

**American Bar Association
Task Force on Corporate Responsibility**

**New York, New York
October 25, 2002**

Statement of Stephen Gillers

My name is Stephen Gillers. I am vice dean and professor of law at New York University School of Law. I have taught legal ethics at NYU since 1978 and am author of *Regulation of Lawyers: Problems of Law and Ethics* (2002), a leading casebook now in its 6th edition.

Thank you for permitting me to address the proposals in your Preliminary Report dated July 16, 2002. I will speak only to the recommendations regarding the ABA Model Rules of Professional Conduct, though I do want to endorse your suggestion for providing clear lines of communication between outside counsel and general counsel and between general counsel and independent directors.

Three Postulates

In proposing amendments to the Model Rules, as part of a set of recommendations in response to the recent wave of corporate wrongdoing, I urge you to keep three postulates in mind.

First. The Model Rules are ethical rules for lawyers. They are not a statute. They are not a repository for civil liability standards. Violation of a rule may provide some evidence in actions against lawyers for damages, but that is incidental. Defining civil duty is not their purpose. Making it so, even in part, will weaken their utility. We must limit the Model Rules to obligations recognizable as *ethical* rules. They must not be an all purpose repository to cure what ails us.

Second. As a practical matter, the Model Rules can have only an indirect role in preventing corporate wrongdoing. Civil remedies, agency regulations, and civil and criminal statutes provide the primary legal recourse. Lawyers have been largely untouched by accusations of wrongdoing in the current investigations. Two law firms have been sued civilly. One lawyer has been mentioned in connection with a criminal investigation. Amendments to the Model Rules must respond proportionately to the role of lawyers in these events. In so far as lawyers can defeat corporate wrongdoing, it is not generally because they are themselves the wrongdoers, but because they are in a position to detect and impede it.

Third. Ethical rules are most useful when they go beyond legal obligations. The main function of ethical rules is to impose duties that the law does not impose. Ethical rules that merely incorporate legal duties add little.

Two Objectives

The upshot of these postulates is this: In the current context, the Rules should strive for two objectives: To define the ethical duties of a lawyer for a corporation to protect it from harm that may result from the unlawful conduct of its other agents; and to describe the lawyer's responsibilities to persons who might be harmed by acts of those agents taken in the client's name.

Before I turn to those objectives, let me concur with Tom Morgan's caution against introducing a "should have known" standard in Rules 1.2(d), 1.13, and 4.1. It is a bad idea. It is, of course, negligent not to know what one should have known. But what will the new language accomplish? We don't use discipline to punish negligence on a particular occasion and ethical rules primarily describe misconduct that can lead to discipline. We rely on the civil law system – malpractice actions or, in limited circumstances liability to third persons – to encourage competence (*i.e.*, the absence of negligence). This change will make no difference in civil cases brought by clients because malpractice actions already compensate for negligence.

The effect, then, of a broader introduction of a "should have known" standard into the Model Rules, especially in the Rules specified, will be to invite increased civil liability for negligence to third persons. To the extent that lawyers should have civil liability to third persons based in negligence, it should be recognized through common law development. While the Model Rules should describe other ethical duties to third persons, defining a lawyer's duty of competence to third persons and clients is best left to the courts.

However, I do support an amendment to the definition of "knowingly" to make it clear that conscious avoidance of knowledge constitutes knowledge. And as stated below, I do support changing the "trigger" in Rule 1.13(b) and (c) from knowledge to reasonable belief.

Turning now to the two objectives I mentioned above, I suggest that they can be advanced in two ways.

I. Protecting Third Persons. Rule 1.6 should be amended to reinstate the provisions that the Ethics 2000 Commission recommended but which the House of Delegates did not adopt. I consider these to be modest exceptions to the rule protecting confidences. Many jurisdictions already incorporate them though often in different (sometimes broader) language.

The ABA is out of step here. I do not understand why lawyers would want to deny themselves the authority to warn victims of their clients' financial frauds or crimes, where the client will not, where the lawyer has unwittingly aided the misconduct, and where the injury can still be avoided or rectified. What possible claim has such a client on the lawyer's loyalty? Existing "noisy withdrawal" authority is not adequate to the task because there may not be a

document or representation to withdraw or because the victim may have been unaware of the lawyer's presence so notice of withdrawal will mean nothing. Further, the lawyer may not even know the identity of the victims. Indeed, they may not yet be identified. In such cases, lawyers will need to prevent the injury through notice to others, such as a regulator.

The debate over whether lawyers should have the power to reveal confidential information to protect third persons from harm often pits the interests of the client against the interests of the third person. Without rehearsing that debate here, when the client is an organization, proponents of a confidentiality exception have an additional argument. The organization has no interest in being used to commit criminal or fraudulent acts that can harm others and subject it to liability. The clash here is not between a client and a victim, but between the interests of control persons who have instigated unlawful activity, on the one hand, and the common interests of the organization and innocent victims, on the other. We should take the view that the lawyer who reveals confidential information to protect victims is serving, not betraying, the corporate client.

I would not make this exception to confidentiality mandatory. Having the power will often be sufficient to cause the client to cease the misconduct and correct the harm. Further, having the power opens the lawyer to civil liability if he or she does nothing and the injury occurs. This is because the lawyer will not then be able to defend against a claim by citing confidentiality duties. That prospect will encourage use of the power when appropriate. Third, in some cases, making the duty mandatory can have the unfortunate result of causing lawyers to breach confidentiality when the facts are not entirely clear, just to be safe from a disciplinary charge.

II. Protecting the Client. Adopting the Ethics 2000 Commission's exceptions to Rule 1.6 will enable a lawyer to protect identifiable third parties against substantial financial injury by the client, whether a corporate client or otherwise, but only in those circumstances in which the lawyer's services have been used or are being used to advance the client's crime or fraud. In addition, the Task Force should recommend an amendment to Rule 1.13 to protect the client from harm because of the misconduct of its officers and directors. The amendments to Rule 1.6 are not sufficient to do this because sometimes the harm may be to the client alone, not to third parties, or because for some other reason the language of the confidentiality exceptions will not apply (*e.g.*, the lawyer's services were not employed in the misconduct, or the third parties cannot then be identified).

As we all know, the client of the corporate lawyer is the entity, not its officers and agents. While this may sometimes be an uncomfortable reality for the lawyer, it is a reality nonetheless. I focus on those situations in which officers or directors of the corporate client are engaged in criminal or fraudulent activities that can result in substantial injury to the client. The client may be the direct victim of these activities (for example, when an officer steals from a client), or officers or directors may be victimizing third persons in the name of the client. Even in this latter situation, of course, the client is a victim because it has no legitimate interest in being the

instrument of criminal or fraudulent activity.

I support the proposition that lawyers should seek to remedy any such situation internally. In the overwhelming number of cases, this will be possible, especially if the lines of communication that you endorse between inside and outside lawyers and between the general counsel and independent directors are also adopted. But sometimes the effort will fail. When that happens, the lawyer should have the authority to reveal confidential information of the corporate client to persons outside the company. Such revelation need not constitute a waiver of the attorney-client privilege. See, *e.g.*, *Purcell v. District Attorney for the Suffolk District*, 676 N.E.2d 436 (Mass. 1997) (privilege not waived where lawyer properly invoked exception to confidentiality to warn of client's future violent act).

We are dealing, then, with rare instances when several unfortunate circumstances arise: the unlawful conduct is objectively apparent; the harm to the client is or could be substantial; and the lawyer is unable to get satisfactory corrective action internally, including from independent directors. To address those circumstances, I suggest that Rule 1.13(c) be amended to read as follows:

(c) If despite the lawyer's efforts in accordance with paragraph (b), the lawyer reasonably believes that the highest authority that can act on behalf of the organization

(i) has violated or intends to violate a legal obligation to the organization that furthers the personal or financial interests of members of that authority and that has caused or is likely to cause substantial injury to the organization, or

(ii) has authorized or acquiesced in prospective or continuing criminal or fraudulent conduct that could reasonably be attributed to the organization and that is likely to cause substantial injury to the organization,

the lawyer may disclose client confidences to the extent the lawyer reasonably believes necessary to protect the organization from substantial harm. In acting as authorized in this paragraph, the lawyer shall make reasonable efforts to assure that the extent of the disclosure is as restrictive as possible consistent with that goal. The lawyer's authority to disclose pursuant to this paragraph shall continue notwithstanding termination of the attorney-client relationship between the lawyer and the organization prior to the disclosure.*

Currently, Rule 1.13 operates from the assumption that it is always in the best interest of the corporation for its lawyer to remain silent (and even to resign) no matter how serious or imminent the potential harm, even if it could lead to the demise of the client. This view of the

* This language is modified from a proposal in Stephen Gillers, *Model Rule 1.13(c) Gives the Wrong Answer to the Question of Corporate Counsel Disclosure*, 1 *Georgetown J. Legal Ethics* 289 (1987). The text here is proposed as a draft whose language can surely be improved. Portions of subsequent paragraphs are also derived from this article.

lawyer's duty, essentially countenancing an abandonment of the client in a time of great need, is unacceptable. By contrast, my proposal gives corporate lawyers the authority to disclose client confidences when the corporation will suffer, or has suffered, substantial harm at the hands of a "highest authority" whose members are pursuing their own conflicting interests in violation of a legal duty to the organization or who are tolerating certain illegal prospective or continuing misconduct likely to be attributed to the organization. The disclosure should be as restrictive as possible, consistent with the goal of protecting the client. Notification of a major shareholder may be sufficient. Alternatively, the lawyer may have to approach a regulator or some other party. In most cases, the threat to go beyond the entity will suffice.

The proposal requires that the lawyer reasonably believe that the highest authority is acting or failing to act as described in paragraphs (c)(i) or (ii) and that these actions or failures to act have caused, or are likely to cause, the organization substantial injury. Requiring an objective good faith belief, which is the standard in Rule 1.6(b), assures that the lawyer will conduct an appropriate factual and legal investigation before taking action. The mental state in Rule 1.13(b) should also be changed from knowledge to reasonable belief. The responses that this provision contemplates are milder than the exceptions to confidentiality in Rule 1.6(b) and Rule 1.13(c) as proposed, both of which contain a reasonable belief standard.

Subparagraph (i) of the proposal encompasses both past and future actions and omissions by the highest authority. It applies whether the injury to the client is concluded or prospective. If the injury is prospective, the lawyer may be able to prevent it. If concluded, he or she should be able to put the client in a position where it can seek a compensatory remedy. On the other hand, subparagraph (ii) permits disclosure only when the designated act (or its consequences) remain prospective. Power to disclose is most appropriate then because future injury can be avoided. If the misconduct and its consequences are concluded and the highest authority has chosen not to reveal it for reasons other than the conflicting personal or financial interests of its highest authority (making paragraph (i) inapplicable), then there is no reason why counsel's view of the comparative risks should displace the view of the client's highest authority.

The lawyer is empowered to disclose under this proposal notwithstanding termination of the attorney-client relationship. The highest authority should not be able to impede the lawyer by firing him or her before disclosure occurs.

I would not extend the obligations under Rule 1.13 to lawyers who learn of misconduct that is not "related to [their] representation." First, "related" is a broad word and will capture many representations. Second, it is not likely that lawyers do learn of misconduct unrelated to their work. Third, I have urged changing the mental state in Rule 1.13(b) and (c) from knowledge to reasonable belief. When coupled with the nexus of "related," that change should insure that at least some lawyers are brought within the authority of these paragraphs in the event of misconduct. Fourth, whatever the mental state, lawyers who learn of misconduct unrelated to their work would often have an unenviable dilemma, unsure whether they have the required mental state but unable to follow up by investigating the unrelated matter (especially if they are outside lawyers retained on a smaller matter).

Conclusion

In sum, I support your efforts to reinstate the Ethics 2000 Commission's proposed exceptions to Rule 1.6(b). I urge you to make those permissive, not mandatory. I oppose "should have known" language in Rule 1.2(d), 1.13, and 4.1. And I offer my proposed substitute language for Rule 1.13(b) and (c) as a way to enable organizational lawyers to protect their clients from fiduciaries who would harm the client through unlawful use of their powers.