

# CORPORATE COUNSEL AS CORPORATE CONSCIENCE: ETHICS AND INTEGRITY IN THE POST-ENRON ERA

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*In placing a spotlight on the ethical challenges facing corporate counsel, the author suggests that generalized ethical guidance may be inadequate at best or inappropriate at worst. To this end the paper reviews recent U.S. regulatory changes — including SOX 307 and amendments to the ABA Model Rules of Professional Conduct — and the Canadian response. It concludes that adopting a crime-fraud exception to confidentiality rules in Canada will serve a dual purpose: signaling to legislators and the public the profession's concern for corporate accountability, and providing an ethical anchor for corporate counsel to maintain independence in morally interdependent client relationships.*

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*L'auteur attire notre attention sur les défis éthiques auxquels doivent faire face les avocats de sociétés et suggère ainsi que l'orientation éthique générale offerte aux avocats est, tout au plus inadéquate, voire inappropriée. Avec cet objectif en vue, cet article traite des récentes modifications réglementaires adoptées aux États-Unis incluant le SOX 307 et les modifications apportées aux Règles modèles de déontologie de l'Association du barreau américain — ainsi que la réaction au Canada. Il conclut que l'adoption au Canada d'une exception aux règles régissant le crime de fraude, en matière du secret professionnel, aura comme double effet d'une part de faire valoir auprès des législateurs et du public, l'intérêt que notre corps professionnel porte à l'imputabilité des sociétés et d'autre part celui d'offrir aux avocats de société un dispositif éthique leur permettant de maintenir leur indépendance dans le cadre des relations moralement interdépendantes qu'ils entretiennent avec leurs clients.*

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## *Corporate Counsel: Special Challenges*

The transformation of corporate, or in-house, counsel practice in recent years has rightly garnered considerable attention. Once considered by

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some to be the refuge of those unable to sustain the intense pressure of a private major firm practice,<sup>1</sup> an in-house lawyer now occupies a privileged position in the “corridors of power.”<sup>2</sup> The misperception of corporate counsel as lawyers lacking the “stern stuff required to fill the vast quotas of billable hours and sustain the great partnerships,” and occupying “the lesser part of our profession” is mercifully in decline.<sup>3</sup> Moves of senior practitioners in Canada from private law firms to prominent general counsel positions at major Canadian corporations,<sup>4</sup> as well as similar transitions at more junior levels, have signaled that corporate counsel positions are increasingly attractive as a career option for ambitious lawyers, and that in-house posts are providing both compensation and levels of sophistication sufficient to challenge the cream of the profession.<sup>5</sup> Several American studies<sup>6</sup> have tracked the transformation of the in-house stereotype over the last forty years: from a lawyer who, having been passed over for partner, left private practice to do “routine, repetitive corporate work, while everything interesting was farmed out to private firms” to a near-total reversal, with corporate counsel managing major transactions, complex litigation, and hiring

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<sup>1</sup> Abram Chayes and Antonia Chayes, “Corporate Counsel and the Elite Law Firm” (1985) 37 *Stan. L. Rev.* 277 at 277; see also Geoffrey C. Hazard, “Ethical Dilemmas of Corporate Counsel” (1997) 46 *Emory L. J.* 1011at 1011-1012.

<sup>2</sup> “Corporate Counsel in the Corridors of Power” *Lexpert* 3:6 (April 2002).

<sup>3</sup> Douglas Mah, “The Others — The ethereal life of the in-house lawyer” *CBA National* (January-February 2005) at 62.

<sup>4</sup> Selected moves attracting media attention and comment included Lawson Hunter (formerly head of the competition group at Stikeman Elliot) being appointed as Executive Vice-President and Chief Corporate Officer at BCE. See Sandra Rubin “Lawson Hunter Leaving Stikemans” *National Post* (19 February 2003) FP7. Similarly, J.P. Bisnaire moved from Davies, Ward to become Executive Vice-President and General Counsel at Manulife, see Sandra Rubin, “J.P.’s shift of a double-edged sword?” *National Post* (2 June 2004) FP11; Calin Roivinsescu moved from Stikeman Elliot to Air Canada in April 2000 to become Executive Vice President, Corporate Development and Strategy; see Jeff Sanford, “The dealmaker” *Canadian Business* (March 2005), online: Canadian Business at <[http://www.canadianbusiness.com/managing/article.jsp?content=20050314\\_66100\\_66100](http://www.canadianbusiness.com/managing/article.jsp?content=20050314_66100_66100)>.

<sup>5</sup> Indeed, the cover story of *Lexpert* Magazine’s final 2005 edition for the first time featured profiles of top Canadian corporate counsel 40 years of age and under, selected on the basis of recommendations requested from 4868 in-house corporate counsel and corporate lawyers in private practice across Canada and from a list of 239 candidates so identified: see Irene E. Taylor, “The Top 40 Corporate Counsel: 40 and Under 40” *Lexpert* (November/December 2005) 60 at 62.

<sup>6</sup> For a recent review of the American literature, see John M. Conley and Scott Baker, “Fall from Grace or Business as Usual? A Retrospective Look at Lawyers on Wall Street and Main Street” (2005) *Law & Soc. Inquiry* 783; also John Conley, “How Bad Is It Out There? Teaching and Learning about the State of the Legal Profession in North Carolina” (2004) 82 *N.C.L. Rev.* 1943.

outside lawyers only on an as-needed basis.<sup>7</sup> A seminal 1985 U.S. study asserted that a “new breed of general counsel has left this stereotype behind. Not only have the offices grown in size, but in importance as well. The General Counsel sits close to the top of the corporate hierarchy as a member of senior management.”<sup>8</sup>

Scholars have lamented the lack of empirical evidence about the role of in-house counsel and the performance of their professional and ethical duties in the context of a corporate environment, though at least one study attempted to close this gap by examining ethical decision-making by in-house counsel in Canada.<sup>9</sup> While the U.S. literature is replete with attention to the theoretical and real challenges facing corporate counsel,<sup>10</sup> there is a paucity of attention in the Canadian academic literature and elsewhere to the subject,<sup>11</sup> despite efforts by the Canadian Corporate

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<sup>7</sup> Conley and Baker, *ibid.*, at 796-797.

<sup>8</sup> Chayes and Chayes, *supra* note 1 at 277.

<sup>9</sup> Hugh P. Gunz and Sally P. Gunz, “The Lawyer’s Response to Organizational Professional Conflict: An Empirical Study of the Ethical Decision Making of In-House Counsel” (2002) 39 Am. Bus. L.J. 241 at 241. Gunz and Gunz, management and accounting professors respectively, undertook a study focused upon organizational-professional conflict (OPC) encountered in 484 responses to questionnaires from a sampling of 2414 corporate counsel in Canada. *Ibid.* at p. 263. See also Sally Gunz and Robert V.A. Jones, *The New Corporate Counsel* (Toronto: Carswell, 1991). Complaints about the lack of empirical evidence include Mary C. Daly, “The Cultural, Ethical and Legal Challenges in Lawyering for a Global Organization: The Role of the General Counsel” (1997) 46 Emory L.J. 1057 at 1067. For a complaint about the lack of scholarly attention to legal ethics issues in Canada generally, see Adam P. Dodek, “Canadian Legal Ethics: A Subject in Search of Scholarship” (2000) 50 U.T.L.J. 115.

<sup>10</sup> See, for example, Robert Eli Rosen, “The Inside Counsel Movement, Professional Judgment and Organizational Representation” (1989) 64 Ind. L.J. 479; Hazard, *supra* note 1; Daly, *supra* note 9; Richard S. Gruner, “General Counsel in an Era of Compliance Programs and Corporate Self-Policing” (1997) 46 Emory L.J. 1113; Robert Eli Rosen, “Problem-Setting and Serving the Organizational Client: Legal Diagnosis and Professional Independence” (2001) 56 U. Miami L. Rev. 179. The issue of Ethics in Corporate Representation was the subject of a Colloquium at Fordham Law School in 2005: see, e.g. William H. Simon, “Introduction: The Post-Enron Identity Crisis of the Business Lawyer” (2005) 74 Fordham L. Rev. 947, and Sung Hui Kim, “The Banality of Fraud: Re-situating the Inside Counsel as Gatekeeper” (2005) 74 Fordham L. Rev. 983; see also sources below in notes 17 and 19.

<sup>11</sup> The major Canadian legal ethics references do not pay particular attention to the subject: see e.g. Justice Kenneth Lysyk and Lorne Sossin, eds., *Barristers and Solicitors in Practice* (Markham: Butterworths, 1998) (contains no chapter on ethics issues facing corporate and in-house counsel, though such a chapter has been commissioned from this author). See also Gavin MacKenzie, *Lawyers and Ethics: Professional Responsibility and Discipline* (Scarborough: Carswell, 1993); Randal N. Graham, *Legal Ethics: Theories, Cases, and Professional Regulation* (Toronto: Emond Montgomery, 2004). This is not to be

Counsel Association (CCCA) to focus attention on the special ethical challenges facing in-house practitioners.<sup>12</sup>

This article therefore has a number of goals. First, in placing a spotlight on the ethical challenges facing corporate counsel it seeks to highlight the need for greater attention to an increasingly important segment of the bar for which general ethical guidance may be inadequate at best or inappropriate at worst. Second, in providing a review of regulatory developments in the United States that is relevant to corporate counsel in the post-Enron era, and an overview of the Canadian response, it seeks to encourage Canadian regulators to do better, and more, in order to provide greater clarity and support for corporate counsel making their way through the “moral maze.”<sup>13</sup> Finally, it suggests that adopting a crime-fraud exception to confidentiality, as the ABA eventually did in 2003 and as the CBA has thus far deliberately rejected, will serve a two-fold purpose: sending a signal to legislators and the public that the profession is indeed concerned about corporate accountability, and providing a moral anchor for counsel facing tough choices with potential career consequences that their private firm counterparts simply do not face.

In a post-Enron era the tensions and demands on in-house lawyers to ensure compliance with new corporate governance rules and shifting internal and external requirements and expectations of regulators, directors, officers, shareholders, employees, pensioners, and creditors have made the role of in-house counsel an even more important and ethically complex one.<sup>14</sup> This has prompted some caution amongst those considering a move in-house.<sup>15</sup> Beyond simply managing litigation, the emphasis in ethics and compliance positions in-house has been described

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read as a criticism of the authors, but an observation about the gap in the Canadian literature which my efforts are attempting to fill. For a U.S. example of such work, see Milton C. Regan, Jr. and Jeffrey D. Bauman, eds., *Legal Ethics and Corporate Practice* (New York: West Group, 2005).

<sup>12</sup> The CCCA's Spring 2000 Meeting, for example, focused on corporate counsel as organizational “moral compass.” Apart from one panel on Ethics and Integrity in In-House Practice at the Chief Justice of Ontario's 6<sup>th</sup> Colloquium on Professionalism held at Queen's University in October 2005 (presentations available online: Law Society of Upper Canada <<http://www.lsuc.on.ca/news/a/hottopics/committee-on-professionalism/papers-from-past-colloquia>>) in which an earlier version of this paper was presented, I could find no other academic colloquia dedicated to ethics challenges facing corporate counsel in Canada.

<sup>13</sup> Mark A. Sargent, “Lawyers in the Moral Maze” (2004) 49 *Vill. L. Rev.* 867.

<sup>14</sup> Terry Carter, “Ethics Czars in Demand” (2004) 90 *ABA Journal* 32.

<sup>15</sup> Jill Schachner Chanen, “Cautiously Corporate — In the Sarbanes-Oxley Era, Lawyers Still Go In-House But Enter Carefully” (2004) 90 *ABA Journal* 14.

as “more strategic than tactical.”<sup>16</sup> In-house lawyers now have a role that extends beyond providing technical legal services and litigation management into matters at the heart of proper governance of organizations. Building on whatever experience they have ordinarily gained in a variety of private practice settings, in-house lawyers layer focused legal knowledge with the broader insight into a client or corporate environment that a perch inside an organization affords. That poses unique ethical challenges for lawyers seeking to maintain professional integrity within the confines and constraints of their corporate client, particularly as they typically occupy multiple roles within the organization.<sup>17</sup>

The professional and ethical failings of those in-house counsel involved in the Enron scandal have been the subject of particular attention,<sup>18</sup> but lawyers were involved in most of the major corporate scandals now synonymous with corporate governance reform in the United States — Tyco, Worldcom, Adelphia, Global Crossing, Qwest, Dynegy, Vivendi, Sprint and HealthSouth.<sup>19</sup> These scandals are significant not only for the fact of internal and external lawyer involvement, but as the impetus behind major U.S. reforms, including a direction from the U.S. Congress in the *Sarbanes-Oxley Act* of 2002 to the Securities and Exchange

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<sup>16</sup> *Ibid.*

<sup>17</sup> Deborah A. DeMott, “The Discrete Roles of General Counsel” (2005) 74 *Fordham L. Rev.* 955. DeMott identifies the following identities of chief general counsel: 1) legal advisor to the corporation and its constituents; 2) corporate officer and member of senior management team; 3) administrator of the internal legal department; 4) agent of the corporation in dealings with third parties. See also Taylor, *supra* note 5 at 61 (quoting Jim Riley, senior corporate partner at Ogilvy Renault: “These people are not lawyers in the pure sense anymore. They are a unique hybrid that is part lawyer, part business leader and, in some cases, part entrepreneur.”) See also Robert L. Nelson, “Cops, Counsel and Entrepreneurs: Constructing the Role of Inside Counsel in Large Corporations” (2000) 34 *Law & Soc. Review* 457; Carl D. Liggio, “The Changing Role of Corporate Counsel” (1997) 46 *Emory L.J.* 1201.

<sup>18</sup> See, *inter alia*, Deborah L. Rhode and Paul D. Paton, “Lawyers, Ethics and Enron” (2002) 8 *Stan. J.L. Bus. & Fin.* 9, discussed further below.

<sup>19</sup> For a summary overview of the U.S. scandals, see P. Patsuris, “The Corporate Scandal Sheet” *Forbes Magazine* (26 August 2002), online: <http://www.forbes.com/home/2002/07/25/accountingtracker.html>. See also K.R. Fisher, “The Higher Calling: Regulation of Lawyers Post-Enron” (2004) 37 *U. Mich. J.L. Ref.* 1017; Geoffrey Miller, “From Club to Market: The Evolving Role of Business Lawyers” (2005) 74 *Fordham L. Rev.* 1105; and notably Sargent, *supra* note 13. Also James Fanto, “Whistleblowing and the Public Director: Countering Corporate Inner Circles” (2004) 83 *Or. L. Rev.* 435 at 436-438 (criticizing outside advisors, including lawyers: “[as] sycophantic cheerleaders of top executives and companies during the bubble of the late 1990s, they were often active participants in the fraudulent behaviour or acquiesced in it. Moreover, they generally denied responsibility and blamed others when a scandal emerged”).

Commission (SEC) to develop standards of professional conduct for attorneys, discussed further below. The development of these standards has already had, and will continue to have, a significant impact on both U.S. and Canadian in-house lawyers.

Focusing on work in legal ethics that takes “account of the particular contexts in which lawyers practice”<sup>20</sup> is both necessary and important. As one British study has noted, while “core values” “may survive at a symbolic level, their role as a starting point for the formulation of detailed rules of professional conduct may become more difficult to sustain as the discrete arenas which help shape ethical norms and form the context of regulation become increasingly diverse.”<sup>21</sup> The American Bar Association (ABA), under pressure from its own Task Force on Corporate Responsibility, in August 2003, finally passed an amendment to the ABA Model Code of Professional Responsibility previously rejected in 1983, 1991 and 2002. This amendment permits an exception to the ordinarily strict requirement of confidentiality in circumstances to prevent criminal financial fraud. While the Law Society of Upper Canada (LSUC) adopted a minor change to its Rules of Professional Conduct in March 2004 to address situations involving “organization as client,” both that reform and the August 2004 adoption of a revised Canadian Bar Association (CBA) Model Code of Professional Conduct only go part way to making the same demands — and affording the same protection — for in-house counsel facing ethical challenges in Canada.

Practicing with integrity in an in-house position, whether in the private or public sector, has always required special skill; but along with the advantages of the insider’s perspective come particular challenges. The fact of having one client — the corporation or the government — means that an in-house lawyer is particularly vulnerable when there is challenge from within the organization. Telling senior officers “no” to their proposed plans and schemes may be the right legal and ethical answer, but it can bring a particularly high price, especially if the lawyer finds that he or she has to exercise the ultimate professional recourse and withdraw from representation. Losing a major client in a law firm can have significant consequences, to be sure, but withdrawing from your one client as an in-house lawyer equates to a loss of status, income and employment, raising the ethical stakes for in-house practitioners that much further. Remaining

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<sup>20</sup> Milton C. Regan, Jr., *Eat What you Kill: The Fall of a Wall Street Lawyer* (Ann Arbor: University of Michigan Press, 2004) at 4. See also “The Rule of Law, Not of Lawyers: Ethics and the Legal Profession” (2005) Harv. L. Rev. 2422 at 2425 (reviewing Regan, *Eat What You Kill*).

<sup>21</sup> Andrew M. Francis, “Legal ethics, the marketplace, and the fragmentation of legal professionalism” (2005) 12(2) Int’l J. Legal Prof. 173 at 175.

ethical, independent, and professional in an in-house practice requires a level of personal sacrifice and dissociation from the company or the team not demanded of almost any other corporate player.<sup>22</sup>

Yet the response of Canadian regulators to the challenges faced by in-house counsel has been inadequate, and merits review. In addition to providing the assistance of an imperative, a rule of professional conduct to which in-house counsel might point when faced with client misconduct, the lesson of the United States experience has been that legislators and regulators are no longer content simply to permit the self-regulating legal profession autonomy when it comes to rectifying an obvious failing.

In introducing the amendment to *Sarbanes-Oxley* that directed the SEC to draw up “Rules of Professional Responsibility for Attorneys,” Senator John Edwards said that for “the sake of investors and regular employees, ordinary shareholders, we have to make sure that not only the executives and the accountants do what they are responsible for doing, but also that the lawyers do what they are responsible for doing as members of the bar and as citizens of the country.”<sup>23</sup> Senator Mike Enzi said “[l]awyers have just as much responsibility as accountants and corporate executives to protect the best interest of the shareholder. It is not unreasonable to expect attorneys to play it straight with their clients, especially when we are talking about restoring corporate integrity.”<sup>24</sup> While the perspectives of Senators Edwards and Enzi might be controversial (and, indeed, they are ones with which Canadian law firms and lawyers have vehemently disagreed),<sup>25</sup> their comments signal that public representatives are no longer willing to let the profession determine for itself the boundaries of appropriate lawyer conduct where a greater public interest is identified.

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<sup>22</sup> The notable exception is the internal auditor, for whom the professional and personal stakes may be similarly significant. See Donald Langevoort, “Where Were the Lawyers? A Behavioral Inquiry Into Lawyers’ Responsibility for Clients’ Fraud” (1993) 46 *Vand. L. Rev.* 75 at 95-110, discussing how assimilation of client views can lead to attorney complicity in client fraud. See also Sargent, *supra* note 13 at 880-881.

<sup>23</sup> Quoted in American Bar Association, “Senate Passes Amendment to Accounting Bill Requiring Corporate Lawyers to Report Fraud” (2002) 18(15) *ABA/BNA Lawyers’ Manual on Professional Conduct*.

<sup>24</sup> *Ibid.*

<sup>25</sup> See, for example, Stikeman Elliott, “Comments of Stikeman Elliott on S7-45-02” (18 December 2002), online: US Securities and Exchange Commission, <<http://www.sec.gov/rules/proposed/s74502/selliott1.htm>>; Osler, Hoskin & Harcourt, “Comments of Osler, Hoskin & Harcourt on S7-45-02” (18 December 2002), online: US Securities and Exchange Commission <<http://www.sec.gov/rules/proposed/s74502/osler1.htm>>; Torys, “Comments of Torys LLP on S7-45-02” (18 December 2002), online: US Securities and Exchange Commission <<http://www.sec.gov/rules/proposed/s74502/torys1.htm>>.

That has ramifications for the future of self-regulation of the legal profession as a whole.<sup>26</sup>

*Enron and the Role of In-House Counsel as “Gatekeeper”*

After some regrettable illustrations of misfeasance by lawyers at the in-house counsel bar, the post-Enron era has properly placed a greater focus on the roles and responsibilities of corporate counsel as significant “gatekeepers” in corporate governance. While a complete cast of characters — officers, directors, managers, auditors, investment banks, analysts, and others — all contributed in some way to the Enron debacle, lawyers, too, were part of that story.<sup>27</sup> Lawyers gave advice on all of the transactions (including Special Purpose Entities, or SPEs) later impugned as the primary cause of the firm’s collapse. The Final Report of the Enron Bankruptcy Examiner, Neal Batson, excoriated Enron’s General Counsel James Derrick as having “rarely provided legal advice to Enron’s Board even when significant issues... came to his attention” and having “failed to educate himself adequately on the underlying facts or the applicable law to enable him to carry out his responsibilities as legal advisor.”<sup>28</sup> In addition, the Special Committee of the Enron board investigating the fiasco in late 2002 and early 2003 found that one of the company’s in-house lawyers, Kristina Mordaunt, not only gave advice on the transactions, but also invested her own money in one of the SPEs. Mordaunt reportedly was enriched by a \$1 million return on her \$5,800 investment,<sup>29</sup> which she received without obtaining the consent of Enron’s

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<sup>26</sup> For discussion of the concerns about threats to self-governance as perceived by bar leaders in Canada, see Janice Mucalov, “Walking the tightrope” 13(6) *CBA National* (October 2004) 16 at 17, noting developments in Australia, England and the United States as illustrating the threats: “Governments everywhere — under citizens concerned about access to justice and the accountability of the legal profession — are becoming less inclined to bow to lawyers’ traditional role as governors of their own profession.”

<sup>27</sup> For a more complete treatment, see Rhode and Paton, *supra* note 18, from which portions of this section are drawn; see also Roger C. Cramton, “Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues” (2002) 58 *Bus. Law* 143; Michael F. Fox, “To Tell or Not to Tell: Legal Ethics and Disclosure After Enron” (2002) *Columb. Bus. L. Rev.* 867; Robert W. Gordon, “A New Role for Lawyers? The Corporate Counselor After Enron” (2003) 35 *Conn. L. Rev.* 1185; Susan P. Koniak, “Corporate Fraud: See, Lawyers” (2003) 26 *Harv. J.L. & Pub. Pol’y* 195; also the comprehensive review of the impugned transactions and lawyer responses in the Enron debacle in Milton C. Regan, “Teaching Enron” (2005) 74 *Fordham L. Rev.* 1139. See also Senator John Edwards, “The Ethical Responsibility of Lawyers After Enron” U.S. Senate (18 June 2002).

<sup>28</sup> Final Report of Neal Batson, Court-Appointed Examiner, “Appendix C: Role of Enron’s Attorneys” In *re Enron Corp* (no 01-16034) (Bankr. S.D.N.Y., 4 Nov 2003), online: <<http://www.enron.com/corp/por/examinerfinal.html>>, 190 at 190-202 [Batson Report], cited in Regan, *supra* note 27.

<sup>29</sup> April Witt & Peter Behr, “Losses, Conflicts Threaten Survival” *Washington Post*

Chairman and CEO, in violation of Enron's Code of Conduct.<sup>30</sup> Her investment may also have violated bar disciplinary rules concerning conflicts of interest, though to date there is no indication that Mordaunt has ever been prosecuted by the Texas State Bar.<sup>31</sup> The Internal Special Committee Report itself noted, though, that Mordaunt later admitted that her participation in the SPE was an error in judgment and that "she did not consider the issue carefully enough at the time."<sup>32</sup>

In contrast, at least two Enron attorneys had serious concerns about the company's financial conduct, but were stymied by other Enron lawyers or managers in efforts to respond. A case in point involves a September 2000 memo by an Enron North America attorney expressing concern about the possibility that "the financial books at Enron are being 'cooked' in order to eliminate a drag on earnings that would otherwise occur under fair value accounting."<sup>33</sup> More senior attorneys who received the memo did not believe the factual assertions on which the memo's conclusions were based, but conducted no investigation to verify their belief and took no further action. A second example involves an Enron attorney who reportedly asked the law firm Fried Frank Harris Shriver & Jacobsen to review the legality of the partnerships and SPEs. After Fried Frank recommended that Enron halt the practice of using such structures, the Enron attorney sent written internal memoranda to company executives to the same effect.<sup>34</sup>

The failure by more senior counsel and by Enron executives to respond to warnings, to follow such advice, or to investigate its factual basis, suggested greater problems with the Enron corporate culture and

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(31 July 2002) A01. See also Mike France, "What About the Lawyers?" *Business Weekly* (23 December 2002) 59.

<sup>30</sup> Batson Report, *supra* note 28 at 92-96.

<sup>31</sup> See American Bar Association, "Model Rules of Professional Conduct" (Chicago: American Bar Association, 2001) at Rule 1.7(b), Comment 6, Rule 1.8(a).

<sup>32</sup> William C. Powers, *Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp.* (1 February 2002) at 94, online: FindLaw <<http://fl1.findlaw.com/news.findlaw.com/hdocs/docs/enron/sicreport/sicreport020102.pdf>> [Powers Report].

<sup>33</sup> Powers Report, *ibid.* at 109; see also April Witt & Peter Behr, "Dream Job Turns Into a Nightmare" *Washington Post* (29 July 2002) at A01.

<sup>34</sup> Committee on Energy and Commerce, News Release, "Tauzin, Greenwood Want Law Firm Review of Enron's Related-Party Transactions" (29 January 2002), online: Committee on Energy and Commerce <[http://energycommerce.house.gov/107/news/01292002\\_478print.htm](http://energycommerce.house.gov/107/news/01292002_478print.htm)>; see also Richard A. Oppel, Jr., "Enron's Many Strands: Early Warnings; Lawyer at Enron Warned Officials of Dubious Deals" *New York Times* (7 February 2002) at A1; Peter Behr & April Witt, "Visionary's Dream Led to Risky Business" *Washington Post* (28 July 2002) at A01.

later underpinned subsequent U.S. reforms requiring “up the ladder” reporting by individual lawyers even in the face of corporate reluctance to act. For some, in particular a group of 41 U.S. law professors seeking even more significant reform than what the SEC eventually imposed, the culture at Enron underscored the need for “noisy withdrawal” as one way to ensure that internal and external lawyers could assist in preventing instances of corporate malfeasance or fraud.<sup>35</sup>

These developments in the responsibilities of in-house lawyers have been part of the focus on “gatekeepers” in corporate governance. Professor Reiner Kraakman is credited with the first use of the term “gatekeeper” to describe the role of professionals in corporate reporting and the capital markets. He used the term to describe the function of outside directors, accountants, lawyers and underwriters in using their good reputation to prevent corporate misconduct: as third parties they are uniquely placed to act as private party monitors on behalf of the market, by withholding a specialized good, service or certification needed for the misconduct to be permitted.<sup>36</sup> Professor John Coffee revitalized this conception of “gatekeeper” in the context of the Enron debacle, concluding that the failure of Enron was more a failure of “gatekeepers” than of the Enron board.<sup>37</sup> The notion of gatekeeping is clearly anchored in the public interest, identified as “the role of independent attorneys in protecting the

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<sup>35</sup> See Susan P. Koniak, Roger C. Cramton, and George M. Cohen, “Re: Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys, 17 CFR 205” (17 December 2002), online: Securities and Exchange Commission <<http://www.sec.gov/rules/proposed/s74502/skoniak1.htm>> [Koniak Submission]; also Susan P. Koniak, Roger C. Cramton, and George M. Cohen, “Re: Final and Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys, 17 CFR 205” (7 April 2003), online: Securities and Exchange Commission <<http://www.sec.gov/rules/proposed/s74502/lawprofs040703.htm>>. For a discussion of the corporate culture at Enron, see James Lamder, “Why Should Anyone Believe You?” *Business 2.0* (March 2002) at 40. For consideration of the lessons of Enron in the Canadian context see Janis Sarra, “Rose-Colored Glasses, Opaque Financial Reporting, and Investor Blues: Enron as Con and the Vulnerability of Canadian Corporate Law” (2002) 76 *St. John’s L. Rev.* 715.

<sup>36</sup> See Reiner Kraakman, “Gatekeepers: Anatomy of a Third-Party Enforcement Strategy” (1985) 2 *J.L. Econ. & Org.* 53; also Reiner Kraakman, “Corporate Liability Strategies and the Costs of Legal Controls” (1984) 93(5) *Yale L.J.* 857; Bonnie Fish, “Pointing the Finger at Professionals” in Poonam Puri and Jeffrey Larsen, *Corporate Governance and Securities Regulation in the 21<sup>st</sup> Century* (Toronto: Butterworths, 2004) 97 at 99-102; Anita I. Anand, “The Regulation of Auditors After Enron” in Anita I. Anand & William F. Flanagan, eds., *Conflict of Interest in Capital Markets Structures, Queen’s Annual Business Law Symposium 2003* (Kingston: Queen’s Annual Business Law Symposium, 2004) 197 at 200-201.

<sup>37</sup> John C. Coffee, Jr., “Understanding Enron: It’s About the Gatekeepers, Stupid” (2002) 57 *Bus. Law* 1403 at 1403-1405 (“characteristically, the gatekeeper essentially assesses or vouches for the corporate client’s own statements about itself or a specific

public against corporate malfeasance.”<sup>38</sup> Indeed, the idea of “preventive lawyering” by in-house corporate lawyers is not new, though it has received increased attention in the aftermath of recent corporate scandals.<sup>39</sup>

The ABA’s Task Force on Corporate Responsibility distinguished between lawyers and auditors as gatekeepers, concluding,

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. The auditor is subject to standards designed to assure an arm’s length perspective relative to the firms they audit. In contrast, (...) corporate lawyers are first and foremost counselors to their clients. 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.<sup>40</sup>

While it is understandable that the ABA would seek to restrict the role of lawyers as gatekeeper (and indeed, the ABA has established a Task Force on Gatekeeper Regulation and the Profession, focused in particular on money-laundering),<sup>41</sup> there has been little such hesitation in respect of

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transaction”), 1412 and 1419; also Lisa M. Fairfax, “Spare the Rod, Spoil the Director — Revitalizing Directors’ Fiduciary Duty Through Legal Liability” (2005) 42 Hous. L. Rev. 393; R. William Ide, “Post-Enron Corporate Governance Opportunities: Creating a Culture of Greater Board Collaboration and Oversight” (2003) 54 Mercer L. Rev. 829, 841-843.

<sup>38</sup> Miller, *supra* note 19 at 1106 (seeking to explain “why the gatekeeper function — that is, the role of independent attorneys in protecting the public against corporate malfeasance — seems to have broken down in recent cases”).

<sup>39</sup> See Robert Gordon and William Simon, “The Redemption of Professionalism” in Robert Nelson, David Trubek and Robert Solomon, eds., *Lawyers’ Ideals/Lawyers’ Practices: Transformations in the American Legal Profession* (Ithaca: Cornell University Press, 1992) 230 at 252-253. See also Christine Parker, “A Critical Morality for Lawyers: Four Approaches to Lawyers’ Ethics” (2004) 30 Monash U.L. Rev. 49 at 63-64 (discussing “responsible lawyering” for in-house counsel).

<sup>40</sup> American Bar Association, *Report of the American Bar Association Task Force on Corporate Responsibility* (Chicago: American Bar Association, 2003), online: American Bar Association <[http://www.abanet.org/buslaw/corporateresponsibility/final\\_report.pdf](http://www.abanet.org/buslaw/corporateresponsibility/final_report.pdf)>.

<sup>41</sup> See American Bar Association, “Task Force on Gatekeeper Regulation and the Profession” online: American Bar Association <<http://www.abanet.org/crimjust/taskforce/home.html>>.

auditors.<sup>42</sup> Both auditors and lawyers, though, were affected by *Sarbanes-Oxley* legislative reform: lawyers were subject to S-OX Section 307, directing the U.S. SEC to pass rules “setting forth minimum standards of professional conduct” for attorneys “appearing and practicing before the Commission,” discussed further below.<sup>43</sup>

Misconduct by in-house counsel is not a uniquely U.S. phenomenon, though instances of prosecution in Canada are scant. A search of the most recent five years of LSUC discipline cases disclosed no reported instances of prosecution for malfeasance by in-house counsel by the Law Society. Indeed, in one case a lawyer pleading guilty to professional misconduct as a result of misleading clients and failing to comply with previous Law Society orders suggested that he would be suitable for in-house counsel positions and that “such a form of practice would not place onerous supervisory burdens on the Law Society.”<sup>44</sup> In another case, a lawyer acting as a sole practitioner having run into practice management problems (including failure to pay suppliers) was only reprimanded as he had received an offer of an in-house counsel position; the Panel was clear that but for this offer the lawyer would have been suspended from practice for six months.<sup>45</sup> There were cases in the previous ten years where corporate counsel were in fact disciplined, though reported decisions were in fact few.<sup>46</sup>

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<sup>42</sup> See Bonnie Fish, *supra* note 36, for a more detailed argument in support of the position that lawyers ought not to function as gatekeepers in a corporate governance context, with particular reference to the Canadian context.

<sup>43</sup> A detailed discussion of lawyer conduct rules and requirements under Section 307, is set out in the next section below. See also Paul D. Paton, “But Where are the Professionals? — Director & Officer Liability: Federal and Provincial Reform Initiatives” in *Crime in the Corporation, 11<sup>th</sup> Queen’s Annual Business Law Symposium 2004* (Kingston: Queen’s Annual Business Symposium, 2005) [forthcoming]; Philip Anisman, “Regulation of Lawyers by Securities Commissions: Sarbanes-Oxley in Canada” (Toronto: Capital Markets Institute, March 2003), online: Capital Markets Institute <<http://www.rotman.utoronto.ca/cmi/news/LSUCpaper.pdf>>.

<sup>44</sup> *Law Society of Upper Canada v. Francesco Antonio Sabetti*, 2004 ONLSP 18, online: CanLII <<http://www.canlii.org/on/cas/onlshp/2004/2004onlshp18.html>>.

<sup>45</sup> *Law Society of Upper Canada v. Richard Scott Michna*, 2005 CanLII 26308 (ON L.S.H.P.), online: CanLII <<http://www.canlii.org/on/cas/onlshp/2005/2005onlshp10007.html>>.

<sup>46</sup> See *Re Flak*, 1995 CanLII 1927 (ON L.S.D.C.), online: CanLII <<http://www.canlii.org/on/cas/onlsdc/1995/1995onlsdc10084.html>> (in-house counsel for an entertainment company misappropriated funds and was permitted to resign); *Re Graham*, 1994 CanLII 1227 (ON L.S.D.C.), online: CanLII <<http://www.canlii.org/on/cas/onlsdc/1994/1994onlsdc10031.html>> (lawyer subject to six formal complaints over a number of years, some while in-house, was suspended in the face of tragic personal circumstances).

A curious omission from the recent list is any discipline action by the LSUC arising from a 2004 case in which the Ontario Securities Commission (OSC) sanctioned a lawyer at ATI Technologies for misconduct. The misconduct included misleading the OSC, an action that would on its face appear to have violated at least one of the LSUC Rules of Professional Conduct.<sup>47</sup> In both Canada and the United States, a curious feature of recent developments is the willingness of securities regulators to step in to address malfeasance by lawyers, both on their own and at the urging of legislators.

*Up the Ladder Reporting Requirements and  
Securities Regulation of Lawyer Conduct*

Debates over where the balance between candor and confidentiality ought to lie are important for all professionals in corporate practice. The particular challenge for regulators and for the profession after Enron lies in resolving the choice between disclosure to public officials of corporate misconduct and the traditional requirement of loyalty to the organizational client. In the United States, there was a firestorm over Section 307 of the *Sarbanes Oxley Act* of 2002 and the SEC rule proposals implementing that legislation, and also in response to proposals and eventual changes to the ABA Model Rules of Professional Conduct pertaining to the Organization as Client (MR 1.13) and Confidentiality (MR 1.6). In stark contrast, an amendment to the Rules of Professional Conduct in Ontario in March 2004<sup>48</sup> took place with virtually no public input or debate, with LSUC proceeding after having been prompted by a query from the OSC about the need for the same type of rules on lawyer conduct as had been mandated for the SEC under *Sarbanes-Oxley*.<sup>49</sup>

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<sup>47</sup> *In the Matter of the Securities Act, R.S.O. 1990., C. s-5, as amended, and In the Matter of Sally Daub, Settlement Agreement*, online: Ontario Securities Commission <[http://www.osc.gov.on.ca/Enforcement/Proceedings/2004/set\\_20041214\\_daub-sally-ati.pdf](http://www.osc.gov.on.ca/Enforcement/Proceedings/2004/set_20041214_daub-sally-ati.pdf)> (Daub was Patent Counsel and was reprimanded by the OSC and made to pay \$5000 in costs to the OSC in respect of her involvement in preparing a misleading letter to the OSC from ATI); see also Ontario Securities Commission, *Perspectives* 6:2 (Spring 2003), online: Ontario Securities Commission <[http://www.osc.gov.on.ca/About/Publications/2003\\_v6-i2\\_perspectives.pdf](http://www.osc.gov.on.ca/About/Publications/2003_v6-i2_perspectives.pdf)> at 10.

<sup>48</sup> Law Society of Upper Canada, *Amendments to Rules 2.02 and 2.03 re: Role of Lawyers in Corporate Governance, as approved by Convocation* (Toronto: Law Society of Upper Canada, 2004), online: Law Society of Upper Canada <[http://www.lsuc.on.ca/media/rule\\_amends\\_march2504.pdf](http://www.lsuc.on.ca/media/rule_amends_march2504.pdf)>; see also Law Society of Upper Canada, *Minutes of Convocation* (Toronto: Law Society of Upper Canada, 25 March 2004) online: Law Society of Upper Canada <[http://www.lsuc.on.ca/media/convmar04\\_minutes.pdf](http://www.lsuc.on.ca/media/convmar04_minutes.pdf)>.

<sup>49</sup> Law Society of Upper Canada, "Proposed Amendments to the Rules of Professional Conduct Related to the Lawyer's Role in Corporate Governance" in *Professional*

In contrast to the uncertainty created by other sections of the *Sarbanes-Oxley Act* of 2002,<sup>50</sup> which introduced the most substantial reform of corporate governance in the United States in decades,<sup>51</sup> Section 307 of the legislation has from the start been seen as clear, if extremely controversial.<sup>52</sup> It has two dimensions. First, Section 307 of the Act instructs the SEC to adopt a rule of practice establishing “minimum standards of professional conduct” for lawyers “appearing or practicing before the Commission.” Second, the Section specifically directs the SEC to include a rule requiring all such lawyers to report evidence of fraud and other corporate misconduct in the companies they represent “up the ladder” to the company’s senior management, and if necessary, to the board of directors. The SEC published a proposed rule (Part 205) on November 21, 2002 and closed its comment period on December 18, 2002.<sup>53</sup> The Act required the final rule on this section to be issued on or before January 26, 2003.<sup>54</sup> On January 23, 2003, the SEC passed rules implementing Section 307 of *Sarbanes-Oxley* and published the rule text the following week.<sup>55</sup>

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*Regulation Committee, Report to Convocation* (Toronto: Law Society of Upper Canada, 2004) at paras. 14-18, online: Law Society of Upper Canada <[http://www.lsuc.on.ca/media/convmar04\\_prc\\_report.pdf](http://www.lsuc.on.ca/media/convmar04_prc_report.pdf)> [LSUC Report to Convocation].

<sup>50</sup> *Sarbanes-Oxley Act of 2002*, Pub. L. No. 107-204, online: US Government Printing Office <[http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107\\_cong\\_bills&docid=f:h3763enr.tst.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=107_cong_bills&docid=f:h3763enr.tst.pdf)> [Sarbanes-Oxley].

<sup>51</sup> Roberta Romano, “The Sarbanes-Oxley Act and the Making of Quack Corporate Governance” (2005) 114 *Yale L. J.* 1521 at n. 2 (citing Senator John Corzine’s statement that Congressional legislation enacted in response to the scandals in 2002 was the “most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt”).

<sup>52</sup> Jonathan D. Glater, “A Legal Uproar Over Proposals to Regulate the Profession” *New York Times* (17 December 2002); Stephanie Francis Cahill, “Corporate-Fraud Law Forces Lawyers to be Whistle-Blowers” *ABA Journal E-report* (2 August 2002) online: American Bar Association <<http://abanet.org/journal/ereport/au2corp.html>>; Richard B. Schmitt, “Lawyers Pressed to Report Fraud Under New Law” *Wall Street Journal* (25 July 2002) B1.

<sup>53</sup> Securities and Exchange Commission, “Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys” 17 CFR Part 205, online: US Securities and Exchange Commission <<http://www.sec.gov/rules/proposed/33-8150.htm>>.

<sup>54</sup> The SEC adopted final rules implementing Section 307 on 23 January 2003, and released the text of the rules the following week. See Securities and Exchange Commission, News Release, “SEC Adopts Attorney Conduct Rules Under Sarbanes-Oxley Act” (23 January 2003), online: Securities and Exchange Commission <<http://www.sec.gov/news/press/2003-13.htm>>. For the final rule text see Securities and Exchange Commission, “Final Rule: Implementation of Standards of Professional Conduct for Attorneys” (5 August 2003), online: Securities and Exchange Commission <<http://www.sec.gov/rules/final/33-8185.htm>> [SEC Final Rule on Attorney Conduct]. As noted below, a significant element (“noisy withdrawal”) was deferred for a further 60-day comment period.

<sup>55</sup> SEC Final Rule on Attorney Conduct, *ibid.*

Regardless of the contours of the final rule, the fact the SEC would begin regulating attorney conduct represented a significant shift away from deference to the self-regulatory tradition of the bar. It was also a signal that lawyers were attracting critical attention in the aftermath of Enron, and that legislators view the public interest to be best served by having lawyers more responsible to the public for their clients' conduct.<sup>56</sup> As Senator Michael Enzi, an accountant and a co-sponsor of the amendment to *Sarbanes-Oxley* that became Section 307 noted:

As we beat up on accountants a little bit, one of the thoughts that occurred to me was that probably in almost every transaction there was a lawyer who drew up the documents involved in that procedure. It seemed only right there ought to be some kind of an ethical standard put in place for the attorneys as well.<sup>57</sup>

While exhaustive analyses of the proposal and Final Rule have appeared elsewhere,<sup>58</sup> a few features merit comment in considering the application of the new regime to both US and Canadian lawyers. The Rule casts a very wide net, defining "appearing and practising before the Commission" to include those "preparing, or participating in the process of preparing" essentially anything filed with or incorporated into any communication with the SEC. The definition also includes advising a party that something should *not* be filed with the Commission. The ABA criticized the definition as "inappropriately encompass[ing] non-securities specialists who do no more than prepare or review limited portions of a filing, lawyers who respond to auditors letters or prepare work product in

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<sup>56</sup> These issues are explored in detail in Rhode and Paton, *supra* note 18; see also Patti Waldmeir, "Keeping the Lawyers on the Level" *Financial Times* (11 December 2002).

<sup>57</sup> Quoted in Jonathan D. Glater, "Round Up the Usual Suspects: Lawyers, Too?" *New York Times* (4 August 2003). See also Karl A. Groskaufmanis, "Climbing 'Up the Ladder': Corporate Counsel and the SEC's Reporting Requirement for Lawyers," (2004) 89 *Cornell L. Rev.* 512 at 512 (noting the attention turning to lawyers after scrutiny of the role of accountants in corporate misconduct).

<sup>58</sup> See, for example, Cramton, *supra* note 27 at 31-36; Kim, *supra* note 10 at 1034-1052; Stephen M. Bainbridge and Christina J. Johnson, "Managerialism, Legal Ethics, and Sarbanes-Oxley Section 307" (2004) *Mich. St. L. Rev.* 299; Roger C. Cramton, George M. Cohen, and Susan P. Koniak, "Legal and Ethical Duties of Lawyers After Sarbanes-Oxley" (2004) 49 *Vill. L. Rev.* 725; A. P. Carlton, "Letter re: Implementation of Standards of Professional Conduct for Attorneys" (18 December 2002), online: Securities Exchange Commission <<http://www.sec.gov/rules/proposed/s74502/apcarlton1.htm>> at 12 [ABA Submission]; Richard Painter, "Re: Proposed Rules pursuant to Section 307 of the Sarbanes-Oxley Act of 2002 under File Number 33-8150.wp (12 December 2002), online: Securities Exchange Commission <<http://www.sec.gov/rules/proposed/s74502/rwpainter1.htm>> [Painter Submission]; Koniak Submission, *supra* note 35. This last letter was also signed by 54 law professors who in signing indicated their accord with its general direction and approach, though not necessarily its detail.

the ordinary course unrelated to securities matters that may be used for that purpose, and lawyers preparing documents that eventually may be filed as exhibits.”<sup>59</sup> Others criticized the Rule as not going far enough, by not including law firms as well as individual lawyers in the Commission’s disciplinary sights.<sup>60</sup> They encouraged the SEC to broaden the scope to impute knowledge within law firms and hold the law firm responsible for the acts of its lawyers as agents of the law firm entity.

The fact that the definition also applies to foreign lawyers on an equal basis prompted additional cause for concern. In particular, the reporting requirements raised the spectre that foreign lawyers would be required to violate their domestic bar rules concerning privilege and confidentiality of client communications or risk breaching the SEC rules and possibly invite US criminal sanction. The International Bar Association issued a strong call to the SEC to exempt non-US lawyers from the proposed Rule.<sup>61</sup> The ABA argued that “especially in the case of foreign attorneys, the extraordinary breadth of the term “appearing and practising” is likely to lead to confusion as to who is subject to the obligations of the rules, and to its sanctions in the event of noncompliance.” This concern was partly self-motivated, as the ABA worried “that subjecting foreign attorneys to regulation by the SEC could result in foreign agencies seeking to regulate the conduct of U.S. attorneys representing U.S. companies abroad or foreign companies.”<sup>62</sup>

Others were uncompromising in supporting the proposal’s extra-territorial reach. The submission to the SEC by three leading law school professors, endorsed by at least 53 others, unapologetically applauded the rule, reflecting a “U.S.-first” mood not limited to Section 307 alone: “*No foreign country, lawyer or corporation has a “right” to participate in our securities markets on their own terms. They have a choice: to play by our rules or not*”<sup>63</sup> [emphasis added]. The professors argued that exempting foreign lawyers would simply open a loophole for many large corporations to skirt the SEC’s rules, resulting in “violence to the legislative scheme, harm to investors, and harm to the domestic securities bar who would be placed at a competitive disadvantage vis-à-vis their foreign counterparts.” They concluded:

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<sup>59</sup> ABA Submission, *ibid.*

<sup>60</sup> Koniak Submission, *supra* note 35 at 4, 28-33; Painter Submission, *supra* note 58 at 11-12; See also Ted Schneyer, “Professional Discipline for Law Firms?” (1991) 77 Cornell L. Rev. 1.

<sup>61</sup> Bob Sherwood & Nikki Tait, “IBA Presses SEC Over New Rules” *Financial Times* (18 November 2002).

<sup>62</sup> ABA Submission, *supra* note 58 at 36-37.

<sup>63</sup> Koniak Submission, *supra* note 35 at 28.

The arguments made by foreign bars are virtually indistinguishable from those made by the ABA to ward off SEC regulation of domestic lawyers. What we know of foreign enforcement efforts against securities lawyers suggests that their arguments are as illusory as those advances by domestic lawyers in the effort to ward off effective federal regulation. The Commission should maintain its principled, wise and legislatively justified stance to regulate foreign and domestic lawyers equally.<sup>64</sup>

The particularly vexing part of the proposed rule (and the legislation) for both domestic and foreign lawyers was a proposal that would have required “noisy withdrawal.” In addition to requiring a lawyer to report potential violations “up the ladder” within a company to its chief legal officer or CEO and then to the audit committee, an independent committee, or the board of directors, the original proposal for Part 205 mandated that a lawyer take further steps if the company failed to act to rectify the situation. Where a lawyer believed the company had not adequately responded to reported “evidence of a material violation” of the securities laws, “a material breach of fiduciary duty, or a similar material violation,” the lawyer would then be required to 1) withdraw from representation; 2) notify the SEC of the withdrawal, indicating that it was based on professional considerations, and 3) disaffirm any filing with the SEC that the attorney has prepared or assisted in preparing that the attorney believes is or may be materially false or misleading.<sup>65</sup> Noted as going “to the heart of the attorney-client relationship,” this part was criticized as “almost deputiz[ing] attorneys to become quasi-governmental inspectors,”<sup>66</sup> and for turning all “lawyers into junior regulators, surveillance operatives, whistle-blowers.”<sup>67</sup> The ABA said the rule contradicted legislative intent, relying on comments by Senator John Edwards (one of the principal architects of Section 307) that in *Sarbanes-Oxley* there “is no obligation to report anything outside the client — the corporation.”<sup>68</sup> The President of the American Corporate Counsel Association noted, “There’s a very real

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<sup>64</sup> *Ibid.* at 27-28.

<sup>65</sup> *Sarbanes-Oxley*, *supra* note 50 at ss. 205.3(d)(i); the definitions of “material violation” and “appropriate response” are in ss. 205.2(i) and (b). The proposed rule also provides that a company may create a Qualified Legal Compliance Committee to which a lawyer may report violations. The QLCC would then have the responsibility to act upon the information given to it by the lawyer. See ss. 205.2(j).

<sup>66</sup> See Renee Deger, “Lawyers Gird for Fight Over New SEC Rules: Biggest Fear is that Attorney-Client Privilege May be Compromised” *San Francisco Recorder* (7 November 2002).

<sup>67</sup> Lisa Girion, “Corporate Reform Bill a Defeat for Bar Assn.” *Los Angeles Times* (26 July 2002) C1.

<sup>68</sup> American Bar Association, News Release, “ABA Urges SEC Not to Exceed Sarbanes-Oxley Mandate Without Extended Comment Period” (18 December 2002) (on file with the author).

fear that the rules will change the relationship [with the client].”<sup>69</sup>

These comments overlooked the fact that even in the absence of the “noisy withdrawal” requirement, lawyers in forty-one states were, at the time, permitted (but not obliged) to report evidence of a continuing crime or fraud by a client.<sup>70</sup> The ABA had, prior to this point, twice rejected proposals by its own Ethics 2000 Commission to tighten this requirement.<sup>71</sup> The SEC proposal stepped into that breach and would have made this conduct mandatory; a more rigorous SEC standard would in effect pre-empt state rules.

Other provisions in the Rule further exacerbated these concerns about the attorney-client relationship. Section 205.3(e)(2) allows an attorney to disclose confidential information to the Commission without the issuer’s consent:

- i) to prevent the issuer from committing an illegal act that the attorney reasonably believes is likely to result in substantial injury to the financial interest or property of the issuer or investors;
- ii) to prevent the issuer from committing an illegal act that the attorney reasonably believes is likely to perpetrate a fraud upon the Commission; or
- iii) to rectify the consequences of the issuer’s illegal act in the furtherance of which the attorney’s services had been used.

Section 205.3(e)(1) allows an attorney to use any report under this section in self-defence. Section 205.3(e)(3) provides that sharing of information with the Commission by an issuer through its attorney does not constitute a waiver of any privilege or protection as to other persons. Nonetheless, the ramifications of this part in respect of the lawyer-client relationship, as well as the relationship of lawyers to the SEC, are significant and fundamental: the traditional conception of loyalty and

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<sup>69</sup> Glater, *supra* note 52.

<sup>70</sup> See Deborah L. Rhode and David Luban, *Legal Ethics*, 3d ed. (Westbury, N.Y.: Foundation Press, 2001) at 399-402 (discussing Comment to ABA Model Rules 1.6 and 8.4(c)). See also ABA Model Rule 1.6 Comment 16: “After withdrawal the lawyer is required to refrain from making disclosure of the client’s confidences, except as otherwise provided in Rule 1.6. Neither this Rule nor Rule 1.8(b) nor Rule 1.16(d) prevents the lawyer from giving notice of the fact of withdrawal, and the lawyer may also withdraw or disaffirm any opinion, document, affirmation or the like.” See also MR 1.2(d) and Comment 6-9 (restriction on assisting a client in conduct that the lawyer knows is criminal or fraudulent).

<sup>71</sup> Rhode and Paton, *supra* note 18 at 32-33.

fealty to the client or organization may be infringed upon for the greater public good.

The final Rules implementing Section 307 provisions of *Sarbanes-Oxley* on attorney conduct took a considerably different turn from the original proposals and constituted a major retreat by the SEC. The Final Rule maintained the “up the ladder” reporting requirement for evidence of material violations of securities laws, but changed the test for “evidence of a material violation” from a relatively straightforward determination to a standard which is considerably more difficult to enforce because the definition of what constitutes “evidence of a material violation” is now far more complex than in the proposed rule.<sup>72</sup> Further, even if a lawyer finds such evidence under the new standard, he or she can back down from pressing the company to change the behaviour if another lawyer opines that there is a “colourable defence” for the company’s actions.<sup>73</sup>

The Commissioners also backed down on the “noisy withdrawal” requirement so strongly advocated by the group of law professors and strongly resisted by the practising bar. The SEC extended the comment period on this issue for a further 60 days, and suggested a possible alternative rule requiring a lawyer to withdraw from representation but requiring the client, rather than the lawyer, to publicly disclose the withdrawal or written notice that the lawyer did not receive an appropriate response to a report of a material violation. While formally never concluded, for the time being it appears this fight is over. The CBA called the changes a positive step, but insisted that they did not go far enough to preserve lawyer-client relationships. More importantly, the CBA press release signalled again a more fundamental debate: “The CBA continues to stress that it is unacceptable for any government agency to dictate ethical standards for Canadian lawyers.”<sup>74</sup>

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<sup>72</sup> The proposed rule provided: “Evidence of a material violation means information that would lead an attorney reasonably to believe that a material violation has occurred, is occurring, or is about to occur.” The final version provides: “Evidence of a material violation means credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is occurring, or is about to occur.” See Jonathan D. Glater, “SEC Adopts New Rules for Lawyers and Funds” *New York Times* (24 January 2003) 1, quoting Professor Roger Cramton suggesting that the version of the definition by the SEC “does have that odor, boy, you’ve really got to go over the line to have made a misjudgement.”

<sup>73</sup> See the discussion in Floyd Norris, “No Positives in this Legal Double Negative” *New York Times* (24 January 2003) 1.

<sup>74</sup> Canadian Bar Association, News Release, “CBA Calls New U.S. Securities and Exchange Commission Proposals a Positive Step” (24 January 2003), online: Canadian Bar Association <[http://www.cba.org/CBA/News/2003\\_Releases/sox.aspx](http://www.cba.org/CBA/News/2003_Releases/sox.aspx)>.

For Canadian lawyers, as well as US lawyers, then, the potential exposure and responsibility under the proposed SEC rules for their own conduct, the conduct of their clients, and the conduct of others within their firms or organizations is enormous. The SEC recognized the controversy surrounding the extension of reporting rules to foreign attorneys, and specifically asked for comments on the application of the proposed rules to foreign lawyers. It hosted an interactive roundtable meeting to discuss the matter and other issues affecting non-US actors on December 17, 2002.<sup>75</sup> The proposal brought the role of the lawyer (and in particular the in-house lawyer) as professional charged with acting in the public interest (as well as in the interests of his or her client) closer to the duties ascribed to auditors by the U.S. Supreme Court in *Arthur Young*.<sup>76</sup>

### *Implementation in Canada and the Crime-Fraud Exception*

The direct, long-term impact on Canadian practice of U.S. developments and regulation of lawyer conduct by securities regulators in the United States is at this point unclear, even though the “up the ladder” reporting obligations internal to a company has been implemented by a rule change to the Rules of Professional Conduct in Ontario.<sup>77</sup> Canadian securities regulators’ regulation of lawyer conduct is uneven, with different approaches in Ontario and British Columbia.<sup>78</sup>

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<sup>75</sup> See U.S. Securities and Exchange Commission, News Release, “SEC Roundtables on International Impact of Proposed Rules on Auditor Independence, Attorney Conduct Set for Dec. 17” (5 December 2002), online: US Securities and Exchange Commission <<http://www.sec.gov/news/press/2002-175.htm>>. The Ontario Securities Commission was on the list of participants, but at the time of writing a transcript of the OSC submission and comments was not available.

<sup>76</sup> *United States v. Arthur Young & Co.*, (1984) 465 U.S. 805 at 818, 104 S.Ct. 1495 at 1503, 79 L.Ed 2d 826 (comments that CPAs must “maintain total independence” and act with “complete fidelity to the public trust” when serving as independent auditors). See also *Edenfield v. Fane*, (1993) 507 U.S. 761, 113 S.Ct. 1792 at 1800. See also Linda Galler, “The Tax Lawyer’s Duty to the System” 16 Va. Tax Rev. 681 (1997); Randolph W. Thrower, “2001 Erwin N. Griswold Lecture Before the American College of Tax Counsel: Is the Tax Bar Going Casual — Ethically?” 54 Tax Law. 797 (2001); Audrey I. Benison, “The Sophisticated Client: A Proposal for the Reconciliation of Conflicts of Interest Standards for Attorneys and Accountants” 13 Geo. J. Legal Ethics 699 (2000); Camilla E. Watson, “Tax Lawyers, Ethical Obligations, and the Duty to the System” 47 U. Kan. L. Rev. 847 (1999).

<sup>77</sup> Law Society of Upper Canada, *Rules of Professional Conduct* (Toronto: Law Society of Upper Canada, 2004) at Rule 2.02 (5.1) and (5.2), online: Law Society of Upper Canada <[http://www.lsuc.on.ca/media/rule\\_amends\\_march2504.pdf](http://www.lsuc.on.ca/media/rule_amends_march2504.pdf)>.

<sup>78</sup> While this invites comment on the desirability of a national securities regulator in Canada to parallel the SEC, I simply note that the extraterritorial application of the SEC Rule will be complicated by variations in approaches and rules used by Canadian provincial regulators. As discussed herein, the BCSC has attempted to move closer to the approach

In *Wilder v. Ontario (Securities Commission)* the Ontario Court of Appeal affirmed the right of the OSC to regulate the conduct of lawyers appearing before it.<sup>79</sup> At issue was the right of the OSC to issue a notice of hearing to determine whether it was in the public interest to reprimand a lawyer. In the course of his client's prospectus review, Wilder had written to the OSC referring to a series of favourable due diligence results; the OSC alleged that the reference was deliberately misleading. Both Wilder and the Law Society of Upper Canada, which intervened in opposition to the OSC's actions, sought to halt the OSC proceeding on the grounds that the Law Society had exclusive and exhaustive powers over the regulation of professional conduct of lawyers. The court allowed the OSC hearing to proceed, and held that the Commission was not usurping the role of the law society but rather was properly exercising its powers under the Ontario *Securities Act* to control its own process and remedy a breach of that *Act*.<sup>80</sup> Lawyer conduct would therefore be within the ability of Ontario securities regulators to control, at least to uphold the purposes of the provincial *Securities Act*.

The scope of the British Columbia Securities Commission's (BCSC) ability to do so remains in issue. The BCSC released a concept paper entitled "New Concepts for Securities Regulations" in early 2002, proposing *inter alia*, "to prohibit professionals from engaging in practice involving that Commission if the professionals' conduct related to trading in securities is so egregious or grossly incompetent as to be contrary to the public interest."<sup>81</sup> The concept paper recommended granting the BCSC powers similar to those of the SEC, including the ability to order that a professional, including a lawyer, not appear before it or prepare documents that are filed with it. Building upon the concept paper, the BCSC later released "New Proposals for Securities Regulation: A New Way to Regulate," reducing the scope of its concept proposal to prohibit instead "a professional from practising before the Commission if the professional has intentionally contravened the securities legislation, or has intentionally

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adopted and upheld in Ontario.

<sup>79</sup> *Wilder v. Ontario Securities Commission* (2000), 47 O.R.(3d) 361, 184 D.L.R. (4th) 165, 131 O.A.C. 369 (Ont Ct. Gen. Div.), *aff'd* (2001), 53 O.R. (3d) 519, 197 D.L.R. (4th) 193, 142 O.A.C. 300 (Ont. C.A.).

<sup>80</sup> *Ibid.* (per Swinton J. (Gen. Div.): "In proceedings such as these, the Commission is not usurping the role of the Law Society, as its objective is not to discipline the lawyer for professional misconduct; rather, its concern is to remedy a breach of its own Act which violates the public interest in fair and efficient capital markets, and to control its own processes." at para. 20).

<sup>81</sup> Law Society of British Columbia, "Submissions to the Securities Commission Re: New Proposals for Securities Regulations" (September 2002), online: <[http://lawsociety.bc.ca/publications\\_forms/report.committees?02-09\\_Securities2.html](http://lawsociety.bc.ca/publications_forms/report.committees?02-09_Securities2.html)> [LSBC Submission].

assisted others to do so.” While the Law Society of British Columbia lauded this change, it remained “concerned with the Commission’s proposal that it have the power to prohibit a lawyer from practising law before the Commission.”<sup>82</sup> Echoing the ABA’s resistance to the SEC proposals, the British Columbia Law Society’s primary concern was that the proposal would adversely affect the independence of the bar and permit the BCSC to regulate in an area traditionally reserved to the legal profession alone.

It remains to be seen how Canadian regulators will react (in the longer term, at least) to the new U.S. rules, particularly if U.S. rules retain their extra-territorial application and thus arguably give more protection to investors in companies subject to SEC scrutiny than to purely domestic Canadian issuers. The inclusion of lawyer conduct requirements in *Sarbanes-Oxley* reflects a new reality and a continuing dissatisfaction of legislators, regulators, and the general public that the bar has failed to protect the public interest adequately;<sup>83</sup> rather than attempting to pre-empt needed reforms, the bar might be well advised to recognize the signals from the Ontario courts and from the U.S. that traditional and absolute self-regulatory preserves are no longer sustainable.<sup>84</sup>

#### *ABA Model Rules and The Crime-Fraud Exception*

Pre-*Sarbanes-Oxley* the sources of professional regulation of corporate lawyers in the United States were primarily to be found in the state bar rules. Most state bar rules are based in large part on the ABA Model Rules of Professional Conduct, which itself have “symbolic importance and salience to practicing lawyers that may even exceed that of formally applicable ethics rules of individual states.”<sup>85</sup> Model Rule (MR) 1.2(d) provided that a lawyer “shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent. . . .” MR 1.13 views the organizational entity — and not its individual constituents — as the client.<sup>86</sup> Though criticized as “incoherent,”<sup>87</sup> MR 1.13(b)

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<sup>82</sup> LSBC Submission, *ibid.*

<sup>83</sup> Indeed, Section 307 has its origins in a 1996 article comparing professional accountability of lawyers and accountants under U.S. securities laws and calling for reform: see Richard W. Painter and Jennifer E. Duggan, “Lawyer Disclosure of Corporate Fraud: Establishing a Firm Foundation” 50 SMU L. Rev. 225 (1996).

<sup>84</sup> Rhode and Paton, *supra* note 18 at 33.

<sup>85</sup> Lawrence A. Hammerness, “The ABA Task Force on Corporate Responsibility and the 2003 Changes to the Model Rules of Professional Conduct” (2003) 17 Geo. J. Legal Ethics 35 at 56.

<sup>86</sup> Kim, *supra* note 10 at 1044-1045.

<sup>87</sup> William H. Simon, “Whom (Or What) Does the Organization’s Lawyer Represent?: An Anatomy of Intraclient Conflict” (2003) 91 Cal. L. Rev. 57 at 80.

reiterated that a lawyer had a duty to take steps to protect the corporation:

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 is likely to result in substantial injury to the organization, the lawyer shall proceed as is reasonably necessary in the best interest of the organization. In determining how to proceed, the lawyer shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the lawyer's representation, 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. Any measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization. Such measures may include among others:

- a. asking reconsideration of the matter
- b. advising that a separate legal opinion on the matter be sought for presentation to the appropriate authority in the organization; and
- c. referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act on behalf of the organization as determined by applicable law.

The old MR 1.6(a) provided that “a lawyer shall not reveal information relating to the representation of a client” subject to certain exceptions. Those included one permitting lawyer disclosure to prevent “death or substantial bodily harm” that the client or someone else is “reasonably certain” to cause.

Prior to reconsideration of MR 1.6(b) in August 2003, the ABA had considered and rejected in 1983, 1991 and 2002 proposed changes to the Model Rules that would have mandated or at least permitted disclosure to prevent criminal financial fraud. The ABA Model Code of Professional Responsibility preceded the Model Rules, and all states but California had incorporated the Model Code into state law. The old Model Code permitted disclosure of otherwise confidential information about “the intention of the lawyer’s client to commit a crime and the information necessary to prevent the crime.” When the Model Code was replaced by the Model Rules, over 40 states retained the Model Code exception, or something close to it, instead of the narrower version in the Model Rules.<sup>88</sup> Finally, though, in

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<sup>88</sup> See ABA Task Force on Corporate Responsibility, “Preliminary Report of the American Bar Association Task Force on Corporate Responsibility July 16, 2002” (2002) 58 *Bus. Law.* 189.

August 2003, under pressure from its own ABA Task Force on Corporate Responsibility, and after a “highly visible battle,”<sup>89</sup> the ABA adopted changes originally proposed by its Ethics 2000 Commission into MR 1.6 allowing a lawyer to disclose information the lawyer reasonably believes necessary

to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer’s services [and] [MR 1.6(b)(2)]

to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client’s commission of a crime or fraud in which the client has used the lawyer’s services. [MR 1.6(b)(3)]

In the result, Model Rule 1.6 was changed to allow disclosure of client fraud involving grave future or ongoing harm. Model Rule 1.13 was amended to require the lawyer under certain circumstances to inform the highest authority within an organization when responsible officers failed to take action to address a violation of the law, and to permit that lawyer, under certain circumstances, to disclose confidential information outside the organization when the highest authority within the organization failed to address that violation.

Though criticized as an effort by the ABA simply to derail any further federal regulation of lawyer conduct<sup>90</sup> and making it difficult for lawyers to figure out “how firms should organize themselves so as to comply with both the ABA provisions and with *Sarbanes-Oxley* and its implementing regulations,”<sup>91</sup> the changes to the Model Rules and in particular the introduction of the crime-fraud exception to the confidentiality requirement regularized a situation already extant in forty-one states. These states either permitted or required disclosure to prevent a client from perpetrating a fraud that constitutes a crime. The changes also reflected the existing situation in eighteen other states in which disclosure was either permitted or required to rectify “substantial loss resulting from client crime or fraud in which the client used the lawyer’s services.”<sup>92</sup> The Rules amendments do indeed serve as a “backstop addressing extraordinary and

<sup>89</sup> Hammermesh, *supra* note 85 at 36-37.

<sup>90</sup> Cramton et al., *supra* note 58 at 729-733.

<sup>91</sup> Thomas D. Morgan, “Sarbanes-Oxley: A Complication, Not a Contribution, In The Effort to Improve Corporate Lawyers’ Professional Conduct” (2003) 17 *Geo. J. Legal Ethics* 1.

<sup>92</sup> ABA Task Force on Corporate Responsibility Preliminary Report, *supra* note 88 at 206.

deviant circumstances,”<sup>93</sup> which can provide corporate counsel with the necessary tools required in those especially difficult circumstances where their corporate client might not otherwise be moved.

In contrast, Canadian lawyers receive no such support from their Rules of Professional Conduct. The Report of the LSUC’s Professional Regulation Committee recommending the limited changes implemented in March 2004, while noting the ABA August 2003 revisions, specifically rejected any change to confidentiality rules:

In the Committee’s view, the confidentiality standard is central to the integrity of the “up-the-ladder” reporting regime. If the openness and candour of the lawyer and client relationship is compromised, the lawyer is much less likely to become aware of improper conduct and to be in a position to counsel the client against it or take appropriate steps to address it.<sup>94</sup>

The CBA’s Ethics and Professional Issues Committee began its process of reviewing the CBA Code of Professional Conduct in 2000-2001 and released a consultation paper in February 2002 inviting comment on a number of issues, the question of changing confidentiality rules to permit a crime-fraud exception not amongst them.<sup>95</sup> Its second request for input, in May 2003, incorporated consideration of whether the Code’s Chapter IV “should be amended to require, or permit, the disclosure of confidential information where it is necessary to do so in order to prevent either (i) an imminent risk of substantial financial injury as a result of a client’s fraud; or (ii) an imminent risk of harm to the administration of justice, for example, because of the suborning of perjury or jury tampering by the lawyer’s client.”<sup>96</sup> In its Final Report in March 2004, the CBA Standing Committee on Ethics and Professional Responsibility recommended no change, noting that “[i]t was apparent from the submissions received that there was no clear consensus that the exceptions to the confidential rule should be expanded, and that there was considerable concern about the prospect of the important principle of confidentiality being undermined if further exceptions were permitted.”<sup>97</sup>

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<sup>93</sup> Hammermesh, *supra* note 85 at 36; Kim, *supra* note 10 at 1040-1041.

<sup>94</sup> LSUC Report to Convocation, *supra* note 49 at paras. 25-32.

<sup>95</sup> Canadian Bar Association, “Modernizing the CBA Code of Professional Conduct — A Consultation Paper” (Ottawa: Canadian Bar Association, 2002), online: Canadian Bar Association <<http://www.cba.org/cba/Epiigram/february2002/PrintHtml.aspx?DocId=44174>>.

<sup>96</sup> Canadian Bar Association, “Modernizing the CBA Code of Professional Conduct — Seeking Your Input” (Ottawa: Canadian Bar Association, 2003), online <<http://www.cba.org/cba/EPIIgram/May2003/PrintHtml.aspx?DocId=52476>>.

<sup>97</sup> Canadian Bar Association, “Modernizing the CBA Code of Professional Conduct —

The final version adopted at the CBA's August 2004 meeting thus included no crime-fraud exception, and indeed reiterated (in a commentary entitled "Whistleblowing") that the general rule was that the lawyer shall hold the client's information in strict confidence, subject to only a few exceptions. The commentary attempted to provide guidance where the lawyer becomes aware that an organization retaining or employing the lawyer is engaged in or may commit an act that is "dishonest, fraudulent, criminal or illegal," directing the lawyer to "ask that the matter be reconsidered, and should, if necessary, bring the proposed misconduct to the attention of a higher (and ultimately the highest) authority in the organization despite any direction from anyone in the organization to the contrary. If these measures fail, then it may be appropriate for the lawyer to resign in accordance with the rules for withdrawal from representation."<sup>98</sup>

Unlike their private law firm counterparts in Canada, then, corporate counsel are effectively left in the uncomfortable position of taking best efforts to ensure compliance, and potentially being left in the position both of not being able to report fraudulent activity, and of losing the client and their livelihood. It sets Canada on a course far different from the United States, and invites continued questioning about whether and how legal self-regulation best serves the public interest. As Professor Bill Simon has noted,

The denial of a duty to go outside in cases of egregiously harmful illegality is hard to square with plausible notions of professional duty. If the organizational client is being harmed, and disclosure would mitigate the harm, it arguably follows that disclosure is appropriate. The bar resists this conclusion on grounds of confidentiality. It argues that, as a general matter, clients will not consult lawyers without confidentiality safeguards, and that, since legal advice promotes compliance with the law, this will be socially costly. But the argument is implausible.

Simon notes that corporate agents have incentives for consulting lawyers that do not depend on confidentiality, and that there are instances where the corporate lawyer must insist on disclosure of information from corporate managers that the organization is legally required to disclose (for

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Final Report of the Standing Committee on Ethics and Professional Responsibility" (Ottawa: Canadian Bar Association, 2004), online: <<http://www.cba.org/CBA/EPIIgram/Mar2004/PrintHtml.aspx?DocID=55562>>.

<sup>98</sup> Canadian Bar Association, "Resolution 04-01-A-Annex I (August 2004) Chapter IV — Confidential Information" (Ottawa: Canadian Bar Association, 2004). See Canadian Bar Association, *Code of Professional Conduct* (Ottawa: Canadian Bar Association, 2006) as adopted by Council, August 2004 and February 2006 [*CBA Code*], online: Canadian Bar Association, <<http://www.cba.org/CBA/activities/code>>, Ch. IV, commentary 12 "Whistleblowing."

example, to securities regulators) even when it is harmful for the manager personally. He concludes, “it has always been irrational for a corporate manager to make a disclosure to the organization’s counsel that he would not have been willing to make in the absence of any confidentiality guarantee. Thus, the likely effect in terms of reduced disclosure to counsel, from requirements that increase disclosure by counsel, is trivial.”<sup>99</sup>

Further, a general rule with this impact on corporate counsel indeed opens the question of whether one set of rules is appropriate for all practice contexts, despite Law Society and bar assertions of “the commonality of the profession, its knowledge base and its values.”<sup>100</sup> It invites speculation about the nature of self-regulation by the profession and consideration of the new reality: that securities regulators and governments are now engaged in the business of regulating lawyer conduct. The legacy of *Sarbanes-Oxley*, in particular, is an indictment by legislatures that self-regulation by the legal profession in the public interest has been inadequate.

In addition to the other changes noted above, in January 2003, as part of the response of the U.S. Justice Department to the Enron scandal, then-Deputy Attorney General Larry Thompson issued a memorandum addressing “Principles of Federal Prosecution of Business Organizations” that identified nine factors that federal prosecutors should consider in deciding whether to charge corporations or other business entities. These factors included the willingness of the organization to cooperate in the investigation of its agents, even if that involved the waiver of attorney-client privilege and work-product protection.<sup>101</sup> Amendments to U.S. federal sentencing guidelines relating to corporations and other organizations went into effect November 1, 2004, including commentary to section 8C2.5 of the guidelines, which “authorizes and encourages the

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<sup>99</sup> Simon, *supra* note 10 at 949-950. See also Lisa H. Nicolson, “Sarbox 307’s Impact on Subordinate In-House Counsel: Between a Rock and a Hard Place” (2004) Mich. St. L. Rev. 559 at 563, n. 12 (discussing SEC expectations that lawyers will ensure client compliance with federal securities laws and quoting *In re Fields*, 45 S.E.C. 262, 266 n. 20 (1973): “This is a field where unscrupulous lawyers can inflict irreparable harm on those who rely on the disclosure documents that they produce. Hence we are under a duty to hold our bar to appropriately rigorous standards of professional honor.”).

<sup>100</sup> Francis, *supra* note 21 at 186.

<sup>101</sup> Bruce A. Green and David C. Clifton, “Feeling A Chill” (2005) 91 *ABA Journal* 60 at 63. See also Larry D. Thompson, “Principles of Federal Prosecution of Business Organizations” (20 January 2003), online: US Department of Justice <[http://www.usdoj.gov/dag/cftf/corporate\\_guidelines.htm](http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm)>. For earlier consideration of the threats, see Lance Cole, “Revoking Our Privileges: Federal Law Enforcement’s Multi-Front Assault on the Attorney-Client Privilege (and Why It Is Misguided)” (2003) 48 Vill. L. Rev. 469.

government to require entities to waive their attorney-client and work-product protections in order to show ‘thorough’ cooperation with the government and thereby qualify for a reduction in the culpability score — and a more lenient sentence — under the sentencing guidelines.”<sup>102</sup>

The dynamic of disclosure is thus already changing, regardless of bar rules to restrict the ability of lawyers to identify client misconduct. For corporate counsel, the stakes are especially high and the “moral maze” that much more difficult. An appreciation of the unique position and ethical challenges these lawyers face is simply a starting point.

*Corporate Counsel as Moral Compass — Lawyer as “Corporate Conscience”*

In addition to the increasingly complex array of strategic and legal challenges corporate counsel face, they must also confront the fact that they and their corporate clients are “morally interdependent.” As Professor Richard Painter<sup>103</sup> has noted, the actions of lawyers and clients are “not always easily distinguished. Often, lawyers and clients accomplish objectives together, not separately. They each exercise some independent judgment, but they work together and not always in distinct roles; lawyers do more than render discrete legal advice or advocacy. Lawyers therefore cannot always deny moral responsibility for their clients’ conduct.”<sup>104</sup> For Painter, this interdependence translates into a number of situations: lawyer as “monitor”<sup>105</sup> and as “dealmaker.”<sup>106</sup> Both roles require the lawyer to negotiate through a morass of preexisting relationships within various corporate constituencies and preexisting relationships — “regulator and regulated, shareholder and management, debtor and creditor, and employee and employer.”<sup>107</sup> While lawyers will be required to monitor the “legally defined borders” of these relationships, lawyers more often than not will be directly engaged in those relationships, making the moral interdependence with their clients more likely and the prospect of retaining independence that much more difficult or challenging. These challenges

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<sup>102</sup> Robert D. Evans, “Comments on Notice of Proposed Priorities — Chapter 8 Organizational Guidelines, Section 8C2.5, Waiver of Attorney-Client Privilege” (15 August 2005), online: American Bar Association <<http://www.abanet.org/poladv/commentletter/toussc.pdf>>.

<sup>103</sup> Painter is the author of an article which is widely considered to have driven the U.S. Securities and Exchange Commission to propose a “noisy withdrawal” requirement, discussed *supra* note 83.

<sup>104</sup> Richard W. Painter, “The Moral Interdependence of Corporate Lawyers and Their Clients” (1994) 67 S. Cal L. Rev. 507 at 511.

<sup>105</sup> *Ibid.* at 518, 518-558 [discussion of “Lawyer as Monitor”].

<sup>106</sup> *Ibid.* at 543-553 [discussion of “Lawyer as Dealmaker”].

<sup>107</sup> *Ibid.* at 543-544.

are especially great for corporate counsel, where internalized ethical norms may be tested or overridden by group or organizational priorities.

But remain independent they must. The CBA Code of Professional Conduct and the LSUC Rules of Professional Conduct pertaining to independence (and indeed to all other matters) carve out no exemption for in-house counsel. Recognizing that the client is the corporation, rather than the individual manager or director, means that in addition to defining the borders, the lawyer in a corporate or in-house context must be able to sustain the personal and professional distance requisite to escaping the “cognitive dissonance” particularly dangerous for anyone in an in-house role.<sup>108</sup>

As there are challenges, though, there are also particular opportunities. As Professor Deborah Rhode has noted,

One of lawyers’ most crucial contributions involves helping individuals live up to their best instincts and deepest moral values. That role requires advocates who are willing to pass judgment and to identify ways of harmonizing client and public interests. Even highly profit-driven businesses often need and want counselors who can provide a “corporate conscience.” In that capacity, lawyers can help clients evaluate short-term economic objectives in light of long-term concerns that include maintaining a reputation for social responsibility and managerial integrity.<sup>109</sup>

The ability for a lawyer in an in-house position to have a broader and more complex influence on corporate decision-making is both enticing and dangerous: where does the line get drawn between legal advice and business advice in such a context? Where should it be? How might the personal be detached from the professional? The goal of regulators and the profession should be to assist corporate counsel in negotiating their way through these issues. This is where reviewing the Rules of Professional Conduct and their application to the unique challenges corporate counsel confront should be a first order priority.

Yet I readily concede that more rules may not be the answer. Concerns have already been expressed that the SEC’s new Standards of Professional Conduct “may come to be seen as just another set of rules whose neutralization, avoidance or manipulation is entirely consistent with the prevailing organizational morality.”<sup>110</sup> Understanding and appreciating the

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<sup>108</sup> Langevoort, *supra* note 22. See also MacKenzie, *supra* note 11 at s. 20.5.

<sup>109</sup> Deborah L. Rhode, *In The Interests of Justice: Reforming the Legal Profession* (New York: Oxford University Press, 2000) at 65; See also Robert Gordon, “The Independence of Lawyers” (1988) 68 B.U.L. Rev. 1.

<sup>110</sup> Sargent, *supra* note 13 at 868.

underlying personal and professional pressures is the necessary prerequisite to informing thoughtful rule development and encouraging compliance and then internalization of the new ethos. Rules alone are not enough. Instead, it should be recognized that “all systems and organizations that seek to inculcate absolutes are dependent upon the moral courage of those within their systems and organizations. Nurturing individual strength for that fortitude becomes a critical function.”<sup>111</sup>

Highlighting the need to recognize the unique ethical challenges corporate counsel in Canada face, acknowledging the increasing importance of corporate counsel in the Canadian legal ethical discourse, and taking constructive steps to support them as they face their personal and organizational tests, are all part of the solution. In the end, lawyers, corporations and the public will all be better served by corporate counsel who have the broader bar’s understanding of — and empathy for — the social and professional reality they occupy within the often-crossed fiduciary and professional responsibilities to their clients and the responsibilities they have to the public as gatekeepers in the post-Enron era.

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<sup>111</sup> Marrienne M. Jennings, “The Disconnect Between and Among Legal Ethics, Business Ethics, Law and Virtue: Learning Not to Make Ethics So Complex” (2004) U.S.T. L.J. 995 at 1020.