It Takes More than Cheek to Lose Our Way

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IT TAKES MORE THAN CHEEK TO LOSE OUR WAY

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It was just in August 2001 that the American Bar Association (ABA) House of Delegates resoundingly rejected the idea of turning lawyers into whistleblowers against their clients. By a resounding 2-1 vote, the representatives of the American bar, “in Congress assembled,” let the world know in no uncertain terms that the leadership of the profession put a much higher value on client confidentiality—and the good that comes from guaranteeing this core value of our profession by encouraging clients to trust us and tell us all—than they placed on the notion that lawyers should be free to disclose client fraud. The debate was full. Some thought it was our finest hour. The result was never in doubt, and it was affirmed again in February 2002 when the same house adopted the final version of the Revised Model Rules of Professional Conduct.

Now in the wake of the Enron debacle, the President of the ABA appointed the Commission on Corporate Governance (the “Commission”), chaired by James Cheek, the former Chair of the Business Law Section and a respected and renowned corporate lawyer from Tennessee. President Hirshon filled the Commission with a wonderfully distinguished, but not anything near representative, group of lawyers, most of whom call the Business Law Section their ABA home. That Commission, despite the fact that the ink was not yet dry on the Revised Model Rules, has recommended, along with a whole host of

† These remarks were delivered by the author in an address at ENRON & ITS AFTERMATH SYMPOSIUM held at St. John's University School of Law in the fall of 2002.

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statutory proposals, that the ABA not only revisit the snitch provisions it just rejected but also go further than that. The Commission actually recommended that the ABA turn the discretion to breach confidentiality contained in the August 2001 proposals to a mandatory reporting rule for the profession.\(^1\) Lawyers would be required to disclose client frauds in which their services have been employed.\(^2\)

One would expect, if this were the Cheek Commission's proposal, that the profession would be presented with a body of clear and convincing evidence demonstrating why this change should occur. One would expect that the Commission would establish why Enron and its progeny prove that the ABA was wrong when it acted in such a definitive way by rejecting calls for mandatory disclosure.

But one searches the Commission's report in vain for anything like what one would expect. Rather we are told categorically—but with no citations and no examples—that it is a "clear failure of corporate responsibility when outside ... lawyers, who have important roles in our system of independent checks on corporate management, fail to avert or even discover—and sometimes actually condone or contribute toward the creation of—the grossest of financial manipulation and fraud."\(^3\)

That is a quote. The only thing I omitted are four words: "outside directors," "auditors and."\(^4\) The reason I did that is because, if the Commission is going to make charges about lawyer conduct, the charges have to stand on their own. If they do not, then they should never have seen the printed page.

Of course, on its face, it can be seen that the quoted sentence does not parse. Rather, like so many others,\(^5\) this Commission

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2 Id.
3 Id. at 7 (emphasis added).
4 Id.
5 The editorial page of the New York Times announced on January 28, "As scrutiny turns from accountants to lawyers in this scandal, the legal profession should be looking for ways to assure Americans that when fraudulent activities are under way that threaten their livelihoods, their investments and their pensions, lawyers will be on their side, not on the side of the criminals." Enron and the Lawyers, N.Y. TIMES, Jan. 28, 2002, at A14. This was followed by that master of fair play and balanced judgment, William Safire who opined "[Vinson & Elkins] replaced their shingle with a doormat—but have you heard a disapproving peep from any bar
has simply thrown the lawyers in with the outside directors and auditors without any regard for the different responsibilities and roles each of these three groups have, yet these lawyers should know better. As a result of this guilt by association, the Commission recklessly charges lawyers with failing "to avert" and failing "to discover," when it very well knows that it would be the most extraordinary of circumstances where either duty would or should apply to lawyers, while both would and should apply quite comfortably to auditors. Neither are lawyers in the "condoning" business. Maybe I have missed something, but I know of nothing in the public record that concludes that lawyers created the "grossest" of "manipulation and fraud."

The reckless, unsubstantiated charges do not end there. Next we are told, again lumping the lawyers in with the auditors, that "outside professionals hired by the corporation—particularly its accountants and lawyers—faced increasing pressures of consolidation and global competition, and they found it necessary to compete more keenly to identify ways to enhance their relationships with their corporate clients." As law firms grew larger, "the need increased to put in place internal controls that would allow those firms to assure the necessary quality controls and independent judgment." As a result, the self interest of corporate executives in aggressive accounting and "assuming business risks were not tempered by the checks and balances which the general corporate governance scheme expected from outside directors and professional firms engaged...to provide independent review and advice." Again a description that sounds like what the accountants have been up to—with no citations and no examples. Such descriptions are nothing more than purely speculative musings on causation and a broad-brush indictment of lawyers along with everyone else without regard to the fact that lawyers are supposed to identify with their clients and establish relationships with them, a far different role than what we seek from independent auditors. In the same paragraph, for example, we are informed that "[q]uestionable treatment of financial

6 ABA Report, supra note 1, at 7.
7 Id.
8 Id. at 8.
9 Id.
10 Id. at 8–9.
information evaded audit screens," yet nowhere is there any recognition that is a problem of the accountants, not anything that should be laid at the feet of lawyers, let alone serve as a basis for changing the rules governing our profession's obligation of client confidentiality.

Buried in a footnote is an admission that should have been contained in the first paragraph of the Commission's report regarding its proposed changes in the ethical rules. We are told that the Task Force has not attempted to determine the legal, ethical, or moral responsibility of any individual person or organization associated with any particular failure of corporate governance. Actually, it is worse than that. The Commission does not even disclose any factual inquiry it made into these financial debacles. But without some investigation, factual conclusions and at least tentative views on whether lawyers violated any legal obligations and, more important, any ethical rules, how can we begin to conclude that our rules require any changes and, if so, what the dimensions of the changes should be? One thing is for sure: the last thing the profession should rely upon as a basis for any change is the hysterical response to Enron by politicians and the press, both of whom have demonstrated nothing other than irresponsibility in their wholesale charges of misdeeds. Sadly, the Cheek Commission now echoes these charges.

Instead of demonstrating a foundation for its recommendations, the Commission simply and blithely observes that "[f]or many years the ABA has studied and formulated policies designed to encourage lawyers to promote corporate responsibility." The report then concludes—drum roll please—"[r]ecent criticism of lawyers' conduct demonstrates that this study and formulation of policy has not yet achieved its objective and must be a continuing effort." 13

First, although I believe in corporate responsibility and think that all lawyers should encourage such responsibility, I am not exactly sure that the goal of lawyers is supposed to be the promotion of corporate responsibility. The subtle but critical questions include the following: first, how far are lawyers

11 Id. at 9.
12 Id. at 12.
13 Id. (emphasis added).
supposed to go in promoting corporate responsibility, and second, who should be responsible for corporate irresponsibility?

As to the former, a lawyer fulfills the his or her duty by remonstrating with the client to do the right thing. But the limitations on even this requirement should be recognized In many cases, the right thing is not absolutely clear. Should a drug manufacturer market a product that saves hundreds of lives but has serious side effects? Should a company use off balance sheet financing or enter into a risky but potentially lucrative joint venture or hire a controversial but intriguing CEO? Furthermore, in so many decisions made by organizational clients, right or wrong appears to play no role, unless of course, with the benefit of 20-20 hindsight, things don’t turn out quite as well as everyone hoped they would.

Lawyers are merely advisors. They are neither guarantors of corporate good conduct nor are they particularly well suited for making any judgment as to a whole host of matters that corporate officers and directors have to decide.

The problem with the Commission’s approach was highlighted in a deeply flawed speech by Harvey Pitt last February in Puerto Rico when he mistakenly argued that a lawyer’s duty was to act like a super board of directors of the organizational client and to refuse to permit the company’s officers and directors from pursuing a course the lawyer thought was not in the best interests of the shareholders. Pitt mistakenly argued that a corporate lawyer represents the shareholders.14

Pitt asserted that when lawyers receive direction from corporate management, the lawyers “must be satisfied that objectives management asks them to pursue truly are intended to, and do, further the interests of the company and its shareholders.”15 Up until I heard Pitt speak, it had always been my understanding that it was the directors and officers who had the obligation to decide what was in the best interests of the company. That is what they were elected to do. That is what the law requires them to do. Thus, directors and officers are accountable to the shareholders if they fail in that endeavor.

15 Id.
As to the second question—how liable should lawyers be—unlike the vast liability the Cheek Commission would create for lawyers, it is my view that only the directors and officers of the organization, not the organization’s lawyer, should be held liable if it turns out that the decisions of the directors and officers, of which the lawyer was aware and which the lawyer may have very well opposed, turns out to be more than simply a bad business judgment but also a breach of the securities laws, of the directors’ and officers’ fiduciary duty, or a similar violation, to echo the now sacred words of Sarbanes-Oxley. Unless the lawyer aids and abets the misconduct there is simply no basis for creating liability for the lawyer advisor unless the goal is to force the lawyer to substitute the lawyer’s judgment for that of the client’s duly elected officers and directors.

Second, I take a back seat to no one in urging the bar to stand perpetually prepared to reevaluate our rules. The Ethics 2000 Commission, of which I was a part, spent five years at the task, and the completion of its work does not mean the effort should not be taken up anew.

But the Commission’s premise for this effort is non-existent. How does the Commission know present policies were inadequate to the task? Certainly, recent criticism demonstrates nothing. Some of the criticism, like the Commission’s, has simply been a case of lumping the lawyers in with everyone else. Some of it has occurred because lawyers are popular scapegoats. Some of it has occurred because Congressmen, who gleefully accepted Enron campaign contributions while actively encouraging broad-based deregulation of the energy sector, hoped to divert attention from themselves. So one hopes the Commission is not telling us our rules must be changed simply because lawyers have been criticized. This should be particularly so because our rules governing confidentiality are regularly subject to criticism, criticism from those who want to change lawyers from representatives of their clients to advocates for something they call the public good, a change that in reality would destroy the relationship between lawyer and client. Moreover, such criticism, no matter how strident, makes the need for confidentiality in the lawyer-client relationship no less critical and no less worthy of a vigorous defense.

If the Commission is going to recommend changes, then the Commission, it seems to me, must first demonstrate that a)
those lawyers who are accused of wrongdoing did not violate our present rules; b) their conduct caused or wrongfully exacerbated the harm; c) if the rules were changed in the way the Commission suggests, the harm that occurred would have been prevented; and d) the changes in the rules proposed by the Commission will do more good than harm, in other words, that in preventing the next Enron, we are not creating different mischief.

The Commission has provided us with none of that. The Commission simply reiterates the soundly and correctly rejected misguided arguments of the Ethics 2000 Commission. We are told once again that most states do not follow the ABA Model Rules. We knew that in August 2001, and what we thought then is just as true today: when it comes to important principles, when it comes to leadership, the ABA does not count noses. Rather we do what is best for our clients and the system of justice.

Confidentiality is the second leg of the tripod of core values that support our professional ethic. We say we are committed to the confidentiality of our clients because, without it, we are deeply concerned—for good reason—that our clients will not share with us their innermost secrets and will view their lawyers with suspicion and distrust. To maintain the sanctity of the lawyer-client relationship, the exceptions to confidentiality crafted into our rules must be as narrowly drawn as possible. This the present rules do. The only exceptions to confidentiality that we maintain are the preservation of life, the prevention of serious bodily harm,16 candor to the tribunal,17 and the establishment of a claim or defense of the lawyer against the client.18 But now, if this proposal is adopted, whole new categories of disclosure will not only be possible but also required! In order to prevent, mitigate, or rectify a client fraud in which the lawyer’s services have been employed, confidentiality will now be the grist for the disclosure mill.

16 See Model Rules of Prof’l Conduct R. 1.16 (2002) (noting that the “lawyer may reveal information . . . to prevent reasonably certain death or substantial bodily harm”).
17 Id.
18 Id. at R. 3.3 (“If a lawyer . . . has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.”).
The proponents of this proposal argue that lawyer services should not be misused in this way. That proposition certainly sounds reasonable enough, until it is recognized that the proposed rule both starts from a false premise and at the same time creates more likelihood for lawyers to be held liable than if the rule remained as it is.

The false premise is that when a lawyer is dealing with client fraud it will be apparent on its face. It is so easy to say the words “when a lawyer uncovers fraud, she should be able to disclose it.” But, fraud does not appear that way except in the rarest of cases. Facts are ambiguous, hindsight is 20-20, and the ability of a lawyer to identify a good fraud is at a very low order of magnitude. That is why it's called fraud.

The liability-creating effect will occur when lawyers, who no longer will have the shield of Rule 1.6's prohibition on disclosure of confidential information, become defendants in cases where it will be argued that they knew or, far more likely, should have known about their client's fraud and were therefore required to take steps to save the victims of the fraud. While the rules' preamble provides that they do not necessarily establish the standard of care, all it will take will be one expert witness lawyer, perhaps someone from the “Commission, to assert from the witness stand that violation of the new Rule 1.6 should give rise to civil liability since the Commission urged adoption of the rule to protect the public.”

Most important, however, is the injection into the client-lawyer relationship of this requirement for whistle blowing, an opportunity that must be exercised because of the concerns counsel may have if counsel guesses wrong. The client-lawyer relationship is fragile enough; this additional impediment to trust should not be added to the mix. Its effect on full disclosure by the client to the lawyer—the essential purpose of having a rule governing confidentiality in the first place—is incalculable.

19 Id. at R. 1.6

“...A lawyer may reveal information relating to the representation of a client...to establish a claim or defense...in a controversy between the lawyer and client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client

Id.

20 Id.

21 ABA Report, supra note 1, at 24.
For certain, if this rule is adopted, lawyers will have far fewer opportunities than they enjoy today to remonstrate with their clients to do the right thing.

In the end, the only new reason the Commission offers for this change is that the ABA is more out of step today than it was in 2001 because of “public demand that lawyers play a greater role in promoting corporate responsibility.” Furthermore, changing our confidentiality rules now will be “an effective response to the problems that have provoked public criticism of the bar.” It may be true that the public will give us all Miss Congeniality awards for compromising confidentiality. We may even win regulator of the year awards from President Bush if we are required to disclose otherwise confidential information. Indeed, given the wonderful combination of the ambiguity of information and the need to avoid liability, we can expect lawyers either to become turncoats on a regular basis or to expose themselves to unlimited liability for their commitment to confidentiality. But, society will have lost so much more than it has gained. Furthermore, we will have lost our role as lawyers doing good within the cloak of confidentiality, remonstrating with clients—who are open and willing to share information with us—to do the right thing.

What really worries me is that this shocking proposal—requiring lawyers to blow the whistle on their clients—is really just a stalking horse that the Commission knows this proposal will never fly but that by offering it for its shock value, everyone at the ABA will enthusiastically endorse a compromise just to avoid the havoc the Cheek Commission would create in the profession with its proposed mandatory rule. But the reasons for rejecting the Ethics 2000 proposal are just as true today; nothing about Enron and its progeny justifies turning lawyers into either permissive or mandatory regulators, blowing the whistle on their clients whenever they are forced to worry about their own Cheek-Commission-created liability.

In my view, more is at stake with these proposed amendments to Rule 1.6 than just issues of confidentiality, as important as they are. What I see is a complete redefinition of what it means to be a lawyer. Not only will this proposal change

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22 Id. at 32–33.
23 Id. at 33.
24 See supra notes 16 and 19.
the way the representation is formed but also the entire course of conduct between lawyer and client. Today I look my clients in the eye, urge them to trust me, explain the confidentiality that cloaks the relationship and reiterate again and again how important it is that I know everything. The truth is my stock in trade. Tell me the truth, and I can advise the client to the best of my ability. What I don’t want is surprise, half stories, or convenient omissions. Those are the gremlins that play havoc to my ability to provide the best services for my clients. Mostly I succeed. Yet even with my attempt at a trust-generating speech, clients don’t tell me everything. I do, however, get a lot closer to the ideal than I would if I didn’t start the representation with my little speech about my commitment to keep my client’s confidences and how I am on the client’s side.

Now, under the proposed rule, the client is entitled to be told that anytime I know or should know that the client is about to commit a fraud or has already committed one that I can rectify or mitigate, I reserve the right to disclose my client’s wrongdoing—the only assumption consistent with my duty to communicate with client under Model Rule 1.4.25 My clients and I, henceforth, are going to start off on the wrong foot, and things will simply deteriorate from the formation of the relationship. Is there anything about the required speech I will now have to give my clients that is likely to foster trust, encourage full disclosure, and arm me with the tools to provide the client with the best advice? Hardly. Rather, we will have created a situation in which clients will be discouraged from seeking legal advice at all. When they do so, they will certainly—to a far greater extent than they presently do—hold some key information because they will be concerned that disclosure will turn their trusted legal advisor into the best cop on the beat. Actually, it will be worse than that because, unlike the cop who doesn’t catch the

25 See MODEL RULES OF PROF’L CONDUCT R. 1.4
“A lawyer shall: (1) promptly inform the client of any decision or circumstance with respect to which the client’s informed consent . . . ; (2) reasonably consult with the client about the means by which the client’s objectives are to be accomplished; (3) keep the client reasonably informed about the status of the matter; (4) promptly comply with reasonable requests for information; and (5) consult with the client about any relevant limitation on the lawyer’s conduct.”

Id.
criminal, the lawyer who fails to turn in the miscreant client will be set up to suffer her own kind of liability hell.

Though I could cite dozens of hypotheticals to demonstrate the point, let me provide a few. Imagine a public company client is engaged in negotiations with its primary bank for a renewal of a line of credit. They are not going well. Big Bank announces it will not renew the line. The client thinks the line can be replaced by Little Bank and asks Lawyer to help negotiate the new line. Lawyer explains that the client is probably obliged to disclose the news about Big Bank. The client explains that in the current climate, doing so would be a disaster. The client’s CEO says the company will wait one week to determine if a new line can be put in place. Lawyer explains the risk. CEO says it’s one the company must run. “It’s in the best interest of the shareholders.” Under the Cheek Commission proposal, not only would the lawyer take this judgment away from the client but also the lawyer would be required to disclose the Big Bank’s decision to protect the lawyer from liability for a judgment the CEO should be free—indeed, must be free—to make without any exposure on the part of the lawyer if the second bank does not come through and the company gets second-guessed for failing to disclose Big Bank’s position one week earlier.

Similarly, imagine a lawyer asked to defend a pharmaceutical company in liability claims arising from a new miracle drug. In the course of the lawyer’s investigation, he learns of a company lab employee who believes the drug causes liver damage. When the lawyer asks the head of research about these views, lawyer is told the lab guy is a nut and his charges baseless. Under the Cheek Commission proposal, the lawyer not only would be required to determine whether the nut characterization is true, a tough task for a lawyer who hardly has any expertise on this topic, but also disclose this nut’s opinion if the lawyer thinks there is any chance the liability cases might be lost and some shareholder will come along contending that the liver problem should have been disclosed sooner, the lawyer should have known about it, and the lawyer failed to disclose it.

To cite just one more example, assume a company asks their lawyer to handle the dismissal of a 60-year-old plant superintendent. “Don’t you have an age discrimination problem getting rid of old Tom?” “We’ve thought about that, but we think
our documentation of his repeated performance deficiencies will justify the decision.” “I sure hope you are right,” lawyer intones, then wonders whether he does not have a disclosure obligation to protect the shareholders from possible damage to the company if a successful lawsuit is brought. “Now that you’ve got me involved,” the lawyer observes, “I’m afraid you can’t fire ol’ Tom.”

The substitution of “should have known” for “knows,” while treated cavalierly by the Commission, is almost as destructive of the lawyer-client relationship as the Commission’s proposed evisceration of confidentiality under Rule 1.6. It is one thing for a lawyer to be asked to do something in response to what the lawyer knows; changing the standard to “should have known” has dramatic deleterious consequences.

This is because of the power of 20-20 hindsight. If it turns out that by some action the client engaged in a fraud or made a misrepresentation and the usual suspects are lined up to be held responsible, if the lawyer was on the scene, it will be asserted that the lawyer should have known, even if the lawyer did not know what was about to occur. Why wasn’t the lawyer suspicious? Why didn’t the lawyer ask more questions? Seek documentation? Check further? Contact third parties? Furthermore, as with Rule 1.6, the Commission will have created a whole new area of potential lawyer liability, holding lawyers financially responsible systematically for the damage flowing from the misdeeds, or even bad judgment, of their clients.

If that were all that was at stake—a huge increase in premiums for lawyers and the creation of additional deep pockets to respond to corporate errors—one could be accused of simply professional self-protection, though one could properly ask the question why lawyers would recommend for their professional colleagues self-immolation. That is far from all that is at stake. Rather, this proposal, too, would change the lawyer-client relationship. Instead of lawyers taking their instructions from their clients and permitting the client to determine the scope of the representation, with this new audit function, lawyers, rather than simply providing the requested services, will engage in a wholesale campaign of checking to learn what someone, someday will argue they should have known. Instead of working with their clients, lawyers will treat them with

26 See supra notes 16 and 19.
skepticism at best and suspicion at worst. Instead of reasonable cost for drawing up a contract or assisting with a merger, lawyers will add millions to their fees as they perform due diligence, not simply when it is currently required for initial public offerings, but for all matters handled for the organizational client. What a wonderful trifecta of salutary results the Commission's "should have known" standard will create: mutual suspicion between lawyer and client, higher fees for clients, and expanded liability for lawyers.

If I did not know better, I would have assumed the Commissioners were in the hip pocket of the Legal Malpractice Section of the Association ofTrial Lawyers. But I am sure they are not. No, rather the Commission has simply gotten caught up in the frenzy that was Enron, and in its attempt to do something to respond to the avalanche of unwanted public criticism, the Commission lurched into offering a minor change of "knows" to "should have known" that turns out to be both particularly bad public policy and flawed professional responsibility.

Our profession has taken two body blows from the Big Five, now the Final Four. The first was their attempt to take over the practice of law with their brilliant idea of forming multi-disciplinary practices (MDPs). They almost sold us that bill of goods. The ABA MDP Commission adopted proposals that would have destroyed our core values, succumbing to the Big Five's frantic search for new worlds to conquer masquerading as client demand for one-stop shopping. It took the fallout from Enron to demonstrate what a flawed idea that was.

Now Arthur Andersen has brought us Enron and WorldCom; other members of the Big Five have brought us Adelphia, Qwest, and others. The hysteria generated by the apparent complicity between management and their company's auditors has also brought us charges that somehow the lawyers are also responsible for what occurred and that the cure for that

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27 The five largest audit firms, or "Big 5 firms," were Arthur Anderson LLP, Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, and Pricewaterhouse Coopers LLP. Since the Enron debacle, Arthur Andersen has filed for bankruptcy, changing the firms' nickname to the "Final 4."


responsibility is new rules and expanded liability for our profession.

Let us deflect this body blow as well. Not until those who seek change demonstrate why our rules are flawed and how the rule changes they propose would do more good than harm should we even consider such proposals. This, alas, the Cheek Commission has not and cannot do. So as with the not very lamented MDP proposals, let us give the Commission's proposal the respectful burial it deserves.