

**AMERICAN BAR ASSOCIATION  
ADOPTED BY THE HOUSE OF DELEGATES  
August 11-12, 2003**

**RESOLVED**, That Rule 1.13 of the Model Rules of Professional Conduct and its Comment be amended as follows:

**RULE 1.13: ORGANIZATION AS CLIENT**

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization as determined by applicable law.

(c) Except as provided in paragraph (d), if

(1) despite the lawyer's efforts in accordance with paragraph (b) the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate manner an action or a refusal to act, that is clearly a violation of law, and

(2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization, then the lawyer 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.

(d) Paragraph (c) shall not apply with respect to information relating to a lawyer's representation of an organization to investigate an alleged violation of law, or to defend the organization or an officer, employee or other constituent associated with the organization against a claim arising out of an alleged violation of law.

(e) A lawyer who reasonably believes that he or she has been discharged because of the lawyer's actions taken pursuant to paragraphs (b) or (c), or who

withdraws under circumstances that require or permit the lawyer to take action under either of those paragraphs, shall proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal.

(f) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

(g) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

## **Comment**

### **The Entity as the Client**

[1] An organizational client is a legal entity, but it cannot act except through its officers, directors, employees, shareholders and other constituents. Officers, directors, employees and shareholders are the constituents of the corporate organizational client. The duties defined in this Comment apply equally to unincorporated associations. "Other constituents" as used in this Comment means the positions equivalent to officers, directors, employees and shareholders held by persons acting for organizational clients that are not corporations.

[2] When one of the constituents of an organizational client communicates with the organization's lawyer in that person's organizational capacity, the communication is protected by Rule 1.6. Thus, by way of example, if an organizational client requests its lawyer to investigate allegations of wrongdoing, interviews made in the course of that investigation between the lawyer and the client's employees or other constituents are covered by Rule 1.6. This does not mean, however, that constituents of an organizational client are the clients of the lawyer. The lawyer may not disclose to such constituents information relating to the representation except for disclosures explicitly or impliedly authorized by the organizational client in order to carry out the representation or as otherwise permitted by Rule 1.6.

[3] When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful. Decisions concerning policy and operations, including ones entailing serious risk, are not as such in the lawyer's province. Paragraph (b) makes clear, however, that when the lawyer knows that the organization is likely to be substantially injured by action of an officer or other constituent that violates a legal obligation to the organization or is in violation of law that might be imputed to the organization, the lawyer must proceed as is reasonably necessary in the best interest of the organization. As defined in Rule 1.0(f), knowledge can be inferred from circumstances, and a lawyer cannot ignore the obvious.

[4] In determining how to proceed under Paragraph (b), the lawyer should give due consideration to the seriousness of the violation and its consequences, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters, and any other relevant considerations. Ordinarily, referral to a higher authority would be necessary. In some circumstances, however, it may be appropriate for the lawyer to ask the constituent to reconsider the matter; for example, if the circumstances involve a constituent's innocent misunderstanding of law and subsequent acceptance of the lawyer's advice, the lawyer may reasonably conclude that the best interest of the organization does not require that the matter be referred to higher authority. If a constituent persists in conduct contrary to the lawyer's advice, it will be necessary for the lawyer to take steps to have the matter reviewed by a higher authority in the organization. If the matter is of sufficient seriousness and importance or urgency to the organization, referral to higher authority in the organization may be necessary even if the lawyer has not communicated with the constituent. Any measures taken should, to the extent practicable, minimize the risk of revealing information relating to the representation to persons outside the organization. Even in circumstances where a lawyer is not obligated by Rule 1.13 to proceed, a lawyer may bring to the attention of an organizational client, including its highest authority, matters that the lawyer reasonably believes to be of sufficient importance to warrant doing so in the best interest of the organization.

[5] Paragraph (b) also makes clear that when it is reasonably necessary to enable the organization to address the matter in a timely and appropriate manner, the lawyer must refer the matter to higher authority, including, if warranted by the circumstances, the highest authority that can act on behalf of the organization under applicable law. The organization's highest authority to whom a matter may be referred ordinarily will be the board of directors or similar governing body. However, applicable law may prescribe that under certain conditions the highest authority reposes elsewhere, for example, in the independent directors of a corporation.

## **Relation to Other Rules**

[6] The authority and responsibility provided in this Rule are concurrent with the authority and responsibility provided in other Rules. In particular, this Rule does not limit or expand the lawyer's responsibility under Rules 1.8, 1.16, 3.3 or 4.1. 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. If the lawyer's services are being used by an organization to further a crime or fraud by the organization, Rules 1.6(b)(2) and 1.6(b)(3) may permit the lawyer to disclose confidential information. In such circumstances Rule 1.2(d) may also be applicable, in which event, withdrawal from the representation under Rule 1.16(a)(1) may be required.

[7] Paragraph (d) makes clear that the authority of a lawyer to disclose information relating to a representation in circumstances described in Paragraph (c) does not apply with respect to information relating to a lawyer's engagement by an organization to investigate an alleged violation of law or to defend the organization or an officer, employee or other person associated with the organization against a claim arising out of an alleged violation of law. This is necessary in order to enable organizational clients to enjoy the full benefits of legal counsel in conducting an investigation or defending against a claim.

[8] A lawyer who reasonably believes that he or she has been discharged because of the lawyer's actions taken pursuant to Paragraph (b) or (c), or who withdraws in circumstances that require or permit the lawyer to take action under either of these Paragraphs, must proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal, and what the lawyer reasonably believes to be the basis for his or her discharge or withdrawal.

## **Government Agency**

[9] The duty defined in this Rule applies to governmental organizations. Defining precisely the identity of the client and prescribing

the resulting obligations of such lawyers may be more difficult in the government context and is a matter beyond the scope of these Rules. See Scope [18]. Although in some circumstances the client may be a specific agency, it may also be a branch of government, such as the executive branch, or the government as a whole. For example, if the action or failure to act involves the head of a bureau, either the department of which the bureau is a part or the relevant branch of government may be the client for purposes of this Rule. Moreover, in a matter involving the conduct of government officials, a government lawyer may have authority under applicable law to question such conduct more extensively than that of a lawyer for a private organization in similar circumstances. Thus, when the client is a governmental organization, a different balance may be appropriate between maintaining confidentiality and assuring that the wrongful act is prevented or rectified, for public business is involved. In addition, duties of lawyers employed by the government or lawyers in military service may be defined by statutes and regulation. This Rule does not limit that authority. See Scope.

### **Clarifying the Lawyer's Role**

[10] There are times when the organization's interest may be or become adverse to those of one or more of its constituents. In such circumstances the lawyer should advise any constituent, whose interest the lawyer finds adverse to that of the organization of the conflict or potential conflict of interest, that the lawyer cannot represent such constituent, and that such person may wish to obtain independent representation. Care must be taken to assure that the individual understands that, when there is such adversity of interest, the lawyer for the organization cannot provide legal representation for that constituent individual, and that discussions between the lawyer for the organization and the individual may not be privileged.

[11] Whether such a warning should be given by the lawyer for the organization to any constituent individual may turn on the facts of each case.

### **Dual Representation**

[12] Paragraph (g) recognizes that a lawyer for an organization may also represent a principal officer or major shareholder.

### **Derivative Actions**

[13] Under generally prevailing law, the shareholders or members of a corporation may bring suit to compel the directors to perform their legal obligations in the supervision of the organization.

Members of unincorporated associations have essentially the same right. Such an action may be brought nominally by the organization, but usually is, in fact, a legal controversy over management of the organization.

[14] The question can arise whether counsel for the organization may defend such an action. The proposition that the organization is the lawyer's client does not alone resolve the issue. Most derivative actions are a normal incident of an organization's affairs, to be defended by the organization's lawyer like any other suit. However, if the claim involves serious charges of wrongdoing by those in control of the organization, a conflict may arise between the lawyer's duty to the organization and the lawyer's relationship with the board. In those circumstances, Rule 1.7 governs who should represent the directors and the organization.

## REPORT

### I. BACKGROUND OF THE TASK FORCE

On March 28, 2002, Robert Hirshon, President of the American Bar Association (“ABA”), appointed a task force with the following charge:

The Task Force on Corporate Responsibility shall examine systemic issues relating to corporate responsibility arising out of the unexpected and traumatic bankruptcy of Enron and other Enron-like situations which have shaken confidence in the effectiveness of the governance and disclosure systems applicable to public companies in the United States. The Task Force will examine the framework of laws and regulations and ethical principles governing the roles of lawyers, executive officers, directors, and other key participants. The issues will be studied in the context of the system of checks and balances designed to enhance the public trust in corporate integrity and responsibility. The Task Force will allow the ABA to contribute its perspectives to the dialogue now occurring among regulators, legislators, major financial markets and other organizations focusing on legislative and regulatory reform to improve corporate responsibility.

On July 16, 2002, the Task Force submitted its Preliminary Report in response to this charge.<sup>1</sup> That Report preliminarily recommended reforms in two principal areas: internal corporate governance (relating to the composition, conduct and responsibilities of the public corporation’s board of directors and its committees) and the professional conduct of lawyers. During the months following release of the Preliminary Report, the Task Force convened public hearings on its preliminary recommendations in Chicago, New York City and Palo Alto, California and received a variety of written and oral comments on its Preliminary Report.<sup>2</sup>

After succeeding Robert Hirshon as President of the ABA, Alfred P. Carlton, Jr. reappointed the Task Force and, in his testimony to the Task Force in Chicago, encouraged the Task Force to draw “broad public policy conclusions which lead to policy recommendations for the ABA House of Delegates ... that go beyond the technical aspects of corporate securities law and the ABA’s model rules of professional conduct.”<sup>3</sup> The Final Report of the Task Force, from which this statement in support of proposed changes to Rule 1.13 of the Model Rules of Professional Conduct<sup>4</sup> is largely

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<sup>1</sup> The Preliminary Report of the Task Force is published at 58 BUS. LAW. 189 (2002), and is available at <http://www.abanet.org/buslaw/corporateresponsibility/home.html> (the “Task Force Web Site”).

<sup>2</sup> The written and oral testimony submitted at these hearings is available on the Task Force Web Site.

<sup>3</sup> Testimony of Alfred P. Carlton, Jr., at 91, available on the Task Force Web Site.

<sup>4</sup> Referred to in the Task Force Report as “Model Rules” or “Rules.” These rules are the template used by most state authorities in formulating and promulgating the rules that bind the lawyers admitted to practice in those states. The Model Rules are available at [http://www.abanet.org/cpr/mrpc/mrpc\\_toc.html](http://www.abanet.org/cpr/mrpc/mrpc_toc.html).

drawn, responds to the Task Force's founding charge from Robert Hirshon and to President Carlton's call for broad policy conclusions.<sup>5</sup>

The recommendations of the Task Force have not been developed in a static environment. Since the Task Force was appointed, many reforms significantly affecting corporate responsibility have been effected or proposed:

- The Sarbanes-Oxley Act of 2002<sup>6</sup> has brought about, among many other things, extensive federal regulation of the accounting profession, including the creation of an external regulatory organization (the Public Company Accounting Oversight Board), detailed prescriptions governing the auditing work of the firms that certify the financial statements of public corporations, and limits on the scope of non-auditing services that such firms may supply.
- In response to concern that existing rules of professional conduct did not sufficiently direct the lawyer for the corporation to report illegal conduct to the corporation's board of directors,<sup>7</sup> Congress adopted Section 307 of the Sarbanes-Oxley Act of 2002,<sup>8</sup> requiring the SEC to promulgate rules of professional conduct for lawyers "appearing and practicing"<sup>9</sup> before the SEC.

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<sup>5</sup> Not all members of the Task Force endorse each recommendation and every view expressed in the Report, but the Report taken as a whole reflects a consensus of the members of the Task Force. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be considered as representing the policy of the American Bar Association.

<sup>6</sup> P.L. 107-204, 107<sup>th</sup> Cong., 2d sess. (July 30, 2002).

<sup>7</sup> *E.g.*, letter of Professors Richard W. Painter, *et al.*, to SEC Chairman Harvey Pitt, dated March 7, 2002, available at <http://www.abanet.org/buslaw/corporateresponsibility/pitt.pdf>.

<sup>8</sup> Section 307 requires the SEC to issue rules:

setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including 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

(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.

<sup>9</sup> The term "appearing and practicing" before the SEC is defined for purposes of the SEC's new rules of professional conduct to include "providing advice in respect of the United States securities laws or

The SEC adopted these rules (the “Part 205 Rules”)<sup>10</sup> on January 29, 2003 to be effective on August 5, 2003. In specified circumstances, those rules will require lawyers to report to the highest levels of corporate authority material violations of the securities laws and other failures of legal compliance and permit disclosure to third parties to prevent substantial injury to the corporation or investors..

- At the same time, the SEC proposed additional rules of conduct that in some circumstances would require a lawyer to withdraw as counsel and to have that withdrawal reported outside the company by the lawyer or, alternatively, by the company.<sup>11</sup> In describing these proposed rules, the SEC noted with approval the Task Force’s Preliminary Report, and its Chairman at the same time indicated that further rulemaking would be influenced by action taken by the ABA.<sup>12</sup>

The Task Force’s recommendations, including the proposal to amend Model Rule 1.13, complement and supplement these initiatives. The Task Force believes that implementation of its recommendations would significantly enhance the effectiveness of lawyers in the system of checks and balances necessary to restore public trust in corporate responsibility.

## II. THE ROLE OF THE LAWYER REPRESENTING THE CORPORATION

The concentration of day to day managerial control in the senior executive officers may give rise to potential conflicts of interest and other motivational problems that present persistent challenges for effective corporate governance. First, senior executive officers of public companies may sometimes succumb to the temptation to serve personal interests by maximizing their own wealth or control through manipulation or misreporting of corporate information, at the expense of long-term corporate well-being.<sup>13</sup> Second, senior executive officers are often motivated to report good news, and

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the Commission’s rules or regulations thereunder regarding any document that the attorney has notice will be filed with or submitted to” the SEC. 17 CFR §205.2(a).

<sup>10</sup> 17 CFR Part 205, effective Aug. 5, 2003.

<sup>11</sup> Release Nos. 33-8186; 34-47282; IC-25920, available at <http://www.sec.gov/rules/proposed/33-8186.htm> . The ABA’s comments on these proposals are available at <http://www.sec.gov/rules/proposed/s74502/aba040203.htm>.

<sup>12</sup> *Id.*; speech by former SEC Chairman Harvey Pitt, Jan. 29, 2003, available at <http://www.sec.gov/news/speech/spch012903hlp.htm>.

<sup>13</sup> For example, it has been suggested that increased reliance on stock options in executive compensation packages during the 1990’s encouraged senior executive officers to promote short term stock price performance through accounting maneuvers, at the expense of long term growth and stability. See The Conference Board Commission on Public Trust and Private Enterprise Findings and Recommendations, Part I: Executive Compensation (Sep.17, 2002) available at <http://www.conference-board.org/knowledge/governCommission.cfm>, at 4. It may be that executive compensation packages that are structured more carefully to reward long term performance would more closely align the interests of senior executive officers with corporate and investor interests. See *id.* at 5; Business Roundtable, Principles of Corporate Governance (May 2002), available at <http://www.brtable.org/pdf/704.pdf>, at 19.

are averse to reporting news of business setbacks, mistakes, or worse, out of selfish concern that such reports might adversely reflect on them.<sup>14</sup> Third, senior executive officers may also be motivated to report information and analysis incorrectly or incompletely to the board of directors out of concern that individual directors might pursue unproductive or even disruptive inquiries or initiatives of their own. And finally, senior executive officers may be motivated to report information and analysis incorrectly or incompletely to the public out of a concern about harming shareholder interests by reporting news that may adversely affect the corporation's stock price. Unchecked, these various motivations on the part of senior executive officers can significantly harm the interests of the corporation and the investors, employees, customers and other constituencies affected by the corporation's business.

To check such potentially harmful motivations, and to focus the attention of senior executive officers on the interests of the corporation and its shareholders, our system of corporate governance has long relied upon the active oversight and advice of the key participants in the corporate governance process, including the counsel to the corporation.<sup>15</sup> Corporate responsibility and sound corporate governance thus depend upon the active and informed participation of independent advisers who act vigorously in the best interest of the corporation and are empowered to exercise their responsibilities effectively.

Despite the range of participants who have been in a position to contribute to public corporation governance, the last several years have witnessed spectacular failures of corporate responsibility. Knowledgeable observers have asserted that through inaction, inattention, indifference or, in some cases, conflicting personal interests or loyalties, some of these participants, including counsel, bear significant responsibility for these failures, and lawyers have not been excluded from such assertions.<sup>16</sup>

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<sup>14</sup> See, e.g., Donald C. Langevoort, *Organized Illusions: A Behavioral Theory Of Why Corporations Mislead Stock Market Investors (And Cause Other Social Harms)*, 146 U. PA. L. REV. 101, 130-146 (1997).

<sup>15</sup> See M. EISENBERG, *THE STRUCTURE OF THE CORPORATION* (1976); Noyes E. Leech & Robert H. Mundheim, *The Outside Director of the Publicly Held Corporation*, 31 BUS. LAW. 1799 (1976)

<sup>16</sup> With respect to the conduct of lawyers, see Roger C. Cramton, *Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues*, 58 BUS. LAW. 143 (2002); Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp. by William C. Powers, Jr., Chair, dated February 1, 2002, available at <http://news.findlaw.com/hdocs/docs/enron/sicreport/>; *In re Enron Corp. Securities, Derivative & ERISA Lit.*, 235 F.Supp.2d 549, 704-05 (S.D.Tex. 2002) (denying motion to dismiss securities law claims against Vinson & Elkins arising out of its representation of Enron); Dennis K. Berman, "Global Crossing Board Report Rebukes Counsel," *Wall Street Journal*, Mar. 11, 2003, at B9; Mike France, "What About the Lawyers?," *Business Week*, Dec. 23, 2002 at 58-62; Matthew Brellis and Jeffrey Krasner, "Auditor Knew of Tyco Deals, Prosecutor Says PWC Says It Didn't Know Loans Hadn't Been OK'd," *Boston Globe*, Feb. 8, 2003, at E-1 (reviewing criminal charges against Mark Belnick, former general counsel of Tyco International, Ltd.).

Lawyers are and should be important participants in corporate governance and important contributors to corporate responsibility. Lawyers employed by the corporation and outside lawyers retained by the corporation often serve as key advisers to senior management and usually participate in the negotiation, structuring and documentation of the corporation's significant business transactions. Additionally, lawyers often serve as counselors to the board to assist it in performing its oversight function. In such roles, lawyers obviously do and should play a critical role in helping the corporation recognize, understand and comply with applicable laws and regulations, as well as to identify and evaluate business risks associated with legal issues. The Task Force believes that a prudent corporate governance program should call upon lawyers – notably the corporation's general counsel<sup>17</sup> – to assist in the design and maintenance of the corporation's procedures for promoting legal compliance.

This conception of the lawyer as a promoter of corporate compliance with law emanates from the basic values of the legal profession. It follows naturally from the ABA's goal "to increase public understanding of and respect for the law, the legal process, and the role of the legal profession."<sup>18</sup> It is also in keeping with the ABA's Model Rules of Professional Conduct, which emphasize the lawyer's responsibility "[a]s advisor [to] provide[] a client with an informed understanding of the client's legal rights and obligations and explain[] their practical implications."<sup>19</sup>

The Model Rules reinforce this positive relationship between lawyers and their clients in a number of other ways. They require the lawyer to be competent and diligent in rendering legal services;<sup>20</sup> to respect the client's right to decide on objectives;<sup>21</sup> to consult with the client about the means by which the client's objectives are to be accomplished;<sup>22</sup> to protect the client's information; and to avoid conflicts of interest. The obligations of confidentiality and loyalty, however, never permit the lawyer to "counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent."<sup>23</sup> To the contrary, the lawyer is not permitted to "continue assisting a client

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<sup>17</sup> As used in the Task Force Report, the term "general counsel" refers to the lawyer having general supervisory responsibility for the legal affairs of the corporation.

<sup>18</sup> ABA Goals and mission statement, Goal IV, available at <http://www.abanet.org/about/goals.html>.

<sup>19</sup> Model Rules Preamble ¶[2].

<sup>20</sup> Model Rules 1.1, 1.3.

<sup>21</sup> Model Rule 1.2.

<sup>22</sup> Model Rule 1.4(a)(2).

<sup>23</sup> Model Rule 1.2(d). One of the witnesses in the Task Force hearings usefully suggested that this aspect of Model Rule 1.2 deserved to be expressed in a separate rule. Statement of Mark L. Tuft on behalf of the Bar Association of San Francisco, at 12.

in conduct that the lawyer originally supposed was legally proper but then discovers is criminal or fraudulent.”<sup>24</sup>

The Task Force acknowledges that lawyers for the corporation – whether employed by the corporation or specially retained -- are not “gatekeepers” of corporate responsibility in the same fashion as public accounting firms. Accounting firms’ responsibilities require them to express a formal public opinion, based upon an independent audit, that the corporation’s financial statements fairly present the corporation’s financial condition and results of operations in conformity with generally accepted accounting principles.<sup>25</sup> The auditor is subject to standards designed to assure an arm’s length perspective relative to the firms they audit. In contrast, as several commentators pointed out in the public hearings on the Preliminary Report, corporate lawyers are first and foremost counselors to their clients.<sup>26</sup> Except in clearly defined circumstances in which other considerations take precedence, an alternative view of the lawyer as an enforcer of law may tend to create an atmosphere of adversity, or at least arm’s length dealing, between the lawyer and the corporate client’s senior executive officers that is inimical to the lawyer’s essential role as a counselor promoting the corporation’s compliance with law.

Nevertheless, lawyers for the public corporation must bear in mind that their responsibility is to the corporation, and not to the corporate directors, officers or other corporate agents with whom they necessarily communicate in representing the corporation. This is the bedrock principle recognized in Rule 1.13(a) of the Model Rules. Outside lawyers retained by the corporation and lawyers employed by the corporation both must exercise professional judgment in the interests of the corporate client, independent of the personal interests of the corporation’s officers and employees.

### III. RECOMMENDED CHANGES TO MODEL RULE 1.13

The recommendations in the Task Force’s Report relating to lawyers are intended to enhance the lawyer’s ability to exercise and bring to bear independent professional judgment, and thereby enhance the lawyer’s ability to contribute to corporate responsibility without undermining the constructive and collaborative relationship that must exist with the executive officers of the corporate client so that compliance with law can be most effectively promoted.

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<sup>24</sup> Model Rule 1.2, Comment [10].

<sup>25</sup> *E.g.*, R. William Ide, *Post-Enron Corporate Governance Opportunities: Creating a Culture of Greater Board Collaboration and Oversight*, 54 MERC. L. REV. 829, 841-843 (2003); John C. Coffee, Jr., *Understanding Enron: “It’s About the Gatekeepers, Stupid,”* 57 BUS. LAW. 1403, 1405 (2002) (“Characteristically, the gatekeeper essentially assesses or vouches for the corporate client’s own statements about itself or a specific transaction”); see Regulation S-X Rule 2-02, 17 CFR §210.2-02.

<sup>26</sup> See, e.g., testimony of Hon. Charles B. Renfrew on behalf of the American College of Trial Lawyers; Preliminary Statement of Attorneys’ Liability Assurance Society, Inc., at 6-7; testimony of Patricia Lee Refo on behalf of the ABA Section of Litigation, at 11-12; letter of Oct. 30, 2002 on behalf of the Los Angeles County Bar Association; testimony of the State Bar of California Committee on Professional Responsibility, at 7-10. All of these submissions are available at the Task Force Web Site.

The Task Force recognizes that even where the practices it has recommended are applied, corporate officers and employees may take actions that involve the corporation in material violations of law or of a legal obligation to the corporation. Such actions may occur where officers or employees reject legal advice, or where they fail to consult a lawyer. The Task Force believes that the Model Rules (particularly Rules 1.13 and 1.6) that address the professional responsibility of lawyers when such circumstances arise should be revised to more effectively protect the interests of corporate client and to protect the professional integrity of the lawyer from a client using his or her services to further a crime or fraud.<sup>27</sup>

In their role of promoting their organizational clients' compliance with law, a key function of lawyers is to bring issues of legal compliance to the attention of appropriate authorities within the organization. The Task Force believes that there are two useful approaches to enhancing the efficacy of this role. The first (discussed more fully in Part V(A)(1) of the Task Force's Report) involves the adoption by public corporations of practices and procedures in which both employed (in-house) lawyers and outside lawyers for the corporation can more readily and effectively convey to appropriate organizational authorities information and analysis concerning issues of legal compliance. The second approach (set forth in this recommendation) supplements the first approach by recommending that the Model Rule 1.13 be amended to address the relatively unusual situation in which action or threatened action by an organization's employee violates a law or legal obligation to the organization and is likely to cause substantial injury to the organization.

#### **A. Reinforcing the Obligation to Communicate with Higher Corporate Authorities**

Model Rule 1.13 addresses internal communications among the organization's lawyers, officers, employees and ultimate governing body. The first provision of that Rule recognizes that, for purposes of a lawyer's professional responsibilities, the client is the organization itself. It provides:

- (a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

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<sup>27</sup> The Task Force Report continues the practice traditionally used in the Model Rules of speaking about the responsibilities of individual lawyers. However, in many cases involving representation of publicly held corporations, the corporate client is advised by a law firm. The interplay of lawyer obligations to the corporation and lawyer obligations to each other in the context of law firm practice are generally addressed in Model Rules 5.1 and 5.2. A direct, detailed analysis of the responsibilities of a law firm and the lawyers within the firm and the procedures that would facilitate discharge of their responsibilities would be a useful addition to the literature on professional responsibilities, and the Task Force recommends that an appropriate committee of the ABA undertake such an analysis.

Rule 1.13 next addresses the actions to be taken by the lawyer within the organizational client. The key provision, in current Rule 1.13(b), is that the lawyer must take appropriate action in the best interest of the client, namely the organization. While this obligation is a mandate, the Rule cannot and does not prescribe precisely what action is appropriate; the lawyer is obligated to exercise informed professional judgment in determining what steps are “reasonably necessary in the best interest of the organization.” That can be determined, in specific detail, only in the context of the circumstances in which the problem arises. The current rule suggests, very generally, a few kinds of action open to the lawyer, but mandates none of them. The Task Force has concluded that these provisions confuse rather than clarify the mandatory nature of the lawyer’s obligations under the rule, and accordingly recommends that they be deleted.<sup>28</sup>

In lieu of those open-ended provisions, the Task Force recommends two substantive revisions to Rule 1.13(b). The first is a refinement of the definition of the circumstances that trigger the lawyer’s duty to take action within the organization. The second clarifies the circumstances in which the lawyer is required to communicate with a higher authority within the organization. Currently, Rule 1.13(b) requires a lawyer for an organizational client to act when the lawyer “knows”<sup>29</sup> that a person within the organization is violating or intends to violate the law and is likely to cause substantial injury to the organization. The Task Force recommends that this prerequisite be revised to differentiate between knowledge of facts and evaluation of legal consequences. As under the current rule, the starting point of the recommended rule is subjective: the obligation to take action would arise only on the basis of the facts known to the lawyer.<sup>30</sup> The proposed trigger for requiring action by the lawyer then proceeds to an objective

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<sup>28</sup> For similar reasons, the Task Force recommends that the Comments to the present Rule be modified so as to remove or revise statements that discourage the lawyer from taking a matter up to higher authority within the organizational client.

<sup>29</sup> As defined in Model Rule 1.0(f), the terms “knowingly,” “known,” or “knows” refer to actual knowledge and do not include knowledge that could be imputed to the lawyer. Actual knowledge can, however, be inferred from circumstances. Furthermore, lawyers cannot close their eyes to the obvious, *i.e.* the lawyer may be deemed to “know” that which the lawyer consciously avoided knowing. See Comment [8] to Model Rule 4.2 and *ABA Formal Ethics Opinion 346* (1982) (lawyers cannot “shut their eyes to what was plainly to be seen”).

<sup>30</sup> In its Preliminary Report, the Task Force considered whether the triggering standard should be “reasonably should know,” a standard that under Rule 1.0(j) denotes that “a lawyer of reasonable prudence and competence would ascertain the matter in question.” The proposal to incorporate that standard in the trigger to required action under Rule 1.13 drew substantial criticism from those who presented testimony or statements to the Task Force. See, *e.g.*, written testimony of Prof. Thomas D. Morgan dated Sep. 20, 2002, at 16-17; written testimony of the New York County Lawyers’ Association dated Oct. 25, 2002, at 5-6; written statement of Prof. Stephen Gillers, dated Oct. 25, 2002, at 2; written testimony of Patricia Lee Refo on behalf of the ABA Section of Litigation, at 13-15; written submission of the American Corporate Counsel Association dated Nov. 11, 2002, at 6. The concern of the critics was that this standard may impose a duty, of uncertain extent, to investigate that could only be evaluated after the fact with the benefit of hindsight. They noted also that the lawyer may not be able to insist that the client pay for, or even permit, the investigation that may, in the light of hindsight, prove to have been necessary.

test, namely, whether a reasonable lawyer who knows such facts would, in similar circumstances, conclude that the conduct in which a constituent is engaging or intends to engage constitutes a violation of law or duty to the organization that is likely to result in substantial injury to the organization. This standard recognizes that there is a range of reasonable conduct, and that a lawyer satisfies that standard by acting within that range. Moreover, it does not imply any duty on the lawyer's part to investigate or inquire further as to information provided by a client or the client's agent, or by a person to whom the lawyer has been referred by the client.<sup>31</sup> Although the lawyer is under no duty to investigate or inquire, however, the lawyer may not simply accept such information at face value if to do so would be unreasonable in the circumstances.

The second substantive change to Rule 1.13(b) recommended by the Task Force addresses the lawyer's obligation to report wrongdoing to higher authority in the organizational client. Currently, that rule identifies "reporting up" as a potential course of action when the lawyer has discerned an actual or threatened violation of law or violation of legal obligation to the organization, but the Rule imposes no clear obligation to pursue that course of action. The Task Force believes, however, that the Rule should more actively encourage such action, by requiring that the lawyer refer the matter to higher authority in the organization – including, if warranted, the organization's highest authority -- unless the lawyer reasonably believes that it is not necessary to do so.<sup>32</sup>

Thus, Rule 1.13(b) as recommended by the Task Force would provide:

(b) If a lawyer for an organization knows facts from which a reasonable lawyer, under the circumstances, would conclude that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization as determined by applicable law.

It is important to emphasize that Rule 1.13 is *not* a guide to "best legal practices." It provides instruction in the extraordinary circumstance of a significant failure of governance that puts or threatens to cause substantial injury to the organization client,

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<sup>31</sup> This standard is thus similar to the standard used to trigger the "reporting up" obligations in the Part 205 Rules. See §§ 205.3(b)(2) and 205.2(e).

<sup>32</sup> Thus, unlike the relatively rigid reporting requirements in the Part 205 Rules, proposed Rule 1.13 would continue to allow the lawyer to exercise professional judgment in determining the appropriate way to proceed in the best interest of the organization.

and the nature of the required response of the lawyer for the organization if this extraordinary circumstance should occur. It does not limit the responsibility of the lawyer to act always in the best interest of the organization, and it certainly permits the lawyer to bring to the attention of the client, including its highest authority, matters not covered by the Rule, but which the lawyer reasonably believes to be of sufficient importance that the client needs to be informed of them.

In its deliberations, the Task Force considered whether the lawyer's duties under the Rule should continue to be triggered only by matters that are "related to the representation." The Task Force's Preliminary Report recommended that the Rule require the lawyer to act with respect to any known violation, even if not related to the representation.<sup>33</sup> Others pointed out, however, that it would be unfair to hold responsible a lawyer working in one field of the law to understand that facts of which he was aware should have led to a conclusion of law violation in a field with which he was unfamiliar.<sup>34</sup> The Task Force is persuaded by this analysis and recommends that this qualification be retained in the Rule.<sup>35</sup>

The Task Force also recommends that Rule 1.13 be amended to include a new provision to assure that the organization's highest authority is made aware that a lawyer for the organization has withdrawn or is discharged in circumstances addressed by the Rule. In some instances, the actions of the lawyer within the organization, pursuant to Rule 1.13(b), may fail to prevent or avoid action that seriously threatens the interest of the organization. Current Rule 1.13(c) provides that a lawyer, in this circumstance, may choose to withdraw.<sup>36</sup> In that event, or if the organizational client discharges the lawyer because of the lawyer's actions under Rule 1.13(b) in reporting to higher authority, the lawyer's professional obligations to act in the best interest of the organization should require the lawyer to take reasonable steps to assure that the organization's highest authority is aware of the withdrawal or discharge, and the lawyer's understanding of the circumstances that brought it about. Therefore, the Task Force recommends the adoption of a new Rule 1.13(e) providing:

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<sup>33</sup> Preliminary Report at 29. Some commentators supported that preliminary recommendation. *E.g.*, letter of Prof. Myles V. Lynk dated Sep. 17, 2002, at 5.

<sup>34</sup> See, *e.g.*, statement of Mark L. Tuft on behalf of the Bar Association of San Francisco, Nov. 11, 2002, at 15, available at the Task Force Web Site.

<sup>35</sup> The Part 205 Rules are triggered if "an attorney, appearing and practicing before the Commission in the representation of an issuer, becomes aware" of a violation. This does not seem to require a nexus with the representation. The rule proposal read differently: "If, in appearing and practicing before the Commission in the representation of an issuer, an attorney becomes aware ... ." This wording seems to require that the knowledge be obtained in the course of the representation. The release promulgating the Part 205 Rules gave no explanation for the change.

<sup>36</sup> In the interest of clarity, the Task Force recommends that this choice be reflected in the Commentary to the Rule, through reference to Rule 1.16, rather than by reference in the text of the Rule itself.

(e) A lawyer who reasonably believes that he or she has been discharged because of the lawyer's actions taken pursuant to paragraphs (b) or (c), or who withdraws under circumstances that require or permit the lawyer to take action under either of those paragraphs, shall proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal.

Finally, because the corporate failures that prompted the appointment of the Task Force were concerned exclusively with public corporations, the Task Force also explored the possibility of suggesting a new Model Rule, patterned on Model Rule 1.13, but limited to organizations with publicly traded securities. The Task Force concluded, however, that it was not appropriate to craft a special rule.<sup>37</sup> In any situation in which an organization has multiple owners or members (such as minority owners in a closely held business) other than the organization's managers, the lawyer's duty to the organizational client is an important safeguard. Thus, the modifications of the duties defined in Model Rule 1.13 recommended by the Task Force are likely to be of value to corporations without publicly traded securities, charitable organizations, other not-for-profit entities, and governmental organizations. Conversely, the Task Force has not identified any particular respect in which the recommended modifications to Rule 1.13 would be appropriate for public corporations but inappropriate for other organizational clients.

## **B. Confidentiality and the Organizational Client**

In proposing amendments to Model Rule 1.6, the Task Force has reviewed confidentiality considerations that reflect a balance between the policy of preserving the confidentiality of client information and countervailing policy that a client may not abuse the client-lawyer relationship by using the lawyer's services to commit a crime or fraud. That balance of policy considerations applies to both individual and organizational clients.<sup>38</sup> The Task Force has focused, however, on two additional aspects of the duty of confidentiality with respect to organizational clients. The first such aspect is the uncontroversial but perhaps not universally understood proposition that a lawyer does not violate Model Rule 1.6 by disclosing to an organizational constituent, acting as such, information relating to the representation that was imparted to the lawyer by another organizational constituent (*e.g.*, by sharing with a corporation's general counsel or its board of directors facts learned from a corporate officer). Organizational constituents thus cannot legitimately expect that the lawyer will not reveal to others within the organization information they have imparted to the lawyer.

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<sup>37</sup> The Part 205 Rules establish obligations applicable only to lawyers appearing and practicing before the SEC, thereby normally only lawyers representing public corporations.

<sup>38</sup> See Task Force Report Part V (B)(1), and the narrative in support of the Task Force's concurrent recommendation of amendments to Model Rule 1.6.

The second aspect on which the Task Force has focused arises because, just as with individual clients, full and frank communication with the organization's lawyer is encouraged if organizational constituents expect that information they communicate to the organization's lawyer will not be revealed outside the organization (except as the organization may decide). That expectation is undoubtedly valuable to an organizational client as a general proposition. The organization may have a countervailing interest, however, when a lawyer's actions within the organization, including advice to the organization's highest authority, are unavailing to protect the organization against substantial injury arising from a constituent's clear violation of law. In such a circumstance, the Task Force believes that organization's interest in having the lawyer proceed "as is reasonably necessary in the best interest of the organization"<sup>39</sup> outweighs the organization's general interest in preserving confidentiality.<sup>40</sup>

The Task Force therefore recommends the adoption of the following new provision in Rule 1.13 that permits, but does not require, the lawyer for the organization to communicate with persons outside the organization in order to prevent substantial injury to the organization:

- (c) Except as provided in paragraph (d), if
  - (1) despite the lawyer's efforts in accordance with paragraph (b), the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate manner an action, or a refusal to act, that is clearly a violation of law, and
  - (2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization,then the lawyer 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.

The Task Force agrees with the Reporter to the ALI Restatement that Model Rule 1.6 "... should not be understood to preclude controlled disclosure beyond the organization in the limited circumstances where the wrongdoing is clear, the injury to the client organization is substantial, and disclosure would clearly be in the interest of the entity client."<sup>41</sup> The Task Force considers this especially important in the circumstance

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<sup>39</sup> Model Rule 1.13(b).

<sup>40</sup> Existing Model Rule 1.13 reflects this tension between the two ethical policy considerations when it states that any measures taken by the lawyer should "be designed to minimize . . . the risk of revealing information relating to the representation to persons outside the organization." In the Task Force's recommended changes, this proposition would become part of Comment [4] to Rule 1.13.

<sup>41</sup> Comment f to RESTATEMENT THIRD, THE LAW GOVERNING LAWYERS § 96, comment f.

in which the board of directors or other highest authority of the organizational client is disabled from acting in the best interest of the organization, e.g., because of self-interest or personal involvement in the violation.<sup>42</sup>

Because such disclosure may reveal client information otherwise protected under Rule 1.6(a), the proposed addition to Rule 1.13 contains strict conditions that must exist before any “reporting out” is allowed. The lawyer must have a heightened level of certainty as to the violation of law, and the actual or threatened violation must be “clear.” Moreover, there is no permission to “report out” when the organizational governance failure involves a violation of legal duty to the organization but is not otherwise a violation of law. As under Rule 1.6, communication of client information outside the organization must be limited to information reasonably believed to be necessary to prevent substantial injury to the organization that is reasonably certain to occur. In most circumstances, this limitation would permit communication only with persons outside the organization who have authority and responsibility to take appropriate preventive action.

The Task Force has also concluded that there are two circumstances in which a lawyer for an organizational client should not be permitted to reveal information relating to a representation, even where the governing authority is disabled from acting or unwilling to act in the organization’s best interest. One such circumstance involves the lawyer who has been engaged by the organization to investigate whether an organizational constituent has committed a material violation of law or a breach of duty to the organization. The organization in such a circumstance has an especially compelling need for the ground rules of that investigation to promote open and frank communications between the investigating lawyer and organizational constituents. It is essential to minimize obstacles in the way of the investigating lawyer’s testing the truth of the allegation.

In addition, a lawyer who has been engaged by an organization or a constituent to defend against a claim of a violation of law has an especially compelling need to obtain from organizational constituents all information that might support a meritorious defense to such a claim, without fear by the constituents that the lawyer may disclose the information to a third party. The importance of the advocate’s role in our adversarial dispute resolution process justifies denying to a lawyer in this role the authority under

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<sup>42</sup> Model Rule 1.14, which deals with clients who are natural persons suffering diminished capacity due to minority, mental impairment, or similar reasons, while not entirely apposite, is analogous. In those circumstances the lawyer for the disabled client is “impliedly authorized under Rule 1.6(a) to reveal information about the client, but only to the extent reasonably necessary to protect the client’s interests.” The Task Force’s proposed Model Rule 1.13(c) seeks to accomplish the same result for an organizational client where the capacity of its governing board or other highest authority to act in the best interest of the organization is diminished by its self-interest or personal involvement in the violation. The lawyer should take into account the presence or absence of any such self-interest or other disabling circumstance in evaluating whether substantial injury to the organization is reasonably certain to occur, and if so, whether discretion in favor of disclosure of client information.

Rule 1.13, as recommended by the Task Force, to reveal information relating to the representation outside the organization.<sup>43</sup>

The Task Force therefore recommends the addition of the following paragraph (d) in Rule 1.13 as a limitation on the recommended addition of Rule 1.13(c):

(d) Paragraph (c) shall not apply with respect to information relating to a lawyer's representation of an organization to investigate an alleged violation of law or to defend the organization or an officer, employee or other constituent associated with the organization against a claim arising out of an alleged violation of law.

The Task Force considered whether to recommend a similar provision for investigative and defense lawyers in its Model Rule 1.6 proposals. The Task Force concluded, however, that such a provision is unnecessary. The exceptions proposed to be added to Model Rule 1.6 apply only if the lawyer's services have been, are being, or will be used by the client in the furtherance of the crime or fraud. It is unlikely at best that in such a circumstance the lawyer would or even could agree to represent the organization or a constituent in investigating or defending a claim arising out of the crime or fraud in which the lawyer's services were used. To the contrary, the lawyer would have a personal interest in exposing and preventing or rectifying any crime or fraud, and the lawyer should not undertake the investigation or defense.<sup>44</sup> Therefore, investigating and defense counsel engaged with respect to alleged crime or fraud should never be in a position to reveal information relating to that representation pursuant to the Task Force's recommended changes in Model Rule 1.6.

#### **IV. CONCLUSION**

For the foregoing reasons, the Task Force respectfully urges that the House of Delegates adopt the proposed amendments to Rule 1.13 of the Model Rules of Professional Conduct.

Respectfully submitted,

The Task Force on Corporate Responsibility

James H. Cheek, III, Chair

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<sup>43</sup> The Task Force notes that the SEC made similar provision in §§205.3(b)(6) and (7) of the Part 205 Rules.

<sup>44</sup> See Model Rule 1.7(a)(2).

## GENERAL INFORMATION FORM

Submitting Entity: Task Force on Corporate Responsibility

Submitted By: James H. Cheek, III, Chair

1. Summary of Recommendation(s): The recommendation is to amend Rule 1.13 of the ABA Model Rules of Professional Conduct to require the lawyer for an organizational client to report certain violations of law to higher organizational authority in certain circumstances unless reasonably believed not to be necessary in the best interest of the organization; to require the lawyer to proceed as reasonably believed necessary to assure that the organization's highest authority is informed of the lawyer's withdrawal or discharge in circumstances addressed in the proposed Rule; and to permit the lawyer to reveal client information to prevent reasonably certain substantial injury to the organization where the organization's highest authority insists upon or fails to timely address a clear violation of law. The Comment to Rule 1.13 would be amended to describe these proposed changes to the Rule.

2. Approval by Submitting Entity: The recommendation as submitted was approved by the Task Force through its adoption of its Report dated March 31, 2003.

3. Has this or a similar recommendation been submitted to the House or Board previously?

The recommendation to amend subsection (c) of Rule 1.13 is similar in certain respects to the proposal by the ABA Commission on Evaluation of the Rules of Professional Conduct to amend Rule 1.6 by adding subsections (b)(2) and (b)(3).

4. What existing Association policies are relevant to this recommendation and how would they be affected by its adoption?

The recommendation addresses core areas of concern in relation to the professional responsibilities of lawyers to their organizational clients.

5. What urgency exists which requires action at this meeting of the House?

The Task Force was directed by the President of the ABA in March 2002 to evaluate "systemic issues relating to corporate responsibility" in relation to, among other things, "the framework of laws and regulations and ethical principles governing the roles of lawyers." The Task Force believes that its recommendations merit prompt attention by the House of Delegates in light of recent changes in applicable law, including new federal legislation and related proposed and final rules regulating lawyer professional conduct by the Securities and Exchange Commission.

6. Status of legislation (if applicable): Not applicable.
7. Cost to the Association (both direct and indirect costs): None.
8. Disclosure of Interest (if applicable): None.
9. Referrals: The Task Force's Final Report is expected to be distributed to each of the Sections and Divisions and Standing Committees of the ABA.
10. Contact Person (prior to the meeting): James H. Cheek, III, Chair, Task Force on Corporate Responsibility, Bass Berry Sims, PLC, Suite 2700, 315 Deaderick St., Nashville, TN 37238-3001, business: (615) 742-6223, fax: (615) 742-6298, email [jcheek@bassberry.com](mailto:jcheek@bassberry.com).
11. Contact Person (who will present the report to the House): James H. Cheek, III, Chair, Task Force on Corporate Responsibility, Bass Berry Sims, PLC, Suite 2700, 315 Deaderick St., Nashville, TN 37238-3001, business: (615) 742-6223, fax: (615) 742-6298, email [jcheek@bassberry.com](mailto:jcheek@bassberry.com).