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Task Force on Corporate Responsibility
American Bar Association

Comments on Preliminary Report

To Whom It May Concern:

Here are my comments on the Preliminary Report of the Task Force on Corporate Responsibility ("Report"). I limit my comments to Part III, Recommendations Regarding the Conduct of Lawyers.

1. Recommendations with Respect to Model Rule 1.13

I agree with two of the proposed changes to Model Rule 1.13. It makes sense to extend that Rule's obligation to report serious illegal acts to illegal acts which the lawyer discovers outside the official scope of her representation. Report at 28-29. It also makes good sense to remove or modify the language of the present Rule which can be read as discouraging lawyers from making a full report of illegality which goes uncorrected at lower levels of the corporation. Id.

The other proposed change to Rule 1.13 changes the level of lawyer scienter required to trigger a reporting obligation from knows to "knows or reasonably should know." Report at 29. This strikes me as a mistake, at least without more explanation and justification. "Reasonably should know" on its face is a negligence standard. While the imposition of such a standard under Model Rule 1.13 is normatively defensible, because the obligation runs in favor of the corporate client, there are reasons to doubt its wisdom. In general, disciplinary rules like 1.13 are weak vehicles for enforcing standards of care, because state disciplinary authorities have few resources to devote to enforcing such standards. Indeed, there have been almost no disciplinary actions taken under the current Model Rule, which uses a much stricter knowledge standard. If state disciplinary authorities lack the will and resources to enforce the stricter standard, what appetite will they have for a negligence standard? This change therefore has all the earmarks of window-dressing.

Section 307 of the recently enacted Sarbanes-Oxley legislation was clearly passed too late to be considered in any detail in the Report. That section requires the SEC to prepare rules of practice for attorneys appearing before the Commission, including a federal version of Model Rule 1.13 that will be more stringent in several respects than is the ABA version and that will

preempt the ABA version for almost all publicly held companies. The SEC's comment version of those rules is due later this month or in December. No version of ABA Rule 1.13 can be workable or credible that does not go at least as far as the rule ultimately adopted by the SEC. To help the Task Force in its deliberations, I attach as Exhibit A my comments to the SEC on their rule making process.

2. Disclosure of Crimes or Frauds

The Report is absolutely correct to recommend discretionary disclosure of frauds in which the lawyer's services have been used. This is the approach taken by every ABA ethics task force that has looked at the issue for the past twenty years, including Ethics 2000, and by the Restatement (Third) of the Law Governing Lawyers. The earlier ABA Task Force recommendations on these issues and the Restatement are inexplicably not cited here, and should be.

The Report's proposal for mandatory disclosure of felony offenses, Report at 32, however, strikes me as very poorly thought out and justified. Neither the prior ABA Task Forces nor the ALI have gone this far, and only four states have done so. There are very considerable arguments against required disclosure that have proved decisive in other detailed examinations of these issues but which are not discussed and considered here. The range of felony offenses is broad and includes many regulatory crimes. A broad range of corporate operations potentially may involve felony liability. If there is any setting where mandatory disclosure by the lawyer will chill client communications with the lawyer and increase the likelihood of the lawyer being cut out, it is the case of the ongoing crime. Unless the lawyer is in the room, she will know nothing and will have no leverage on the company's decision and nothing to disclose. Better to have a rule of discretionary disclosure which gets the lawyer in the room, allows the lawyer to advise that the conduct is illegal, and gives the lawyer leverage to insist on corrective action. If this view is to be rejected, a convincing argument needs to be presented. None is offered here.

3. The Reasonably Should Know Standard

A centerpiece of the Report is the recommendation of the adoption of a "reasonably should know" standard, not just under Rule 1.13, but also under Model Rules 1.2 (d) (counseling or assisting a crime or fraud) and 4.1 (material false statements and failures to disclose). The Report defines this standard as meaning that "a lawyer of reasonable prudence and competence would ascertain the matter in question" a standard drawn from the terminology notes to the Model Rules.

Although the Report states that this is not a "negligence" standard, it offers no reason for this conclusion. The lawyer of "reasonable prudence and competence" is a stock figure in the law of professional negligence. The other references to rules of reason in the Model Rules make the tie to the law of professional negligence abundantly clear.

There are three problems here. The first is whether the Report has hit its intended target. The Report seems to be aiming at a point intermediate between knowing and negligent conduct,

captured by the notion that the lawyer should not be permitted to “ignore the obvious.” Report at 35. The classic midpoint is recklessness. This appears to be where the doubting members of the Task Force were headed. See Report at 35 & n. 24. Recklessness is a well-known and widely accepted normative standard for criminal and civil liability for fraud and for aiding and abetting intentional torts directed at a third person. It is the natural next step for a tightening of the disciplinary rules in this area. The failure to consider it gives the Report the appearance of unreflective overreaction to the current financial scandals. At a minimum the Report should demonstrate that the possibility of a recklessness standard was fully considered and explain why it was rejected as inadequate.

The second problem is that the Report fails to make a persuasive affirmative case for a “reasonably should know” standard. The principal authorities relied upon all relate to lawyers’ professional opinions prepared with the expectation that they will be relied upon by third parties. See Report at 34-35 & nn.32-33. But the law is clear that these are very special cases, where the lawyer assumes, expressly or by implication, an obligation of due care that runs in favor of the person who is the intended beneficiary of the opinion. Yet the proposed change would create a due care obligation for the benefit of non-clients in all cases, including settings, such as the settlement of litigation, in which there is absolutely no plausible argument that the lawyer has assumed any such obligation and where even a recklessness standard may sometimes bite too hard.

The third problem is that there is a raft of prior deliberations by the ABA, stretching back to the early 1980’s, suggesting that holding lawyers to a negligence standard with respect to client conduct harmful to third parties is (a) inconsistent with longstanding principles of common law¹ and (b) bad social policy.² The Report’s failure even to mention, let alone to distinguish or reject, this mass of prior authority seriously undermines its credibility.

4. Omitted Topics

There are many topics that the report could profitably discuss. I will mention only three.

First, there is the question of how lawyers who comply with their obligations under the proposed Model Rule 1.13 are to be encouraged and protected in doing so. The hard fact is that lawyers who report misconduct over the heads of their business colleagues often risk their jobs and even their careers. The risk is most grave for in house lawyers. Lawyers who comply with Model Rule 1.13 or who reasonably believe that they are doing so need and deserve more protection. Section 806 of the Sarbanes Oxley bill gives them some—what does the Task Force make of it? More widespread recognition of a state law right of an in house lawyer to sue for wrongful discharge, and, if necessary to disclose client confidences reasonably related to the

¹ Hazard, How Far May A Lawyer Go In Assisting a Client in Unlawful Conduct, 35 U. Miami L. Rev. 669 (1981).

² Hazard, The Lawyers’ Obligation to Be Trustworthy When Dealing with Opposing Parties, 33 So. Car. L. Rev. 181 (1981).

prosecution of that claim, would give them more. The Task Force should speak out on these issues. In my judgment, reforming Model Rule 1.13 without addressing this issue will not make much of a real world difference.

Second, the Report should say something about disciplinary enforcement. The Rules that the Report is talking about changing are enforced through professional discipline, but the sad fact is that state disciplinary authorities rarely even look at, let alone prosecute, cases of lawyer involvement in questionable business transactions. Shouldn't the Task Force at least consider this issue—otherwise what is the point of changing the Rule?

Third, there is the issue of civil damage liability under federal law for aiding and abetting client fraud. The Supreme Court's 5-4 decision in the Central Bank case³ eliminated such liability under federal law, thereby overruling some 40 years worth of unanimity in all the federal Circuit Courts. The Securities Litigation Uniform Standards Act of 1998 then eliminated such liability under state law, at least in actions prosecuted as class actions. These results are indefensible. They provide the nation's best paid and most prestigious lawyers with civil immunity for intentional torts that have historically been subject to both criminal and disciplinary prosecution and that still give rise to civil damage actions when engaged in by their less well-paid and prestigious colleagues who represent small businesses and individuals. Moreover, these holdings sharply reduce the financial disincentives for engaging in such conduct. Such actions are particularly important given the sad history of state bar enforcement in this area of practice. If the Commission is serious about improving lawyer conduct it should take a strong position in favor of restoring this basic form of civil liability.

Respectfully submitted,

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³ Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994).