

**Testimony Presented by the New York County Lawyers' Association
Michael Miller, President
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at the
Hearing of the ABA Task Force on Corporate Responsibility
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INTRODUCTION

The New York County Lawyers' Association ("NYCLA") is grateful to have the opportunity to comment on the ABA's Preliminary Report on Corporate Responsibility issued in July 2002. NYCLA is located on the edge of Ground Zero, a few short blocks from the heart of our nation's financial markets. On September 11, 2001, NYCLA found itself on the front line of a heinous attack on America. Today, we find ourselves on the front line of an attack no less dangerous – an attack on our financial markets. A century ago, in the face of corporate excess and exploitation when monopolies juggled the stock market and created false scarcities, Theodore Roosevelt launched an attack on the corporate titans. He called his crusade a Fair Deal for America. Unfortunately, it seems that America again needs a fair deal.

As the reports of corporate malfeasance, looting and impropriety began to appear, like so many other Americans, we wondered, "How can this be?" We were particularly dismayed by the revelations of financial fraud, self-dealing and

manipulations in America's capital markets and in the businesses that seek financing in those markets. We were deeply disappointed to learn that lawyers seem to have played key roles in some of the deception and wrongdoing, for these events have wrecked tens of thousands of lives and wiped out billions of dollars of savings and pensions.

In light of the numerous cases of corporate malfeasance discovered in recent months, NYCLA established a Task Force on Corporate Responsibility and charged it with examining both the laws and regulations pertaining to corporate conduct. It was also entrusted with the task of reviewing the ethical principles and rules that govern the role of officers and other corporate officials, including those pertaining to the professional responsibility of lawyers in such positions and lawyers advising persons in such positions. Chaired by Edwin David Robertson, NYCLA's Vice President and a partner at Cadwalader Wickersham and Taft, the Task Force includes experts in securities, corporate and ethics laws who have prepared some thought-provoking comments and recommendations.

The rapidity of legislative and regulatory response to these events is unprecedented since the 1930s. While we must do whatever is necessary to protect America from the wicked and greedy cheats that loot our corporations and jeopardize our markets

and our financial security, we must not move so quickly that we make changes in haste that produce undesirable results. It is important that we review and comment on the governmental measures that are being developed and, in particular, those proposals directed toward the responsibility of lawyers who advise corporations and participants in the United States' capital markets. In furtherance of this goal, we trust you will entertain NYCLA's comments and recommendations and that you will afford them serious consideration.

NYCLA'S COMMENTS

1. The first portion of the ABA's Report has been overtaken by proposed NYSE Rules and by enactment of the Sarbanes-Oxley Act of 2002. The SEC will be proposing rules pursuant to that Act, and NYCLA's Task Force and Committees will offer comments on those proposed rules.
2. Under Sarbanes-Oxley, the SEC and GAO will release reports and studies in compliance with the new statute in regards to investment advisors and such financial institutions as banks and investment banks. When those reports are issued, the organized bar will have an opportunity to comment, based on the record developed by those agencies, rather than based on the incomplete media reports and interim developments. If the state legislatures or Congress

undertakes new legislation in the meantime, comment and constructive suggestions may be appropriate from the organized bar.

3. The second half of the ABA Task Force's Report contains general suggestions for modifying the Model Rules in regard to a lawyer's obligation to "report up the ladder" in cases where legal services are being rendered to a corporation as a client. NYCLA is supportive of that proposal because it is generally consistent with the notion that the entity (rather than some officer or director) is the client. Our comments on this proposal are general in nature because the ABA Task Force proposes no specific language:

- a. The disciplinary rules governing lawyers must be congruent (if not consistent) with such Federal regulations as the SEC may propose.
- b. Those rules should be relatively workable (if not uniform) from state to state, because it would be a professional nightmare for a lawyer to be subject to differing rules of conduct depending on the location of the client or the location of some branch office of that client or the lawyer's firm.
- c. The terms of engagement or retainer agreements between a lawyer and a corporate client should be particularly clear in identifying to whom the lawyer should report wrongdoing when it is encountered.

Furthermore, in instances involving subsidiary corporations and affiliates, both the rules and any retainer agreements should carefully define the mechanism for reporting wrongdoing, whether such reports should be in writing, and what sort of declination of action would trigger an obligation to go to the next higher level of authority within the client. The clarity of these matters is especially important in instances where the corporate client lacks the governance infrastructure of a multi-billion-dollar publicly held enterprise with identifiable lines of authority or readily apparent internal checks and balances.

- d. Formalizing these sorts of details is necessary to assure that (1) officials within a corporation have the correct perception and expectation about the role of counsel as the organization's lawyer and not as a subsidiary's, officer's or division's lawyer and (2) the lawyer and client have a clear understanding about to whom and under what circumstances a report should go "up the ladder."
- e. We are particularly troubled by a "should know" or "should have known" standard for awareness of wrongdoing. That formulation would impose (when applied with the benefit of 20-20 hindsight) upon a lawyer the duty of investigating the client at every turn.

Furthermore any “should know” or “should have known” standard will force a lawyer to adopt an attitude of skepticism, if not distrust, toward anything that a client tells a lawyer during the engagement.

Injection of that attitude into the attorney-client relationship will contaminate the professional relationship between lawyers and clients, undermine the element of trust necessary for that relationship to exist, and impair the very independence that is necessary for a lawyer to render advice.

4. We strongly oppose the ABA Task Force’s proposal to *require* disclosure of crimes to law enforcement agencies in instances where knowledge of the existence of a crime or the intention to commit a crime is imparted to a lawyer through communications that are rendered confidential or secret by reason of the attorney-client relationship. This assault on the attorney-client privilege will undermine a lawyer’s ability to give useful advice to any client. We emphasize that we do not oppose the ABA Task Force’s modification of the Model Rules to permit discretionary disclosure of a client’s intention to commit a crime. In New York, our disciplinary rules permit such disclosure without the limitation that is contained in the Model Rules constraining the discretionary disclosure of a client’s intent to commit a crime to instances of threatened death or serious bodily injury. Also we are deeply troubled by the ABA Task Force’s proposed

addition of the “should know” or “should have known” standard into the formulation of a lawyer’s knowledge of a client’s intention to commit a crime in any instance where some mandatory disclosure obligation is triggered by such knowledge. As we note above, that formulation would not only impose an investigatory obligation upon lawyers but also render the client less likely to be forthcoming with all factual materials necessary for a lawyer to render competent advice.

5. We observe that the ABA Task Force’s proposal seems based on a notion of “independence” drawn from the accounting profession. Accountants are “independent *public* accountants,” and the opinions that are contained in their reports are prepared and drafted for the specific purpose of use by others. Indeed, the regulation of the accounting profession, its auditing standards, and its accounting principles is designed to assure independence in the context of professional activity that is (a) paid for by the client but (b) used by a third party. We stress that a lawyer’s independence is a professional standard regarding the lawyer’s freedom from outside influence in giving advice to the client, not a duty to blow the whistle on the client. The touchstone of a lawyer’s independence is *freedom from* any third party’s influence, while a public accountant’s independence is grounded in a *responsibility to* the third-party user

of financial statements. The bar's current professional standards emphatically forbid a lawyer from engaging in any dishonest conduct. Current law and professional standards do not permit any lawyer's assisting a client's fraudulent scheme that damages a third party or the client itself when it is the victim of its own officers' or agents' infidelities.

6. Currently, the ethical rules in New York mandate that a lawyer refrain from any activity that is dishonest. Those rules forbid a lawyer from counseling or assisting a client "in conduct that the lawyer knows to be illegal or fraudulent." The rule in New York is clear that, when a lawyer learns that a client has "perpetrated a fraud upon a person or tribunal," then the lawyer must "call upon the client to rectify the same, and if the client refuses or is unable to do so, the lawyer shall reveal the fraud to the affected person or tribunal, except when the information is protected as a confidence or secret." If the client declines to adopt the lawyer's recommendation, then our professional standards describe the steps that a lawyer may or must take to disengage from the client relationship and to avoid assisting the client's infliction of harm on others parties. NYCLA is troubled by the ABA Task Force's perception that these provisions are insufficient to prevent or ameliorate corporate wrongdoing in the context of the other ethical rules that govern lawyers' conduct and the corporate governance structure that the ABA proposes.

7. For many years the bar of New York County – Manhattan’s “official” name – has been recognized as composed of competent lawyers, of the highest integrity, who have counseled clients to behave responsibly, to obey the law, to refrain from fraud, and to conform to this nation’s securities laws. The effectiveness of that counseling is the direct result of the integrity of the relationship between the lawyer and client. For more than a century, the organized bar has nurtured that relationship by insisting that a lawyer, above all else, be independent from any influence that might (a) taint the advice given to a client or (b) affect the lawyer’s loyalty to the client. The ABA Task Force’s proposed rule mandating disclosure of a client’s confidential communications to prevent or rectify harm to a third party will destroy the lawyer’s ability to render independent advice. It is hard to imagine that any lawyer would receive an accurate rendition of the facts regarding a client’s legal problem if the relationship began with the lawyer’s warning: “I must advise you that I am duty bound to advise a governmental agency of anything that you tell me that indicates that you or your employer have engaged in illegal activity that has inflicted or will inflict financial damage on a third party. Furthermore, I am duty bound to deliver to that agency such information as may be necessary to prevent you from doing what you contemplate in the event that I determine that your conduct constitutes

a crime that will physically or financially hurt somebody else.” A warning like that will surely cause every attorney-client relationship to germinate in distrust and gestate in skepticism. That distrust and skepticism will not only harm the American legal profession but also inflict even greater damage on those clients it strives to serve.

8. NYCLA strongly believes that our bar contributes positively to the effectiveness of the securities laws in this country. There is no indication that either the current problems were caused by lawyers who exploited some “loophole” in the standards of professional conduct or some gap in the current regulatory scheme. The “parade of horrors” portrayed in the press and in the ABA Task Force’s report does not describe situations that are “appropriate” under the current disciplinary rules and under the existing laws criminalizing or redressing fraudulent conduct. We are skeptical that any of these scandals could have been prevented by a disciplinary rule of the legal profession that *requires* a lawyer (a) to second guess some technical accounting rule, (b) to question its application to a set of facts, and (c) to report a problem to the authorities when the lawyer remains unsatisfied with the determinations made in an area of expertise outside of the realm of the legal profession.

9. NYCLA is very concerned about these topics because we are in the heart of the financial capital of the world. The integrity of the financial markets and businesses who are participants in those markets is essential to this City's economy and this bar's vitality. NYCLA believes that the integrity of those financial markets will be strengthened by professional standards that foster lawyers' rendering the best and most competent advice to participants in those markets. That advice, and the information on which it is based, can flow freely only where our professional standards actively promote an attorney-client relationship that encourages clients to be forthcoming with their lawyers and lawyers to be candid with their clients. That relationship will founder if some disciplinary rule discourages a client's telling a lawyer all the information necessary for the lawyer to render appropriate advice, and clouds a lawyer's judgment with fear of being second guessed by some third party benefited by 20-20 hindsight, focused not on whether the lawyer's advice was sound but on whether the lawyer blew the whistle soon enough.