THE AMERICAN BAR ASSOCIATION'S ROLE IN SHAPING THE DUTIES OF THE MODERN CORPORATE ATTORNEY IN THE WAKE OF SARBANES-OXLEY: A DISCUSSION AND QUESTION AND ANSWER SESSION

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The American Bar Association's ("ABA's") policy-making body is called the House of Delegates, a body made up entirely of ABA member-lawyers. Imagine this: the House of Delegates, roughly 550 representative-lawyers who constitute a body as large as the Congress in Washington, D.C. The chair of the House is responsible for trying to keep order among those 550 representative-lawyers, who all think that they know Robert's Rules and are highly trained and expertly skilled in the art of finding the most obscure sections of Robert's Rules in order to challenge a ruling. I learned quickly from a friend and mentor that I did not need to know Robert's Rules, I just had to be decisive about what I thought I knew about Robert's Rules. I learned to cope with and preside over all 550 lawyers, and it was one of the most enjoyable experiences of my life.

For example, during my time as chair of the ABA's House of Delegates, a debate on multi-disciplinary practice arose. The crux of the debate concerned whether accounting firms should be allowed to create jointly-owned firms similar to a business model often found in Europe, wherein accounting firms are allowed to own law firms and vice versa (by the way, accounting firms are the largest law firms in the world because foreign laws permit multi-disciplinary practices). The then-president of the ABA commissioned a committee of ABA members to examine the viability of this idea for use in the United States.

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The end product of the committee's work was a report on the state of the industry and a set of proposed guidelines. In its industry report, the committee noted that the climate in our legal markets had changed-and that, in fact, some of the lines of distinction between what clients wanted and what they needed had changed. The committee observed that what clients truly desired from professional services providers was an all-in-one package that allowed them to access all the services they needed through a single relationship with a conglomerated professional services provider. The commission then penned its recommendations based on an industry analysis as a set of hotly debated rules that would, if adopted, govern the creation of such conglomerates and would likely change the face of the legal profession as we knew it. The debate centered around two main issues: the independent professional judgment of the attorney, and the confidential relationship between the attorney and his or her client.

The Delegates felt that if other professional services, such as accounting and consulting, were packaged into the same jointly-owned service business, the co-owners from those other professions would be in a position to exert too much influence over the independent decision making process of the lawyer. In that context, a number of questions arise. If you work for a professional services conglomerate, who is the boss? Whom are you obligated to serve? Is it your client, your partners, the shareholders, or your bosses? Some argued that a conflict might arise when your partners, the shareholders, and your bosses decide that the client needs a given answer to an accounting, operations, or marketing question. Because of their position of power in relation to the attorney, they have the ability to apply pressure and influence the attorney's professional opinion. Others argued that if clients wanted one-stop shopping, lawyers would be at a competitive disadvantage if they did not form these conglomerates and that the financial ruin of the legal field was imminent if it did not position itself according to client desires.

The Delegates also debated whether the professional services conglomerate model might compromise the right to privileged communications-confidences that a client gives us in furtherance of our advice-giving role. They questioned whether this confidential relationship could be maintained when fees are shared with non-lawyer professionals, and whether such information sharing might begin to erode or even dissolve client confidentiality and the privileged relationship.

The House of Delegates declined to adopt the set of rules propagated by the professional service conglomerates committee for two main reasons. First, it deemed the ability to exercise independent and detached judgment to be too central to the lawyer's function. Second, it felt that conglomerates might compromise the confidential attorney-client relationship. Hindsight, though not always perfect, would suggest that the ABA Delegates made the right choice in not approving the

Professional Service Conglomerates Committee's proposed regulations because of the high-profile corporate collapses that occurred a year later. Much of the debate in the national media centered around the independence of the auditing accountants because they worked in a firm that also provided the consulting services to the corporation. The standard theory about the reason that auditing groups failed to recognize and correct the problems that led to the collapses was that those accountants were under pressure from their own firm's consulting arm to come up with the "right answer" to fit the strategies the consultants recommended.

As a result of these collapses, a number of issues were pushed to the forefront and had to be addressed in order to halt the erosion of client and investor confidence in professional services. Congress responded accordingly and passed the Sarbanes-Oxley Act[1]("the Act"), which basically said, "if corporations cannot effectively monitor themselves, the government will do it for them." The primary focus of the Act was to reform the accounting profession. To do this, Sarbanes-Oxley created an accounting oversight board[2] to establish rules and maintain responsibility for the actions of the accounting industry and to eliminate the chances that similar problems would occur in the future. In the wake of the corporate collapses of 2001 and Sarbanes-Oxley, a number of accounting firms dissolved.

The legal profession was also faced with several issues as a result of Sarbanes-Oxley concerning the role lawyers really played in those corporate collapses. Sarbanes-Oxley addressed accounting abuses by separating the auditing functions, and creating an accounting oversight board.[3] However, the Act did not specifically address the lawyer's role in transactions. The question posed to the profession has become what will it do to assure the public that it does, in fact, exercise independent judgment without oversight.

The Securities and Exchange Commission ("SEC") was tasked to regulate corporate attorneys advising public corporations, but only in a narrow, specific way.[4] In particular, Section 307 of the Act instructed the SEC to adopt a new federal rule requiring all lawyers appearing and practicing before the agency to report evidence of

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[1] Pub. L. No. 107-204, 116 Stat. 745 (2002).

[2] *See* 15 U.S.C. § 7211 (2004) (establishing the Public Company Accounting Oversight Board).

[3] *Id.*

[4] *See* 15 U.S.C. § 7245 (2004) (mandating that the SEC regulate attorneys practicing within its jurisdiction).

material violations of the securities laws and other misconduct "up the ladder" to the company's senior management, and if necessary, to its board of directors.

Between November 2002 and January 2003, the SEC issued several different proposed rules under Section 307 of the Act, including an "up the ladder" reporting rule that was specifically required by that section, as well as an additional "noisy withdrawal" rule stating that if the corporate client fails to take appropriate remedial steps after being informed by the lawyer of illegal activity, the lawyer would be required to withdraw from representation, notify the SEC of the withdrawal, and disaffirm any tainted documents. The SEC also issued an alternative "noisy withdrawal" proposal that would require the company–instead of the lawyer–to notify the SEC of the withdrawal. In addition to the "up the ladder" and "noisy withdrawal" rules, the SEC also issued a "permissive disclosure" rule permitting, but not requiring, the attorney to reveal confidential client information to the extent reasonably necessary to prevent the client from committing an illegal act or to rectify a previous illegal act in which the attorney's services had been used.

In response to these proposed rules, the ABA—working though its Section 307 Task Force—submitted two lengthy comment letters to the SEC that generally endorsed the "up-the-ladder" and "permissive disclosure" rules while vigorously opposing the "noisy withdrawal" proposals. The SEC's "up the ladder" rule essentially said that if you, as corporate counsel, discover something wrong, tell the vice-president. If the vice-president fails to act, report it to the president. If the president fails to act, report it to the CEO. If the CEO fails to act, go to the entire board and confront it directly. Take it "up the ladder" to the extent necessary to get it fixed.

The proposed "up the ladder" and "noisy withdrawal" rules also had ramifications for outside corporate counsel. The proposed rules required outside counsel to report up as well, and to make it clear to company superiors and senior partners that the corporation is operating fraudulently or with willful disregard of its fiduciary obligations. If that step failed, under the proposed rules, outside counsel had a duty to make a "noisy withdrawal." That is, outside counsel would be required to not only withdraw as counsel, but also to notify the SEC that it was doing so "for professional considerations"—code words for "my client committed illegal acts."

From time to time, the ABA publishes advisory rules on professional conduct. In 2000, the ABA tasked a committee called "Ethics 2000" to revise and propose new ethics rules. Ethics 2000 reviewed a proposal of a similar ilk to the "permissive disclosure" rule proposed by the SEC, under which lawyers would be permitted to turn in their clients if they suspected that the client had committed fraud. The Delegates declined to adopt such a proposal at that time because it truncated the scope of the attorney-client privilege in that clients would not feel free to divulge the full range of their activities and the lawyer's role would be both diminished and compromised.

Then after the 2001 collapses of Enron, World Com, Tyco, and Adelphia, and the passage of the Sarbanes-Oxley Act in 2002, the SEC seemed poised to require noisy withdrawal. The ABA responded with multiple statements asking the SEC to reconsider its noisy withdrawal proposals. In those statements, the ABA explained how the proposals would harm the confidential attorney-client relationship and make it more difficult for attorneys to effectively counsel their clients to follow the law. In addition, the ABA informed the SEC that the ABA House of Delegates was about to consider two significant changes to its Model Rules of Professional Conduct and other proposed reforms aimed at improving the role of lawyers in corporate governance. For these and other reasons, the SEC agreed to postpone a final decision on its noisy withdrawal proposals.

Subsequently, in August 2003, the ABA House of Delegates adopted three important new policies, including (1) a set of twelve proposed corporate governance practices, including regular executive meetings between the company's general counsel and its independent directors; (2) an amendment to ABA Model Rule of Professional Conduct 1.13 requiring corporate attorneys to report misconduct "up the corporate ladder" to the company's senior management and, if necessary, its board of directors; and (3) an amendment to ABA Model Rule 1.6 permitting lawyers to reveal confidential client information to third parties if necessary to prevent serious financial harm resulting from a client's crime or fraud. All three of the ABA's new policies were received favorably by the SEC, and in April, 2004, the SEC's general counsel informed that ABA that although the Commission still had not yet decided whether to proceed with a mandatory "noisy withdrawal" rule, it is closely monitoring lawyer compliance with the new "up the ladder" reporting rule as well as the bar's efforts to address the concerns raised by Congress in enacting Section 307.

We have yet to see how the SEC's regulations on the legal and accounting industries will affect the marketplace, but we are certainly positioned to achieve higher investor confidence and a better-managed corporate structure.

The last piece of corporate governance reform to discuss is rules regarding directors. The independence of a corporation's directors is imperative. Corporations must have directors who are not there for the purpose of making management feel good, but for providing oversight and impartial judgment.

So, what are the results of the corporate collapses of 2001, the Sarbanes-Oxley Act, and the subsequent professional services shake-up? From my perspective, I see a shift in the business environment that places a high value on the independent professional. I think that businesses today realize that without these independent professional opinions concerning their business, investor confidence will lag and, ultimately, faith in the corporate structure will falter. I think that faith in the corporate structure will rebound, and that, with the steps taken since these corporate collapses occurred, investors, regulators, and the public in general will regain their confidence in public companies.

The United States has one of the most envied economies in the world, and that economy was created by striking a co-equal balance between freedom-of-choice and regulation and between creativity and uniformity. Independent auditors, accountants, lawyers, and boards of directors all contribute to the effectiveness of our regulatory mechanisms; those groups of people act as the gatekeepers. We have demanded their independence so that no one can play games with the investors' money.

The basic premise is that we want you to make as much as you want, as creatively as you can, but to do it using uniform rules. When some businesses choose to make up or bend existing rules; it hurts everyone who plays by the rules. In the past, Congress has leveled the playing field by passing anti-trust legislation that created a business environment in which smaller companies could emerge between what were then mega corporations. With Sarbanes-Oxley, Congress has again tried to level the playing field, this time with respect to how corporations get to the bottom line.

Now the challenge is to accomplish this not just on the national level, but also on a global level. The question becomes: what happens next? Do we create international rules? Is there an oversight board? Are governments and businesses overseas going to play by the same rules that the United States has instituted, or is Congress tying the hands of U.S. businesses, making them less competitive in an increasingly global economy? While those of us who are now involved in these professional endeavors are having to work with the rules as they are being set, the real test of this new legislation will come as the rules are actually used in the marketplace. A lot of the repercussions are going to unfold, be tested and litigated for some time, and we may not know the extent to which these rules will truly effect change for years.

We all need to appreciate the fact that the reason our system has endured for so long is that it has had a level of integrity, credibility, independence, and a partnership with government unmatched in history. Those fundamentals have allowed this economy to achieve all that it has to date.

QUESTION: As we approach three years with Sarbanes-Oxley, what do you see as some unintended consequences of the biggest Act to affect corporate America since the 1930s?

MR. GREY: After three years of Sarbanes-Oxley, I don't know whether the consequences we are seeing are intended or unintended. I think the intended consequence is a greater degree of corporate disclosure. Disclosure may be good for investor confidence because it allows investors to have more information. It can also lead to more litigation by those who may be disappointed by a particular outcome of corporate action. That could be an unintended consequence until we litigate those issues and determine exactly what the disclosure is and what it means under Sarbanes-Oxley.

One of the issues inherent in this question is the fact that our transactions are not the transactions of the 1920s. Today's transactions are very complicated and the basis upon which a board or auditor acts is not easily revealed in public documentation. Whether we can second guess what a board or auditor has done based on a set of circumstances and complex transaction structures that are sometimes based on a gut feeling or other subjective criteria remains to be seen. We can hope that our courts and agencies will be thoughtful about their interpretations and consider the ramifications of any decisions based on this new legislation.

I think that what Congress believes it has done and what the SEC believes it is doing is taking a measured response to a very difficult issue. Whether they got it right is still to be determined. I think we are going to have to wait and see how our regulated independence as directors, lawyers, and accountants really works.

My sense is that we have always known that independent and aboveboard decision-making is a necessity in corporate practice. We just got a wake-up call and we now have to execute and be the fiduciaries that we, as lawyers, hold ourselves out to be. We have to detach ourselves from the interest of the team and be able to make the tough calls as independents when the team may have it wrong.

QUESTION: In light of Ethics 2000 and Sarbanes-Oxley Section 307, what are your thoughts on the future of the attorney-client privilege?

MR. GREY: Well, in light of Sarbanes-Oxley Section 307, I do not think that the attorney-client privilege is in jeopardy. Remember, "up the ladder" reporting amounts to a lawyer reporting misconduct to the highest authority *within the* *corporate client*, not to third parties or the government. The SEC, meanwhile, has wisely deferred further action on its "noisy withdrawal" proposals indefinitely. I hope that what we have done is to say that the confidential relationship between lawyers and their clients still is critical to the opportunity for clients to be honest and forthcoming with information about their corporate situations.

Also, with respect to the "permissive disclosure" rules issued by the SEC, these are not inconsistent with existing attorney-client principles because you have to keep in mind that at least forty-two states have some form of client disclosure standard relating to issues concerning financial harm to others. In that sense, Sarbanes-Oxley and the SEC's subsequent regulations has not effected a dramatic change; it has simply codified the general law of the land. On the other hand, it is quite important that, as an independent profession, we remain able to advise clients on some very technical, involved, and complicated issues. We still need the full protection of the attorney-client privilege to do that because we, as lawyers, cannot provide the best possible advice when we are only privy to half the facts because our client is too afraid to disclose the whole situation for fear of being sued or fired.

I think most clients believe that lawyers will immediately advise against untoward practices instead of allowing such practices to commence rather than opting to divulge the impropriety. Hopefully, our clients will seek our advice on such practices early enough so that lawyers will have the opportunity to advise against it before it becomes a problem. On balance the profession still feels very strongly that attorney-client privilege is still imperative to the role of the attorney as evidenced by the fact that the ABA, in its investor confidence rule, made the disclosure requirement voluntary.

QUESTION: If an attorney makes a noisy withdrawal and is incorrect, or only partially correct, as to the factual basis for the noisy withdrawal, is the attorney then subject to liability to the company for malpractice?

MR. GREY: Fortunately, the SEC has declined to proceed with mandatory noisy withdrawal at this time. If the attorney decides to make a permissive disclosure, as permitted by the SEC rules and by the ABA's Model Rules in some instances, my initial reaction is that the attorney could face some liability issues. I think the possibility of liability for an incorrect permissive disclosure is going to require lawyers to be a lot more diligent in terms of the advice that they give and require them to recognize that there are going to be situations where you, as a lawyer, only get to see parts of a transaction. If the lawyer believes that the part of the transaction he or she works on is illegal and advises the client of that fact or takes other action based on this belief, and then the lawyer is found to be incorrect, hopefully the lawyer will have some defense because of the "reasonableness" standard that applies to permissive disclosure.

QUESTION: What is the ABA doing to coordinate with Europe and other regions in terms of regulation regarding corporate transparency and governance so that we do not have an international race to become the least regulated jurisdiction?

MR. GREY: Harmonization of rules, regulations, conventions, treaties, among other things is something that is very much on the plate of the international and business law sections of the ABA. We meet regularly with the International Bar Association and others to try to anticipate some of what will happen in this new global economy and marketplace. I do not know what the answer is because we have not really implemented any major collaborative standards, but I think that the process is going to be reactive as opposed to proactive. I do think that, in the future, we will develop a set of standards by which there will be some rules that codify those standards to allow global transaction-predictability and security.

The logical follow-up question to that is: who oversees and polices those standards? I do not think it will be the ABA. Though, I am not sure who it will be. I think another question stemming from the creation of such standards is how to resolve issues that come into conflict once we adopt those standards. I think that the resolution function of those disputes will affect the ability of those standards to achieve legitimacy. I do not think that the global marketplace will stand for a resolution function that relies on the American jury trial system, with extensive discovery and docket management problems. I think, in addressing global dispute resolution, we will develop other ways of resolving issues as those international standards become clearer.

QUESTION: If a lawyer does not make a noisy withdrawal where there is a possibility of that option being in the best interest of the public and the underlying issue does somehow come to light, are there any consequences the lawyer must face or can they just claim the attorney-client privilege?

MR. GREY: I think that a lawyer who refuses to withdraw when the ethical rules require it does so at his or her own peril, quite frankly. I think if you absolutely know that the issue, on its face, is a problem, I think you have to withdraw or be held accountable. The question becomes whether you make a noisy withdrawal or not. Lawyers have always been able to get out of situations where they believe their clients are acting against their advice in a way that would be harmful. So that has not changed and lawyers are still expected to do that. As for the issue of liability, that if a lawyer continues to represent a client even when he or she is aware of a problem, they will likely be held liable, because they had an opportunity to do something about it or get out. If you choose to continue the representation to protect the client, then you do so at your own peril.

QUESTION: Have you seen a emerging specialization in corporate practice for lawyers and law firms representing the interests of independent directors and independent directors of committees and how, if at all, their professional role might need different rules and regulations than the general rules governing lawyers who represent corporate constituents?

MR. GREY: There is a growing market for representing the interests of independent directors. Whether it really develops and rises to the level of a cottage industry remains to be seen, but I do think that there will be those within law firms who will focus on this as an area of specialty.