that entities created by law "want" to obey the law, but if an action or nonaction has a 40% chance of being viewed by a court as illegal, how does that presumption aid us in determining whether the entity wants to take such actions? Clearly the Code's definition of the corporate client, while theoretically pure, provides little guidance for behavior.

2. *The Lawyer Owes a Client Undivided Loyalty*

It is clear from ECs 5-14 to 5-16 that the lawyer should neither accept employment that would create potentially divided loyalties nor continue employment if a conflict of loyalty actually arises. Those ECs, derived directly from Sharswood's work, are established as minimal standards by DRs 5-101(a) and 5-105. However, the questions raised previously concerning the nature of the corporate client become even more substantial if the loyalty to that client must be "undivided." If the lawyer is to watch out for some group other than the group that hired him and with which he customarily communicates, divisions of loyalty would seem inevitable.

There is, for example, a growing body of law concerning the requirement that perquisites of corporate management be disclosed as remuneration.[22] It is clear, however, that many legitimate business

21. In recent years, of course, similar conflicts have become visible with corporate officers who take actions that are either unauthorized or not clearly authorized and that constitute crimes for the officer and, possibly, for the corporation; the most frequent examples are the cases involving "sensitive" payments by corporations. Similarly, it has long been clear that individual directors might need separate counsel in some situations. However, to suggest the existence of a general conflict between the board and the client is to elevate the particularized, isolated conflict to a general condition requiring permanent dual counsel.

22. *See, e.g.*, SEC v. Sharon Steel Corp., Civil No. 77-1631 (D.D.C., filed Sept. 20, 1977), SEC Litigation Release No. 8119 (Sept. 20, 1977); SEC v. Ormand Indus., Inc., Civil No. 77-0790 (D.D.C., filed May 10, 1977), SEC Litigation Release No. 7910 (May 10, 1977); SEC v. Stephen Kneapler, Civil No. 77-969 (S.D. Fla., filed March 25, 1977), SEC Litigation Release No. 7854 (April 4, 1977); SEC v. Potter Instrument Co., Civil No. 77-0394 (D.D.C., filed March 9, 1977), SEC Litigation Release No. 7816 (March 1, 1977); SEC v. Gould Inc., [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,077 (D.D.C. 1977); Securities Act Release No. 5904 (Feb. 6, 1978), *reprinted in* 2 FED. SEC. L. REP. (CCH) ¶ 23,019A (Feb. 6, 1978); Securities Act Release No. 5856 (Aug. 18, 1977); *In re* Steadman Sec. Corp. (Securities Exchange Act Release No. 13695), [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,243 (June 29, 1977).

expenses, such as those for entertainment, may be viewed as attractive to management without rising to a level requiring specific disclosure, even though material in amount. Indeed, it would seem difficult in many cases to determine the precise point at which the business expense becomes a form of remuneration. In that regard, assume that the remedy for nondisclosure is reimbursement by the recipient, that counsel is present when the board of directors discusses an expenditure of a material amount for which arguable nonremunerative purposes may be present, and that it is clear, because of the nature of the expenditure or the character of the individuals, that counsel will not be able to dissuade the board from making the expenditure, and that any subsequent request for disclosure will be vehemently resisted. If counsel views the board of directors as the client, it would seem proper at the meeting to address the disclosure question, with the likely result that there will be produced in the minutes a substantial discussion of why the expenditure satisfies an important corporate need rather than a management desire. If the public shareholders are viewed as the client, it is arguable that counsel should remain silent at the meeting, thereby increasing the likelihood of prevailing in the anticipated argument with the board over disclosure or reimbursement.

Undivided loyalty, then, is a pristine quality and, though admirable, of unclear meaning in the corporate context when coupled with the confusion surrounding the identity of the "client." In essence, the concept of undivided loyalty derives from adversary considerations; indeed, it is the answer to Sharswood's "gainsayers." But, though it is meaningful in the adversary context to establish that the lawyer's specific duty to the client supersedes any general duty to justice (within prescribed limits) and that the client is entitled to full and undivided representation, the corporate adviser's duty to the client is much more ambiguous.

3. *The Duty To Be Free from Influence*

There has always been recognized a duty of "independence" on the part of attorneys, in the sense that the attorney's advice to his or her client should not be influenced by any external considerations. In Judge Sharswood's language, "a client . . . has a right to presume . . . that [his attorney] has no interest which may betray his judgment or endanger his fidelity."[23] That duty is recognized in a

23. G. SHARSWOOD, *supra* note 6, at 46 (quoting Story, J., in Williams v. Reed, 29 F. Cas. 1386, 1390 (C.C.D. Me. 1824)).

number of instances in the Code and, it is important to note, relates to the acceptance of clients as well as to their representation. Even though the American bar has never adopted the view of the English barrister's *obligation* to accept clients, ECs 2-26 through 2-28 clearly establish as an aspirational goal that representation should not be declined because of the unpopular nature of the client or, in the language of EC 2-28, "to avoid adversary alignment against . . . public officials, or influential members of the community."[24] Similarly, the duty of representation precludes, as a minimum—*i.e.*, disciplinary—obligation, withdrawal from representation without reasonable precautions to avoid prejudice to the rights of the client.[25] Furthermore, the lawyer's representation of the client must be free of "compromising influences," including the "desires of third parties,"[26] that might impair representation.[27]

Again, as the reference to "adversary alignment" in EC 2-28 quoted above makes clear, the duty to be free from influences stems from historical adversary considerations, and it seems to have been disregarded by the SEC in recent years.[28] Whether or not it should be disregarded is a separate question, but it is clear that there is no systemic requirement for such a principle with respect to the practice of the corporate adviser. While the system of justice we have adopted may be dependent upon both sides having roughly equal representation, that consideration is not nearly as convincing in an advisory as in an adversary context.

4. *There Is a Strong Ethical Obligation To Preserve Confidences*

This obligation to preserve confidences is the entire subject of Canon 4: "A Lawyer Should Preserve the Confidences and Secrets of a Client." "Confidences" and "secrets" are defined—for reasons not entirely clear—in a disciplinary rule, DR 4-101(A): a confidence is an item of information protected by the attorney-client privilege under applicable law, and a secret is an item of information not so protected but nonetheless gained in the representation, the disclosure of which would be contrary to the desires or interest of the client. Clearly the scope of the Canon is considerably broader than the legal requirements of the attorney-client privilege.

24. CODE, *supra* note 1, EC 2-28.

25. CODE, *supra* note 1, DR 2-110(A)(2).

26. CODE, *supra* note 1, EC 5-1.

27. CODE, *supra* note 1, EC 5-21.

28. *See* text at note 91 *infra*. *See also* Freedman, *supra* note 14.

While this obligation is not absolute and other considerations may permit, or even require, disclosure in some circumstances, it cannot be lightly regarded. Its significance arises once again from the Code's identification of a particular need of the adversary system. Within that system the lawyer must to a large extent be the vocal chord of the client. And if that system is to function at all well, the client must be encouraged to be completely open to the lawyer, and the lawyer must be able, with free conscience, to obtain the fullest disclosure from the client. "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."[29]

5. *Final Decisions Are the Province of the Client, Not the Lawyer*

A lawyer is expected to exercise independent judgment[30] and is not to be disciplined for withdrawing from representation in matters not pending before a tribunal when a client insists that the lawyer engage in conduct contrary to the lawyer's judgment and advice.[31] Nevertheless, it is clear that the client has the right to disregard advice. "[T]he authority to make decisions is exclusively that of the client and, if made within the framework of the law, such decisions are binding on his lawyer."[32] Indeed, DR 7-101 provides that a lawyer "shall not intentionally fail to seek the lawful objectives of his client through reasonably available means" not involving conduct that the lawyer believes to be unlawful or contrary to other disciplinary rules;[33] likewise, the lawyer may not "prejudice or damage his client during the course of the professional relationship" except as *required* by other disciplinary rules.[34]

6. *A Lawyer May Not, However, Participate in or Countenance Fraud or Other Illegal Activity*

This principle, clearly recognized in the Code, creates the conflict to which this Article is addressed. Notwithstanding the lawyer's obligation of loyalty to the client, the duty to avoid the pressure of "other persons" such as the SEC, the duty to maintain confidences, and the duty to leave final decisions to the client, the lawyer also has

29. CODE, *supra* note 1, EC 4-1.
30. CODE, *supra* note 1, Canon 5.
31. CODE, *supra* note 1, DR 2-110 (C)(1)(e).
32. CODE, *supra* note 1, EC 7-7.
33. CODE, *supra* note 1, DR 7-101(A)(1).
34. CODE, *supra* note 1, DR 7-101(A)(3).

a duty not to counsel criminal activity, not to be a participant in the commission of fraud, and to prevent the perpetration of fraud. Since the corporate legal adviser, particularly in the securities area, spends a substantial quantity of time in advising clients on whether a given course of conduct will violate the law—and ipso facto be deemed fraudulent in nature—the modern corporate lawyer runs the continuous risk of having failed—or at least of being perceived as having failed—in one set of duties or the other.

To some extent, the problem is one of history. The initial duty to disclose future crimes was derived from a commonsensical application of priorities in the case of murder or other threatened bodily harm. The duty developed before modern concepts of economic crime were commonly accepted. Similarly, the "fraud" to which the Code addresses itself arises out of an historical context, relating primarily to fraud on the court, an institution of which the lawyer was characterized as an officer. The historical dictates on behavior that the lawyer could not countenance were not addressed to the kind of fraud and illegality envisioned by the modern securities laws, even acknowledging that the *Hochfelder*[35] decision has reinserted some of the common-law elements of fraud into securities law questions. In short, the Code's mandates were not directed to the lawyer whose function is advising about business practices.

These concepts are rendered incredibly more complex—if not completely unworkable—by disclosure obligations, some of a continuous nature, that make the failure to disclose a past crime or fraud a future crime or fraud in itself. In the relatively simple world of the past, it was clear that the lawyer could not, for example, disclose a client's confession of murder. The lawyer would, however, have an obligation to disclose, even to the police, a planned future murder, so that it might be prevented. But what is the duty of the contemporary lawyer whose client is a corporation, when the client's president advises that he has killed his wife? That information may be material to investors for a number of reasons, such as its reflection on the "integrity of management" or its indication of the risk that the individual's ability to serve the corporation will be impaired because he may be incarcerated, or, for that matter, simply because he will have to go through a trial. While the failure to disclose would quite possibly be both criminal and fraudulent under the securities laws, is this really the *type* of crime or fraud that the lawyer should have an affirmative obligation to disclose? Are we satisfied by saying, as seems

35. Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (reading a scienter requirement into § 10(b) of the Securities Exchange Act).

clearly true, that the president is not the lawyer's client, and thus the lawyer has no confidentiality obligation to him? And if we allow ourselves that excuse, what of the lawyer who *does* represent the president personally, with the consent of an independent majority of the board of directors?

In these respects, then, the Code is not dispositive of or even helpful with the difficult issues, because it is simply not addressed to the corporate context. Nor should it be thought that the example posed above is simply improbable, for similar situations arise in cases where the past behavior involved alleged failure of a president to file tax returns,[36] larceny by the corporation itself,[37] manipulative conduct by principals in a corporation's securities,[38] and improper corporate payments.[39] In any such case where the past illegalities (or possible illegalities) have ceased, the notion of failure to disclose as an additional crime in itself creates a dilemma for the corporate adviser.

The specific provisions of the Code that relate to the disclosure obligation of the lawyer in such circumstances, inadequate though they may be, are EC 4-2, EC 7-10, and DRs 1-102(A)(4), 2-110(B)(2), 4-101(C)(2), 4-101(C)(3), 7-101(B)(2), 7-102(A)(5), 7-102(A)(7), and 7-102(B). Those provisions may be summarized as follows:

36. In late 1976 it was discovered that the president of RCA Corp. had failed to file his personal income tax for five years, although apparently all—or at least substantially all—taxes had been paid. Although there was no litigation involving disclosure, the materiality of the information is suggested by the cancellation of a then-pending public offering of common stock. *See* N.Y. Times, Sept. 17, 1976, § A, at 1, col. 4. If the information was sufficiently material to cause cancellation of an underwriting, disclosure questions would presumably have arisen if the underwriting had proceeded.

37. *See Solon Agrees To Pay $900,000 That SEC Says It Owes Lessors*, Wall St. J., April 26, 1977, at 3, col. 5, describing a remarkable case in which the SEC brought an action for failure to disclose that a portion of revenues of a corporation arose from "skimming" from vending machines, and, as a remedy in a consent decree, required the defendant to disgorge the amounts so stolen and return the funds to the lessors of the vending machines. From the facts of the case as reported, it appears that the defendant had ceased the allegedly larcenous behavior at the time the action was brought, but obviously the nondisclosure problem would remain. *See also* FOURTH ANNUAL INSTITUTE, *supra* note 20, at 214-18, 233-37 (responsibilities for past securities law violations).

38. *See* the indictment in United States v. Bloom, Crim. No. 77-383 (E.D. Pa., filed Sept. 6, 1977), charging conspiracy to commit crimes including not only basic stock manipulation, but also failure to disclose material facts necessary to make statements made not misleading. The indictment also charges disclosure of "material non-public inside information"; most lawyers view that as the proper thing to do with such information.

39. *See, e.g.*, Babcock & Wilcox Co. v. United Technologies Corp., 435 F. Supp. 1249 (N.D. Ohio 1977); SEC v. Lockheed Aircraft Corp., [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,509 (D.D.C. 1976).

EC 4-2. A lawyer may reveal information "when necessary to perform his professional employment, when permitted by a Disciplinary Rule, or when required by law."

EC 7-10. Notwithstanding the duty of zealous representation, the lawyer should "avoid the infliction of needless harm."

DR 1-102(A)(4). A lawyer shall not "engage in conduct involving dishonesty, fraud, deceit, or misrepresentation."

DR 2-110(B)(2). A lawyer must cease representation if continued employment will result in violation of a Disciplinary Rule.

DR 4-101(C). A lawyer may reveal:

(2) Confidences or secrets when permitted under Disciplinary Rules or required by law or court order; or

(3) The intention of a client to commit a crime, and sufficient information to prevent it.

DR 7-101(B)(2). A lawyer *may* refuse to participate in conduct he *believes* to be unlawful, even though that conclusion is not clearly correct.

DR 7-102(A). A lawyer shall not:

(5) Knowingly make a false statement of law or fact; or

(7) Assist in conduct he knows to be illegal or fraudulent.

DR 7-102(B). A lawyer who receives information *clearly establishing* that his client, in the course of the representation, has perpetrated a fraud shall reveal the fraud if his client does not, "except when the information is protected as a privileged communication."

Of the foregoing, the last is generally thought to be the most significant, particularly since it was amended in 1974 in light of some of the developments discussed in this Article. However, that amendment, which added the words "except when the information is protected as a privileged communication," was apparently designed only to avoid having a requirement in a DR that might directly conflict with state law obligations to protect the privilege.[40] As such, it is considerably less broad than the "confidences and secrets" to be protected by Canon 4.

It is probably neither necessary nor useful for this Article to attempt to reconcile these disclosure obligations with the lawyer's countervailing duties. It is clear that only very nice—and essentially disingenuous—distinctions, based on the role of disciplinary rules versus ethical considerations, on the importance of terms such as "clearly establishing" or on the implications of permissive language in minimal standards could lead to any roadmap of ethically proper conduct. Even then, the map would be harder to follow than Vespucci's chart of the New World and, more important, would only reflect

40. ABA National Institute, *Advisors to Management*, 30 BUS. LAW. 20 (special issue, March 1975) (remarks of Lewis H. Van Dusen, Jr.).

"ethically proper conduct" according to a set of historical standards of questionable contemporary application. Rather than pursue such efforts to their inevitably futile end, the time has come to make a de novo examination of the role of the corporate adviser and to establish relatively specific standards for the conduct of those filling that role.

II. Changes in the Role

The introduction to this Article referred to the changing role of the corporate legal adviser, a phenomenon occurring principally through development of the common law, though affected to some extent by the intrusions of a governmental agency with both an adversary and a quasi-judicial role. While these events certainly are not dispositive of what can or should be done in the future, a consideration of them is appropriate both so that the proposed reexamination of the corporate lawyer's role can be made against a factual background and so that account can be taken of the views explicitly or implicitly adopted by different bodies.

The developments referred to in the introduction are not, by any means, the only discernible indications of a societal reexamination of the role of corporate lawyers, or of lawyers in general. Similar evidence can be seen in the general atmosphere created by Watergate,[41] in the sudden—and perhaps unfortunate—trend toward ethics questions on bar examinations,[42] and in the prevailing suspicion that appears to surround the activities of lawyers. Much of that criticism, of course, can be summarily dismissed as no more perceptive or deserv-

41. For example, Dean Monroe Freedman, in his LAWYERS' ETHICS IN AN ADVERSARY SYSTEM at 11 (1975) refers to several cartoons by Herblock depicting former President Nixon's attorney as a burglar, and suggests that similar implied accusations of the lawyers representing communist defendants of an earlier era would have been unacceptable.

42. The problem is that it is difficult for bar examinations to test ethics except in the sense of finding out whether the examinee knows the minimum levels of ethically permissible behavior, which has the unfortunate effect of emphasizing these minimum-level obligations.

For example, question number 20 of the California Professional Responsibility Examination (February 1975 ed.) is a conflict question in which Poe consults Attorney about a matter which, Attorney subsequently discovers, involves Client, a prior client of Attorney. The question asked is whether it is "*proper* for Attorney to represent Client" when Poe subsequently brings a suit. "Proper" is defined in the exam to mean that Attorney would not be subject to discipline for taking the action and that such action is not inconsistent with the Ethical Considerations of the Code. The right answer is that it *is* proper "because Attorney acquired no disqualifying information from Poe." However, two of the four possible answers give reasons why such representation would be improper and, although they may be "wrong" answers, we should hardly be disappointed if an examinee were so sensitive to conflicts that he concluded that Attorney must decline the representation of Client assuming that Client would suffer no disadvantage thereby. *See* State Bar of California, California Professional Responsibility Examination 2, 7, 12 (February 1975).

ing of respect than the age-old attack upon the lawyer who would represent the "known" murderer.[43] The specific developments discussed below, however, are of a more substantial nature and have been at least tacitly endorsed by many prominent members of the profession. They must accordingly be given serious attention.

A. *The Audit Letter Response Settlement*

The audit letter response controversy arose between the ABA and the American Institute of Certified Public Accountants (AICPA) and involved the amount of "comfort" a lawyer could give to an accountant regarding the adequacy of disclosure in financial statements. The controversy brought into focus all of the implications of the attorney's obligation to maintain the confidences of the client and pitted against that interest the desire of auditors—fostered by the pressures of public attack and private liability for failure to discern fraud[44]—to make sure that the audited financial statements upon which the public relies are free from material error. Both of those interests are important, although the latter might have a more apparent, and therefore more immediate, appeal to the lay analyst. Given the pressure accumulating on the accounting profession in recent years, the conflict was inevitable. Its resolution will have broad implications for concepts of the legal adviser's role in society.

1. *The Dispute*

In the early part of this century, accountants operated in an atmosphere relatively free from specific regulation. When the Securities Act of 1933 (the 1933 Act) and the Securities Exchange Act of 1934 (the 1934 Act) were adopted, the notion of a profession of accountancy was recognized, but audits generally were not required and the concept of the accountant's "independence" was, at best, embryonic.[45] Commencing in 1939, however, with the notorious scandal in the *McKesson & Robbins* case,[46] greater responsibility was

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43. *See* G. SHARSWOOD, *supra* note 6, at 24-25.

44. In recent years, private litigants seem to have brought actions against auditors for failure to discover fraud whenever there has been a major fraud that involved financial statements in any way. *See, e.g.*, Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976); *In re* Equity Funding Corp. of Am. Securities Litigation, [1973-1974 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,456 (J.P.M.D.L. 1974). It is not yet clear whether the *Hochfelder* decision requiring scienter in a private action arising under § 10(b) of the Securities Exchange Act of 1934 will significantly reduce such private actions against accountants.

45. *See* L. RAPPAPORT, SEC ACCOUNTING PRACTICE AND PROCEDURE 26.1-26.4 (3d ed. 1972).

46. *See* SEC Accounting Series Release 19 (Dec. 5, 1940); L. RAPPAPORT, *supra* note 45, at 5.4-5.8. The case involved the minor matter of $21 million of fictitious assets (22% of total

placed upon the accounting profession to maintain independence from audited clients and to verify the fair presentation—viewed by at least some courts as an obligation to investigate any suspicion of fraud[47]—of financial statements to which audit reports were appended. Recent years, of course, have seen an accelerating concern with these aspects of the auditors' obligations.[48]

Given such pressures, auditors naturally came to give greater attention to obtaining independent verification of information contained in financial statements. One new source to which auditors began to look was corporate counsel. It is not entirely clear when various accounting firms commenced the practice of requesting information from counsel regarding "contingent liabilities," but it is clear that the trend was well under way and was causing some consternation among lawyers in 1972 when the ABA Section of Corporation, Banking and Business Law began to look into the matter through its Committee on Corporate Laws. The work of that Committee generated, in April 1973, Richard Deer's brief but most important article,[49] which gave widespread publicity to the proper role of counsel in discussing such matters with auditors.

The primary concern of lawyers was the extent to which counsel could satisfy auditors about compliance with Statement of Financial Accounting Standards Number Five of the Financial Accounting Standards Board (FASB), "Accounting for Contingencies."[50] Paragraph Ten of that standard requires financial statement disclosure if "there is at least a reasonable possibility that a loss . . . may have been incurred"[51]—*i.e.*, on an accrual basis, that facts have occurred that will give rise to an eventual payment. Disclosure is not required when "there has been no manifestation by a potential claimant of an awareness of a possible claim . . . unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable."[52] Given that standard, members

stated assets) appearing in the balance sheet and over $18 million of fictitious sales and $1.8 million fictitious gross profits on the income statement.

47. United States v. Simon, 425 F.2d 796, 806-07 (2d Cir. 1969), *cert. denied*, 397 U.S. 1046 (1970).

48. *See, e.g.*, OPINION RESEARCH CORP., PUBLIC ACCOUNTING IN TRANSITION (1974), (report prepared for Arthur Andersen & Co).

49. Deer, *Lawyers' Responses to Auditors' Requests for Information*, 28 BUS. LAW. 947 (1973).

50. *Reprinted in* ABA, *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, 31 BUS. LAW. 1709, App. A (1976) [hereinafter cited as ABA Statement].

51. *Id.* at 1728.

52. *Id.*

of the bar were concerned both with the practical difficulties of discerning the level at which disclosure was required and with counsel's professional obligations to the client. Paragraph Three, which defines "probable," "reasonably possible" and "remote" does not provide a great deal of clarification:

a) *Probable.* The future event or events are likely to occur.
b) *Reasonably possible.* The chance of the future event or events occurring is more than remote but less than likely.
c) *Remote.* The chance of the future event or events occurring is slight.[53]

It is only slightly helpful that a matter may also be omitted if it is not material, which the Supreme Court has succinctly defined as a matter about which "there is a substantial likelihood that a reasonable [person] would consider it important."[54]

When the legal profession became fully aware of the implications of such requests for information regarding contingent liabilities, the die was cast. By then the accounting profession had come to view responses to these inquiries as essential to an audit, and a failure to receive the appropriate response was viewed as a limitation on the scope of the audit, necessitating a disclaimer of opinion or, depending on the circumstances,[55] other qualification, which could render the financial statements effectively unaudited.[56] That, in turn, had a serious impact on the client—which often was required to pay its auditors and its attorneys to debate the question—since it was required to file audited financial statements under the 1934 Act[57] or, in the case of any new registration of securities, the 1933 Act.[58]

For a number of reasons, however, the lawyers could not readily submit to such an inquiry. First, the lawyer has the ethical obligation, discussed earlier in this Article, to "Preserve the Confidences and Secrets of a Client." Accompanying that ethical obligation is the legal obligation, imposed under slightly varying conditions, to maintain the attorney-client privilege. While each of those barriers to dis-

53. *Id.* at 1727.

54. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

55. *See* Committee on Auditors' Inquiry Responses, *Lawyers Responses to Auditors' Requests for Information—a Report,* 31 BUS. LAW. 561, 562-63 (1975) [hereinafter cited as Auditors' Inquiry Committee Report].

56. *See* Certification of Income Statements, Securities Act Release No. 4458 (Mar. 1, 1962): "A 'subject to' or 'except for' opinion paragraph in which those phrases refer to the scope of the audit . . . is not acceptable in certificates filed with the Commission in connection with the public offering of securities."

57. Securities Exchange Act of 1934, § 13, 15 U.S.C. § 78(m) (1976).

58. Securities Act of 1933, § 7, 15 U.S.C. § 77(g) (1976).

closure might technically be overcome by the client's consent, there was significant doubt about whether consent coerced in this fashion could be valid, particularly when—as was usually the case—the client was not fully cognizant that such disclosure might destroy the confidentiality privilege for all purposes.[59] Moreover, most law firms, and in particular the larger ones, reasonably feared liability for a failure to recognize the full consequences of facts coming to the attention of their lawyers in a context other than request by the client for advice.[60] For example, a lawyer involved in litigating one case might easily become aware, through discovery, of facts that could constitute the basis for another action by a different party against the client.

Finally, of course—and to this difficulty clients were most sensitive—disclosure of a contingent liability could often lead to removal of its contingent aspect. While a publicly held company might properly be required to disclose some potential liabilities to existing or potential shareholders, the analysis of whether or not disclosure was, in fact, required could often be a close question of judgment. Since it was obviously not in the interest of all shareholders to increase the claim's potential by disclosure, lawyers were understandably reluctant to substitute their judgment for that of their clients. And since the lawyers themselves received no economic benefit from nondisclosure, ran no risk from disclosure, but did run a risk in nondisclosure, one could reasonably expect that a disclosure decision made by lawyers would have an overly conservative bias not necessarily in the public interest.

Thus, there was an impasse of a substantial nature. The resolution of that impasse, a high point in cooperation between the accounting and legal professions, was both commendable and highly successful in resolving the stalemate. Unfortunately, it may be viewed as resting, in the final analysis, upon a mutual abdication of

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59. *See* Penn Cent. Commercial Paper Litigation, [1973-1974 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,311 (S.D.N.Y. 1973). *See also* ABA Statement, *supra* note 50, at 1716. *But see* Diversified Indus. v. Meredith, 572 F.2d 596, [1977-2] Trade Cases (CCH) ¶ 61,591 (8th Cir. 1978) (en banc).

60. The problem is exemplified by Capital Foundry Co. v. Gundelman, 166 F. Supp. 429 (S.D.N.Y. 1958). That case involved misstatements about the exoneration proceeding of a lawyer who had been disbarred; the statements were made in a proxy statement relating to the former lawyer's attempt to take over a corporation. The case indicates that the lawyer handling the exoneration proceedings, who did not participate in drafting the proxy, simply (and naturally) did not realize the problem. In testimony, that lawyer said, "I should have written a letter to the SEC." 166 F. Supp. at 434 n.11. Obviously, much of this Article questions that facile conclusion.

purported responsibilities. As such, it is only a matter of time before its frailty is exposed.

2. *The Settlement*

In July 1974 a proposed response to audit inquiry letters was first circulated to the membership of the Section of Corporation, Banking and Business Law.[61] In November 1974 a revised proposal was circulated to Section members.[62] Finally, a further revised proposal was circulated in November 1975[63] and, in substantially that form, was adopted by the House of Delegates of the ABA Board of Governors as a formal statement of policy on December 8, 1975.[64] Concurrent with the approval of the ABA statement, the AICPA Auditing Standards Executive Committee on January 7, 1976, adopted a Statement on Auditing Standards coordinated to the ABA approach.[65]

Before criticizing such a worthy effort, it is only proper to recognize the significance of what was accomplished. For the first time in an area of such importance, the two professional bodies negotiated a specific set of procedures for the benefit of their mutual clients. In addition, the ABA, a purely voluntary organization that has as members only about half of the legal profession,[66] successfully spoke in specific ways for the profession as a whole and adopted procedures that the profession has accepted. Furthermore, the ABA statement without question provides useful guidance for internal law firm review and for the expression of opinions on pending and threatened litigation, where there is no dispute that disclosure is required and the opinion of counsel is important. Finally, even though the settlement has potentially hazardous deficiencies, as outlined below, it did "buy time," in that it provided a mechanism by which law firms could at least in form satisfy the auditors' needs. Indeed, the remaining deficiencies may simply be irremediable. Certainly, if the auditors' needs are simply to live up to the "industry standards" of the

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61. *Scope of Lawyers' Responses to Auditors' Requests for Information*, 29 Bus. Law. 1391 (1974).

62. This was subsequently printed as *Scope of Lawyers' Responses to Auditors' Requests for Information*, 30 Bus. Law. 513 (1975).

63. Auditors' Inquiry Committee Report, *supra* note 55.

64. ABA Statement, *supra* note 50.

65. *Id.* at Editor's Note.

66. National Conference of Lawyers and Certified Public Accountants, *Professional Services of Lawyers and CPA's*, 63 A.B.A.J. 825, 826 (1977).

accounting profession,[67] the ABA statement could be viewed as satisfactory, even though it is based on something of a legal fiction.

The settlement reached between the professions, insofar as it relates to contingent liabilities, has several elements. First, the client's request to its counsel may identify, and request comment upon, specific liabilities of a contingent nature. It will then contain a further statement to the following effect:

> We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment which may call for financial statement disclosure, if you have formed a professional conclusion that we must disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will so advise us and will consult with us concerning the question of such disclosure . . . . Please specifically confirm to our auditors that our understanding is correct.[68]

The ABA statement—or the "model" form of letter annexed to but not a part of it—provides that outside counsel should respond with an appropriate confirmation in substantially similar language.[69]

The reason that this exchange is satisfactory to the auditors is the ABA position, expressed as a part of the ABA statement, that if the client fails in an obligation to disclose, the attorney "has an obligation not knowingly to participate in any violation by the client of the disclosure requirements of the securities laws. The lawyer may also be required under the Code . . . to resign his engagement if his advice concerning disclosures is disregarded by the client."[70] Thus, on the surface, there is at least a suggestion that the accounting firm can assume that the client must have disclosed all "required" contingent liabilities, since counsel would otherwise have resigned.

That assumption, however, is clearly unwarranted. The determination of whether a set of facts constitutes a contingent liability about which disclosure is required involves two highly subjective evaluations: first, the likelihood that the potential claim will ripen into an actual one, and second, the likelihood that such a claim would succeed, a determination that must be made before the plaintiff has surfaced to give his or her version of the facts. Moreover,

67. *But see* United States v. Simon, 425 F.2d 796 (2d Cir. 1969), *cert. denied*, 397 U.S. 1046 (1970).

68. Committee on Audit Inquiry Responses, *Introductory Analysis and Guides to Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, 31 BUS. LAW. 1737, 1744-45 (1976).

69. ABA Statement, *supra* note 50, Annex A at 1734.

70. ABA Statement, *supra* note 50, at 1714.

qualifying each of those determinations is the ever-present question of materiality. Finally, as discussed earlier in this Article,[71] the dictates of the Code are not at all clear on when counsel has an affirmative obligation to resign. Indeed, it was only a few months prior to the settlement that the ABA House of Delegates adopted a statement of policy opposing disclosure by lawyers counseling on the securities laws and suggesting a very limited context within which such lawyers would be obliged to terminate a representation.[72] These problems have troubled lawyers who adopt the "standard" response language, and the Committee on Audit Inquiry Responses of the Section has properly—in terms of construing the statement's precise language—responded that the statement only provides that there must be *consultation* when a claim is, *in fact*, recognized.[73] Thus, consistent with a careful and precise construction of the statement's language, the real obligations of the lawyer were not expanded by the settlement in any significant way.

Yet, this state of affairs, in which such stress must be placed on ambiguous phrases and references are made to obligations the lawyer "may have" to resign based on a Code really designed for other purposes, clearly sets a trap for the unwary—or relatively unsophisticated—accountant. It is inevitable that a case will arise in which an accountant will claim that he understood the lawyer's response to provide him with satisfaction that there were no material contingent liabilities requiring disclosure. Moreover, the request and proposed response are identical whether the recipient is general counsel or special counsel. Yet there can be no doubt at all that special counsel, advising on limited matters, has no duty to resign if the client, with

71. *See* text at notes 30-40 *supra.*

72. ABA, *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). In this statement of policy the lawyer's obligation was set forth as follows:

> In appropriate circumstances, a lawyer may be *permitted or* required . . . to resign . . . if his advice concerning disclosures is disregarded by the client *and*, if the conduct of a client *clearly establishes* his prospective commission of a crime or the past or prospective perpetration of a fraud *in the course of* the lawyer's representation, even to make the disclosures himself. However, the lawyer has neither the obligation *nor the right* to make disclosure *when any reasonable doubt exists* concerning the client's obligation of disclosure. . . .

Id. at 545 (emphasis added). The statement then stressed that the lawyer should not limit the client's rights by the lawyer's own concerns with potential liability or reprisals. *Id.* at 545. The language contained in the statement of policy adopted four months later as a part of the ABA/AICPA settlement was not inconsistent with the August statement, but was considerably less specific and more suggestive. *See* text at note 70 *supra.* Accountants' knowledge of prior ABA statements, like lawyers' of AICPA deliberations, is no doubt very limited.

73. *See* Committee on Audit Inquiry Responses, *ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information—Second Report*, 32 BUS. LAW. 177, 181-82 (1976).

the advice—whether or not followed—of its general counsel, determines not to disclose matters that the special counsel, had his advice been sought, would have viewed as requiring disclosure. Additionally, if the special counsel's representation relates only to litigation—where knowledge about other potential liabilities may be most likely to arise—there may be an ethical or even legal obligation *not* to withdraw from the representation. And it need hardly be stated that the perceptive client who *does* want to engage in actual fraud will make appropriate use of special counsel.

Thus, the ABA-AICPA settlement, although a significant achievement, is deficient in material respects. And the nice distinctions that the settlement requires, as well as the ease with which the less sophisticated may misinterpret it, suggest both that it is a resting place rather than a destination and that it will eventually be the subject of litigation.[74] Whether that litigation will hold liable the accountant who thought he could rely or the lawyer whose letter written in accordance with the ABA statement created a misleading appearance—or both or neither—is not for this Article to predict, but at least one case[75] suggests that little can be gained from following the provisions of the ABA-AICPA settlement.

The principal importance of the ABA-AICPA dispute and settlement to the present analysis is not its somewhat disingenuous treatment of the contingent liability disclosure problem. Rather, it lies in the fact that through the settlement the organized bar has accepted a role in the disclosure process that differs from the purely confidential nature of the traditional corporate adviser. Regardless of whether that role is as broad as the future accountant-defendant will argue or as narrow as the lawyer-defendant will claim, it constitutes a change endorsed by the profession itself.

B. *The SEC Litigation*

The staff and members of the Commission have frequently taken the position that the practitioner who behaves honestly has nothing to fear from SEC enforcement action because proceedings are initiated only in cases involving complicity or otherwise egregious be-

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74. For a good analysis of the ABA-AICPA settlement in all of its dimensions, see Note, *Attorney Responses to Audit Letters: The Problem of Disclosing Loss Contingencies Arising from Litigation and Unasserted Claims*, 51 N.Y.U. L. REV. 838 (1976).

75. United States v. Simon, 425 F.2d 796 (2d Cir. 1969), *cert. denied*, 397 U.S. 1046 (1970) (an earlier case suggesting rather strong auditor responsibilities).

havior.[76] That view is accurate as far as it goes;[77] most of the proceedings initiated by the SEC, whether in the form of disbarment proceedings under Rule 2(e) of the Commission's Rules of Practice[78] or of civil injunctive actions or of criminal proceedings prosecuted through the Department of Justice, have been brought against parties whose behavior has violated that standard. But, for two reasons, actions brought by the SEC have an impact substantially beyond the specific focus of the complaint and, indeed, inevitably tend to influence the ethical standards governing the day-to-day practice of the corporate adviser.

First, the simple fact that the SEC files a complaint may, given the prestige of the agency, have implications significantly beyond the specific activity cited.[79] That possibility is accentuated to the extent the SEC shares the normal plaintiff's tendency to overstate a claim. Second, in a number of cases involving attorneys, SEC actions have been settled through a stipulation adopting internal law firm policies for future conduct. The two most significant of those cases are *In re Jo M. Ferguson*[80] and the relatively recent settlement of a portion of *National Student Marketing*.[81] Such law firm policies, even though

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76. *See, e.g.*, Sommer, *The Commission and the Bar: Forty Good Years*, 30 BUS. LAW. 5, 8 (1974).

77. *But see* Kivitz v. SEC, 475 F.2d 956 (D.C. Cir. 1973), where the District of Columbia Circuit criticized the SEC's action of suspending an attorney from practicing before it without sufficient evidence. *See* M. FREEDMAN, *supra* note 41, at 23 (discussing *Kivitz*).

The Commission's power to disbar, challenged in Complaint, Touche, Ross & Co. v. SEC, [1976-1977 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,742 (S.D.N.Y., filed Oct. 12, 1976), *dismissed for failure to exhaust administrative remedies*, [Current Volume] FED. SEC. L. REP. (CCH) ¶ 96, 415 (S.D.N.Y., Apr. 24, 1978), is set forth in rule 2(e) of the SEC's Rules of Practice, 17 C.F.R. § 201.2(e) (1977). The SEC's concept of what constitutes "practice" before it is itself an interesting study, and it appears to embrace opinion letters to the effect that securities may be sold, *see* Sam Clammer, Securities Act of 1933 Release No. 5518 (Aug. 2, 1974) (4 SEC DOCKET 656 (1974)), written or oral legal opinions regarding matters "involving or related to" any documents normally filed with the SEC under any acts within its jurisdiction, *see* Sitomer, Securities Exchange Act of 1934 Release No. 12501 (June 1, 1976), and consulting with the Commission or its staff, *see id.* These concepts are remarkable, among other reasons, because some of the activities in *Sitomer* may legitimately be, and often are, performed by a layman. It is also clear that the opinions referred to in *Clammer* are not of a type that need be filed with or otherwise come before the SEC. A recent case, Koden v. United States Dept. of Justice, 564 F.2d 228 (7th Cir. 1977), involving a rule of the Immigration and Naturalization Service comparable to rule 2(e), 8 C.F.R. § 2923(a)(14) (1977), suggests that rule 2(e) itself is a valid exercise of the SEC's authority.

78. 17 C.F.R. § 201.2(e) (1977).

79. That is certainly the case with the complaint in SEC v. National Student Marketing Corp., [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,360 (D.D.C. 1972). *See* notes 84-86 *infra* and accompanying text.

80. Securities Act of 1933 Release No. 33-5523 (Aug. 21, 1974), *reported in* 5 SEC DOCKET 37 (1974).

81. SEC v. National Student Marketing Corp., [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,027 (D.D.C. May 2, 1977).

adopted in the context of specific Commission proceedings, obviously contain suggestions on what is thought by that agency to be proper conduct. That the behavior of lawyers generally will be affected by these suggestions seems indisputable,[82] and that conclusion is supported by the Supreme Court's recent recognition that SEC settlements have some precedential value.[83] Thus, while it may be true that "honest practitioners" do not have to fear the SEC, they do have to fear private litigants who follow SEC-provided precedent, and they do have to determine what it means to be an "honest lawyer."

Thus, the SEC, in this rather oblique and perhaps even inadvertent manner, tends to create standards of practice through its actions based on specific occurrences that it finds to be extreme. Absent any broad policy-oriented and fully responsive action by the bar, there is a clear danger that ethical standards will be developed on a haphazard basis. If, on the other hand, the standards are developed by the SEC with a clear view of what that agency wants in the broader context of securities regulation, they suffer from the infirmity of being established by a process in which significant interests are not being represented. One fairly recent event puts this problem in focus. In *National Student Marketing*, the SEC charged two major law firms with failing to take proper action when they "permitted" their clients to consummate a merger transaction that had been approved by shareholders on the basis of a proxy statement containing materially misleading financial information. The language of paragraph 48(i) of the SEC complaint shocked the corporate bar by its suggestion of what proper conduct included: "As part of the fraudulent scheme [the law firms and certain identified partners] . . . failed to insist that . . . shareholders be resolicited, and failing that, to . . . notify the plaintiff Commission concerning the misleading nature of the nine month financial statements."

That complaint was filed February 3, 1972. Within less than one year, an attorney, unable to compel what he viewed as a required disclosure related to his law firm's fee arrangement with the client and undoubtedly influenced by the *National Student Marketing*

82. *See, e.g.*, Chappel & Cheek, *The Development of Law Firm Policies and Procedures Relating to Securities Matters*, in 2 PRACTISING LAW INSTITUTE, NINTH ANNUAL INSTITUTE ON SECURITIES REGULATION [hereinafter cited as NINTH ANNUAL INSTITUTE]; Feller & Loo, *The Audit Committee*, in 1 NINTH ANNUAL INSTITUTE, *supra*, at 5, both of which draw from consent decrees, among other sources, in giving advice on the way in which lawyers and audit committees should conduct themselves.

83. *See* DuPont v. Collins, 432 U.S. 46, 54-55 (1977): "In reviewing a decision of the [Securities and Exchange] Commission . . . '[c]ontemporaneous construction is entitled to great weight . . . even though it was applied in cases settled by consent rather than by litigation.' " (quoting FTC v. Mandel Bros., 359 U.S. 385, 391 (1959)).

complaint, resigned from his law firm and reported the matter to the SEC.[84] Viewed solely by reference to the specific facts of this case and without regard to broader societal considerations, the lawyer's action could be seen as achieving a beneficial result. Following it, the disclosure he had demanded was made and, naturally, a class action followed. The action was subsequently settled for $785,000, of which $625,000 was paid by the attorney's former law firm and $160,000 by his former client.[85] If the settlement indicates a realistic fear of loss, rather than a fear of the substantial nonmonetary damage that the law firm might have suffered had the matter been decided in court, the argument can be made that his action made possible the righting of a wrong.[86]

But is it really desirable for lawyers to proceed in this fashion? Are important questions not at least raised when a lawyer takes actions so detrimental to his client, particularly when substantial doubt apparently existed about the materiality of the nondisclosure?[87] It is certainly true that the provisions of the Code can be interpreted to permit—or even to require—the lawyer's behavior, but they can also be interpreted to prohibit it. And either course of behavior could be dictated as proper by a rational society. Admitting, then, that the merit of the lawyer's action is at least debatable, the crucial point is that his conduct was undoubtedly the result of three factors—an ambiguous Code with consequent uncertainty as to what "proper pro-

84. *See* Meyerhofer v. Empire Fire & Marine Ins. Co., 497 F.2d 1190, 1192-94 (2d Cir. 1974). It would appear that the Stuart Charles Goldberg whose activities were reported in the *Meyerhofer* case is the same Stuart Charles Goldberg who edited a volume entitled *Expanding Responsibilities Under the Securities Laws* (1973), a transcript of a conference sponsored by the *New York Law Journal* held on June 5-6, 1972, which was concerned with the responsibilities of lawyers and accountants under the securities laws and the relationship of those professionals to their clients, to the SEC, and to the public.

85. Federman v. Empire Fire & Marine Ins. Co., [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,418 (S.D.N.Y. 1976).

86. From the facts available in the reported decisions in this case, *see* Federman v. Empire Fire & Marine Ins. Co., [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,822 (S.D.N.Y. 1974), and cases cited in notes 84 and 85 *supra*, it is difficult to appraise the settlement in terms of the realistic potential recovery. The case related to a public offering of 500,000 shares of common stock at $16 per share. The stock price rose to at least $17 per share during the period in which the allegedly incomplete prospectus was circulated, and thereafter fell at least as low as $7 per share. A potential claim of almost $5,000,000 could thus be envisioned, with the $785,000 settlement being only approximately 15% of the claim. However, during the relevant time period there were substantial market declines generally, and particularly in the stocks of companies in the same business as the defendant corporation; proof of such general declines has been permitted to be used to mitigate damages by showing that losses were "caused" by factors other than the omission in a prospectus. *See* Securities Act of 1933 § 11(e), 15 U.S.C. § 77k(e) (1976); Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544 (E.D.N.Y. 1971). Moreover, the contribution of the law firm to the settlement fund would seem substantial relative to its potential exposure.

87. *See* Federman v. Empire Fire & Marine Ins. Co. [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,418, at 99, 114-15 (S.D.N.Y. 1976).

fessional conduct" encompasses, the rather strong language of paragraph 48(i) of the *National Student Marketing* complaint, and the lawyer's understandable apprehension about his own potential exposure. It is not difficult to argue that this is not the stuff of which such delicate decisions should be made.

Furthermore, society's interest in controlling the extent to which SEC actions or settlements influence ethical standards for the legal profession is made all the more apparent by a consideration of the character of an SEC proceeding. The SEC perceives particular behavior as an extreme example of bad representational conduct and then decides to bring an action. At that point, however, normal adversarial tendencies likely will characterize the processing of the case—*i.e.*, there may be a desire to obtain the maximum victory in a partisan rather than social sense, and the complaint issued may be drawn in that spirit. The defendant law firm, on the other hand, is faced with protracted and potentially very embarrassing proceedings against a well-financed opponent, with the ever-present risk of defeat and consequent exposure both to disbarment from practice before the Commission and to private suits for civil damages. In light of such circumstances, it is understandable, if disappointing, that any settlement reached will evidence little consideration of the lawyer's general role and social obligations.

Thus far, this portion of the analysis has focused primarily on questions of process, questioning whether society ought not to be more concerned about the SEC's influence, intended or otherwise, over ethical standards for corporate practice when the Commission has been denied direct authority in that regard.[88] The substantive aspects of recent SEC litigation, however, remain to be considered. Although it should be clear that the author has substantial concern with the developments in this area, that concern is less with the specifics than with the cumulative impact and direction of the cases. The *Ferguson* and *National Student Marketing* settlements, together with some others of lesser importance,[89] are, for the most part, inof-

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88. See 5 U.S.C. § 500 (1976), in which Congress specifically refrained from giving administrative agencies the right to establish minimum requirements for admission to practice. Section 500(d)(2), however, makes clear that the provision does not by itself preclude disciplinary actions by such agencies.

89. *See, e.g.*, Plotkin, Yolles, Siegel & Turner, Securities Act of 1933 Release No. 5841 (July 5, 1977) [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,236; SEC v. Petrofunds, SEC Litigation Release No. 8001 (June 28, 1977); SEC v. Geo Dynamics Oil & Gas, Inc., [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,565 (D.D.C. 1976); Stipulation of Wright, Robertson & Dowell, in SEC v. Allegheny Beverage Corp., Civil No. 932-73 (D.D.C. 1975); *reported in* SEC Litigation Release No. 6978 (July 11, 1975); McLaughlin & Stern, Ballen & Miller, Securities Exchange Act of 1934 Release No. 11553 (July 25, 1975).

fensive: the clear thrust of the procedures adopted is toward a more careful administration of the function of lawyering.

Considered in a broader frame of reference, however, the details of the *Ferguson* and *National Student Marketing* settlements offer substantial grounds for concern. Specifically, the internal law firm procedures adopted appear to conflict significantly with provisions of the Code and with other standards of professional conduct previously accepted as legitimate. This Article will later consider whether we should view those conflicts as a measure of progress.[90] For the present it is sufficient that we recognize the nature of the diversions.

1. *The Acceptance of Clients*

In both the *Ferguson* settlement and the more recent settlement of a part of *National Student Marketing*, procedures were established that appear clearly designed to discourage representation of clients that may be characterized as disreputable. The first case provided for review and investigation prior to acceptance of a position as bond counsel. The latter case established a more detailed procedure, in which the firm agreed both to have a committee of partners consider any new representation of a client with registered securities and to make inquiry—with the client waiving its confidentiality privilege for these purposes—of prior counsel if that counsel had terminated its representation and of any auditors who were terminated within the preceding two years. Disregarding the risk that such a coerced waiver of confidentiality could unknowingly subject the client to a much broader waiver,[91] this process of screening of clients is clearly contrary to the dictates of three ethical considerations: ECs 2-26, 2-27, and 2-28:

> A lawyer is under no obligation to act as adviser or advocate for every person . . . but . . . a lawyer should not lightly decline proffered employment.
>
> [A] lawyer should not decline representation because a client or a cause is unpopular or community reaction is adverse . . . .
>
> The personal preference of a lawyer to avoid adversary alignment against . . . public officials . . . does not justify his rejection of tendered employment.

2. *Representational Ethics*

Both the *Ferguson* and *National Student Marketing* settlements include provisons to the effect that the firms involved will maintain

90. *See* text at notes 132-61 *infra*.

91. *See* note 59 *supra* and accompanying text.

written evidence of their client investigations. In the more recent case, which involved a very large firm, the purpose of that provision is said to be to ensure that information gathered will be available "on a continuing basis to lawyers actively involved in the Firm's representation of the client."[92] But two other, and more likely, purposes may be seen as the bases for the preparation and retention of such documents. One is that, in any subsequent proceeding, these documents will make it easier to examine the firm's behavior. The other, which is to the firm's self-interested advantage, is that in a future proceeding it will be easier to confirm what advice the client was given, and the extent to which the firm was innocent if the client participated in any fraudulent activity. For the latter reason, it is not at all unusual for lawyers presently in practice to maintain comprehensive files containing the information received from clients and the advice given when sensitive questions arise.

While no provisions of the Code specifically discuss the propriety of such memoranda, it is generally clear that they serve no client-related purpose. Rather, they create a record by which lawyers may free themselves of blame and place it squarely at the feet of the client. Given that purpose, there is clear conflict with the spirit both of Judge Sharswood's view that "[a]ll considerations of self should be sunk by the lawyer in his duty to the cause,"[93] and of Canon 7, which requires zealous representation of clients. Without even inquiring about whether the client is charged for the time the lawyer spends developing such insulation from the client's liability, it is apparent that the maintenance of these records drives a wedge into the notion of the lawyer's loyalty to the client.

3. *Limitation of Engagements*

The propriety of limited engagements is a third area in which the SEC settlements indicate a departure from what may have been considered the normal practice. *Ferguson,* which involved claims of securities law violations by bond counsel with admittedly little expertise in securities matters, implicitly suggests that the lawyer whose engagement is limited may be unable to avoid some responsibility for the transaction as a whole. That suggestion is supported by recent charges involving tax counsel issuing opinions that are used in securities transactions[94] and by the criticism of bond counsel in the

92. SEC v. National Student Marketing Corp., [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,027 (D.D.C. May 2, 1977), at 91,599.

93. G. SHARSWOOD, *supra* note 6, at 51.

94. To date, the enforcement actions brought by the SEC have not involved the claim that

recent SEC report on transactions in securities of the City of New York.[95] In cases of this sort, the clearly emerging view of the SEC, although a view disputed by the only recent decision in the area,[96] is that it is improper for a lawyer to accept a limited engagement and to deliver an opinion consisting of legal conclusions on relatively narrow issues without making an analysis both of the entire transaction and of the adequacy of disclosure. While the SEC's view does not contravene any aspect of the Code and may even find some minimal support in the provisions relating to the obligation to provide adequate and competent representation,[97] it certainly is at odds with heretofore normal expectations that a client could permissibly limit the scope of the legal engagement.

4. *Disclosure and Confidentiality*

The *Ferguson* settlement required that counsel make clear to potential clients that the firm has a duty to bondholders as well as to the issuer. It also required, in bond offerings pertaining to the construction of facilities—as was the bond issue in that case—that counsel to the user of the facilities and to any guarantor be asked to review the offering circular and confirm that there were no recognized material omissions. The *National Student Marketing* settlement contained a provision requiring "appropriate" response to inquiries from independent public accountants in accordance with the ABA-AICPA settlement and other provisions[98] designed to provide for all disclosure deemed necessary by the firm.

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tax counsel, issuing a limited tax opinion, has participated in a securities fraud; all of the cases have involved greater complicity of counsel, or have involved claims that the tax opinions themselves were, or were described in a manner that was, inaccurate and misleading. *See* cases cited at note 89 *supra*.

95. *See* SEC, STAFF REPORT ON TRANSACTIONS IN SECURITIES OF THE CITY OF NEW YORK, ch. 6 (1977).

96. Franke v. Midwestern Okla. Dev. Auth., 428 F. Supp. 719 (W.D. Okla. 1976) (firm retained as "bond counsel" for $6500 fee could not reasonably be expected to investigate overall soundness of issue).

97. *See* CODE, *supra* note 1, Canon 6 and Ethical Considerations 6-1 to 6-6.

98. The agreement to conform to the ABA-AICPA settlement is set forth in paragraph eight of the letter from the firm to the SEC that constituted a part of the settlement. Paragraph four of that letter provided that if, in the course of a transaction involving the issuance of securities, the firm became aware of a false or misleading representation that was not corrected by the client, the responsible partner would "*consider* with at least two other partners of the Firm the need for the Firm to withdraw from employment *or take other appropriate action*." (emphasis added.) Paragraph six provided for review of most registration statements under the Securities Act prior to their effectiveness by a partner experienced in securities matters who had not been involved in the transaction. SEC v. National Student Marketing Corp., [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,027 at 91,600 (D.D.C. 1977).

These provisions clearly move toward a view that the public is the true client of the attorney and suggest a concomitant departure from the more traditional views expressed in the Code and discussed earlier in this Article. The *Ferguson* case is particularly dramatic, in that the case does not involve a proxy statement, or even an equity offering, where the shareholder could come within a reasonable but extended definition of the corporate "client." Given the Code's ambiguity, it certainly would be difficult to make clear exactly what the duty to bondholders is thought to embrace, and by no stretch of the imagination can that duty, at least on the basis of any existing standard, be put on a level with the duty to the issuer. One must presume that the settlement envisions some stronger responsibility than that to which the Code refers, though its dimensions remain uncertain.

The substantial questions and ambiguities of the ABA-AICPA settlement have already been analyzed. The apparent imprimatur granted to it by the SEC in the *National Student Marketing* settlement, particularly in light of the strong disclosure obligation asserted by the complaint in that action, suggests that the SEC may view the lawyer's obligations under that settlement to be more extensive than the bar has been prepared to admit.[99] The provision in the *Ferguson* settlement for a comparable inquisition of other counsel, particularly without the voluminous analysis that preceded the ABA-AICPA settlement, raises even more perplexing questions. Why should counsel to an entity not a "party" to the offering circular pass upon it? What are the limits on *that* counsel's behavior? Does that counsel have some obligation of "due diligence" review? Does that counsel become a potential aider and abettor[100] if his letter permits a misleading offering circular to go to the public? Is that counsel's duty to his client subordinated to a general public responsibility?

It is clear then, that there is substantial movement away from the Code. It is not at all clear where that movement is going or what its boundaries are.

5. *The Locus of Decisionmaking Authority*

Finally, and perhaps most important, certain of the specific procedures adopted in the *National Student Marketing* settlement con-

99. *See* text at notes 70-73 *supra.*

100. *Cf.* SEC v. Universal Major Indus., [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,229 (S.D.N.Y. 1975), *affd.*, 546 F.2d 1044 (2d. Cir. 1976), *cert. denied*, 434 U.S. 834 (1977) (aiding and abetting violation in opinion letter by offeror's counsel used to convince offerees that shares were exempt from registration requirements); SEC v. Spectrum, Ltd., 489 F.2d 535 (2d Cir. 1973).

cerned the circumstances under which the firm would refuse to deliver an opinion or would consider taking other affirmative action. While some parts of those provisions relate to the confidentiality question discussed above, others raise questions about who is responsible for making decisions. That is seen particularly in the settlement provision setting forth that

> [i]n connection with any transactions involving the issuance of securities to the public where the Firm represents the issuer . . . the Firm will not deliver any opinion . . . if it has knowledge that (i) any material representation or warranty . . . is not true and correct in material respects . . . or (ii) there has been any material adverse change . . . unless in either case the client has taken appropriate corrective action.[101]

Obviously "knowledge" and "material" are imprecise terms, and reasonable minds may differ about their application in specific cases. But it appears that the law firm is now expected to determine their meaning on its own and, by refusal to deliver an opinion, to force its interpretation on the client. Thus, the SEC settlement has shifted the locus of decisionmaking authority from that envisioned by the Code.[102] Furthermore, in the circumstances of a normal public offering, when timing is critical, a firm's refusal to deliver an opinion is tantamount to withdrawal from the representation and seriously disadvantages the client, again contrary to the dictates of the Code.[103]

It is important to note that the settlement does *not* make any reference to the contents of the opinion—*i.e.*, whether it is general or limited in scope—or to the type of securities offering involved. A persuasive argument could be made that, if the firm thought there were a material misrepresentation in a public offering made on a firm underwriting basis, the attorney's obligation would not extend past making an appropriate disclaimer or reference in any part of the opinion affected by the misrepresentation. If the issuer and the underwriter—which has the advice of its own counsel and is the initial purchaser of the securities—disagreed with the firm's conclusion and were willing to accept the business risks of that disagreement, they could reasonably be allowed to do so. Under the terms of the *National Student Marketing* settlement, however, that will not be permitted, since the counsel's opinion is designed to be used as leverage. No opinion at all will be delivered if the firm concludes that there is

101. SEC v. National Student Marketing Corp., [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,027 at 91,600 (D.D.C. 1977).

102. *See* text at notes 30-34 *supra.*

103. CODE, *supra* note 1, DR 2-110(A)(2) and EC 2-32.

a material misrepresentation. Such use of the lawyer's opinion substantially changes the lawyer's position with regard to public offerings. And, though the consequences of a failure to deliver an opinion in a merger or acquisition transaction could be less severe, the settlement draws no such distinctions.

C. *Implications of the SEC Litigation*

It is apparent that there are substantial trends, some of them accepted by the bar, that draw the corporate adviser ever closer to a direct disclosure obligation and suggest that the function served by the corporate legal adviser is increasingly to be viewed as equivalent to the view that many have of the accountant—*i.e.*, an independent protector of the public interest.[104] However, that trend is occurring without any recognition of it in the Code, and as a result lawyers are more and more called upon to interpret the Code's conflicting provisions or even to determine on their own whether to satisfy the Code's assertions of propriety or those of the newly developing standards. Further, since these developments tend to occur in the incremental fashion of the common law, there is little guidance for questions that have not arisen in the past. For example, do the same considerations apply to counsel in a bond offering as in a communication with shareholders? Certainly a persuasive case can be made for a stricter duty to the corporate owners than to lenders; if "public interest" is the critical element, however, that distinction may not carry the day, as, indeed, *Ferguson* suggests that it will not.

Just as these developments demand the conclusion that the perceived role of the corporate legal adviser is changing, so also do they call for a broadly based, thoughtful, and authoritative determination of what that role should be. Surely corporate advisers must have, at the present time, a sense of frustration. They might be willing to accept a new role if it were rationally defined, so that they could pattern their behavior to comply with it. But the role is changing in an uncoordinated fashion, and the formal structure within which the

104. The accounting profession does not necessarily admit the accuracy of this description. *See* note 113 *infra.* However, virtually all of the legal literature on the question of the role of the lawyer assumes some such description of the accountant's role, and it is reasonably clear, to date at least, that the accountant's role is a more public one than the lawyer's. The most recent analysis, carried out by an independent commission established by the AICPA, concluded that the role of the auditor is to eliminate the inherent potential conflict between management and the users of financial statements, which suggests a relatively publicly oriented function. THE COMMN. ON AUDITORS' RESPONSIBILITIES, REPORT, CONCLUSIONS AND RECOMMENDATIONS 1-12 (1978) (The Cohen Commission Report).

corporate adviser operates has not changed in pertinent respects over the past twenty years.

III. The Corporate Legal Adviser's Environment

This Article has implicitly accepted the argument that the present Code should not extend to the corporate adviser since it was designed for the lawyer serving as an advocate.[105] Historically, that argument is indeed well founded. The Code draws heavily from Judge Sharswood's original work, which, in turn, was based upon the then-accurate view of the lawyer as participant in an adversary process. Since Judge Sharswood's time, however, society has, through the adoption of volumes of laws, moved more and more toward governmental regulation of private enterprise. As lawyers increasingly are called upon to advise on and assist in compliance with those laws, it can no longer be said that the typical lawyer is a litigator.

Still, it is neither fruitful nor fully accurate to assert that the Code, because not designed for corporate advisers, is irrelevant to them. Though the adviser cannot entirely share the orientation of the advocate, the corporate adviser not infrequently operates in a context that has many adversarial characteristics. In arguing for the concurrence of the SEC staff in an interpretation of the securities laws, for example, the corporate lawyer seems clearly to be an advocate. While good practice requires that all pertinent facts be disclosed so that the "concurrence" of the staff will be meaningful, the lawyer seems clearly entitled to avoid discussion of legally irrelevant facts that might adversely influence the staff, and he certainly may argue for a statutory interpretation favorable to the client. Other examples easily come to mind. In a public offering with a firm underwriting, counsel to the issuer is clearly in a position adverse to that of the underwriter's counsel, since it is the underwriter who is purchasing the securities. In an acquisition or merger, it is typically true that there are two opposing parties each represented by counsel. Certainly such adversarial interests are not always present in the work of corporate advisers, and there is no question that they operate outside the adversarial system of justice upon which the Code primarily focuses. But in establishing standards for the corporate adviser, it is wrong to assume that advice is given free from adversarial considerations.[106]

105. For support for this argument, see, *e.g.*, articles cited in note 14 *supra*.

106. It is quite difficult to define "adviser" and "advocate" in a way that satisfactorily

Thus, though corporate advisers do not participate directly in the adversary system, it is inaccurate to view them as entirely isolated from it. By and large, corporate advisers practice in partnerships with lawyers who do serve in a traditional adversarial capacity. Indeed, it is not unusual for lawyers to perform both functions. That the adviser or the adviser's partners are fully a part of the traditional adversary system is an important consideration that seems largely to have been ignored.

Assume, arguendo, that we accept some notion of public disclosure obligation for the lawyer as "adviser." What priorities do we establish for the law firm serving as adviser in the preparation of a registration statement and also representing the client in adversary activities? If, in the course of litigation, the firm learns of harmful though not conclusive evidence that is material and that, if discovered by the opponent, will dramatically and adversely affect pending litigation, is the firm's duty of confidentiality growing out of the litigation superseded by its duty to disclose material facts in the registration statement? Can the firm satisfy its obligations by simply withdrawing from the latter representation? Was it improper for the firm to handle both corporate and litigation matters, given that the conflict would not have arisen if the firm next door were handling the lawsuit? What about a potential dispute over a tax deduction taken by the corporation that may be disallowed *if* the IRS becomes cognizant of it—assuming, for present purposes, that tax counsel does not yet have a disclosure obligation to the IRS as representative of the public? And what about the distributorship agreement in which the distributor was represented vigorously by counsel who did not notice a potential antitrust problem—assuming here that there is no obligation of disclosure to the Department of Justice or the Federal Trade Commission? And what if the disclosure conflict relates to a matter in which the firm is representing the corporation, or its

differentiates between the two for purposes of this analysis. The Code definitions are clearly inadequate: "an advocate . . . deals with past conduct and must take the facts as he finds them. By contrast, a lawyer serving as adviser primarily assists his client in determining the course of future conduct and relationships." CODE, *supra* note 1, EC 7-3. That distinction, however, ignores the sense of an adversary process that is key to our view of the role of an advocate. Moreover, a few practical examples make clear that it is not the right distinction. A lawyer drafting a disclosure document certainly takes "the facts as he finds them" but is hardly in the position of an advocate. A lawyer negotiating an agreement in settlement of litigation is primarily determining the course of future conduct, yet he seems clearly to be an "advocate" for purposes of a determination of professional responsibilities. Probably the best definition is that an advocate is one who represents a client in or in connection with a contested pending or probable legal proceeding. Thus, a lawyer arguing with an administrative agency about an interpretation of a law or regulation is an advocate if the determination is made in the context of a "legal proceeding," which is admittedly an ambiguous term. A lawyer negotiating a merger, even though both parties are represented, would not be an "advocate."

president, in a criminal matter? Corporations may not be able to avail themselves of the privilege against self-incrimination,[107] but it would appear that they have a right to counsel,[108] and to subject counsel to such pressures may be unconstitutional.

The questions are obviously endless and not fully answerable. However, their very existence provides an answer of sorts: it is simply impractical, unfair, and improper within the current legal environment to saddle the securities lawyer—or other corporate legal adviser—with affirmative disclosure obligations. These lawyers can certainly *advise* disclosure, but to require them to insist upon it, whether directly or through the leverage of withholding opinions, creates irreconcilable conflicts with other clear obligations. Moreover, to grant a priority to the disclosure obligation threatens to subvert the adversary system of justice as long as the legal profession is organized as it presently is.

Must we, then, abandon any notion of public responsibility except in the extreme case of known fraud? Of course not. What we must do is *either* abandon much of that developing notion or reorder the legal environment. Either choice will require affirmative action, however, for the Code simply fails to provide adequate guidance.

IV. Rational Alternatives for the Future

A. *A Comparison of the Alternatives*

There are two rational alternatives: the lawyer as autonomous adviser and the lawyer as confidant. In a real sense the division between those two approaches is not as absolute as it may seem, for even the lawyer as confidant remains independent to the extent traditionally required by the Code. Recognizing the importance of the confidential role in no way releases advisers from Judge Sharswood's demand that they remain true to the dictates of conscience and resist complete deferral to the wishes of the client.[109] Without question it remains important under either alternative that the lawyer maintain the highest standards of integrity. The distinction be-

107. *See* California Bankers Assn. v. Shultz, 416 U.S. 21, 55 (1974); Hale v. Henkel, 201 U.S. 43, 74-75 (1906).

108. *See* Avco Delta Corp. Canada v. United States, 540 F.2d 258 (7th Cir. 1976); Vandersee v. United States, 321 F.2d 57 (3d Cir. 1963). *Henkel* explains the lack of fifth amendment privilege as based in the corporation's existence as a creature of the state, without the natural rights of natural persons, 201 U.S. at 74-75, an explanation that would not carry over to the right to counsel, which serves societal interests.

109. *See* text at note 10 *supra*.

tween the alternatives lies in their respective definitions of the lawyer's proper role in appraising and responding to client behavior.

With the complexity of the modern regulatory framework, many client-proposed activities are neither clearly legal nor clearly illegal. Conclusions on compliance with the law require substantial educated judgment, and the legal adviser's task is often to evalute the risk that a proposed course of action, if challenged, will be found to have been improper. And, since the cost of mounting a defense may itself be sufficient to deter a proposed activity, the legal adviser may instead be asked simply to gauge the likelihood that a challenge will be brought. In this context, assigning the adviser the autonomous or the confidential function will produce different consequences along the spectrum of activities on which he or she may advise.

As an indication of that generalization, let us consider, although quantification is obviously something of a fiction, three situations with varying and specific probabilities of legality. In Case 1 the adviser concludes that there is a 40% chance that a given public disclosure is legally required, in Case 2 a 50% chance and in Case 3 a 60% chance. In all three cases both the autonomous adviser and the confidant should no doubt urge disclosure, but remain alert to legitimate reasons for nondisclosure. In Cases 1 and 2, there will probably be no difference between the behavior of the autonomous adviser and the confidant if efforts to obtain disclosure prove fruitless, since even the autonomous adviser, while regarding disclosure as better, likely cannot conclude that it *must* be made.[110] In Case 3, however, substantial differences arise. In that situation, the autonomous adviser, sitting in the position of judge, would conclude that the disclosure is required, and accordingly he would have a duty to compel disclosure, even in the manner suggested by paragraph 48(i) of the *National Student Marketing* complaint. The confidant, on the other hand, certainly could not initiate disclosure and properly should not attempt to prevent the client's activity by resigning the representa-

110. The obligation that would be imposed here is unclear. There is a useful analogy to be seen in the accounting debate of recent years. In that context the SEC has adopted a requirement in Instruction H(f) of Form 10-Q that when a change in accounting methods is made, the independent accountant must file a letter stating whether, in his judgment, the change is an alternative preferable to the prior method. Securities Act of 1933 Releases No. 5549 (Dec. 19, 1974), 5 SEC DOCKET 727, 731 (1974), and 5611 (Sept. 10, 1975), 7 SEC DOCKET 816, 823 (1975). The accounting profession has objected to that procedure, however, primarily on the ground that, of two "acceptable" methods of accounting, the determination of which is "preferable" for a particular firm in a particular industry is a highly subjective judgment and not easily made. *See* Securities Act of 1933 Releases No. 5729 and 5729A (July 27, 1976), 10 SEC DOCKET 99, 142 (1976); *The Public Accounting Profession and Its Critics* 23, 25 (1976) (proceedings of a conference held at the Wharton School, University of Pennsylvania, May 25, 1976).

tion or otherwise. As the likelihood of illegality increases and as the perceived significance of the matter increases, the confidant would eventually have an obligation to resign, the turning point coming when the confidant concludes, without reasonable doubt, that to continue would be to participate in fraud. But self-initiated disclosure cannot be permitted except in the most unusual cases, for if the lawyer is a confidant, it is because we perceive an importance in confidentiality and its fruits that outweighs the autonomous function.

Additionally, it must be recognized that the choice of roles leads to a more subtle result. The autonomous adviser, sitting as judge and inherently having less of a sense of client loyalty, is probably more likely to conclude that action is required contrary to that desired by the client. In the general disclosure situation, for example, the law remains unclear on when and whether issuance of a press release is required. Currently, it is possible to conclude that—assuming there is no trading by insiders or "tippees"—a corporation is required to issue a press release upon the occurrence of a material event unless there is a legitimate business reason for nondisclosure.[111] If the autonomous adviser and the confidant both view the law that way, it nevertheless is true that the autonomous adviser will be less inclined to accept the legitimacy of a business reason for nondisclosure. Thus, if Case 1 above involved a press release, it is likely that the confidant would perceive the probability that disclosure is required by law as being less than 40%, the autonomous adviser as more than 40%. In a world where any given disclosure affects many competing interests—those of the corporation as well as of its creditors, its shareholders, persons contemplating purchases or sales of its securities, and its competitors, to name a few—it is not obvious which sort of bias society should desire the corporate adviser to possess.

B. *An Evaluation*

In light of the diverse interests involved, it is clear that we as a society can decide how advisers should behave only by attempting to evaluate the costs and benefits of the alternative roles. What follows, therefore, is an analysis of how the lawyer as autonomous adviser would differ from the lawyer as confidant.

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111. *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 850 n.12 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969); SEC v. Shattuck Denn Mining Corp., 297 F. Supp. 470 (S.D.N.Y. 1968).

1. *The Lawyer as Accountant*

Let it be admitted that the title of this subsection is misleading. A common reaction to the *National Student Marketing* complaint was to claim that lawyers were being charged with the sort of independent public duties properly belonging to certified public accountants.[112] The accounting profession, however, has not by any means admitted that it is responsible to the public in general rather than to clients,[113] and the growing recognition of an accountant-client confidentiality privilege in state law[114] lends some support to that position. However, it is fair to suggest that the common perception of the accountant's duty is that it is primarily public in nature, and certainly the accountant's duty is more nearly public than is the traditional duty of the lawyer.

But a public duty for advisers certainly could be adopted by a rational society; there is nothing inherently wrong with a structure in which they would have such obligations. The societal advantage of this publicly oriented role is that it gives substantial, independent authority to the talented minds that participate in the advisory process. In effect, it recruits for public use all that talent that Justices Douglas[115] and Stone[116] so long ago saw as being employed for anti-public purposes. And, while that thought may suggest to some an invasion of the corporate boardroom by quasi-governmental spies, it must be acknowledged that accountants, with at least a relatively greater public duty, have escaped being viewed in that way. Indeed, social and professional relationships between accountants and their clients appear as harmonious as those between lawyers and their clients.

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112. *See generally* S. GOLDBERG (ed.), EXPANDING RESPONSIBILITIES UNDER THE SECURITIES LAWS (1973); ABA National Institute, *supra* note 40, at 91.

113. *See* Hicks, *The Role of the Auditor in Disclosure*, in *Disclosure: Benefits and Problems*, background papers, *The Third Seaview Symposium* 194 (1974) (arguing that CPAs should be independent of both client and general public); AICPA, Statement of Auditing Standards No. 20 at ¶ 8 (discussing the question of disclosing control weaknesses only to management, not whether they should be disclosed to the public). *But see* Axelson, *Critique*, in *Disclosure: Benefits and Problems*, *supra*; Wiesen, *The Cohen Commission Report: A Perspective on Disclosure Regulation*, J. ACCOUNTANCY, Aug. 1977, at 90; Carmichael, *The Auditor's Role and Responsibilities*, J. ACCOUNTANCY, Aug. 1977, at 55; *A Wider Look at What CPA's Do*, BUS. WEEK, Jan. 30, 1978, at 71.

114. Fifteen states or territories currently recognize an accountant-client privilege. 8 WIGMORE ON EVIDENCE 533 n.22 (McNaughton rev. ed. 1961) & 1975 Supp. at 72.

115. Douglas, *Directors Who Do Not Direct*, 47 HARV. L. REV. 1305, 1329 (1934).

116. Stone, *The Public Influence of the Bar*, 48 HARV. L. REV. 1 (1934). The article reprints the address given by Justice Stone on the occasion of the dedication of the Michigan Law Quadrangle.

For lawyers, an important advantage of the independent model is that it provides a relatively clear definition of their responsibilities and thus rescues them from the current schizophrenia. In essence, the autonomous adviser would serve as an investigative reporter, determining that all relevant documents and data have been obtained and reviewed and then preparing the document for which he or she has been hired. At the conclusion of the investigation, an appropriate opinion would be delivered.

But while that concept might quickly be accepted, it must be recognized that its realization would not be easy. If this public function is to be served, some mechanism would have to be developed that would cause corporations to retain autonomous advisers. At present, the *required* role of the lawyer in securities disclosure documents is quite limited. A corporation need not use a lawyer to prepare any of its disclosure documents, and, unless there is good reason for a corporation to avail itself of an autonomous adviser's services, many corporations would not do so. Two mechanisms appear feasible to implement the autonomous adviser system. The first, and less intrusive, is not really a "mechanism" in the usual sense: the market, through the bank and brokerage community, might demand that a corporation associate autonomous counsel as a condition precedent to receiving external financing. In many respects that is the current practice with municipal bond issuances, and it is for that reason that municipal bond legal opinions tend to be given by a relatively small number of firms. The bonds simply will not be salable without the legal opinion of one of those recognized firms. The second and more direct method would be to require by statute or regulation that certain documents be reviewed by autonomous legal advisers.[117]

Assuming that corporations are effectively compelled to use autonomous legal advisers, a more detailed definition of "autonomy" is required. It would seem clear that inside counsel could not be autonomous, and so whatever documents require such counsel could not be prepared by inside counsel alone. Similarly, the impossibility of maintaining a public responsibility and a simultaneous client-oriented confidential relationship dictates that the autonomous adviser

117. At present, the only required involvement of lawyers in the disclosure process relates to an opinion about the legality of an issue of stock. It is suggested in item 23 of Schedule A and item 12 of Schedule B, 15 U.S.C. § 77aa (1976), under the 1933 Act, and reflected in most pertinent forms for registration under the 1933 Act. In practice, of course, lawyer involvement in the preparation of most disclosure documents is far more extensive, although it remains true that many of the current reporting forms under the 1934 Act—*e.g.*, forms 10-K (annual report), 10-Q (quarterly report), and 8-K (periodic report)—are often prepared with relatively little lawyer involvement.

and his firm not perform many services for clients other than the preparation of documents requiring the autonomous adviser's opinion.[118] Given the confidential nature of the information that becomes available in litigation and the lawyer's obligations in that context, it would appear that autonomous counsel should be prohibited from representing the publicly held client in any litigation.[119] As to matters of a less sensitive nature, such as business planning, contract negotiation and drafting, and tax advice, where it might be argued that confidentiality plays a less critical role, it seems possible that the conflict would not be such as to destroy autonomy. Certainly that is the general view of the accounting firms that perform similar services for their clients. However, accountants continually debate these questions,[120] and, with the luxury of writing on a clean slate, it may be that all activities performed by lawyers should be categorized as either adversary or advisory in nature, and the autonomous adviser—with public responsibilities—should be permitted to perform only advisory services. If the autonomous model gains acceptance, it is reasonable to expect that tax advice and some other quasi-adversary functions would eventually be shifted into the advisory column. It should be even clearer that the autonomous legal adviser must not be director or shareholder of the client.

It would also be useful to establish mechanisms to protect autonomy. Again, we may look to the accounting profession for guidance. In that context, the SEC requires issuers that replace auditors to notify the Commission in a public report[121] and to advise it of any disagreements regarding disclosure within the past two years; the discharged accounting firm must also review that report and confirm its views to the SEC. Similarly, the SEC requires that the client not be in substantial debt to its auditors, since that obviously could re-

118. Similar problems continue to plague the independent accounting profession. *See* Securities Act of 1933 Release No. 5869 (Sept. 26, 1977), [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,306. *See also* Securities Act of 1933 Release No. 5270 (July 5, 1972), relating to doubts about the independence of auditors from clients resulting from family relationships, financial interests, business relationships, creditor relationships, occupations with conflicting interests, interests as counsel to clients, interests as a broker-dealer, and the performance of bookkeeping services.

119. The only alternative, some form of "Chinese Wall," is simply not satisfactory. *See* The Fund of Funds, Ltd. v. Arthur Andersen & Co., 567 F.2d 225, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,237 (2d Cir. 1977). *But see* Hunsicker, *Conflicts of Interest, Economic Distortions, and the Separation of Trust and Commercial Banking Functions*, 50 S. CAL. L. REV. 611, 634-47 (1977) (advocating "Chinese Wall" between commercial and trust departments of larger banks to avoid illegitimate use of information).

120. *See* note 118 *supra*.

121. The requirement is contained in Item 4 of Form 8-K, adopted pursuant to Section 13 of the 1934 Act, 17 C.F.R. § 249.308 (1977). *See also* Securities Act of 1933 Release No. 5868 (Sept. 26, 1977) [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,305.

duce independence.[122] If these provisions are necessary in the accounting field, where the dominance of the larger firms creates an inherently less dependent structure, they should certainly be minimum requirements for the autonomous branch of the legal profession, given that there is no basis to anticipate that it will soon develop similar centralization.

The foregoing is a brief analysis of the types of structural change necessary to create a workable autonomous legal advisory profession. It may well be that a separate branch of the ABA should also be formed for such firms, much as the AICPA is establishing a branch for accountants who audit publicly held firms,[123] since the concerns and aims of autonomous advisers would be very different in nature from those of traditional lawyers. Certainly if the autonomous path is the one we choose to walk, a much more precise codification of the meaning of autonomy and of the duties and responsibilities of the autonomous adviser is required.

Ultimately, what this separation of the functions of adviser and advocate suggests is something akin to the separation in the English bar between barristers and solicitors. While that separation was established without any thought to the conflicts that the present suggestion seeks to eliminate, it is at least worthy of note that this "radical" proposal has an historical antecedent in the very source of our concept of a system of law.[124]

2. *The Lawyer as Confidant*

In contrast to implementing the role of autonomous adviser, no new trail need be cut to retain, or perhaps to readopt, the role of confidant for the legal adviser. Though it may be necessary to remark the road and possibly to remove a few weeds, its outlines remain those of the present Code.

The confidential adviser serves the client—and society—through advice and, to the extent possible, persuasion based on an analysis of the law and its progress. Some would criticize that role as being merely diagnostic, as placing the modern adviser in a position where

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122. Securities Act of 1933 Release No. 5270 (July 5, 1972) at 8: "When the fees for an audit or other professional service remain unpaid over an extended period and become material in relation to the current audit fee, it may raise questions concerning the accountant's independence . . . . [N]ormally the fees for the prior year's audit should be paid prior to the commencement of the current engagement."

123. *See* note 150 *infra*.

124. One relevant distinction is that in the English system barristers cannot receive fees for serving on the board of directors of a client corporation, while solicitors suffer no such inhibition. *See* B. HOLLANDER, THE ENGLISH BAR: A PRIESTHOOD 41-42, 67 (1964).

the client is the "keeper of the attorney's professional conscience." Indeed, that perception of the corporate adviser's function may well lie at the heart of current attacks upon confidentiality and the corresponding push for autonomy.

Such analysis, however, fails to recognize that the role of the corporate adviser is not merely to advise whether a particular course of conduct is likely to survive a challenge under the present law. He is also to come to conclusions about the direction in which the law will move. The facts that culminated in *Blue Chip Stamps v. Manor Drug Stores*[125] took place as early as seven years before the decision. Those of *Ernst & Ernst v. Hochfelder*[126] preceded the decision by at least ten years. *Mills v. Electric Auto-Lite Co.* was before the courts for fourteen years prior to its conclusion.[127] Under such circumstances, the adviser must always have a sense of movement in the law, a sense based to some degree upon fundamental notions of how the law ought to develop and of what society, through its judges or administrative agencies, will at a future date determine to be fair or unfair, proper or improper. In that regard, the lawyer does not advise only as an individual or bring only an individual sense of right to the appraisal of corporate behavior. To the extent that society's conscience is or, within the attorney's predictive ability, will be manifested in its laws, the confidential adviser brings that conscience to bear on the actions of the corporate client.

If that function of expressing the societal conscience is to be retained, confidentiality must be protected, though for reasons other than those involved with the adversary context. Confidentiality is essential to the advocate because the advocate exists to represent the client in the traditional sense by speaking, acting, and arguing on his behalf. The adversary system assumes that justice will result from the clash of opposing representatives in a court of law, a conception that is indefensible unless the advocates have at their command all information known to their respective clients. Confidentiality is necessary to protect the free flow of information without which the advocate cannot perform the assigned function.

Similar needs are not present in the advisory context, for the adviser does not represent the client or argue the client's case. The adviser quite simply assists the client in selecting and carrying out a course of behavior. As noted above, it is peculiar to the legal ad-

125. 421 U.S. 723 (1975).

126. 425 U.S. 185 (1976).

127. 552 F.2d 1239 (7th Cir.), *cert. denied*, 434 U.S. 922 (1977). *See* Lorne, *A Reappraisal of Fair Shares in Controlled Mergers*, 126 U. PA. L. REV. 955 (1978).

viser's function that that assistance necessarily involves perceptions of societal conscience. But the adviser cannot accurately articulate the societal conscience without knowledge of facts. To return to the example of the press release, "insider" purchases may well have a bearing on conclusions about whether an item is material.[128] But, since these purchases may also increase the risk of individual and corporate liability, the adviser may hesitate to ask such questions or at least not expect honest answers unless there can be an assurance of confidentiality. Thus, although the needs for a free flow of information and thus the justifications for confidentiality differ markedly in the adversary and advisory contexts, protection of confidentiality is necessary if corporate advisers are to serve the function of articulating the societal conscience.[129]

3. *The Critical Additional Factor*

It should be clear, then, that a rational society might choose that corporate advisers serve in either an autonomous or a confidential capacity. It should also be clear that the two functions are incompatible and that, if corporate lawyers are directed to be autonomous, their role as corporate conscience will be destroyed. Indeed, the public value of an autonomous adviser will, to a large extent, depend on the ability of society to deceive clients into believing that they have a confidential relationship with their legal advisers.

An even stronger reason for discarding the autonomous model is that the choice between roles must be considered not in isolation, but in the context of the corporate world. In that world, one profession already approximates the autonomous model, and unless we are somehow convinced that lawyers are better investigators than accountants, or more intelligent or more honest than accountants, or deal in areas not considered by accountants, or that accountants themselves are not expected to be autonomous, it makes little sense to push both professions toward autonomy. The advantage of two autonomous professions over one cannot compensate for the loss of confidentiality.

Although many commentators have observed and apparently endorsed the parallel movement of accountants and lawyers toward

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128. *See, e.g.*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 851 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

129. The value of the corporate adviser's ability to obtain the confidence of the client is discussed in Chief Judge Lumbard's dissent in United States v. Tellier, 255 F.2d 441, 451 (2d Cir. 1958). Such concerns did not seem to perturb the *Tellier* majority, however.

autonomy,[130] the development is fundamentally ill-conceived. We are not dealing simply with "professionals," but rather with two distinct professions. There is no reason that both should serve the same or even similar functions; if that were a goal, we could save considerable duplication by removing lawyers from the disclosure process. Accountants are already well versed in it, and their familiarity with disclosure principles is unquestionably greater than lawyers' familiarity with accounting principles and auditing standards.

Against that background, the argument against autonomy for the legal adviser becomes compelling. In essence, that shift in roles duplicates existing services while destroying the lawyer's ability to function as corporate conscience—and, absent psychosis or the phenomenon of parapraxis, a conscience has no ability to initiate disclosure. Furthermore, to adopt the current trend and to assert independent obligations on a confidential relationship is deception without purpose. It is to tell clients that they can repose confidence in their lawyers and yet to tell lawyers not to respect those confidences. It will work only so long as both lawyers and clients are fooled. When it is finally understood that confidentiality has been lost, clients will no longer permit information to flow to their lawyers, and conscientious lawyers will not seek to obtain it. The lawyer, then, will be left as a relatively autonomous figure in an environment in which that autonomy cannot properly function. And with the adviser in that ambiguous role, the traditional lawyering efforts of his litigating partners will suffer significantly from restrictions on the flow of information.

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130. *See, e.g.*, Lowenfels, *Expanding Public Responsibilities of Securities Lawyers: An Analysis of the New Trend in Standard of Care and Priorities of Duties*, 74 COLUM. L. REV. 412 (1974).

It is at least of historical interest that the SEC in the past has not only recognized, but has seemingly endorsed, separate roles for accountants and lawyers. In American Fin. Co., 40 SEC. DEC. & REP. 1043, 1049 (1962), the SEC stated:

> Though owing a public responsibility, an attorney in acting as the client's advisor, defender, advocate and confidant enters into a personal relationship in which his principal concern is with the interests and rights of his client. The requirement of the Act of certification by an independent accountant, on the other hand, is intended to secure for the benefit of public investors the detached objectivity of a disinterested person.

In that case, the SEC determined that a person who served as counsel to a corporation was not, for the reasons expressed, sufficiently independent to be its accountant; the view was seemingly reaffirmed as recently as 1972. *See* Securities Act of 1933 Release No. 5270 (July 5, 1972).

The SEC has urged client loyalty when one of its own lawyers left to join the private sector, arguing for the required confidentiality of information he obtained while counsel for the SEC. U.S. v. Mahaney, 27 F. Supp. 463 (N.D. Cal. 1939).

V. THE CODE OF PROFESSIONAL ADVISORIAL RESPONSIBILITY

The preceding portions of this Article have dealt with the question whether society is better served by the corporate legal adviser's serving in an autonomous or in a confidential capacity. The author's conviction should be obvious: the confidential role is important and should not be eroded; countervailing needs of society are adequately served through other existing means. Whether or not that conclusion is accepted, however, the preceding analysis should make clear to all that there is a need to establish a body of ethical precepts for the conduct of the corporate adviser. The Code, with its unquestionably adversarial birthright, is simply inadequate to that task.[131] Accordingly, this Article now addresses some of the more critical elements of a Code of Professional Advisorial Responsibility—the needed codification of standards relevant to the practice of the corporate legal adviser.

This portion of the Article does not purport to consider the entire body of standards properly applicable to the conduct of the corporate legal adviser, for that is properly the task of a diversified group of minds capable of representing a more general consensus. However, there are some particularly critical elements of the relationship between adviser and client that may properly be considered at this juncture. Specifically, this section of the Article addresses several crucial concerns: the question of who properly speaks for the client to its adviser—*i.e.*, the question of who "is" the corporate client; the question of what, if any, restrictions should apply to the acceptance of clients or to the acceptance of limited engagements; the extent to which the corporate adviser's confidentiality obligation should be recognized in the face of conflicting societal interests; and the duty of the corporate adviser to avoid improper alignments with the client.

In designing the Code of Professional Advisorial Responsibility, it must be recognized that we need not write upon a blank slate. While the present Code does not sufficiently illuminate the duties of the adviser, it is true that the role of the adviser and the relationships between advisers and their clients have developed against a background in which the present Code and its ancestors were the only bases for the determination of duties. Consequently, it should not be surprising if many of the duties expressed in the Code are comparable to what society expects of its advisers. Additionally, it should not

131. *See also* Cheek, *Professional Responsibility and Self-Regulation of the Securities Lawyer*, 32 WASH. & LEE L. REV. 597 (1975); Shipman, *The Need for SEC Rules To Govern the Duties and Civil Liabilities of Attorneys Under the Federal Securities Laws*, 34 OHIO ST. L.J. 231 (1973).

go unsaid that the first task in the preparation of a new code such as that proposed here is the drafting of a careful preamble that should, *inter alia*, clearly distinguish between when a member of the bar is serving as an adversary and when he is serving as an adviser.

A. *Who Speaks for the Client?*

The inadequacy of the definition in the present Code—that the corporate client is the entity itself—has already been discussed.[132] The problem is that the difficult questions in this area most often arise when there is a perceived difference between the interests of the entity and the interests of persons related to it. Those latter interests may, in some instances, be sufficiently connected to the entity to present an argument that the persons interested in them should be viewed as the client. In *National Student Marketing*, for example, concern was with the rights of shareholders, the owners of the enterprise in the historical view. It is easy in such a case to argue that the shareholders are really the client. But the public nature of the shareholders is such that accepting them as the client renders a confidential relationship with the attorney impossible. And, indeed, it takes no more than a review of the facts of *Ferguson* to realize that the position of the SEC in such cases does not view shareholders as clients, since the duties of the attorneys asserted in that case ran to persons who were merely potential—not even present—holders of debt securities.

If, then, we are left, as the present Code properly argues, with the "entity" as the client, who is to speak for it? If the lawyer is counsel to the entity, with whom does the lawyer consult, to whom are questions to be addressed, from whom are responses to be accepted? The immediate answer is the board of directors or persons properly delegated by it, but that is certainly not acceptable in all instances. Though it is probably permissible for the lawyer to rely generally on the board, the existence of—or the lawyer's perception of—an actual or potential conflict between the board members and the interests that might be ascribed to the corporate entity[133] should qualify that reliance. Thus, for example, when measures are proposed that make acquisition of the corporation more difficult, consideration should be given to requiring, as an ethical standard, that the lawyer request, or even insist upon threat of withdrawal, that a committee of the

132. *See* text at notes 19-20 *supra.*

133. *See also* March, Relations with Management and Individual Financial Interests (Background paper for ABA Airlie House Conference on Ethical Responsibilities of Corporate Lawyers, June 9-11, 1977), *subsequently published in* 33 BUS. LAW 1227 (1978).

board consisting of persons not otherwise affiliated with the corporation be established to advise counsel.[134] To the extent feasible within the board's membership, that committee should be free from the influence of any executive or substantial shareholder.

Of course, it should be recognized that the conflict that would demand appointment of such a special committee cannot involve simply differences of opinion between the board and the lawyer on what is "right," for the corporate adviser has no more divine inspiration than did Judge Sharswood's advocate.[135] Rather, the lawyer's responsibility should be limited to a determination of whether the board, or its designee, or one of its members has some interest apart from those of the entity that, in the judgment of a reasonable person, would likely affect decisions on corporate behavior.

Illustratively, consider the question of corporate perquisites. To date, attention has focused primarily on whether such perquisites must be recognized as a form of remuneration either for disclosure[136] or income taxation[137] purposes. However, it is often difficult to draw the line between what is a legitimate corporate expenditure for non-compensatory business purposes and what is effectively an additional form of management compensation. Assume that the law is simply unclear on whether a particular payment for an activity of the chief executive officer is a form of remuneration and therefore must be disclosed. Under such circumstances, the officer, who may have personal and economic motivations differing from those of the corporation, should not be permitted to determine the answer to the disclosure question. But the adviser should be entitled—and even required—to accept the determination of an informed, independent board of directors, even if the adviser harbors a personal view that such expenditures should not only be disclosed, but abolished out-

134. *Cf.* Lasker v. Burks, 567 F.2d 1208 [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,282 (2d Cir. 1978) (discussing the role of independent directors of mutual funds and the problems inherent in defining "independence").

It is particularly important to bear in mind certain pertinent considerations. First, the question is not who is the client, but who speaks for it. When the focus of inquiry is on the locus of authority, and not on many of the other questions that attend attorney-client relationships, those other questions should not be permitted to cloud the analysis. That is, even though the present Code is entirely correct in asserting that the entity itself is the client, the attorney still needs a reasoned basis by which to judge from whom he should accept direction. Absent a conflict—as to the existence of which the adviser has an obligation to be particularly sensitive—the board of directors, including its designees, should be seen as clearly filling that role.

135. *See* G. SHARSWOOD, *supra* note 6, at 26.

136. *See* authorities cited in note 22 *supra.*

137. *See, e.g.,* R.T. Armantrout v. Commissioner, 67 T.C. 996 (1977); Halperin, *Business Deductions for Personal Living Expenses: A Uniform Approach to an Unsolved Problem,* 122 U. PA. L. REV. 859 (1974).

right. If the payments involved the entire board, however, such as a program reimbursing all board members for certain expenses, the analysis advanced above suggests that the program's adoption and the question of disclosure should be considered and passed upon by an external committee made up of persons who are not board members. Though counsel would have the authority—indeed, the responsibility—to express views contrary to those of the committee, he should not be allowed to insist either that his views be adopted or that they be aired publicly. In an unclear case, the ultimate decision is not counsel's to make.

The appointment of such external committees to direct counsel is not, of course, a mechanism envisioned or even authorized by current state laws.[138] Indeed, the special committee would not have the legal authority to bind the corporation, and any of its recommendations or decisions would have to be adopted by the corporation through processes appropriate under applicable state law. Even so, the mechanism, if adopted by the organized bar, would operate in relatively efficient fashion to provide the corporate adviser with guidance about the desires of the speechless entity. The solution is not, perhaps, completely satisfactory, but it is a reasonable means to a necessary end.[139]

B. *The Acceptance of Representation*

1. *The Acceptance of Clients*

Some of the recent developments discussed earlier in this Article suggest that a notion may be evolving that counsel should not accept some kinds of clients or some limited engagements. As to the former, the trend toward rejection of disreputable clients can be seen in the *Ferguson* and *National Student Marketing* settlements, both of which

138. *But cf.* DEL. CODE tit. 8, § 145(d) (providing for opinion of independent counsel as a prerequisite to indemnification of officers or directors under certain circumstances when there is a conflict within the board).

139. A related problem not addressed in the text is how the difficulty in determining who is the client affects the attorney-client privilege. It has been held that under some circumstances the corporation may not claim the privilege in litigation with its own shareholders, the persons to whom financial statements might be considered primarily addressed. Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971). *See generally* Note, *The Attorney-Client Privilege and the Corporation in Shareholder Litigation*, 50 S. CAL. L. REV.303 (1977). *Garner* does not, however, stand for the proposition that there is no privilege with a corporation or even for the more limited proposition that the privilege can never prevail as against shareholders. It simply holds that, under some circumstances, when shareholders challenge actions of the corporation they own, they may be able to discover communications with counsel. As to the propriety of representing both a corporation and its directors in a shareholders' derivative action, see Messing v. FDI, [1977-1978 Transfer Binder] FED. SEC. L. REP. ¶ 96,217 (D.N.J. 1977), and cases discussed therein.

required an investigation of potential clients prior to accepting their representation. Those settlements do not conflict in general with the current position of the practicing lawyer: most lawyers who are economically able to be selective consider it unwise, if not unprofessional, to accept representation of a disreputable client.[140] Indeed, the recent experience is such that any corporate legal adviser must be fearful of such clients, since it appears that the lawyer will likely be subject to investigation, if not sanction, if the client raises the wrath of the authorities.

The question whether disreputable corporate clients are entitled to good legal advice does not, of course, rise to the systemic dimensions achieved by the question whether such clients could be denied representation in litigation. Yet, it is an important issue involving important societal considerations. When the agreement to investigate clients prior to accepting representation is imposed by the Commission in a settlement, as it was in *Ferguson* and *National Student Marketing*, a suggestion surfaces that disfavored clients either should be denied the benefit of counsel or should be required to engage lawyers who are unaware of or unconcerned with their purported obligations. It is conceivable that the SEC's intent is less suspicious, aiming simply either to prevent disfavored clients from engaging in activities that require lawyers or to require that extraordinary care be given to such clients. If either of those is the goal of such provisions, however, reality is being ignored and extra-legal penalties are being imposed on the disfavored. But whatever their purpose, such procedures raise severe questions of due process.[141]

From a broader perspective, these procedures also make it important to question whether society is not better served if even the disreputable clients have access to principled counsel. Certainly it will occasionally happen—as it should—that better counsel will enable the client to achieve ends legally that some might view as undesirable—the popular, overused, misused and no longer meaningful phrase is "find a loophole." But if the law as written by society does not prevent the achievement of such ends, society has itself to blame, not those who rely upon its rules. More important, as often as better counsel may help the disreputable client in achieving an "undesir-

140. This may be one respect in which Dean Freedman's concerns that the securities bar has become the captive of the SEC are particularly evident. *See* Freedman, *supra* note 14. There can be no doubt but that the concern of the lawyer or the firm over its relationship with the SEC has played a substantial part in decisions not to accept clients.

141. The Securities Subcommittee of the Senate Banking Committee, chaired by Senator Harrison Williams, recently commenced an investigation of denial of due process in SEC enforcement activities. SEC. REG. & L. REP. (BNA) No. 425 at A-1 (Oct. 26, 1977).

able" end, such counsel will dissuade the client from that illicit undertaking or channel the client's efforts along more appropriate lines.

Of course, it may be that both the role of corporations in society and the general considerations of due process in the context of economic behavior are such that we are no longer concerned with denying qualified counsel to disreputable corporate clients—although it might be noted that qualified counsel are probably less adept at achieving socially undesirable goals than unprincipled counsel. But if we do desire that even clients of poor reputation have counsel available—that is, if we are willing to take the risk that some such clients will be helped to "evade" (read: follow too precisely) the law in the hope that others will be prompted to mend their ways—two things are essential. The first is uniform action. It should be clear that for one firm today to announce that henceforth it will advise the disreputable together with their white-hatted brethren would succeed only in destroying that firm's reputation. Accordingly, the organized bar must dictate, and the major law firms must accept, that *all* clients are entitled to representation and that representation should not be denied except in the case of conflict or of a representation that is actually believed to involve activity that is fraudulent or otherwise contrary to law.

The second requirement is probably beyond the control of any organized group other than Congress and the state legislatures, and they, in fact, are not likely to act on it. But regardless of that constraint, it should be established that lawyers cannot be held liable, absent malpractice (with liability only to the client), active participation, or gross negligence, when they are found in the presence of clients who have committed fraud. It may reflect an idealistic view of the integrity of the bar, but the author believes, and recognizes it as a matter of faith that most lawyers are conscientious and will not knowingly countenance fraud. But it is inevitable that, if honest counsel make their services available to disreputable clients, they will on occasion be found in the middle of wrongful behavior. That is the necessary price for the general availability of counsel. It is no different in nature and quite possibly less damaging to society than the price we pay when a good lawyer wins an acquittal of the criminal defendant who is in fact guilty. Nobody has yet suggested that the criminal lawyer should be held responsible, either legally or morally, for a subsequent crime by the client. The analogy admittedly is imperfect, but the societal questions are comparable. In sum, we should not hesitate to remove counsel's fear of accepting a corporate representation.

2. *Acceptance of Limited Engagements*

A comparable question, but one that is far more perplexing, is whether the corporate adviser should be prohibited from accepting a very limited engagement within a larger transaction. Nothing in the Code or tradition suggests that there is a responsibility to do more than the client requests, and yet there surely is some point at which it is improper to accept a request to perform no investigation and to deliver, on an assumed state of facts, an opinion that is essential to a larger transaction. But under what circumstances does an investigative obligation arise for the corporate attorney? The ABA[142] and the Association of the Bar of the City of New York[143] seem agreed both that the lawyer may rely on facts recited by the client unless there is reason to suspect their veracity and that the lawyer's obligation is to avoid *knowingly* issuing an opinion to be used in a fraudulent transaction. The SEC's view appears to go further.[144]

It would not necessarily be improper to impose broader responsibilities on the lawyer with an ostensibly limited engagement such as issuing an opinion necessary to the sale of municipal bonds, or to the distribution of tax-shelter securities, or to the private unregistered sale of stock. Nor do any fundamental societal interests appear involved other than the obvious ones of cost to the client—which may be substantial—and protection of those investors who may construe the opinion as an endorsement by the lawyer. Simple fairness, however, requires that both lawyers and clients at least be made aware of the extent of the lawyer's obligation to investigate.

Although most of the attention given this issue, both in the litigation[145] and in the deliberations of the organized bar,[146] has focused upon the issuance of opinions, the real question is somewhat broader. At the heart of the matter is whether lawyers ethically may accept limited engagements. The specific questions that arise out of

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142. ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 335 (1974).

143. Special Committee on Lawyers' Role in Securities Transactions, *Report*, 32 REC. ASSN. B. CITY N.Y. 345 (1977).

144. *See* notes 94-96 *supra* and accompanying text.

145. *See* Franke v. Midwestern Okla. Dev. Auth., 428 F. Supp. 719 (W.D. Okla. 1976); cases cited in note 89 *supra*.

146. *See* ABA COMM. ON PROFESSIONAL ETHICS, *supra* note 142; Special Committee on Lawyers' Role in Securities Transactions, *supra* note 143. *See also* Babb, Barnes, Gordon & Kjellenberg, *Legal Opinions to Third Parties in Corporate Transactions*, 32 BUS. LAW. 553 (1977).

that larger inquiry range from whether the adviser may render limited advice to whether a lawyer may be publicly associated with an essential element of a transaction without being to some degree responsible for the transaction as a whole. Somewhere in between those questions lies the issue of the adviser's obligation to examine and pass upon the work of other counsel with greater responsibility for the entire transaction.

To focus better upon the questions raised in this area, let us assume that a tax lawyer *(TL)* is asked to give tax advice to the general partner *(GP)* of a proposed limited partnership. The more significant issues involving the scope of *TL*'s responsibilities might be posed as follows:

1. If the sole function requested of *TL* is to provide advice on the structure and activities of the partnership that will maximize tax advantages to the limited partners, does he under any circumstances have an obligation to examine, or at least be sensitive to, the broader implications of the transaction as a whole?

2. Are *TL*'s obligations increased if he renders a formal, written opinion to *GP* about tax consequences, assuming that the opinion is neither intended to be, nor is, disclosed to any person other than *GP*?

3. Are his obligations increased if the opinion states that it is for *GP* alone, but its contents are disclosed to the limited partners, assuming *TL* should anticipate such disclosure?

4. Are his obligations increased if the opinion is addressed to and delivered to prospective limited partners?

5. If, in any of the foregoing situations, it is determined that *TL* has obligations beyond those associated purely with the tax opinion or advice, are those obligations reduced, and, if so, to what extent, by the presence of other counsel with specific responsibility for general advice? If *TL*'s obligations are so reduced, does he then have any responsibility to satisfy himself as to the competence of such other counsel?

While the hypotheticals sketched above relate to tax advice, it should be recognized that substantially similar questions arise with respect to bond counsel,[147] counsel issuing the relatively narrow "duly and validly issued" opinion required under the Securities Act,[148] antitrust counsel, counsel passing on state securities law ques-

147. *See* SEC, *supra* note 95, ch. 6.

148. *See* note 117 *supra.*

tions, litigation counsel, or counsel in a variety of other situations whose duty, as defined by the client, is to some degree limited.

A sufficiently broad analysis, of course, would dictate that in all of the situations identified *TL* would have a general duty to investigate and to refuse any participation in the transaction if fraud is found. In all probability, the partnership could not have been properly structured without some professional tax guidance, and thus the rendering of such assistance could be held to create a broader professional responsibility for the entire transaction. So broad a standard, however, should readily be seen as going too far. The adviser who rendered advice about partnership structure is not truly any more responsible for *GP*'s activities than the real estate broker who sold land to the partnership, the government officer who accepted limited partnership articles for filing, or the paper manufacturer on whose paper the documents were printed; each of those individuals was also an essential link in the chain. Certainly the adviser is a "professional" and greater responsibilities attach to that position, but those responsibilities should not include any generalized duty of investigation. Rather, regardless of how essential *TL*'s services may have been, his affirmative duty to investigate should arise only if there are facts clearly putting him on notice of a fraudulent intent. In short, a "but for" test of causation yields irrational results in this context.

If, then, we reject the kind of analysis that will place investigative responsibilities upon the corporate adviser regardless of how limited is the nature of his engagement, it remains to be determined at what point such responsibilities do arise. An examination of the series of roles assumed by *TL* yields the conclusion that, as his direct involvement becomes successively greater, the reader is less outraged by a requirement that our tax adviser accept additional responsibilities. In all likelihood the reason for that emotional progression is that expressed long ago by Judge Cardozo in the famous *Ultramares*[149] case—as the series progresses, each case prior to the last yields some greater sense that the limited partners may be relying on the imprimatur of *TL*.

But under what circumstances is a reasonable investor likely to place actual reliance on tax counsel to investigate all aspects of a transaction or even to be sensitive to the existence of fraud? Suppose, for example, that the partnership is a complete fraud, and, though *TL*'s tax advice was entirely correct, he failed to detect that *GP* intended to abscond with the funds rather than invest them. Or sup-

149. Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931).

pose that the property in which the funds were to be invested was swampland and that fact was not disclosed. It seems unlikely that any reasonable investor would assume that *TL* had given any consideration to such matters in preparing an opinion regarding tax consequences. Unless we conclude that reliance on an investigation would be reasonable, we should not impose the investigation as a duty. Obviously the suggestion that there is neither reasonable reliance nor professional responsibility is enhanced in the case where there is other counsel with responsibility for the entire transaction.

Two elements of social cost become compelling in the absence of a fundamental basis for expanding the responsibilities of the adviser hired for a limited purpose. First, there is substantial additional cost to the client. Professional legal services are not inexpensive, and providing an even relatively minor obligation to be particularly sensitive to the existence of fraud or nondisclosure will in practice cause advisers to undertake substantial investigation. If there is no persuasive reason for imposing such costs, simple notions of efficient allocation of capital demand that they be rejected.

The second element of social cost arises because a move toward prohibiting limited engagements involves, in reality, a separation of lawyers similar to that existing between accountants who audit publicly held companies and those who do not.[150] In that regard, it is likely that only the "full service" law firm could render any sort of opinion in the investment context. Not only would that appear an unnecessary disruption of the profession, it would also, curiously enough, be diametrically opposed to the developing trend of separating advocates from advisers. If limited engagements were ethically prohibited, no clear distinction would exist between the duty of the adviser opining about tax consequences and that of the advocate advising on pending litigation. And, in an era of increasing legal specialization, it clearly seems inappropriate to expect the lawyer inexperienced in securities matters to be familiar with developing notions of securities "fraud" and the requisite elements of disclosure.[151]

Without question, it is easy to look only at the hard cases and to

150. The AICPA is in the process of dividing into two sections, one for those who audit publicly held firms and one for those who do not. *See Late Development*, J. ACCOUNTANCY, Oct. 1977 at 3. That action, however, is currently being challenged in court by several AICPA members. *See* Alam v. AICPA (N.Y. Sup. Ct., filed Jan 6, 1978), SEC. REG. & L. REP. (BNA) No. 435 at D-1, *complaint dismissed*, Wall Street Journal, Aug. 4, 1978, at 4, col. 5 (western ed.).

151. *See* Jo M. Ferguson, Securities Act of 1933 Release No. 5523 (Aug. 21, 1974) (attorney censured for aiding release of misleading prospectus).

assert, with Professor Donahue,[152] that their existence demonstrates that the law must be bad. Moreover, as with the question of confidentiality, there will eventually be cases in which lawyers, having been permitted to accept limited engagements, will render opinions that, although neither incorrect nor improper in themselves, were necessary elements in improper schemes. But to prohibit limited engagements or to establish a body of opinion—primarily through consent judgments—suggesting that limitations are not fully valid is a step for which no demonstrable need has been shown to exist.

The foregoing should not be taken to suggest that limited engagements of a vertical nature are proper. While horizontal limitations—allowing a tax lawyer to practice tax law without worrying about general securities disclosure—may be fully appropriate, the tax opinion itself must be competently drafted. It should be clear that the tax lawyer has an obligation to review the partnership agreement before passing upon it and may not properly issue an opinion on the basis of verbal representations about what it contains. And it should be equally clear that the tax lawyer has an obligation to make sure, to the extent reasonably possible, that any anticipated disclosure of the opinion to persons who might rely on it should be complete and adequate.

Fortunately, although to some degree as a result of cases involving lawyers as aiders and abettors of securities fraud, the duties of lawyers rendering opinions have been adequately explored elsewhere.[153] It is sufficient here, then, to note that vertical limitations on opinions are not proper, that counsel may generally rely upon the veracity of the client, absent contrary indications, on matters of fact, and that the opinion, if of such a nature that it likely will be disclosed to others, should contain all the assumptions, limitations, and conditions upon which it relies.

C. *Confidentiality, Decisionmaking, and Withdrawal*

The earlier portions of this Article were devoted in large measure to analyzing the proper role of the corporate legal adviser, with spe-

152. Donahue, *Comparative Reflections on the "New Matrimonial Jurisprudence" of the Roman Catholic Church*, 75 MICH. L. REV. 994, 1019 (1977). I make public apology to Professor Donahue for singling out the one erroneous assertion in an otherwise informative and well-considered essay.

153. *See* ABA COMM. ON PROFESSIONAL ETHICS, *supra* note 142; Special Committee on Lawyers' Role in Securities Transactions, *supra* note 143; Babb, Barnes, Gordon & Kjellenbert, *supra* note 146. *See also* SEC v. Universal Major Indus. Corp., 546 F.2d 1044 (2d Cir. 1976), *cert. denied*, 434 U.S. 834 (1977); SEC v. Spectrum, Ltd., 489 F.2d 535 (2d Cir. 1973); Lloyd Feld, Securities Exchange Act of 1934 Release 11775 (Oct. 30, 1975).

cific reference to the confidentiality obligation. However, it is relatively clear that, even if the primacy of the confidentiality norm is accepted, it is not an exclusive value. There is a level at which the corporate adviser, like the litigator, should properly surrender confidentiality in recognition of more compelling social needs. However, the historical determination of that level, as expressed in the Code, is not useful in the world of the modern corporate adviser, as evidenced by the confusion that presently exists in the area. Furthermore, it is readily apparent that in the context of the adviser's activities, the question is seldom as simple as whether another social need outweighs confidentiality. In most cases two other aspects of the adviser's obligations will simultaneously be at issue: the obligation to recognize that decisionmaking authority resides in the client and the obligation not to withdraw from a representation without sufficient cause where to do so would be to the client's disadvantage. The ABA-AICPA settlement, discussed earlier in this Article,[154] amply illustrates the need for a more coherent approach to the duties of the adviser in this context. That settlement may easily be read as imposing greater duties on the corporate adviser than it intends. But in the absence of a general statement of when counsel may be required to resign a representation or to initiate disclosure, it is difficult for the lawyer who has not reviewed all the related materials, as it certainly is for the auditor, to understand just what the language of the proposed form of lawyer's response means.

It is useful for the discussion that follows to attempt to identify the social interests involved when the corporate adviser faces an issue raising questions about the extent of the confidentiality obligation. They are the following:

1. The interest of society in having available to corporations a relatively detached and professional group of persons to whom disclosures can be made, and from whom advice can be sought, in confidence.

2. The interest of clients and of society in having ultimate decisionmaking authority rest with the client. It is important to recognize society's interest in having decisions made by the persons who will receive their primary economic benefits or burdens.

3. The interest of society in being protected from fraudulent and criminal activity. To subordinate this interest to confidentiality is not to disregard it, for there will always be some level at which one should compel even disclosure of confidences.

4. The interest of the client in being able to deal with the lawyer without undue burden and expense. Specifically, clients should not

154. *See* text at notes 61-75 *supra.*

have to worry about whether lawyers will withdraw from representation without very good reasons.

5. The interest of the lawyer in being able to withdraw from a professionally offensive representation.

Balancing these varied interests is obviously a difficult endeavor even in the context specifically addressed by the present Code. Take as an example the seemingly manageable case of the criminal defendant who has threatened murder. It is obvious that the lawyer cannot buy a gun for the client. But if the client has sworn that he will commit the murder, does the lawyer "assist" in the crime's commission by defending the client vigorously in a pending robbery trial? "But for" such representation, the client would be incarcerated and unable to commit the murder. Is the answer different when counsel argues for a low bail bond on the robbery charge? And what if the client has not sworn to commit the murder, but counsel suspects, without any real evidence, that the client is likely to attempt the murder?

Obviously there must be some limitation on the extent to which any such analysis will satisfy our concept of what it means for a lawyer to "assist" a client. But, just as obviously, the lines are not easily drawn. In the environment of the corporate adviser, the inquiries become incredibly more complex. The social interest in protecting a potential murder victim is considerably clearer than the interest in protecting potential fraud victims; while both certainly deserve protection, the substantially greater penalties for murder indicate society's evaluation of the relative harms involved. Furthermore, what constitutes "fraud" in the modern corporate arena is not at all clear—the concept goes far beyond a taking by deception. Thus, when the criminal lawyer's client threatens murder, there is a clear crime involved, but when the corporate adviser's client proposes a course of conduct, there may be substantial doubt about whether it is illegal. On the other hand, the nature of the adviser's activities may be viewed as less critical to society, and certainly less critical to the judicial system, than those of criminal defense counsel.

The task that must be performed is to determine when the countervailing social interests are sufficiently compelling that we would move away from the general obligation not to disclose confidential information and not to withdraw from a representation. In making that evaluation we must recognize that, in requiring counsel to withdraw from a representation, we are likely sacrificing the social interest in leaving the locus of decisionmaking authority at the client level. In most such situations, the adviser's statement that he will be compelled to resign as counsel will cause the client to accede to counsel's wishes. If we require a disclosure of a client confidence, we are almost certainly accomplishing that shift of authority and are also sacrificing the general interest in confidentiality. We should not undertake such sacrifice without good cause. Determining when that cause exists, however, is no simple matter.

We are dealing with two variables: the level of lawyer participation in the activity and the extent of the social harm involved in the activity. The first of those, the extent of counsel's participation, is itself comprised of two other variables—the nature of the lawyer's participation in the client's actions and the clearness with which those actions are wrongful. Suppose, for example, that a client corporation wishes to purchase shares of its own common stock in transactions on the stock exchange, and there exists a difficult technical question about the propriety of the transaction under rule 10b-6. Suppose further that after a thorough review of the law, counsel advises that it is an extremely close question and that there is no precedent, but that counsel expects a court would find the transaction to constitute a violation of the rule. If the client then decides to go ahead with the transaction, it would appear improper to conclude that counsel would be participating in a fraud by drafting necessary documents, thereby generating a withdrawal or disclosure obligation, even though a violation of rule 10b-6 is a fraud. Before sacrificing society's interest in having decisions made by clients, we should require at a minimum that counsel be reasonably sure that the proposed activity is, in fact, fraudulent or illegal. Similarly, if the discussion between client and counsel took place over dinner and the client then by itself consummated the transaction without giving the adviser the opportunity to research the matter, the limited involvement of counsel in the transaction should cause us not to give counsel affirmative obligations to protect the public.

With respect to the social harm involved, it should be clear that we should not sacrifice the general role of the corporate adviser unless a meaningful social harm is anticipated. The variety of activities that may constitute crimes, or be included within definitions of fraud, in the modern regulatory framework is simply too great for us to be satisfied that every such activity represents a sufficiently compelling social interest to cause us to disregard the adviser's general obligations. For example, section 5 of the Securities Act of 1933 generally requires that an offering of securities be registered; failure to do so is a crime. But in a given case, where there is substantial public information about a corporation and registration would be little more than a formality, it is not at all clear that a client's intention to make a relatively small sale without registration should cause counsel to have an obligation to disclose the client's intended crime.

The interest-balancing task requires that we recognize all of these variables. When there is relatively little involvement of the adviser in an improper activity, either because the involvement is slight or the impropriety is unclear, and the social harm is not perceived as substantial, the adviser should be permitted to resign, but only if to do so will not operate to the disadvantage of the client. As the involvement and the perceived social harm become greater, withdrawal should become mandatory. When the involvement is substantial and the social harm grave, an obligation of public disclosure, abandoning confidentiality, might properly be imposed.

Admittedly such an approach needs further definition, and substantial judgment on the part of the individual adviser will always be required. But simpler approaches, such as the traditional view embodied in the present Code, have only the appearance, and not the substance, of greater clarity.

D. *Avoidance of Conflicting Roles*

The Code of Professional Advisorial Responsibility should resolve authoritatively the propriety of the adviser serving as a director, or being a shareholder, of the publicly held client. While both of these matters have received some attention, they have provoked curiously little discussion in the literature. Certainly there can be no doubt about their importance. Indeed, one might say that much of the trouble besetting the corporate adviser today is attributable to the presence of a lawyer on the board of directors of BarChris Construction Corp.[155]

Representation on a corporate board is clearly the more significant of the questions. And, although several major law firms continue to have partners serving on the boards of their clients,[156] no legitimate basis exists for allowing the practice to continue. Setting aside considerations that should directly affect the law firms, such as whether they have deputized partners who sit as directors,[157] the cor-

155. *See* Escott v. BarChris Constr. Corp., 283 F. Supp. 643 (S.D.N.Y. 1968). Recently the Chairman of the SEC did suggest the impropriety of directorships for outside counsel, as well as for bankers and members of management other than the chief executive. Address by Harold Williams, Corporate Accountability, delivered at the Fifth Annual Securities Regulation Institute, Jan. 18, 1978.

156. *See* W. HUDSON, OUTSIDE COUNSEL: INSIDE DIRECTOR (1973).

157. *Cf.* Feder v. Martin Marietta Corp., 406 F.2d 260 (2d Cir. 1969) (because corporation

poration gains no perceivable benefit by having its counsel sit on its board. The practice does, perhaps, enable the corporation to announce to the world that a reputed firm is willing to have a partner on its board, but, besides creating risks for the law firm,[158] that sort of advertisement is certainly antithetical to the notion, endorsed herein, that all clients should have available to them counsel of repute. Furthermore, though it could be argued that the value to the corporation of its counsel's advice at board meetings is significant, that advice is available regardless of whether counsel is present as a director.

In sum, then, the benefits of permitting corporate counsel to serve as a director are, at most, minimal. While that might be sufficient if no substantial costs were present, such is not the case. If it is accepted that counsel should defer to the board as the voice of the entity, how can counsel constitute a part of that voice? Beyond that, if counsel's role is properly one of advising the entity how best to meet its goals, is it not an irreconcilable role conflict for counsel also to have the director's obligation of gauging the propriety of these goals? More broadly, regardless of whether we assign directors the "managerial" or the "monitoring" function,[159] their role will differ necessarily from that which the corporate adviser will fill. And the same conflict exists whether a single person serves both roles or one person is in one role and his partner in the other. While the two roles often may not be directly adverse, they are also seldom identical, and to allow one to be influenced by the other is simply unprofessional.

Moreover, on a purely pragmatic level, management asking a corporate adviser to serve on the board is often not expecting that counsel will fulfill the duties of a director. Rather, management frequently views counsel as another "inside" director with an appearance of being independent. That is, management is pleased to list counsel as not being an employee or any sort of affiliate, but it views him as an essentially captive director whose vote is reliably pro-management except, perhaps, in extreme cases. Clearly, that view of the

president was on plaintiffs' board of directors, corporation was held to be a director and thus liable to plaintiff for short-swing profits).

158. *Cf.* Black & Co. v. Nova-Tech, Inc., 333 F. Supp. 468 (D. Ore. 1971), in which presence of California counsel's name on an annual report circulated within Oregon was held sufficient to give Oregon courts jurisdiction of a claim against counsel related to the corporation's alleged securities law violations.

159. *See* N. LEECH & R. MUNDHEIM, THE OUTSIDE DIRECTOR OF THE PUBLIC CORPORATION (1976). *Cf.* Securities Exchange Act Release 13482 (Apr. 28, 1977) (requesting public comment on this issue).

director's function is inappropriate and should not be condoned by the bar.

Much of this analysis may seem purely speculative. How likely is it that a conflict actually will arise? Does not the fact that the practice has at least the implicit approval of some major law firms entitle it to a certain presumption of regularity? The difficulty with that view is that conflicts can arise, that the adviser-director may be less apt to perceive them, and that if such conflicts do arise, the adviser who sits on the board may not easily be able to extricate himself. As a consequence, it seems to be one of those situations where an ounce of prevention should be a mandatory professional responsibility.

Consider, for example, the statutory procedures established in the Securities Act of 1933 for directors who are concerned about a disclosure in a prospectus. Sections 11(b)(1) and (2) provide that a director may escape the very substantial liability provisions generally applicable when a prospectus is inaccurate or incomplete only if the director resigns *and* "advise[s] the Commission and the issuer in writing that he [has] taken such action and that he would not be responsible for such part of the registration statement." Even if the conclusions reached by this Article about the importance of confidentiality are not accepted, it is not likely that the threshhold level at which a disclosure obligation would arise for the corporate adviser would be the same as for the director who sought to follow the resign and disclose procedure. Thus the resign and disclose procedure, which, *inter alia,* is a statutory means of helping directors to force disclosure, could be hampered by lawyers' concerns with confidentiality obligations. While that conflict becomes increasingly tense as greater acceptance is given to the ethical obligation of confidentiality, it remains substantial at every level.

Nor is the conflict limited to the statutory framework of the Securities Act registration process. A director should be free at any time to dissent and to demand that the dissent be publicly known. The lawyer, however, does not have that freedom, and is in fact duty-bound to assist the client in accomplishing legally permissible ends. Assuming a business judgment disagreement with no hint of illegality or impropriety, the lawyer's traditional obligation to assist the client is clearly at odds with the director's right, and perhaps obligation, to make known the reasons for the business disagreement.[160]

160. *See also* Report of Investigation in the Matter of National Tel. Co., Inc., Relating to Activities of the Outside Directors of National Tel. Co., Inc., Securities Exchange Act Release

Why, then, does it remain true that partners of major law firms continue to serve as directors of client corporations? The reasons vary, and, though all of them are understandable, none of them are compelling. Perhaps the greatest reasons are those arising from the not unrelated interests of self-esteem and personal income. Without doubt, there is a substantial sense of self-worth associated with being asked to serve a client as a director. In some ways, it may be seen as a form of appreciation far beyond the payment of fees. A pertinent part of this consideration is the corporate adviser's personal relationship with the client's management. Once the client has asked, declining to join the board for whatever reason is likely to be perceived as a rebuff. Understandably, declining the invitation is not a comfortable thing to do, and it is potentially harmful to the human relationships involved.

The other primary reason for joining the board—the economic reason—is as understandable as the personal motive. The client on whose board the lawyer sits is less likely to cease being a client. From a slightly different viewpoint, if the client wants a lawyer on its board and another lawyer is available, allowing that lawyer to take the position provides him with an edge in the competition for the client's business.

While neither of those rationales is professionally acceptable, they both indicate the need for setting forth as a clear standard of professional responsibility the impropriety of sitting on a client's board of directors. With respect to the lawyer's personal motivations, it is important to provide an explicit restraint on the adviser's ego and a clear source by which to explain to the client the impropriety of the request. For similar reasons, it is important that the client not view the declination as inconsistent with generally accepted procedures. In relation to the economic incentives, it is important at least to reduce the possibility that the proffered board seat will be given to a law firm that will thereafter be able to be a competitor.

It is not, however, necessary to proscribe any representation of a corporation on whose board a lawyer, or a member of a lawyer's firm, sits. Certainly a general representation should be barred for the reasons elucidated above. But it is by no means clear that a lawyer's service on a board would preclude representation in patent matters, some types of tax advice, some litigation matters, and the like. And to the extent that some limited representation is inoffensive, there

14380 (Jan. 16, 1978), [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,410, indicating general directors' disclosure obligation.

would seem no reason either to deprive corporations of such services from law firms represented on their boards, or to force all lawyers to decide at the outset between acceptance of a tendered board position and some future limited representation.

Precise lines cannot be drawn on which sorts of limited representation might be acceptable. Clearly, however, the proper view of an advisory code should be that no lawyer should accept the general representation of a client while serving on its board, but that a representation of limited scope and duration may be accepted if there is no reasonable expectation that a conflict exists or will develop between the individual's obligations as a director and those pertinent to behavior as a lawyer.

The matter of share ownership is less important, but still worthy of attention. Except in unusual circumstances—primarily where a client's only feasible means of paying for legal services is through the issuance of equity—there is no client benefit from share ownership by counsel. On the other hand, corporate counsel's ownership of stock creates both a temptation for insider trading[161] and a clear conflict, since shareholder interests are not those of the entity and are even further removed from it than those of directors. Acquisition of a client's securities should therefore be prohibited.[162] At the same time, disposition of an existing interest in a corporation that becomes a client, particularly if the representation is of a limited nature, should not necessarily be required; indeed, rule 10b-5 may prohibit such a sale, depending on the matter for which the lawyer was retained.

The problem of whether advisers may serve as directors or shareholders provides a typical example of the flaws in the present Code to which this Article has been addressed. Over the years, commencing with Judge Sharswood's analysis, there has been substantial thought given to the propriety of various relationships between the litigating attorney and his client. Whether contingent fees are per-

161. The SEC has issued a caution about such matters. *See* Securities Exchange Act of 1934 Release No. 13437 (Apr. 8, 1977), [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,116.

162. The directive of Guide 56 of the SEC's *Guides for Preparation and Filing of Registration Statements Under the Securities Act of 1933*, published in various Securities Act releases commencing with Securities Act of 1933 Release No. 4936 (Dec. 9, 1968), that counsel disclose in a prospectus any interest of counsel in the issuer (with some specified exceptions) is obviously a recognition of potential conflict that, for securities law purposes, is curable through disclosure. For purposes of determining proper behavior, it might well be that such disclosure is insufficient, since the concern is not with what the investing public may expect, but with counsel's ability to give disinterested advice. *See also* Lefkowitz, *The Attorney-Client Relationship and the Corporation*, 26 REC. ASSN. B. CITY N.Y. 697 (1971).

missible, whether costs of suit may be advanced, whether one who will be a witness may undertake a representation, and other questions have been the subject of great and continuous debate. But similar questions surrounding the limitations on the adviser's involvement with the corporate client have been virtually ignored. That realization alone should provide evidence enough of the need to consider and adopt a Code of Professional Advisorial Responsibility.

VI. CONCLUSION: THE MECHANICS OF DECISION AND IMPLEMENTATION

Viewed as a trend, the recent developments indicating a changing role for the corporate legal adviser portend, if they continue without full, organized review, nothing less than disaster. Moreover, the changes that need to be made are not readily susceptible to the evolutionary process of the common law. We need, rather, to decide consciously whether we, as a society, want the lawyer in the corporate setting to be receptive to confidential information. We need to determine—with an awareness of history, though not an unyielding commitment to it—whether the lawyer is to serve the client or the broader public interest. While the proper choice seems clear to me, the existence of a contrary trend indicates that there are opposing views and, perhaps as well, that society does not fully understand the direction in which recent developments have headed.

But whether my view or the contrary view is accepted may be less important than that society act to implement one or the other. The current situation benefits no group. How, then, do we make the choice, and how do we effect it? One possibility, of course, is Congress, which already is moving toward greater involvement in the accounting profession.[163] Recent history suggests that when accountants are being challenged, lawyers cannot be far behind. As a member of the profession that would thereby be subject to federal regulation, I am, with admitted bias, loath even to mention it, but it remains a possibility.

The only apparent alternative is through the auspices of the ABA, and that could be accomplished sensibly only through a com-

163. *See Accountants Plan Key Changes in Section for Firms Auditing Publicly Held Firms*, Wall St. J., March 7, 1978, at 110, col. 2; *The CPAs Are Trying To Outrace Congress*, Bus. Week., Sept 26, 1977, at 58-59; Senate Governmental Affairs Subcommittee on Reports, Accounting, and Management, Report on Improving the Accountability of Publicly-Owned Corporations and Their Auditors (1977), *reprinted in* SEC. REG. L. REP. (BNA) No. 428, at H-1—H-8 (1977).

mittee of lawyers, clients, public representatives, regulators, and accountants, all of the highest calibre, which is given substantial autonomy from the ABA itself. The issues are simply too important and too close to the legal profession to leave available the challenge that conclusions were reached by lawyers for lawyers, mindless of the public interest.[164] If such a committee is established, implementation of its conclusions could be accomplished within the ABA, with continued, but reduced, external involvement.

Once the role of the corporate legal adviser is established, substantial effort will be required to provide the lawyer with criteria by which to govern his conduct. Indeed, it would be appropriate, and not likely a waste of time, immediately to begin the development of a Code of Professional Advisorial Responsibility based on the assumption that the historical role of the corporate lawyer will, as it should, be retained. While such a Code might not govern the SEC,[165] Congress' clear denial of any right in the Commission to establish admission standards for its bar,[166] and the SEC's deference to state law in this regard,[167] strongly suggest that if the SEC does not willingly accept such standards, the courts should.

It is all too clear that the conflicting demands currently placed on lawyers are no more healthy for society than for the legal profession. The time for their resolution, if it has not passed, is most assuredly at hand.

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164. *See* Morgan, *supra* note 13, at 704: "The analysis will suggest that lawyers' ethics are consistently self-serving . . . ."

Again, the procedures being implemented by the accounting profession provide an instructive example; the AICPA is in the process of forming a public oversight board, composed of persons who are not primarily accountants, to review its practices from a broader perspective. *See A Wider Look at What CPA's Do*, BUS. WEEK, Jan. 30, 1978, at 71.

165. The Code is not formally binding except where it is adopted bylaw. Since 5 U.S.C. § 500 (1976) precludes the SEC from establishing minimum standards for practice before it, there may be some question whether the SEC *could* "adopt" the Code. Proceedings brought by the SEC under rule 2(e) of its Rules of Practice, 17 C.F.R. § 201.2(e) (1977), make clear that in disciplinary proceedings the SEC does not view itself as bound by the law or standards of the state in which the practitioner is licensed to practice. *See* cases cited at note 77 *supra*.

166. *See* note 88 *supra*.

167. Rule 2(b) of the SEC's Rules of Practice, 17 C.F.R. § 201.2(b) (1977), provides that "[a] person may be represented in any proceeding by an attorney at law admitted to practice before the Supreme Court of the United States, or the highest court of any State or Territory of the United States, or the Court of Appeals or the District Court of the United States for the District of Columbia."