

AMERICAN BAR ASSOCIATION
TASK FORCE ON CORPORATE RESPONSIBILITY

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Testimony by

JOHN W. ALLEN¹

**Varnum, Riddering, Schmidt & Howlett, LLP
Kalamazoo, Michigan**

SUMMARY

If we think our only tool is a hammer, there is a temptation to view every problem as a nail. It is unwise to look at the Model Rules of Professional Conduct as the instrument with which to address every issue affecting lawyers.

Taking the Preliminary Report at its own words, the arrow widely misses the mark. The Report (p25 - 26) says:

“...the amendments proposed...are designed to help lawyers comply with their duties to an organizational client in circumstances in which corporate officers engage in or countenance criminal, fraudulent or deceptive conduct likely to cause harm to the organization or its shareholders....All of these recommendations address the role of counsel of all corporations, and not just those with publicly traded stock....Such guidance should be given, in the view of the Task Force, by clear and precise direction in the Model Rules [of Professional Conduct].”

The Preliminary Report then proceeds to ignore the Model Rules' declarations on the separation between shareholders and the corporate organization in the lawyer-client relationship, and seeks to impose obligations upon all lawyers, as to all clients, which are murky at best and mischievous at worst.

The Model Rules of Professional Conduct (MRPC) comprise a strict liability, quasi-criminal code intended to govern disciplinary conduct. Each of its provisions holds the fate of

¹ Mr. Allen serves as Chair of the firm's Quality Control Committee. He also chairs the ABA Tort, Trial and Insurance Practice Section (TTIPS) Professionalism Committee, and the State Bar of Michigan Grievance Committee. In the past, he has chaired the State Bar of Michigan Ethics Committee. These views are those of Mr. Allen, and not necessarily those of TTIPS, nor the State Bar of Michigan.

careers and reputations. It is not the place for undefined terms, or negligence standards. Amendments to MRPC should not be the product of faddish headlines or the hype of an off-year congressional election. Especially in light of the just-completed, long, and careful study by the Ethics 2000 Commission, we should view with extreme caution cavalier attempts to use the MRPC to purchase media favor or political respite. We also must recognize that the MRPC is used increasingly as an avenue of approach to fix after-the-fact civil liability on lawyers, in many circumstances where it does not belong.

Each of the Preliminary Report's recommendations (and especially those relating to MRPC 1.6 and 1.13) suffers three (3) fatal flaws:

- **Each changes the present discretionary authority of the lawyer, to a mandatory affirmative duty.**
- **Each changes the present threshold of "actual knowledge," to a "should have known standard."**
- **Each changes the threshold of a likely effect, using terms which are not well defined now, nor likely to be in the future.**

Finally, and by far most importantly, the Preliminary Report proposes unacceptable intrusions upon the attorney-client privilege, which, if implemented, would only serve to deter candid requests for legal advice. If persons believe they will be ratted out by their lawyers, they will not talk to their lawyers. There will be no opportunity for lawyers (as they do now) to remonstrate with the client to obey the law. The result will be that fewer laws will be obeyed.

The Preliminary Report's Section III (p.p. 24-45), "Recommendations regarding the Conduct of Lawyers," ranges from technically flawed to plainly wrong; its proposals should be rejected.

MODEL RULE 1.13 – ORGANIZATION AS CLIENT

Under MRPC 1.13, the emphasis is that the "client" is the organization, and only the organization (as distinct from its constituents). This is consistent with and necessary to the lawyer's fundamental duty of loyalty as a fiduciary, and that duty's basic premise that the lawyer may only have one client at a time.

The Preliminary report proposes several changes to MRPC 1.13, by both additions and deletions. Some lawyers regard this proposal as benign, because it appears to call for only increased obligations upon the lawyer to remonstrate **within** the organization. But, taken together with the proposal as to MRPC 1.6, the lawyer's obligations would go outside the organization, too. Moreover, the MRPC 1.13 proposal muddles the important distinction as to "who is the client."

MRPC 1.13 says clearly that the lawyer only "represents the organization, as distinct from its directors, officers, employees, members, shareholders, or other constituents." That is the starting point.

And right from its starting point, the Preliminary Report gets it wrong. The Task Force says (p. 10) that it wants to "enhance...ethical principles to make it more likely that ...corporate counsel will work effectively to help ensure that the corporation is ethically and legally responsible and managed in the long run best interests of the corporation and its shareholders." It wants (p. 12) "to further the interests of the corporation and its shareholders." Such desires may be fine for politicians, interesting to business ethicists, and mandatory for management, but they put the corporation's lawyer in an impossible position of conflict of interest.

The Preliminary Report's implicit assumption is that all shareholders have common and compatible interests. But on any given day, various shareholders' interests might include any or all of the following:

- Senior company management, desiring management continuity;
- Lower level company employees, desiring job security in preference to greater profit;
- Speculators, desiring short-term profit, or increased stock price, or even lower stock price if in a "short" position;
- Retirees, desiring maximum consistent dividend returns, in preference to equity value;
- Young investors, desiring long-term equity growth.

Each of these goals is legitimate and reasonable. Many are incompatible with the others. No lawyer can represent all of them, and the organization as well.

Of course, the lawyer can enter a "dual representation" of more than one client, and, in the same or simultaneous engagement(s), represent both the organization AND one or more of its constituents (such as an affiliate, subsidiary, officer, employee, shareholder et al.). But this does introduce the prospect of an INdirect conflict of interest.

Under MRPC 1.7(b), in EVERY dual representation, even if the lawyer concludes that the dual representation will not "materially interfere" with the lawyer's responsibilities owed to each client, nevertheless and in addition, the lawyer must obtain the consent of EACH client, after conducting a "consultation" ("provide information reasonably sufficient to appreciate the significance of the matter"); and the consultation "shall" include the "implications, advantages, and risks involved."

With even a small group of shareholders in a closely-held corporation, the required "consultation" is difficult; with very large groups (such the "shareholders" of publicly held companies), it would be impossible. Therefore, a lawyer representing both a publicly held corporation and "its shareholders" is a lawyer in an impermissible conflict. That is why lawyers do not purport to do that, and why it is unwise to campaign for the proposition that lawyers ought to do so.

Lawyers should not be deluded into pretending that they should be trying to represent “the shareholders,” when, in fact, only the “organization” is the client. Formal Opinions of the ABA Standing Committee advise precisely the opposite (see Formal Opinion #95-930) and more correctly admonish all lawyers to make this distinction clear from the beginning of the engagement. See MRPC 1.13, Comment, “*Clarifying the Lawyer’s Role.*” To do otherwise would alter the fundamental relationship of the lawyer to the client, attempting to diminish the most profound fiduciary duty of loyalty to the client, and change it into some undefined “duty” to the “public” in general, and to the stock-buying and stock-selling public in particular.

At the core of these proposals is a misdirected desire to alter the fundamental relationship of the lawyer to the client and to society. In the Introductory Perspective of the Preliminary Report (p. 24), The Task Force states its motives with commendable candor:

“The conduct of inside and outside lawyers representing companies...has been the subject of legislative inquiry and public criticism...Members of Congress and commentators have questioned whether, in light of the events that transpired, the rules of professional conduct governing lawyers adequately serve and protect **the public interest** in circumstances such as those that were present in such corporate failures.”

The short response is: the “question” is wrong, because it misunderstands the relationship between a lawyer and a client. The lawyer's principal duty is not to be popular, nor to serve the pleasures of the government (and certainly not those of “commentators”), nor to place the lawyer's subjective view of “public good” over the interests of the client. If someone wants to do that, they can have many fine and honorable jobs: social worker, politician, philosopher. But not lawyer, at least not a lawyer in America.

The question also betrays a fundamental rejection of capitalism and the American belief that the best for all is achieved by preserving the right of private persons to act individually (including the use of a lawyer whose primary duty is to the client, not others) within and right up to the limits of the law, rather than a more totalitarian approach that all persons are mere agents of the government and under a duty to be loyal to some pre-determined “public interest.” Who tells the lawyer what this “public interest” is? Where is the list of “ethical considerations” that the lawyer must be certain to satisfy? Or, do we just make them up as we go along. It is the latter consequence which should be feared-- just ask all the folks who used to work for Arthur Anderson.

Back around the invention of the electric light bulb, when I began to practice law, we had a list of “Ethical Considerations,” as part of the former Code of Professional Responsibility (CPR). But in 1983, the ABA Commission on Evaluation of Professional Standards (Kutak Commission) and the House of Delegates decided correctly that these “purely aspirational guidelines” had become corrupted into mischievous legal obligations, imposing undefined duties where none were intended, and forming bases for civil liability being visited upon lawyers in

circumstances no one could have predicted. ABA *Annotated Rules of Professional Conduct*, 4th Ed., p. xx-xxii.) For those reasons, the “Ethical Considerations” were eliminated from the Model Rules of Professional Conduct, in favor of objective, fact-based tests more appropriate to a strict-liability, quasi-criminal disciplinary code.

Those who ignore history are doomed to repeat it. The text of the MRPC is not the place for moral guidance. If we cannot define it with sufficient certainty to guide the conduct of those expected to obey it, we should not be putting it, into the MRPC.

As with the proposed changes to MRPC 1.6, this “recommendation” to amend MRPC 1.13 suffers three fatal flaws (p.28):

- **The present discretionary authority of the lawyer** (to determine how to proceed “as is reasonably necessary”), becomes a mandatory affirmative duty to prevent harm to third parties, other than the client (the corporation);
- **The present threshold of actual "knowledge,"** becomes "should have known" (an after-the-fact determination, which traditionally includes standards of negligence, due diligence etc);
- **The threshold of likely effect** changes from "minimize disruption of the organization and risk of revealing information relating to the representation," to a preference for the “more important goal of minimizing harm resulting from the misconduct." (Emphasis in original.)

The “harm” being “minimized” is not that to the client corporation, but rather that to third parties. Thus, the lawyer, based on little more than suspicion (not actual knowledge), is obligated under an affirmative mandatory duty to prefer the interests of third parties to the interests of the client. It is significant that the Task Force also chose to subordinate the existing duty to consider the “risk of revealing information relating to the representation," since, at its roots, these proposals are all really staggering attacks on the Attorney-Client Privilege and MRPC 1.6.

CHANGES TO MRPC 1.6

The recommendations to change MRPC 1.6, again, display the same three fatal flaws:

- **The lawyer's present discretionary authority ("may reveal") becomes a mandatory affirmative duty to disclose**, to third parties, including law enforcement;
- **The present threshold of actual "knowledge," becomes "should have known"** (an after-the-fact determination, which traditionally includes standards of negligence, due diligence etc);
- **The threshold of likely effect** changes from "death or serious bodily harm," to also include "fraud or serious financial damage."

These changes are also based on a wrong-headed premise: namely, that the interests of the client should be subordinated to the interests of third-parties and some undefined "public interest."

It is basic that persons know the requirements of the law in advance. This is especially important when the law is enforced on a quasi-criminal, strict liability basis, as are the Rules of Professional Conduct. Historically, much more than most professions, lawyers have looked to their Rules of Professional Conduct for the answers. And that answer has always been that our first and most important duty is NOT to the public, but to the client. Amidst the voices of Barrabas, made much worse by the media and an off-year congressional election, these hurried proposals seek to change all that.

The effect of these recommendations would be to change lawyers into public accountants. We are not that, and never have been. While the public accountant's duty is, and should be, to the public and third parties who rely on the accountant's financial reports, the lawyer's primary duty has always been to the "client," not to the public. No, we cannot allow our services to be used to perpetrate a fraud (if we discover that, we remonstrate with the client, and failing with that, we withdraw, and have the discretionary authority, but not duty, to reveal protected information to prevent crimes or serious bodily harm) [MRPC 1.6(c)(3)]. Our disclosures to tribunals must be with candor (MRPC 3.3), and we must be truthful in our statements to others (MRPC 4.1).

But, it is not and should not be our duty to disclose to third parties protected information communicated by a client in confidence. Lawyers should not be required to subject their clients to due diligence investigations instigated by the lawyer, to meet some amorphous "should have known" threshold which is unadorned by any standards of how to conform their conduct to the requirements of the law. And that is what is preferred by the Edward Amendment and the Task Force proposal.

Once the word is out that lawyers are required to rat out our client, no client will ever tell us the truth again. Even the Edward Amendment to the Sarbanes Oxley Act does not say that the lawyer's "duty to report" will necessarily end at the internal corporate board; that is only the minimum. The SEC could decide that we must also report to their National Accounting Board. Federal regulators should not preempt the traditional state determination of the scope and duties of the attorney-client privilege. If they attempt, our energies should be directed at informing them about the error of their ideas, and, failing that, vigorously oppose these invasions of the privilege.

Any "public interest" is better served by strengthening lawyer-client confidentiality, not by weakening it. As explained in the MRPC Preamble, Parts [7] and [8]:

"So also, a lawyer can be sure that preserving client confidences ordinarily **serves the public interest because people are more likely to seek legal advice, and thereby heed their legal obligations, when they know their communications will be private.**" (Emphasis added.)

Without the protection of the privilege, how can we advise the client to do the "right" thing? The rationale of the privilege is better to assure that clients will seek legal advice so that they can better obey the law. Making every lawyer an informer for the SEC and FBI will not make things better. It will only make clients stop talking.

Who would share a confidence with someone who is under an affirmative mandatory duty to reveal it, based only upon undefined thresholds such as "should have known," "fraud," and "serious" damage? "Should have known," by necessity, is an "after the fact" determination, done with full benefit of hindsight. This would require the lawyer to guess at the several elements of fraud (What is "material?" Will there be "reasonable reliance?") The lawyer will have an abundance of guidance, since these terms have already devoured millions of pages of statutes and case reports!

The Preliminary Report also scraps the years of work just completed by the Ethics 2000 Commission and approved by the ABA House of Delegates. The most vigorous debates were about the expansion of MRPC 1.6 discretionary authority to disclose protected information. It is well summarized in *For the Defense* (August, 2002), Pope and Dettling, "Professional Conduct in the New Millennium:"

"Under former Model Rule 1.6, a lawyer was **permitted** to reveal client information only if expressly authorized to do so, to defend himself against criminal or disciplinary charges, in a fee controversy with the client, or to prevent 'the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm.' As amended, Model Rule 1.6 now **permits, but does not require**, disclosure 'to the extent the lawyer reasonably believes necessary to prevent

reasonably certain death or substantial bodily harm,' to allow the lawyer to obtain legal advice about compliance with the Model Rules, and where required by law or court order. The Commission explicitly intended this change to 'include a present and substantial threat that a person will suffer such injury at a later date, as in some instances involving toxic torts.' See Reporter's explanation of Changes, <http://www.abanet.org/cpr/e2k-rule16rem.html>. However, the new commentary to Model Rule 1.6 also directs that 'a disclosure adverse to the client's interest should be no greater than the lawyer reasonably believes necessary to accomplish the purpose.'

The most controversial of the proposed changes to Model Rule 1.6, however, involved the Commission's proposal, rejected by the House of Delegates, that a lawyer be allowed to disclose confidential information to prevent the client from misusing the lawyer's services to commit a crime or fraud. The Commission also proposed to allow disclosure to prevent or rectify a financial loss arising from the client's misuse of the lawyer's services to commit a crime or fraud. That proposal was withdrawn before House action." (Emphasis added.)

The Preliminary Report resurrects these issues, with no new facts to overturn what the ABA just spent years studying and the recommendation goes even further, not only reversing what the House of Delegates rejected, but also changing MRPC 1.6's discretionary authority into a mandatory obligation of disclosure.

No supporting evidence emerges from American jurisdictions regarding the need to mandate disclosure of protected information to prevent a non-criminal fraud, and the Task Force analysis of current usage is fuzzy, at best. Only two (2) states (New Jersey and Wisconsin) require such a disclosure. Forty (40) prohibit any such disclosure whatsoever. Nine (9) permit the discretionary authority for disclosure in the MRPC. The Preliminary Report (p. 32) skews this comparative data by mixing both the "discretionary" and "mandatory" jurisdictions (as if 40+ states support its conclusion), but then recommends a "mandatory" disclosure obligation, with the inference that anything else would be "out of step with public policy;" the specific "public policy" at issue is left in doubt, but it is certain that a mandatory disclosure obligation would be a monumental change in forty-eight (48) states, as well as in the District of Columbia.

The privilege is not something to be bartered away in response to media frenzy or political pressure. As the MRPC Preamble, Sections [19] and [20] says:

"The attorney-client privilege is that of the client and not of the lawyer. The fact that in exceptional situations the lawyer under the rules has limited discretion to disclose a client confidence does not

vitiating the proposition that, **as a general matter, the client has a reasonable expectation that information relating to the client will not be voluntarily disclosed** and that disclosure of such information may be judicially compelled only in accordance with recognized exceptions to the attorney-client and work-product privileges.

The lawyer's exercise of discretion not to disclose information under Rule 1.6 should not be subject to reexamination." (Emphasis added.)

NEW PLATFORM FOR CIVIL LIABILITY

Despite the admonition to the contrary in Rule 1.0(b), violations of the MRPC are used increasingly as a basis for or evidence supporting lawyer professional liability in civil damage actions. ABA Annotated Model Rules of Professional Conduct (4th Ed.), pp. xx-xxii. Restatement of the Law Third, *The Law Governing Lawyers*, Sec. 52. The Preliminary Report's recommendations will make it worse.

Near the top of the list of additional unintended consequences will be the effective resurrection of lawyer "aiding and abetting" civil liability, in every business failure, using the lawyer, law firm and their LPL policy as the guarantor for every unhappy investor, and as the funding mechanism for the plaintiff/class action bar.

Under the present law and MRPC, that is a very hard row to hoe, as shown by the furtive attempts to hold law firms liable in Enron, WorldCom et al.; in fact, much of the vaunted "public criticism" cited by the Task Force (Preliminary Report, Footnote #19) goes to that very difficulty. This is because those actions lack one necessary element: no duty owed by the lawyers, except to the client, which is only the "organization" under MRPC 1.13.

By broadening the duties under MRPC 1.13 and 1.6, and changing the linchpin from a discretionary authority to an affirmative mandatory duty to third parties, shazam!, "lack of duty" problem solved. With that in place, every defendant accused of fraud will have a co-defendant in the person of every lawyer or firm who (identified, of course, in hindsight) had the misfortune to have tried to assist them as their legal counsel, even if the lawyers did not know it was going on. In fact, NOT knowing of the fraud will be just the proof the plaintiff will use under the proposed "should have known" standard, because it will show a lack of reasonable care and due diligence. Every business lawyer will need classes in clairvoyance, and a crystal ball, as well as a good audit firm to conduct due diligence on our own clients. Let the games begin!

CONCLUSION

The Preliminary Report's recommendations for changes in MRPC 1.13 and 1.6 should be rejected. They will not benefit clients or lawyers, nor, in the final analysis, the public interest. It is not appropriate to use amendments to the Model Rules of Professional Conduct as appeasements to the media or to the government. When there are misguided efforts to curtail the attorney-client privilege, the energies of the ABA should be expended in defeating those efforts, not assisting them.

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