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Sarbanes-Oxley and Regulation of Lawyers' Conduct: Pushing the Boundaries of the Duty of Confidentiality

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SARBANES-OXLEY AND REGULATION OF LAWYERS' CONDUCT: PUSHING THE BOUNDARIES OF THE DUTY OF CONFIDENTIALITY

> An advocate, in the discharge of his duty, knows but one person in all the world, and that person is his client. To save that client by all means and expedients, and at all hazards and costs to other persons, and, amongst them, to himself, is his first and only duty; and in performing that duty he must not regard the alarm, the torments, the destruction which he may bring upon others.[1]

I. INTRODUCTION

While the words of Lord Brougham from *Queen Caroline's Case* might sound unreasonable to most laymen, they reflect a central and longstanding canon of legal ethics.[2] The attorney has a duty to act as a "zealous advocate" for the client.[3] Corporate attorneys,[4] however, operate in a slightly different context. Whereas most attorneys' loyalties lie solely with their clients, the corporate attorney must frequently balance the interests of the client against the interests of the investing public.[5] These attorneys often find themselves in the troubling situation of having to decide what to do when they become aware that their corporate client has engaged or is engaging in wrongful or fraudulent conduct.[6] Society places responsibilities on corporate and securities lawyers not faced by most attorneys: to play the role of corporate gatekeeper,[7] a role

1. MONROE H. FREEDMAN, LAWYERS' ETHICS IN AN ADVERSARY SYSTEM 9 (1975) (citing 2 Trial of Queen Caroline 8 (J. Nightingale ed., 1821)).

2. *Id*.

3. *Id*.

4. Throughout this comment, references to corporate attorneys, corporate clients, and corporate actors refer to parties who represent or work for corporations which are publicly traded and subject to federal securities laws.

5. Lisa H. Nicholson, *A Hobson's Choice for Securities Lawyers in the Post-Enron Environment: Striking a Balance Between the Obligation of Client Loyalty and Market Gatekeeper*, 16 GEO. J. LEGAL ETHICS 91, 94-95 (2002).

6. *Id*. at 102-03.

7. "The term 'gatekeeper' suggests a guardian with independent professional responsibilities, including a responsibility for protecting the institution." SEC Commissioner Harvey J. Goldschmid, The Orison S. Marden Lecture Before the Association of the Bar of the City of New York (Nov. 17, 2003), http://www.sec.gov/news/speech/spch111703hjg.htm [hereinafter Goldschmid Speech]. Corporate gatekeepers are responsible for vouching for the

traditionally associated with corporate accountants and auditors.[8] However, exactly how these attorneys should behave in order to fulfill the dual roles of corporate gatekeeper and client advocate has frequently been a subject of debate.[9]

Recently, this debate has been reignited. Following the revelation of corporate fraud and misconduct at major corporations such as Enron, WorldCom, and Tyco,[10] the federal government attempted to stabilize the securities markets and bolster investor confidence by passing the Sarbanes-Oxley Act of 2002 (the "Act").[11] The Act includes civil and criminal provisions intended to affect the way in which corporate actors approach reporting financial information, conducting public audits, and compensating executives and officers.[12] However, Congress did not intend to reach only corporate officers and accountants with this Act. Section 307 of the Act includes a provision directing the Securities and Exchange Commission[13] to promulgate "standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers."[14]

SEC Rule 205[15] provides corporate and securities lawyers with greatly needed guidelines of behavior in the face of client fraud. While some oppose any rules which would seemingly hamper the ideal of attorney-client confidentiality, section 307 of Sarbanes-Oxley and corresponding SEC Rule 205 serve an overriding purpose because they promote the public policy of

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transactions and statements of their clients. Credibility, based on professional standards and reputation, is essential to their role because it enables the public to trust in their capability and integrity. Typical categories of gatekeepers for public companies include independent auditors, debt rating agencies, securities analysts, investment bankers, and lawyers. John C. Coffee, Jr., *Understanding Enron*: *"It's About the Gatekeepers, Stupid,"* 57 BUS. LAW. 1403, 1404-05. *See also* Nicholson, *supra* note 5, at 100-01.

8. Coffee, *supra* note 7, at 1417-18.

9. Nicholson, *supra* note 5, at 100-01. "Securities lawyers must continually strike a balance between the competing considerations of protecting society's interests in maintaining client confidentiality and ensuring the lawyers' loyalty on the one hand, and that of protecting society's interests in avoiding the substantial financial consequences of crimes or fraud on the other." *Id.* at 94-95.

10. 148 CONG. REC. S6561-01 (daily ed. July 10, 2002) (statement of Sen. Levin).

11. Peter Zalewski, *Sarbanes' First Year: Lawyers and Executives Have Spent Months and Money to Comply With Strict Corporate Governance Law, and More Limits Are Coming*, MIAMI DAILY BUS. REV., July 21, 2003, at 11; Marc I. Steinberg, *Lawyer Liability After Sarbanes Oxley – Has the Landscape Changed?*, 3 WYO. L. REV. 371, 371 (2003).

12. Zalewski, *supra* note 11.

13. Hereinafter the "Commission" or the "SEC."

14. Sarbanes-Oxley Act of 2002 § 307, 15 U.S.C. § 7245 (2002).

15. Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer, 17 C.F.R. § 205 (2004).

investor protection.[16] Furthermore, traditional arguments against allowing attorney disclosure of fraudulent conduct by the corporate client may be misguided and poorly reasoned.

This comment will argue that federally mandated standards of attorney conduct for corporate and securities lawyers are necessary in light of the unique position these attorneys occupy. The previous regime of imprecise federal standards, as well as conflicting and often inadequate state ethical standards, have proven ineffective in regulating the conduct of attorneys in the corporate arena.[17] State ethics rules, which apply to attorneys generally, rarely adequately account for the particular role of corporate and securities lawyers. Because these attorneys are in the unique position of having to ensure their clients' compliance with federal securities laws,[18] they must balance competing interests: those of their clients and those of the investing public. In order to successfully fulfill these dual roles, corporate and securities lawyers need a federal set of guidelines which proscribe standards of appropriate conduct when presented with client misconduct in order to successfully fulfill these dual roles.

These standards should be imposed at the federal level because they serve the ultimate purpose of promoting compliance with federal securities laws. Furthermore, greater uniformity can be achieved by imposing these standards at the federal level as opposed to the state level. Such uniformity is especially desirable due to the national and even international scale of many corporate clients and the law firms that represent them.

Section II of this comment explores the background and history of the Sarbanes-Oxley Act and section 307 by first examining regulation of attorneys by the SEC prior to the Act and then examining the social and economic background of the Sarbanes-Oxley Act and section 307. Section III will discuss and explain section 307 of the Act and corresponding Rule 205 as drafted by the SEC. Section IV will discuss the actions taken by the American Bar Association in response to the corporate scandals which occurred at corporations such as Enron, WorldCom, and Tyco. Section V of this comment will discuss the reactions of some state bar associations to Rule 205. Section VI will present some of the major arguments both supporting and criticizing the adoption of a federal rule regulating the conduct of corporate attorneys and section VII will present a detailed analysis explaining why Rule 205 is ultimately a justified and necessary addition to federal securities laws.

16. *See infra* Part VII.
17. Nicholson, *supra* note 5, at 139.
18. *Id*. at 128.

II. BACKGROUND AND HISTORY

A. Federal Regulation of Attorneys Prior to Sarbanes-Oxley

Despite the traditional and well established role of the states and the organized bar in regulating attorney conduct,[19] federal regulation of corporate attorneys is by no means a new concept.[20] The SEC has traditionally used two primary avenues for sanctioning attorneys.[21] One approach available to the SEC is to seek injunctions against attorneys in federal courts on the basis of violations or aiding and abetting violations of the anti-fraud provisions of federal securities laws.[22]

A prominent example of this first type is *Securities and Exchange Commission v. National Student Marketing Corp.*, in which the Commission sought injunctive relief against numerous defendants, including some of the lawyers representing their respective clients in a merger.[23] The Commission attempted to impose sanctions against the lawyers of one of the parties to the merger, arguing that the lawyers had aided and abetted the client's violations of securities laws because the lawyers did not attempt to dissuade their clients from going through with a planned merger upon discovery that some of the information disclosed in proxy statements for the merger was false.[24] In this case, the SEC argued that because the attorneys did not withdraw their opinion letters regarding the merger and demand resolicitation of the shareholders of the company being acquired when they learned of certain misinformation, the lawyers aided and abetted the fraud.[25] The SEC further argued that had the attorneys suggested an appropriate course of action and the directors refused, the "attorneys should have withdrawn from the representation and informed the shareholders or the Commission."[26] In this case, the court denied injunctive relief, finding that the SEC failed to demonstrate, as is required under section 21(e) of the Securities Exchange Act of 1934 and section 20(b) of the Securities Act of 1933, that injunctive relief would be necessary to

19. JAMES E. MOLITERNO & JOHN M. LEVY, ETHICS OF THE LAWYER'S WORK 64 (1993).

20. Ann Maxey, *SEC Enforcement Actions Against Securities Lawyers: New Remedies vs. Old Policies*, 22 DEL. J. CORP. L. 537, 540-44 (1997).

21. *Id*. at 548. Maxey identifies other forms of sanctions available to the SEC as well: "In appropriate cases, the SEC can also refer cases to the Justice Department for criminal prosecution. In addition, the SEC can issue reports on investigations pursuant to § 21(a) of the Exchange Act." *Id*. at 548 n.46.

22. *Id*. at 550.

23. SEC v. Nat'l Student Mktg. Corp., 457 F.Supp. 682, 686-87 (D.D.C. 1978).

24. *Id*. at 699-701.

25. *Id*. at 700-01.

26. *Id*. at 701.

prevent further violations of anti-fraud provisions.[27] The court did hold, however, that the lawyers had aided and abetted the violations by not taking steps to persuade the client to comply with the law or ensure that shareholders were informed of the misstatements in the proxy solicitations.[28] *National Student Marketing* sent an important message to attorneys about the Commission's expectations regarding lawyers' obligations when they become aware that their client is violating securities laws. While the case did not suggest a clear course of action in such a situation, it did make clear that the Commission considered it unacceptable for attorneys to acquiesce to their clients' fraudulent conduct.[29]

A second regulatory tool available to the SEC is the use of Rule 102(e) of the Commission's Rules of Practice, which has long been available to the SEC as a means of sanctioning securities lawyers.[30] It allows the Commission to censure, suspend, or disbar professionals engaged in unethical or otherwise improper conduct;[31] it does not, however, establish standards of behavior for such professionals.[32] Three years after the conclusion of *National Student Marketing*, the Commission used its power to sanction professionals under Rule 102(e) in "its most prominent administrative proceeding against lawyers."[33] In *In re Carter and Johnson* ("*Carter*"), the Commission brought an action against two lawyers for concealing their knowledge of a client's poor

27. *Id*. at 717.

28. *Nat'l Student Mktg. Corp.*, 457 F.Supp. at 714.

29. *Id*. at 712.

30. Appearance and Practice Before the Commission, 17 C.F.R. § 201.102(e) (2004); Maxey, *supra* note 20, at 548-49. Prior to 1995, Rule 102(e) was referred to as Rule 2(e), which was originally promulgated in 1935. Implementation of Standards of Professional Conduct for Attorneys, Sarbanes-Oxley Act, 67 Fed. Reg. 71671 n.11 (proposed Dec. 2, 2002) (to be codified at 17 C.F.R. pt. 205). Rule 102(e) does not apply strictly to lawyers, but rather any professionals who appear and practice before the Commission, including attorneys, accountants, and engineers. *Id*. at n.12.

31. Rule 102(e) provides:

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice and opportunity for hearing in the matter: (i) [n]ot to possess the requisite qualifications to represent others; or (ii) [t]o be lacking in character or integrity or to have engaged in unethical or improper professional conduct; or (iii) [t]o have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

17 C.F.R. § 201.102(e)(1)(i)-(iii).

32. Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71670 & n.11.

33. Maxey, *supra* note 20, at 551.

financial position in order to ensure that a deal closed.[34] The Commission decided that there were no clear and unambiguous standards of behavior to guide the attorneys in this case and therefore did not impose sanctions.[35] The Commission did, however, interpret the meaning of "unethical or improper professional conduct"[36] for purposes of Rule 102(e) proceedings against attorneys, to be applied in any future proceedings.[37]

The standard laid down in *Carter* requires an attorney who becomes aware of a client's violation of securities laws to "take[] prompt steps to end the client's noncompliance."[38] Furthermore, the Commission indicated that as a preliminary matter, the attorney may simply "counsel[] accurate disclosure."[39] Should the client fail to comply, however, the Commission stated that the attorney should take additional "affirmative steps," which could include reporting the violation to higher officials within the organization in order to correct the problem.[40] In this respect, the standard supplied by this case is simply a predecessor to the standards required by section 307 of the Sarbanes-Oxley Act.[41]

The rule from *Carter* contributed to a mounting controversy between the Bar and the SEC regarding the SEC's attempts to infringe upon the Bar's traditional role in regulating attorney conduct.[42] This controversy abated somewhat when then SEC General Counsel Edward Greene, in a 1982 speech, stated that the Commission would not initiate Rule 102(e) proceedings against a lawyer unless a federal court had determined that the lawyer had violated or aided and abetted a violation of securities laws.[43] The SEC had abated its ability to enforce the standards promulgated only a year before in *Carter*. While still retaining the ability to discipline attorneys based on aiding or

34. *In re* Carter & Johnson, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847, at 84,158 (Feb. 28, 1981).

35. *Id*. at 84,172-73.

36. 17 C.F.R. § 201.102(e)(ii).

37. *In re* Carter & Johnson, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847, at 84,172. Prior to *Carter*, the SEC had not previously defined this standard. Theodore Sonde & F. Ryan Keith, "*Up the Ladder and Over": Regulating Securities Lawyers—Past, Present & Future*, 60 WASH. & LEE L. REV. 331, 336 (2003).

38. *In re* Carter & Johnson, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847, at 84,172.

39. *Id*.

40. *Id*.

41. Like the standard first articulated in *Carter*, section 307 of the Sarbanes-Oxley Act required the SEC to promulgate a rule requiring an "up the ladder" reporting requirement for corporate attorneys. See *infra* note 65 and accompanying text for further discussion of the requirements of section 307 of the Sarbanes-Oxley Act.

42. Maxey, *supra* note 20, at 553.

43. *Id*.

abetting liability or through Rule 102(e) sanctions, the Commission rarely did so in the years following the *Carter* decision.[44]

B. The Enactment of Sarbanes-Oxley and Section 307

The Sarbanes-Oxley Act came on the heels of various corporate and accounting scandals which had severely shaken investor confidence in the adequacy of corporate governance practices, independent accounting, and the trustworthiness of corporate attorneys.[45] During the 1990s, American businesses and the stock market boomed.[46] Companies, especially those in the high-tech sector, announced huge profit increases every year, which were often accompanied by huge increases in executive pay and compensation.[47] According to Senator Arthur Levin, chairman of the Senate's Permanent Subcommittee on Investigations, this corporate success was seen as "a justification for deregulating business, weakening regulators, and making it harder to seek corporate insiders and advisers."[48] Levin contends, however, that much of this loosening of corporate regulation shielded discovery of corporate misconduct which may have in large part contributed to the inflated profits of the 1990s.[49]

The most highly publicized corporate scandal leading up to Sarbanes-Oxley involved the collapse of Enron Corp.[50] When the public became aware that Enron was creating outside partnerships as a means to remove debt from its balance sheets, Enron executives and auditors were not the only ones to face scrutiny and criticism.[51] Enron's outside attorneys, Vinson & Elkins, were also implicated in the scandal.[52] When the firm was brought in to investigate suspicious activities at Enron, it issued opinion letters effectively authorizing fraudulent and illegal activities of the corporation.[53] The firm's role in either facilitating or at the very least overlooking the fraudulent activities of its client is by no means a unique situation.[54] The potential ability of lawyers to play a more active role in promoting compliance with securities laws, and their disappointingly frequent failure to do so, prompted some members of Congress

44. *Id*. at 553-55.
45. 148 CONG. REC. S6561-01 (daily ed. July 10, 2002) (statement of Sen. Levin).
46. *Id*.
47. *Id*.
48. *Id*. at S6561-62.
49. *Id*.
50. *See, e.g., One Big Client, One Big Hassle*, BUSINESS WEEK ONLINE (Jan. 28, 2002), *at* http://www.businessweek.com/magazine/content/02_04/b3767706.htm.
51. *Id*.
52. *Id*.
53. *Id*.
54. 148 CONG. REC. S6524, S6556 (daily ed. July 10, 2002) (statement of Sen. Corzine).

to suggest an addition to the Sarbanes-Oxley Act that would enhance lawyers' obligation to act as corporate gatekeepers.[55]

Section 307 was introduced based on the belief of its drafters that attorneys likely played major roles in many of the corporate scandals that had occurred in recent years.[56] Senator Michael Enzi from Wyoming, one of the senators who introduced the bill, stated: "[O]ne of the thoughts that occurred to me was probably in almost every transaction there was a lawyer who drew up the documents involved in that procedure."[57] This was the rationale behind section 307. The accounting industry has long been under the scrutiny of the federal government and the SEC due to the well established duty of corporate accountants and auditors to act as corporate gatekeepers.[58] Furthermore, the SEC has had the power to regulate corporate attorneys for years under Rule 102(e).[59] Despite this, regulation of attorney conduct has traditionally been

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55. *Id*. at S6551. In introducing section 307 as a floor amendment, Senator Edwards stated:

> The truth is that executives and accountants do not work alone . . . . If executives and/or accountants are breaking the law, you can be sure that part of the problem is that the lawyers who are there and involved are not doing their jobs. For the sake of investors and regular employees, ordinary shareholders, we have to make sure that not only the executives and the accountants do what they are responsible for doing, but also that the lawyers do what they are responsible for doing as members of the bar and as citizens of the country.

Id.

56. *Id*.

57. 148 CONG. REC. S6524, S6554 (daily ed. July 10, 2002) (statement of Sen. Enzi).

58. The Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737 (1995), ("PSLRA") added section 10A to the Securities Exchange Act of 1934. This section mandated that outside auditors comply with standards issued by the SEC as well as Generally Accepted Accounting Principals. The PSLRA also required accountants/auditors to report illegal acts to the issuer's audit committee. Finally, the PSLRA required that an accountant/auditor resign and notify the SEC of the resignation and the reason for it if the issuer continues in the illegal activity. Sonde & Keith, *supra* note 37, at 341-42. *See also* Coffee, *supra* note 7, at 1405. This final requirement is almost identical to "noisy withdrawal" provision of SEC Rule 205 for attorneys. *See infra* notes 73-78 and accompanying text.

59. Speech to the New York County Lawyers' Association by SEC General Counsel Edward F. Greene, Lawyer Disciplinary Proceedings Before the Securities and Exchange Commission, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,089, at 84,800 (Jan. 18, 1982) [hereinafter Greene]. *See also* Letter from Richard W. Painter, Professor of Law, University of Illinois (and 39 other law professors), to Harvey Pitt, SEC Chairman 2 (Mar. 7, 2002), *at* http://www.abanet.org/buslaw/corporateresponsibility/responsibility_relatedmat.html) [hereinafter Letter from Richard W. Painter]; Stephanie R.E. Patterson, *Professional Responsibility and Liability in a Post-Enron World: Section 307 of the Sarbanes-Oxley Act: Eroding the Legal Profession's System of Self-Governance?*, 7 N.C. BANKING INST. 155, 162 (2003).

regarded as a job for state bar associations, and the federal government has only reluctantly challenged state authority on this matter in the past.[60]

Following the revelation of multiple scandals in corporate America,[61] the sponsors of section 307 felt that the corporate attorney's time had come. Senator John Edwards, one of the sponsors of section 307, stated, "[w]ith Enron and WorldCom, and all the other corporate misconduct we have seen, it is again clear that corporate lawyers should not be left to regulate themselves no [sic] more than accountants should be left to regulate themselves."[62] The general belief was that state bar associations had failed to adequately safeguard against attorney misconduct and intervention by the federal government was needed.[63]

III. SARBANES-OXLEY AND S.E.C. RULE 205

Section 307 of the Sarbanes-Oxley Act directed the SEC to issue rules establishing "minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers."[64] According to section 307, these standards should include a rule

> (1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and

60. *See* Greene, *supra* note 59, at 84,802. *See also* SEC Chairman Harvey L. Pitt, Remarks Before the Annual Meeting of the American Bar Association's Business Law Section (Aug. 12, 2002), *at* http://www.sec.gov/news/speech/spch579.htm. Twenty years ago Congress considered and rejected Senator Arlen Specter's legislation entitled "Lawyer's Duty to Disclose Act of 1983." The legislation advocated imposing criminal sanctions against lawyers who failed to disclose to law enforcement prospective future crimes of their corporate clients, as well as past crimes where the client had misappropriated legal advice. Abraham C. Reich & Michelle T. Wirtner, *What Do You Do When Confronted With Client Fraud?*, BUS. L. TODAY, Sept.-Oct. 2002, at 39-40. The SEC has also occasionally used its power to sanction attorneys under Rule 102(e) or through aiding and abetting liability. *See supra* notes 21-44 and accompanying text.

61. See 148 CONG. REC. S6561, S6562 (daily ed. July 10, 2002) (statement of Sen. Levin) for a discussion of some of the corporate scandals which occurred at major corporations like WorldCom, Tyco, Adelphia, Global Crossing, etc.

62. 148 CONG. REC. S6524, S6552 (daily ed. July 10, 2002) (statement of Sen. Edwards).

63. *Id*. Similarly, Senator Enzi remarked, "[I]n this case, the [s]tate bars as a whole have failed. They have provided no specific ethical rule of conduct to remedy this kind of situation. Even if they do have a general rule that applies, it often goes unenforced." *Id*. at S6555. *See also* Implementation of Standards of Professional Conduct for Attorneys, Sarbanes-Oxley Act, 67 Fed. Reg. at 71671 (proposed Dec. 2, 2002) (to be codified at 17 C.F.R. pt. 205).

64. Sarbanes-Oxley Act § 307, 15 U.S.C. § 7245 (2002).

> (2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.[65]

On January 23, 2003 the Commission announced its adoption of Rule 205.[66] The basic provisions of Rule 205 provide for an "up the ladder" reporting regime.[67] According to the rule, an attorney must report evidence of a material violation of securities laws, breach of fiduciary duty, or similar violations to appropriate parties within the client corporation.[68] An objective standard should be applied in interpreting "evidence of a material violation" meaning that it would be "unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur."[69] The attorney must first report such evidence to the chief legal counsel, chief executive officer, or both.[70] The rule further outlines what actions must be taken by a chief legal counsel who receives such information.[71] The next step an attorney may take if he or she does not reasonably believe the chief legal

65. *Id*. The SEC was given 180 days from the day the Act was signed into law (July 30, 2002), to adopt rules implementing section 307. Implementation of Standards of Professional Conduct for Attorneys, Sarbanes-Oxley Act, 67 Fed. Reg. at 71670 n.4.

66. Press Release, Securities and Exchange Commission, SEC Adopts Attorney Conduct Rule Under Sarbanes-Oxley Act (Jan. 23, 2002), *at* http://www.sec.gov/news/press/2003-13.htm.

67. *Id*. *See* Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer, 17 C.F.R. § 205.3(b)(1)-(4) (2004).

68. 17 C.F.R. § 205.3(b)(1).

69. *Id.* § 205.2(e).

70. *Id.* § 205.3(b)(1).

71. *Id.* § 205.3(b)(2).

> The chief legal officer (or the equivalent thereof) shall cause such inquiry into the evidence of a material violation as he or she reasonably believes is appropriate to determine whether the material violation described in the report has occurred, is ongoing, or is about to occur. If the chief legal officer (or the equivalent thereof) determines no material violation has occurred, is ongoing, or is about to occur, he or she shall notify the reporting attorney and advise the reporting attorney of the basis for such determination. Unless the chief legal officer (or the equivalent thereof) reasonably believes that no material violation has occurred, is ongoing, or is about to occur, he or she shall take all reasonable steps to cause the issuer to adopt an appropriate response, and shall advise the reporting attorney thereof. In lieu of causing an inquiry under this paragraph (b), a chief legal officer (or the equivalent thereof) may refer a report of evidence of a material violation to a qualified legal compliance committee under paragraph (c)(2) of this section if the issuer has duly established a qualified legal compliance committee prior to the report of evidence of a material violation.

Id.

officer or chief executive officer has taken appropriate steps is to report to the audit committee of the board of directors; another committee consisting solely of directors not employed by the corporation and not "interested persons" in the case of an investment company; or the actual board of directors.[72]

In the original proposed Rule 205, the SEC included a provision which would require an attorney to make a "noisy withdrawal" where an attorney had reported up the ladder and the board of directors had not provided an "appropriate response."[73] This portion of the rule required an attorney, in limited circumstances, to withdraw from representation and give the SEC written notification of the attorney's withdrawal on the basis of "professional considerations" as well as disaffirm any documents or representations made to the SEC "that the attorney has prepared or assisted in preparing and that the

72. *Id*. § 205.3(b)(3). Under 17 C.F.R. § 205.3(c), the rule provides an alternative reporting method where the corporate client has established a qualified legal compliance committee ("QLCC"). Where such a committee has been established the attorney may report directly to this committee as opposed to the "up the ladder" process outlined in section 205.3(b). An attorney who reports to a QLCC has satisfied his or her legal obligations under Rule 205 and is not expected to assess the committee's response to any reports of material violations. 17 C.F.R. § 205.3(c)(1).

73. Implementation of Standards of Professional Conduct for Attorneys, Sarbanes-Oxley Act, 68 Fed. Reg. 6324, 6326-27 (proposed Feb. 6, 2003) (to be codified at 17 C.F.R. pt. 205). Section 205.2(b) provides:

> (b) Appropriate response means a response to an attorney regarding reported evidence of a material violation as a result of which the attorney reasonably believes:
>
> (1) That no material violation . . . has occurred, is ongoing, or is about to occur;
>
> (2) That the issuer has, as necessary, adopted appropriate remedial measures, including appropriate steps or sanctions to stop any material violations that are ongoing, to prevent any material violation that has yet to occur, and to remedy or otherwise appropriately address any material violation that has already occurred and to minimize the likelihood of its recurrence; or
>
> (3) That the issuer, with the consent of the issuer's board of directors, a committee thereof to whom a report could be made pursuant to § 205.3(b)(3), or a qualified legal compliance committee, has retained or directed an attorney to review the reported evidence of a material violation and either: (i) [h]as substantially implemented any remedial recommendations made by such attorney after a reasonable investigation and evaluation of the reported evidence; or (ii) [h]as been advised that such attorney may, consistent with his or her professional obligations, assert a colorable defense on behalf of the issuer (or the issuer's officer, director, employee, or agent as the case may be) in any investigation or judicial or administrative proceeding relating to the reported evidence of a material violation.

17 C.F.R. § 205.2(b). This definition of what constitutes an "appropriate response" subjects the lawyer's evaluation of the issuer's response to a reasonableness standard. An attorney may exercise his or her own judgment, so long as his or her determination is "reasonable." Implementation of Standards of Professional Conduct for Attorneys, Sarbanes-Oxley Act, 68 Fed. Reg. 6296, 6298-99 (proposed Feb. 6, 2003) (to be codified at 17 C.F.R. pt. 205).

attorney reasonably believes is or may be materially false or misleading."[74] On November 21, 2002, the SEC released a proposed version of Rule 205 and invited interested parties to comment on the rule.[75] The Commission's release generated significant interest; 167 comment letters were received.[76] The "noisy withdrawal" provision was one of the most controversial and highly criticized portions of the proposed rule.[77] Due to the controversy generated by this provision of the rule, and the deadlines imposed by the Act, the Commission withdrew this portion in its final version of the rule, released on January 29, 2003.[78] On that date the Commission also issued another release seeking further comment on the "noisy withdrawal" provision and an alternative version of this portion of the rule.[79] Whereas the original version of the "noisy withdrawal" provision required the attorney to withdraw from representation and alert the Commission, the alternative suggested by the Commission in the January 29th proposed rule release required the issuer, as opposed to the attorney, to report the attorney's withdrawal to the Commission, and additionally required the issuer to report such withdrawal to the public through 8-K, 20-F, or 40-F forms.[80] While the Commission has received

74. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6326-27.

75. Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71670 (proposed Dec. 2, 2002) (to be codified at 17 C.F.R. pt. 205).

76. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6296.

77. *See, e.g.*, Letter from Alfred P. Carlton, Jr., President, American Bar Association, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission (Dec. 18, 2002), *at* http://www.sec.gov/rules/proposed/s74502/apcarlton1.htm [hereinafter Carlton Letter]; Letter from The Association of the Bar of the City of New York to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission (Apr. 7, 2003), *at* http://www.sec.gov/rules/proposed/s74502/abcny040703.htm.

78. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6296. The release accompanying the final rule stated:

> In light of the compressed time period resulting from the 180-day implementation deadline prescribed in the Act, a number of commenters requested that the Commission allow additional time for consideration of several aspects of the proposed rule, including . . . the impact of the "noisy withdrawal" and related provisions.

Id.

79. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6326.

80. *Id*. The release states:

> Section 205.3(e) of the alternative proposal requires an issuer (rather than its attorney) to report to the Commission an attorney's written notice of withdrawal or failure to receive an appropriate response, as described in [section] 205.3(d) of the alternative proposal. In connection with [section] 205.3(e) of the alternative proposal, the Commission also proposes to amend Forms 8-K, 20-F, and 40-F to require issuers to disclose publicly an attorney's written notice of withdrawal within two business days of

numerous comments on both of these proposed alternatives, no decision has been made as to whether either one will eventually be included in the final rule.[81]

To account for the situation where the attorney has reported "up the ladder" and does not believe appropriate remedial actions have been taken by the corporate client,[82] the final rule as adopted also includes a provision allowing an attorney to reveal confidential information related to the representation of the client to the extent the he or she reasonably believes necessary

> (i) To prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;
>
> (ii) To prevent the issuer, in a Commission investigation or administrative proceeding from committing perjury . . . or committing any act . . . likely to perpetrate a fraud upon the Commission; or
>
> (iii) To rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used.[83]

This section of the rule is in line with Rule 1.6 of the ABA's recent amendments to the Model Rules of Professional Conduct[84] and with the rules of a majority of state bar associations.[85] Though not nearly as controversial as the "noisy withdrawal" provision, this section of the rule prompted some

> that notice. Section 205.3(f) of the alternative proposal permits (but does not require) an attorney to inform the Commission of his or her withdrawal if the issuer does not comply with paragraph (e).

Id. at 6328.

81. Sue Reisinger, *Coping with Tighter Rules for Lawyers: Violations Must Go 'Up the Ladder.' Will 'to the Government' Be Next?*, NAT'L L.J., Aug. 11, 2003, at 8.

82. See *supra* note 73 for the Commission's definition of an "appropriate response" by an issuer.

83. Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission, 17 C.F.R. § 205.3(d)(2).

84. *See infra* notes 100-11 and accompanying text.

85. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6310 n.92. *See also* TASK FORCE ON CORPORATE RESPONSIBILITY, AMERICAN BAR ASSOCIATION, REPORT OF THE AMERICAN BAR ASSOCIATION TASK FORCE ON CORPORATE RESPONSIBILITY 48-50 (2003), *at* http://www.abanet.org/buslaw/corporateresponsibility/final_report.pdf (last visited Oct. 29, 2004) [hereinafter ABA CORPORATE RESPONSIBILITY REPORT].

criticism,[86] and while the SEC considered removing it from the final rule, it was ultimately included with only minor changes from the original proposal.[87]

IV. THE AMERICAN BAR ASSOCIATION RESPONSE

In what may have been an attempt to avoid federal regulation of attorney conduct,[88] the ABA, before the passage of Sarbanes-Oxley, established the Corporate Responsibility Task Force ("Task Force") to deal with the problem of attorney participation in and tolerance of corporate misconduct.[89] The Task Force issued its final report on March 31, 2003,[90] suggesting two major changes to the Model Rules of Professional Conduct.[91] One change was an amendment to Model Rule 1.13, which covers the organization as client.[92] The amendments to Rule 1.13 include a mandatory "reporting up" requirement, requiring that an attorney representing an organization report crime or fraud to "higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization."[93] Rule 1.13 was further amended to provide that, where an attorney has referred a violation of law to the highest authority in an organization and such authority fails to address the referral "in a timely and appropriate manner," the attorney may "reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization."[94] The changes to Rule 1.13(b) impose a fairly

86. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6310-11.

87. *Id*. at 6310.

88. *Corporate Lawyers Smell a Rat*, N.Y. LAW. (Sept. 26, 2002), *at* http://www.nylawyer.com/news/02/09/092602d.html. Bruce A. Green, an ethics professor at Fordham University School of Law, was quoted as saying: "If for no other reason, the recommendations were an attempt to head Congress off at the pass." *Id*. Despite the ABA's hopes to self-regulate before Congress could take action, Sarbanes-Oxley, which included section 307 that mandated Rules of Professional Conduct for Attorneys, was signed into law on July 30, 2002, two weeks after the Task Force issued its preliminary report. *Id*.

89. Linnea B. McCord & Gia H. Weisdorn, *Blowing the Whistle: Will Your Corporate Attorney Be the New Whistleblower?,* 6 GRAZIADIO BUS. REP. 6, ¶ 9 (2003), *at* http://gbr.pepperdine.edu/033/lawyers.html.

90. ABA CORPORATE RESPONSIBILITY REPORT, *supra* note 85.

91. *Id*. at 77-89.

92. *Id*. at 82-89; MODEL RULES OF PROF'L CONDUCT R. 1.13 (2003).

93. MODEL RULES OF PROF'L CONDUCT R. 1.13 (2003). The Task Force recommended this change to Rule 1.13(b) because, by suggesting some general potential courses of action, the former rule could "confuse rather than clarify the mandatory nature of the lawyer's obligations under the rule." ABA CORPORATE RESPONSIBILITY REPORT, *supra* note 85, at 41-44.

94. MODEL RULES OF PROF'L CONDUCT R. 1.13(c) (2003). Under pre-amended Rule 1.13(c), the attorney had the option to resign in accordance with Rule 1.16. The pre-amended

similar duty to that required by the "up the ladder" requirements of section 307 of Sarbanes-Oxley and SEC Rule 205.[95]

The Task Force also recommended changes to Model Rule 1.6.[96] Prior to the 2003 amendments, Rule 1.6 permitted an attorney to disclose client confidences in limited circumstances: "to prevent reasonably certain death or substantial bodily harm; to secure legal advice about the lawyer's compliance with these Rules; to establish a claim or defense on behalf of the lawyer . . . or to comply with other law or court order."[97] While the ABA's Model Rules are typically consistent with the Rules of Professional Conduct in most states,[98] the majority of states had gone beyond the limits of Model Rule 1.6 and provided further exceptions to the lawyer's duty of confidentiality in their rules of professional conduct.[99] It was in recognition of this fact that the ABA Commission on Evaluation of the Rules of Professional Conduct ("Ethics 2000 Commission") suggested updating Model Rule 1.6 to better reflect the law in most states in its August 2001 report.[100] Ultimately, the ABA House of Delegates rejected the recommended changes in its 2001 amendments.[101] However, in light of increasing scrutiny of the failure of gatekeepers following

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rule did not permit the attorney to "reveal information relating to the representation." The amended comments to Rule 1.13 state:

> Paragraph (c) of this Rule supplements Rule 1.6(b) by providing an additional basis upon which the lawyer may reveal information relating to the representation, but does not modify, restrict, or limit the provisions of Rule 1.6(b)(1)-(6). Under Paragraph (c) the lawyer may reveal such information only when the organization's highest authority insists upon or fails to address threatened or ongoing action that is clearly a violation of law, and then only to the extent the lawyer reasonably believes necessary to prevent reasonably certain substantial injury to the organization. It is not necessary that the lawyer's services be used in furtherance of the violation, but it is required that the matter be related to the lawyer's representation of the organization.

MODEL RULES OF PROF'L CONDUCT R. 1.13 cmt. 6 (2003).

95. Judith Burns, *Attorneys Face a Paradox in the SEC's Conduct Rules*, WALL ST. J., Aug. 19, 2003, at C1.

96. ABA CORPORATE RESPONSIBILITY REPORT, *supra* note 85, at 77-81.

97. MODEL RULES OF PROF'L CONDUCT R. 1.6 (1983).

98. Nicholson, *supra* note 5, at 136.

99. ABA CORPORATE RESPONSIBILITY REPORT, *supra* note 85, at 51. According to the final report of the Task Force, "forty-one states permit a lawyer to disclose client information in order to prevent a client from perpetrating a fraud that constitutes a crime, and eighteen states permit such disclosure to rectify substantial loss resulting from client crime or fraud in which the client used the lawyer's services." *Id*. at 49. The report provides a state by state break down of which states allow disclosure and under what circumstances. *Id*. at 49 n.89.

100. *Id*. at 52. *See* ETHICS 2000 COMMISSION, AMERICAN BAR ASSOCIATION, ETHICS 2000 REPORT 20-26 (2001), *at* http://www.abanet.org/cpr/e2k-report_home.html (last visited Oct. 29, 2004).

101. Nicholson, *supra* note 5, at 143-44.

the corporate scandals at Enron, WorldCom, Adelphia, and others,[102] as well as a desire to "keep Congress from intruding on its turf,"[103] the ABA established the Task Force in 2002, and was once again offered the suggestion of updating Model Rule 1.6.[104] This time, the House of Delegates listened. At its August 2003 Annual Meeting, the ABA House of Delegates added two further exceptions to the general mandate of Rule 1.6 prohibiting disclosure of client confidences.[105] According to the amended rule, a lawyer is permitted to disclose client confidences

> (2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;
>
> (3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services.[106]

The amendments to Model Rule 1.6 permit attorneys to breach client confidentiality and report the misconduct of corporate clients if necessary to prevent or rectify criminal or fraudulent acts of such clients that could cause financial harm to others.[107] This change to the Model Rules is important because it is a more accurate reflection of the existing law in the majority of states.[108] However, the changes and additions may have little practical effect. The final version of Rule 205 was published in the Federal Register on February 6, 2003,[109] months before the ABA House of Delegates met to amend their Model Rules.[110] Furthermore, because the changes to Rule 1.6 merely bridge the gap between the ABA's former position and the approach already

102. 148 CONG. REC. S6561, S6561-63 (daily ed. July 10, 2002) (statement of Sen. Levin).

103. *Corporate Lawyers Smell a Rat*, *supra* note 88.

104. ABA CORPORATE RESPONSIBILITY REPORT, *supra* note 85, at 77-81.

105. Myron Levin, *ABA Code Targets Corporate Crimes*, L.A. TIMES, Aug. 13, 2003, at C1. The general rule regarding client confidences provides: "A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b)." MODEL RULES OF PROF'L CONDUCT R. 1.6(a) (2003).

106. MODEL RULES OF PROF'L CONDUCT R. 1.6(b)(2)-(3) (2003).

107. *Id*.

108. ABA CORPORATE RESPONSIBILITY REPORT, *supra* note 85, at 51.

109. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6296 (proposed Feb. 6, 2003) (to be codified at 17 C.F.R. pt. 205).

110. Nat Slavin, *ABA Sends General Counsel on a Rough Ride*, CORP. LEGAL TIMES, Oct. 2003, at 4.

taken by most states in their rules of professional conduct,[111] these changes should only have a minor impact upon the rules of individual states.

V. STATE BAR REACTIONS AND THE PREEMPTION DEBATE

When the SEC released the final version of Rule 205, it noted in the accompanying release that some commentators on Rule 205 questioned whether the Commission's rule could preempt state ethics codes.[112] The Commission responded to these concerns, stating:

> The language which we adopt today clarifies that this part does not preempt ethical rules in United States jurisdictions that establish more rigorous obligations than imposed by this part. At the same time, the Commission reaffirms that its rules shall prevail over any conflicting or inconsistent laws of a state or other United States jurisdiction in which an attorney is admitted or practices.[113]

Despite the SEC's assertions, the Washington State Bar Association's Board of Governors took issue with the rule, and released an Interim Formal Ethics Opinion on July 26, 2003,[114] ten days before Rule 205 was to take effect, warning Washington attorneys not to reveal any client confidences outside of the corporate organization.[115] The opinion clearly states: "To the extent that the SEC regulations authorize but do not require revelation of client confidences and secrets under certain circumstances, a Washington lawyer should not reveal such confidences and secrets unless authorized to do so under the RPCs [Rules of Professional Conduct]."[116]

111. Carlton Letter, *supra* note 77.

112. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6297. In the release accompanying Final Rule 205 the Commission stated:

> A number of commenters questioned the Commission's authority to preempt state ethics rules, at least without being explicitly authorized and directed to do so by Congress. Another comment letter noted that the Constitution's Commerce Clause grants the federal government the power to regulate the securities industry, that the Sarbanes-Oxley Act requires the Commission to establish rules setting forth minimum standards of conduct for attorneys appearing and practicing before it, and that, under the Supremacy Clause, duly adopted Commission rules will preempt conflicting state rules.

Id.

113. *Id*.

114. Washington State Bar Association Board of Governors, Interim Formal Ethics Opinion Re: The Effect of the SEC's Sarbanes-Oxley Regulations on Washington Attorneys' Obligations Under the RPCs (2003), *at* http://www.wsba.org/lawyers/ethics/default1.htm (last visited Oct. 29, 2004) [hereinafter Washington Ethics Opinion]; Sue Reisinger, *Two State Bar Groups Protest SEC Rule on Disclosing Civil Violations*, PALM BEACH DAILY BUS. REV., Sept. 29, 2003, at 18.

115. Washington Ethics Opinion, *supra* note 114, at 1.

116. *Id.*

Under Rule 1.6 of the Washington Rules of Professional Conduct, an attorney may only reveal client confidences in very limited circumstances.[117] Like the SEC rule, this is a permissive rule; the lawyer is not required to report anything. The important distinction between the Washington ethics rule and SEC Rule 205 is the circumstances under which a lawyer may make such disclosures. Under the Washington rule, such disclosure is limited to the extent necessary to prevent the client from committing a crime, to establish a claim or defense on the lawyer's behalf, to respond to allegations in any proceeding concerning the representation, or pursuant to a court order.[118] Under Rule 205, however, an attorney is authorized to reveal client confidences to the SEC to the extent that he or she reasonably believes necessary to prevent the client from committing a material violation likely to cause "injury to the financial interest or property of the issuer or investors."[119] Furthermore, a "material violation" is defined in the rule to mean "a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty . . . , or a similar material violation of any United States federal or state law."[120] Therefore, the SEC's rule allows for disclosure under a much broader set of circumstances than Washington's rule permits.

In order to prevent Washington state attorneys from relying on an argument of good faith compliance with the SEC Rule,[121] the Washington opinion clearly states "an attorney who takes action contrary to this Formal Opinion cannot . . . fairly claim to be complying in good faith with the SEC

117. WASH. RULES OF PROF'L CONDUCT R. 1.6 (1990). The Washington rule prohibits a lawyer from revealing client confidences or secrets relating to the representation except "to the extent the lawyer reasonably believes necessary: (1) [t]o prevent the client from committing a crime; or (2) [t]o establish a claim or defense on behalf of the lawyer . . . ." *Id*.

118. *Id*.

119. Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission, 17 C.F.R. § 205.3(d)(2)(i). An attorney may also reveal client confidences to the Commission in two other situations under Rule 205:

> (ii) To prevent the issuer, in a Commission investigation or administrative proceeding from committing perjury . . . or committing any act . . . likely to perpetrate a fraud upon the Commission; or
>
> (iii) To rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used.

17 C.F.R. § 205.3(c)(2).

120. 17 C.F.R. § 205.2(i).

121. Subsection (c) of Rule 205.6 states: "An attorney who complies in good faith with the provisions of this part shall not be subject to discipline or otherwise liable under inconsistent standards imposed by any state or other United States jurisdiction where the attorney is admitted or practices." 17 C.F.R. § 205.6(c).

Regulations."[122] The Board justifies this assertion by arguing that there would be no conflict between Rule 205 and the Washington Rules of Professional Conduct.[123] Furthermore, because Rule 205 is permissive,[124] an attorney may comply with the stricter Washington RPCs limiting disclosure and still technically be "in compliance" with the SEC Regulations.[125] The Board argues that because Rule 205.6(c) uses the term "complies"[126] a lawyer can use this good faith defense against state disciplinary actions only in relation to mandatory, not permissive, provisions of the SEC Regulations.[127]

In an attempt to dissuade the Washington Bar from issuing its opinion, SEC General Counsel Giovanni Prezioso wrote a letter to the President and President-Elect of the Washington Bar Board of Governors on July 23, 2003.[128] He began by noting that because Rule 205 applies only in limited circumstances, conflicts between the state and federal laws would be uncommon.[129] Prezioso then discounted the Washington Bar's argument that such conflicts would not occur.[130] Furthermore, he argued that Supreme Court precedent clearly validates the Commission's ability to preempt conflicting state law.[131] Prezioso referred to *Sperry v. State of Florida*[132] to establish "the authority of federal agencies to implement rules of conduct that diverge from and supersede state laws that address the same conduct."[133] Prezioso also

122. Washington Ethics Opinion, *supra* note 114, at 7.

123. *Id*.

124. "[T]he fact that Section 205(d)(2) states that a lawyer 'may reveal' confidential information but does not mandate a revelation gives the lawyer discretion to determine whether to make such a disclosure." *Id.*

125. *Id*.

126. *Id*.

127. Washington Ethics Opinion, *supra* note 144, at 7.

128. Letter from Giovanni P. Prezioso, SEC General Counsel, to J. Richard Manning, President, and David W. Savage, President-Elect, Washington State Bar Association (July 23, 2003), *at* http://www.sec.gov/news/speech/spch072303gpp.htm [hereinafter Letter from Giovanni P. Prezioso]. Prezioso's intent was clearly to convince the Washington State Bar Board of Governors to back down from the position taken in the Washington Ethics Opinion. He stated: "As the Board of Governors considers the Proposed Interim Formal Opinion, and as the WSBA RPC Committee contemplates revisions to Washington RPC 1.6, perhaps these comments will aid your deliberations by providing the Commission's perspective on the relevant sections of its new attorney-conduct rules." *Id*.

129. *Id*.

130. *Id*. Prezioso's letter states: "Despite the narrow scope of the Commission's rules, the Proposed Interim Formal Opinion does identify potential areas of conflict." *Id.*

131. *Id*.

132. Sperry v. State of Florida, 373 U.S. 379 (1963).

133. Letter from Giovanni P. Prezioso, *supra* note 128. In *Sperry*, the Supreme Court held that, where Federal Patent Office regulations authorized practice before the Patent Office by non-lawyers, Florida could not enjoin a non-lawyer from preparing and prosecuting patent

asserted that *Fidelity Federal Sav. & Loan Ass'n v. de la Cuesta*[134] establishes that where a state law prohibits an attorney from pursuing a course of action which the attorney has discretion to pursue based on a federal regulation, the federal regulation takes priority.[135] Finally, Prezioso disputed the Washington Bar's assertions regarding the ability of an attorney to establish a defense of good faith compliance with federal regulations in a state disciplinary proceeding.[136] Prezioso cited several Supreme Court cases in asserting that, when interpreting a federal regulation, states must defer to the federal agency's interpretation.[137] Therefore, it would be improper for Washington's State Bar to determine whether an attorney could establish a "good faith" defense in a state disciplinary proceeding; as such, a determination of what constitutes "good faith" compliance should be made by the SEC.[138]

While Washington attempted to make the argument that there was not necessarily a conflict between the SEC Rule and the Washington Rules of Professional Conduct,[139] some members of the California Bar took an even stronger stance in opposition to the SEC's Rule 205.[140] In an August 13, 2003 letter to Prezioso,[141] the Corporations Committee of the Business Law Section of the California State Bar (the "Committee") questioned the SEC's authority

applications in Florida, even though such practice was unauthorized under Florida's State Bar rules. *Sperry*, 373 U.S. at 400-03.

134. Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141 (1982).

135. Letter from Giovanni P. Prezioso, *supra* note 128 (quoting *de la Cuesta*, 458 U.S. at 155).

136. *Id*. See *supra* notes 121-27 and accompanying text for an explanation of the Washington ethics opinion's position regarding the unavailability a "good faith" compliance defense.

137. Letter from Giovanni P. Prezioso, *supra* note 128. Prezioso's letter cites three Supreme Court cases for this assertion: *Barnard v. Walton*, 535 U.S 212 (2002), *United States v. Locke*, 529 U.S. 108 (2000), and *City of New York v. FCC*, 486 U.S. 57 (1989).

138. Letter from Giovanni P. Prezioso, *supra* note 128.

139. Peter Erlichman, a spokesman for the Washington Bar, stated that because Rule 205 is permissive, not mandatory, the Washington Bar had found no conflict between the SEC rule and Washington law. Sue Reisinger, *States' Rights All Over Again*, CORP. COUNS., Nov. 2003, at 24.

140. George A. Riemer, *SEC v. State Bars? Preemption Showdowns Could Be on the Horizon*, OR. ST. BAR BULL., Dec. 2003, at 22.

141. This letter was written in response to SEC General Counsel Giovanni P. Prezioso's July 23, 2003 public statement/letter to the Washington State Bar Association. The position set forth in this letter is that of the twenty-five member Corporations Committee of the Business Law Section of the State Bar of California; it has not been adopted by the California State Bar as a whole or by the Business Law Section. Letter from the Corporations Committee of the Business Law Section, State Bar of California, to Giovanni P. Prezioso, General Counsel of the U.S. Securities and Exchange Commission (Aug. 13, 2003), *at* http://www.ethicsandlawyering.com/Issues/0903.htm [hereinafter Corporations Committee Letter].

to preempt state ethics rules.[142] Like Washington, California imposes a stricter duty upon its attorneys with regard to maintaining client confidences.[143] The permissive disclosure allowed by Rule 205 is contrary to this standard.[144] In its letter to the SEC, the Committee made a strong argument questioning the authority of the Commission to adopt Rule 205 in its current form.[145] According to the Committee, "the preemptive effect of these rules will be challenged on the basis that there is no evidence of Congressional intent to preempt state ethics rules."[146] The Committee went on to point out that "in other instances, courts have struck down SEC rulemaking for lack of authority,"[147] and argued that none of the statutory provisions which the SEC relied on as authority in adopting the final version of Rule 205 demonstrate

142. *Id*. "The Committee believes that the authority of the SEC to adopt either Rule 205.3(d) or Rule 205.6(c) could be challenged and that it is realistic to believe that the SEC's authority will be challenged." *Id*.

143. CAL. BUS. & PROF. CODE § 6068(e)(1) (West 2004). Section 6068(e)(1) requires an attorney to "maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client." Effective July 1, 2004, section 6068 was amended to allow permissive disclosure where necessary to prevent a criminal act likely to result in death or substantial bodily harm. This is the still, however, the only exception to the California lawyer's duty of confidentiality. *Id*. *See also* CAL. RULES OF PROF'L CONDUCT R. 3-600 (2003) (describing an attorney's duty of confidentiality in the representation of an organization). This duty has also been adopted by federal district courts in California:

> Thus, attorneys appearing and practicing before these federal courts are obligated to comply with California's rules regarding the protection of client confidences. For example, Local Rule No. 83-3.1.2 of the United States District Court for the Central District of California Provides:
>
>> In order to maintain the effective administration of justice and the integrity of the Court, each attorney shall be familiar with and comply with the standards of professional conduct required of members of the State Bar of California and contained in the State Bar Act, the Rules of Professional Conduct of the State Bar of California, and the decisions of any court applicable thereto. These statutes, rules and decisions are hereby adopted as the standards of professional conduct, and any breach or violation thereof may be the basis for the imposition of discipline.

Corporations Committee Letter, *supra* note 141.

144. *See supra* notes 83-87 and accompanying text.

145. Corporations Committee Letter, *supra* note 141.

146. *Id*. The committee has not been alone in advancing this argument based on legislative intent. Michael O'Sullivan, a corporate partner at Los Angeles law firm Munger Tolles & Olson, argued that the cases cited by Prezioso (in his letter to the Washington State Bar Association Board of Governors) as the basis for federal preemption were based on congressional intent, whereas the legislative history of Sarbanes-Oxley does not indicate an intent to change lawyers' reporting requirements to the SEC. Sue Reisinger, *Two State Bar Groups Protest SEC Rule on Disclosing Civil Violations*, PALM BEACH DAILY BUS. REV., Sept. 29, 2003, at 18. According to O'Sullivan, on a number of occasions members of Congress were told that the bill would not require corporate lawyers to report to the SEC. *Id.*

147. Corporations Committee Letter, *supra* note 141.

congressional intent to allow the SEC to grant corporate lawyers the right to disclose client confidences.[148] Furthermore, the Committee's letter discounted Prezioso's reliance on *Sperry v. State of Florida* as authority for the SEC's ability to preempt state law.[149] In *Sperry*, the Committee argued, there was clear Congressional intent to grant a federal agency the authority to formulate regulations,[150] whereas here, there was no evidence that Congress intended the SEC to have the authority to preempt state ethical rules and grant attorneys a right of permissive disclosure to the SEC.[151] Furthermore, the Committee noted that the United States Supreme Court has previously made a point of avoiding the federalization of corporate laws, an area typically governed by state law, "absent a clear indication of congressional intent" to do so.[152] The Committee cited the language of federal case law to reiterate this point.[153] The court in *Pennsylvania Medical Soc'y v. Marconis* stated "[w]hen Congress remains silent regarding the preemptive effect of its legislation on state laws it knows to be in existence at the time of such legislation's passing, Congress has failed to evince the requisite clear and manifest purpose to supersede those state laws."[154]

After questioning the authority of the SEC to pass Rule 205 in its current form, the Committee's letter to the SEC raises another important objection.

148. *Id*. The Committee's letter states:

> In the adopting [sic] the final rules, the SEC cites as authority the following statutory provisions: Sections 3, 307, and 404 of the Sarbanes-Oxley Act; Section 19 of the Securities Act of 1933; Sections 3(b), 4(C), 13 and 23 of the Securities Exchange Act of 1934, Sections 38 and 39 of the Investment Company Act of 1940, and Section 211 of the Investment Advisers Act of 1940. Not one of these statutes even hints that Congress intended to invest the SEC with broad authority to permit lawyers disclose [sic] client secrets much less require that they do so and then immunize or otherwise protect those lawyers who do.

Id. Furthermore, in evaluating the SEC's reliance on section 307 as granting authority to adopt a rule making disclosure of client confidences to the SEC permissive in certain circumstances, the Committee states that "references in Section 307 to 'public interest' and 'protection of investors' are simply too general to evidence any actual intent by Congress to empower the SEC to adopt rules allowing attorneys to divulge client confidences and establish immunity for those who do." *Id*. at n.9.

149. Corporations Committee Letter, *supra* note 141. See *supra* notes 132-33 and accompanying text for a discussion of Prezioso's reliance on *Sperry v. State of Florida*.

150. Corporations Committee Letter, *supra* note 141. The letter also argues that *Sperry* can be distinguished from the present situation because, in that case, the regulations of the Patent Office allowed non-lawyers to practice before it, which was a commonplace occurrence before Congress passed the statute. *Id.* However, in this situation, "the SEC's rules represent a radical change from historical patters of state regulation of attorneys." *Id*.

151. *Id*.

152. *Id.* (quoting Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 479 (1977)).

153. *Id*.

154. *Id.* (citing Pa. Med. Soc'y v. Marconis, 942 F.2d 842, 844 (3d Cir. 1991)).

According to the Committee, Article III, section 3.5 of the California Constitution prevents the State Bar from failing to enforce section 6068(e) of the California Business and Professions Code.[155] Section 3.5 states:

> An administrative agency, including an administrative agency created by the Constitution or an initiative statute, has no power . . . (c) To declare a statute unenforceable, or to refuse to enforce a statute on the basis that federal law or federal regulations prohibit the enforcement of such statute unless an appellate court has made a determination that the enforcement of such statute is prohibited by federal law or federal regulations.[156]

Based on this section, the Committee argued that the State Bar is required to enforce section 6068(e), despite the claims of the SEC that Rule 205 preempts.[157] Furthermore, a final order or judgment of an appellate court[158] upholding the preemptive effect of the federal law would be necessary in order for the State Bar to fail to enforce section 6068(e) in favor of Rule 205.[159]

In a speech before the New York City Bar Association[160] SEC Commissioner Harvey J. Goldschmid[161] commented upon some of the preemption issues raised by the Washington opinion and the letter from the Committee of the California Bar.[162] Goldschmid pointed out that section 307 of the Act states that the "Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys . . . including a rule . . . [requiring 'reporting up']."[163] Goldschmid argued that this language clearly indicates that Congress intended the SEC to have fairly broad discretion in drafting these standards.[164] Furthermore, while not commenting upon the letter from the Corporations Committee of the Business Law Section of the California State Bar,

155. Corporations Committee Letter, *supra* note 141. See *supra* note 143 for a discussion of section 6068(e).

156. CAL. CONST. art. III, § 3.5.

157. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. at 6297 (proposed Feb. 6, 2003) (to be codified at 17 C.F.R. pt 205); Letter from Giovanni P. Prezioso, *supra* note 128.

158. The Committee's letter states that a judgment from a trial court would not be sufficient. In order for the State Bar to refuse to enforce section 6068(e), an affirmation by an appellate court would be needed. Corporations Committee Letter, *supra* note 141.

159. *Id*.

160. Goldschmid Speech, *supra* note 7.

161. Harvey Goldschmid has been a Commissioner of the SEC since July of 2002. *Id*.

162. *Id*.

163. *Id*. (quoting Sarbanes-Oxley Act § 307, 15 U.S.C. § 7245 (2002)).

164. *Id*. Goldschmid stated: "Obviously, the words 'minimum standards' and 'including' are critical to any serious consideration of the various 'reporting out' issues that I am about to discuss." *Id*.

Goldschmid said the following with regard to the Washington Interim Formal Ethics Opinion:

> I believe that the position of the Washington State Bar Association is legally untenable, and its ethical opinion constitutes an essentially lawless act. In policy terms, the Washington State Bar Association is acting contrary to the positions of the SEC, at least 40 states, and, since August, the American Bar Association. It will be a tragedy, for which the Washington State Bar Association will have to accept substantial responsibility, if a Washington State lawyer – who would have "reported out" ongoing, serious financial fraud – fails to do so on the basis of the Bar Association's deeply flawed ethical opinion.[165]

While thus far, the conflict between the states and the SEC has yet to come to a head, the fact that such a conflict will eventually occur appears to be inevitable.[166] Both the Washington Bar and the Committee of the California Bar have posed serious challenges to Rule 205, setting the stage for future questions and confusion.

VI. ARGUMENTS FAVORING AND OPPOSING RULE 205

A. Arguments Favoring Federal Standards for Attorney Conduct

While the SEC gave corporate attorneys some indication of what standards of behavior the Commission expected them to adhere to in cases such as *In re Carter* and *SEC v. National Student Marketing Corp.*,[167] the task of regulating and disciplining attorneys was still seen primarily as the role of state bar

165. Goldschmid Speech, *supra* note 7.

166. While such a conflict is likely to occur at some point, the question of when is much less clear. Goldschmid makes an important point in his speech to the New York City Bar Association. He argues that issues related to reporting outside a corporate client when such client has failed to stop or rectify fraud or other serious violations, "while of large emotional concern to many in the bar, are of considerably less practical importance than the 'reporting up' approach . . . it will be a most unusual circumstance . . . where reporting up to senior executives and independent directors will not stop wrongdoing or reckless behavior." *Id.* Goldschmid's statement seems especially valid in light of the "zero tolerance" regulatory environment post Sarbanes-Oxley. John J. Falvey, Jr. & Matthew A. Wolfman, *The Criminal Provisions of Sarbanes-Oxley: A Tale of Sound and Fury?*, 12 ANDREWS DEL. CORP. LITIG. REP. 23 (2003). If an attorney could potentially report violations outside the corporate entity, it seems likely that corporate actors would do everything in their power to avoid such an outcome.

167. *See supra* notes 23-44 and accompanying text. In *Carter*, the SEC warned that lawyers must "take prompt steps to end the client's noncompliance," yet failed to explain what course of action an attorney in that position should pursue. Nicholson, *supra* note 5, at 120 (quoting *In re* Carter & Johnson, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847, at 84,172 (Feb. 28, 1981)).

associations.[168] While these cases gave some indication of appropriate behavior, the standards are merely suggestive, and the infrequent use of sanctions under Rule 102(e) and aiding and abetting liability pursuant to Rule 10b-5 have provided only limited guidance to corporate attorneys.[169] Prior to Rule 205, there was no consistent set of guidelines for corporate lawyers to follow when they became aware of fraudulent conduct by their clients.[170] While some have criticized the rule because it requires an attorney to make difficult determinations as to the legality of the client's conduct,[171] it serves an important purpose by providing attorneys with a framework of actions not available under the myriad of current federal securities laws or state ethical rules.[172]

Not only does Rule 205 provide lawyers with a workable framework of potential behavior, it also remedies the problem of inconsistency in the current scheme of state ethics rules governing attorney conduct in this area.[173] Professor of legal ethics Richard W. Painter, commenting on the SEC's proposed Rule 205, stated that "[w]hen the client is an issuer of securities subject to federal securities laws, there should be a nationwide standard allowing the lawyer to disclose."[174] Current state ethics rules on client confidentiality impose inconsistent standards regarding disclosure of confidential information.[175] Such inconsistency is especially troubling for law firms with offices in different jurisdictions, or any attorney or firm

168. *See supra* notes 42-43 and accompanying text.

169. Nicholson, *supra* note 5, at 107. See *supra* Part II.A. for a discussion of lawyer liability under SEC Rules 102(e) and 10b-5.

170. Nicholson, *supra* note 5, at 107.

171. *See infra* note 193 and accompanying text.

172. Nicholson, *supra* note 5, at 120-22, 136.

173. Letter from Richard W. Painter, *supra* note 59 (commenting on proposed Rule 205).

174. *Id*. *See also* Nicholson, *supra* note 5, at 139. In arguing for the need for the American Bar Association to update its current Model Rules to allow permissive disclosure by attorneys faced with client fraud, Nicholson states:

> [A]n amended Model Rule 1.6 will promote uniformity among the states. The ABA's goal of uniformity by establishing clear-cut rules is lost with respect to Model Rule 1.6. However, as in the case of the professional responsibility rules in other substantive areas, an amended Model Rule 1.6 could persuade all states to review their existing rules and sign on to a new, clear-cut ABA disclosure standard.

Id. Since publication of Nicholson's article, the ABA has made changes to Model Rule 1.6. *See supra* Part IV.

175. Nicholson, *supra* note 5, at 136-37. "An overwhelming majority of these states have adopted, whole cloth, the standards articulated by the ABA in most of the significant areas of professional responsibility, with one glaring exception: client confidentiality. States have adopted varying versions of Model Rule 1.6. Consequently, Model Rule 1.6 is anything but the 'model.'" *Id*. at 136.

representing a national or multi-national corporation.[176] For example, a large firm with offices in both Hawaii and California faces a special dilemma. Under the laws of one state, disclosure in certain circumstances is mandatory, but in another it may not be permitted at all.[177]

Furthermore, Rule 205's permissive disclosure standard does not necessarily pose a threat to the lawyer's ethical duty of confidentiality owed to the client. According to legal scholar Paul G. Haskell, while the duty of confidentiality is unquestionably an important one, it should not necessarily be applied in all situations.[178] In his book *Why Lawyers Behave as They Do*, Haskell states that "[t]he purpose of confidentiality is to facilitate the lawyer's efforts to obtain what the client is entitled to under the law."[179] By this reasoning, the purpose of confidentiality is not served when the client has committed a fraud, because the client is not entitled to do so under the law. Similarly, in discussing pre-amended Rule 1.6 of the ABA Model Rules of Professional Conduct, professor of law Lisa Nicholson points out that the right to confidentiality should effectively be waived by a client who wrongfully uses the attorney's legal services.[180] Where a client puts the attorney in such a situation, the attorney is exposed to potential liability.[181] As Nicholson states, "[W]here clients abuse the lawyer-client relationship, they should be deemed to have waived any claim to client confidentiality that is a by-product of such relationship."[182]

B. Arguments Opposing Federal Standards of Attorney Conduct

Many legal scholars and practitioners have long been opposed to any change in federal securities laws or the ABA Model Rules of Professional Conduct that may hamper the lawyer's ability to fulfill his duty of confidentiality and zealous advocacy. Following the passage of the Sarbanes-

176. Letter from Richard W. Painter, *supra* note 59 (commenting on Proposed Rule 205).

177. *See* HAW. RULES OF PROF'L CONDUCT R. 1.6 (2002); CAL. BUS. & PROF. CODE § 6068(e) (West 2004).

178. PAUL G. HASKELL, WHY LAWYERS BEHAVE AS THEY DO 59 (1998).

179. *Id*. at 57. Haskell specifically discusses the non-applicability of confidentiality when a client seeks a lawyer's assistance in connection with the commission of a crime. However, Haskell's argument for why the duty of confidentiality should not apply in such circumstances is equally applicable to a situation where the client has or is going to commit fraud or a violation of securities laws.

180. Nicholson, *supra* note 5, at 147. While Nicholson's argument relates to a client actually using the attorney's services in committing fraud, the same argument can be applied where the client has asked the attorney to keep confidential information relating to a past or ongoing fraud or crime.

181. *Id*.

182. *Id*.

Oxley Act, the President of the State Bar of Texas criticized section 307 of the Act:[183]

> Historically, and in the best interest of our clients as well as the general public, lawyers have not been perceived as 'certified public attorneys.' Our responsibility has been to our clients, with specific rules that apply if our opinions and/or advice are known by us as being intended to be relied upon by third parties or the public in general. Our responsibility is and should continue to be to zealously represent our clients. We are not and should not be expected to be whistleblowers, corporate policeman, [sic] or graders of the accountant's school papers.[184]

The most frequently cited argument against permissive disclosure is that it would harm the attorney's ability to zealously represent the client.[185] The traditional reasoning for the rule regarding client confidentiality is that if the client cannot trust that all communications with the attorney will be kept confidential, the client will not feel comfortable communicating with the attorney in order to seek legal advice.[186] Many attorneys do not feel that they should be held responsible for protecting the public-at-large in addition to protecting the interests of their individual clients.[187]

Lawrence J. Fox, an attorney at Drinker, Biddle & Reath in Philadelphia, has consistently been a vigilant and vocal supporter of the importance of protecting client confidentiality.[188] Fox has stated, "Academics have this lofty notion that lawyers should do good for society. But I'm not buying it. I don't think we should put the lawyers in a position where they have duties to the

183. Guy Harrison, *Protecting Our Profession*, 65 TEX. BAR J. 678 (2002).

184. *Id*.

185. Mitchell Pacelle & Michael Schroeder, *Proposed SEC Rules Could Turn Lawyers Into Whistle-Blowers*, WALL ST. J., Jan. 9, 2003, at A1. *See also* Corporations Committee Letter, supra note 141. The letter of the Corporations Committee of the California Bar states:

> The Committee recognizes that lawyers in private practice can play a unique and often pivotal role under the federal securities laws. Nonetheless, that role does not make private attorneys an adjunct to the SEC in enforcing those laws. Indeed, the Committee believes that our adversarial system of justice will not work unless attorneys can act as independent advocates and advisers to their clients.

Id.

186. James P. Schaller, *The Wrong Tack: Upending Client Confidentiality Would Destroy Client Confidence*, CAL. LAW (Aug. 15, 2001), *at* www.law.com/regionals/ca/opinions/stories/edt0815_com_schaller.shtml (last visited Oct. 29, 2004); Steven Andersen, *Plaintiffs Chip Away at Attorney-Client Privilege*, CORP. LEGAL TIMES, Oct. 2003, at 22.

187. Sarah Boxer, *Lawyers Are Asking, How Secret Is a Secret?*, N.Y. TIMES, Aug. 11, 2001, at B7.

188. *Id*. *See also* LAWRENCE J. FOX, ETHICS 2000 COMMISSION, AMERICAN BAR ASSOCIATION, ETHICS 2000 MINORITY REPORT (2001), *at* http://www.abanet.org/cpr/e2k-dissent.html (last visited Oct. 29, 2004).

public, except in cases of death or bodily harm."[189] When the ABA Ethics 2000 Commission proposed changes to the Model Rule 1.6, which would allow disclosure to "prevent, mitigate or rectify a client fraud in which the lawyer's services have been employed," Fox disagreed with the Commission's recommendations in his dissenting opinion.[190] Fox cited a number of reasons why attorneys should not be allowed to disclose clients' confidences.[191] One major problem cited by Fox is that asking an attorney to be responsible for catching client fraud may be asking too much.[192] Fox argues: "The false premise is that when a lawyer is dealing with client fraud, it will be apparent on its face. It is so easy to say the words 'when a lawyer uncovers fraud, she should be able to disclose it.' But fraud does not appear that way save in the rarest of cases."[193]

VII. ANALYSIS

An evaluation of the need for a federal rule regulating attorney conduct implicates a balancing test of competing and often conflicting interests. Those two interests are the lawyer's duty to the client and the need to protect the investing public from unscrupulous corporate behavior. Resolution of this conflict requires two basic considerations. The first issue requires consideration of what the proper role of the corporate attorney is. Should attorneys, representing a corporate client, be subject to the same standards and duties regarding client confidentiality as lawyers acting in more of an adversary role?[194] The second issue requires a determination of who should be responsible for regulating attorney conduct. Should the bar associations of the individual states be responsible for regulating members' conduct and disciplining them if they fail to act appropriately, or should the SEC, the federal agency charged with protecting the investing public, have a say in the regulation of attorney conduct when those attorneys are appearing and practicing before the Commission? Legal scholars, law practitioners, and regulators have heatedly debated these questions and have presented powerful arguments for both sides.[195]

189. Boxer, *supra* note 187 (quoting Lawrence J. Fox).

190. FOX, *supra* note 188.

191. *Id*.

192. *Id*.

193. *Id*.

194. Some legal scholars have argued that securities lawyers are in "professional jeopardy" because of attempts by the SEC to alter their duties to their clients, thereby hampering their ability to "zealously represent" the client. FREEDMAN, *supra* note 1, at 21.

195. See *supra* Part VI for some of the central arguments in favor of and in opposition to a federal rule regulating attorney conduct.

The classic role of the attorney as an advocate of the client is a longstanding canon of legal ethics. This role has traditionally embraced two important duties of an attorney: the duty of loyalty to the client, and the duty to protect and preserve client confidences.[196] Without these basic elements of the attorney-client relationship, clients would not be able to put full trust in their attorneys, and the attorneys' ability to best protect the interests of their clients could be damaged.[197] The corporate attorney, however, operates in a somewhat different role than a criminal attorney or civil litigator. When a corporate entity acts in a way contrary to the interests of the investing public, the corporate attorney who knows of such malfeasance and fails to take steps to prevent or rectify these acts may be taking his or her duties to the client too far. In these circumstances, the lawyer is not protecting the client's best interests in the face of an opposing party in the courtroom. Rather, the opposition in such cases is the investing public, who, despite the best efforts of the SEC,[198] has no advocate acting on its behalf when dealing with the corporation. In these circumstances, the role of the attorney is different than it would be in a litigation or negotiation setting. The corporate attorney must be aware of an obligation to the public at large, as well as to his or her client.

Recently, it has become increasingly clear that the existing system of checks on corporate America has failed to provide adequate safeguards to investors.[199] Lawyers can no longer be viewed merely as tools of their corporate clients. Instead, they must also be aware of a duty to protect investors from their clients' wrongful acts. Clearly, such conflicting roles of advocate and gatekeeper may often be difficult to reconcile. Because these lawyers are in the unique position of having to ensure their clients' compliance with federal securities laws, they must continually balance the competing interests of their clients and the investing public, who the federal securities laws are meant to protect. It is for this reason that a clear set of standards of behavior are needed to guide corporate attorneys in striking a balance between their conflicting duties. Furthermore, federal, as opposed to state, regulation is desirable for two reasons. First, it allows for uniformity in an area of law where state ethical standards have varied significantly.[200] This is especially desirable in light of the national and sometimes international operations of so

196. John W. Amberg & Jon L. Rewinski, *Issues of Loyalty and Confidentiality Continue to Dominate Developments in Legal Ethics*, 26 L.A. LAW. 31, 32 (2003).

197. *Id.* at 34.

198. Despite the important task faced by the Commission, the agency has only limited resources and a "meager" staff with which to achieve these lofty objectives. FREEDMAN, *supra* note 1, at 21.

199. *See supra* notes 44-54 and accompanying text.

200. Letter from Richard W. Painter, *supra* note 59. This letter was written in response to the SEC release seeking comments on proposed Rule 205.

many public companies, as well as the large scale of many of the law firms which represent these corporate clients.[201] Second, because such standards would ultimately serve the purpose of promoting greater compliance with federal securities laws, it seems logical that a set of federal standards would be most appropriate.

Rule 205 provides corporate attorneys with much needed guidance regarding how to behave when faced with evidence of fraudulent behavior by the corporate client. As discussed above, under the current scheme of state ethical rules and corporate securities laws, attorneys may have had little helpful guidance as to appropriate conduct when dealing with client fraud prior to SEC Rule 205.[202] Furthermore, Rule 205 will not only benefit corporate attorneys, it should also impact positively upon capital markets because it allows investors to have greater confidence that corporate fraud will be less likely to be overlooked by corporate attorneys.[203] The rule will provide much needed uniformity among jurisdictions regarding ethical rules for corporate attorneys.[204] Moreover, because Rule 205 introduces the threat of disclosure, corporate attorneys may be able to more successfully dissuade clients from continuing or failing to rectify the results of fraudulent conduct.[205]

While many authorities, especially many practicing attorneys, argue that allowing disclosure of client confidences in the face of fraudulent conduct will have a "chilling effect" on clients' willingness to communicate with attorneys and seek legal counsel,[206] this argument may be more theoretical than practical.[207] Corporate actors still have incentives to seek the advice of attorneys.[208] Furthermore, despite the above discussed policy rationales for

201. *Id*.

202. Nicholson, *supra* note 5, at 107.

203. *Id*. at 139. Nicholson argued for the need for the ABA to amend Model Rule 1.6, however, the same rationale lends support to the argument favoring federal standards of behavior for attorneys, as provided by SEC Rule 205.

204. *See supra* notes 175-77 and accompanying text.

205. Nicholson, *supra* note 5, at 139; William H. Simon, *Perspective: Managerial Confidentiality Is Overrated*, N.Y. LAW J., Oct. 2, 2003, at 2.

206. Schaller, *supra* note 186; Andersen, *supra* note 186, at 22.

207. Simon, *supra* note 205.

208. Letter from Susan P. Koniak, Professor of Law, Boston University School of Law, et al., to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Apr. 7, 2003), *at* http://www.sec.gov/rules/proposed/s74502/lawprofs040703.htm. This letter was sent in response to the January 29, 2003 SEC release seeking commentary on final and proposed Rule 205. The letter states:

> Corporate clients (through their agents) confide in corporate lawyers (to the extent they do, which is now imperfect and always will be) because corporations need legal advice. Period. There is no evidence whatsoever that corporate clients have avoided lawyers in those few states that now *require* disclosure of client illegality or those states that permit such disclosure.

confidentiality,[209] the policy supporting disclosure by corporate attorneys where their corporate client is engaging in violations of securities laws should ultimately be deemed to outweigh any conflicting considerations. When corporate attorneys are forced to balance the interests of their clients against the interests of the investing public, the need to protect the public from fraud and misinformation must outweigh the duty to protect the clients' confidences.

VIII. CONCLUSION

Corporate attorneys occupy a unique role in the legal system. Unlike most lawyers, who must concern themselves only with the interests of their clients, corporate attorneys must recognize and take responsibility for their duty to the investing public to act as a corporate gatekeeper. Recent scandals in corporate America have prompted many to ask what went wrong.[210] While corporate officers, boards of directors, and auditors are often looked to as the source of corporate malfeasance, the role of lawyers in these debacles has not escaped scrutiny.[211] Therefore, when Congress decided to take action by passing the Sarbanes-Oxley Act of 2002, a provision directed toward regulating the conduct of corporate attorneys was included.[212] Corresponding SEC Rule 205 has prompted substantial debate and controversy in the legal community. Many have opposed the rule as an improper infringement upon the territory of the state bar associations in regulating attorney conduct. Others have claimed

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Id. *See also* Simon, *supra* note 205. Simon states:

> [A]gents continue to seek legal advice, in part because there are compensating inducements to do so, and risks of not doing so. Failing to seek legal advice can forfeit the protections of the "business judgment" rule for civil liability, and the benefits of the "advice of counsel" defense for criminal liability. The Sarbanes-Oxley Act, by increasing the threat of both kinds of liability, will probably have a far greater effect in encouraging legal consultation than any attorney-disclosure duty could have in reducing it.

Id. In his article, Simon was specifically addressing the potential effects of the "noisy withdrawal" provision still under consideration by the SEC, as opposed to the "permissive disclosure" standard which the current version of Rule 205 imposes.

209. *See supra* Part VI.B.

210. *See supra* notes 45-55 and accompanying text.

211. 148 CONG. REC. S6524, S6551 (daily ed. July 10, 2002) (statement of Sen. Edwards). In introducing section 307 as a floor amendment, Senator Edwards stated:

> The truth is that executives and accountants do not work alone . . . . If executives and/or accountants are breaking the law, you can be sure that part of the problem is that the lawyers who are there and involved are not doing their jobs. For the sake of investors and regular employees, ordinary shareholders, we have to make sure that not only the executives and the accountants do what they are responsible for doing, but also that the lawyers do what they are responsible for doing as members of the bar and as citizens of the country.

Id.

212. Sarbanes-Oxley Act § 307, 15 U.S.C. § 7245 (2002).

that the rule violates the ethical duty of confidentiality by allowing for permissive disclosure of client confidences in certain circumstances. Some legal professionals, such as those in Washington and California, have expressly challenged the Rule.

Despite whatever validity these arguments may or may not have, Rule 205 serves important policy rationales that are too often ignored or overlooked by the legal community. Corporate attorneys must take responsibility for their duty to the public. When the corporate client misbehaves, attorneys must not look the other way and hope for the best. Rule 205 will help to ensure that these lawyers start taking responsibility and thereby promote full disclosure and protect the greater public interest against corporate wrongdoings.

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