The Pit, the Pendulum, and the Legal Profession: Where Do We Stand After Five Years of Sarbanes-Oxley?

By C. Evan Stewart

Evan Stewart is a partner at Zuckerman Spaeder LLP in New York. Mr. Stewart is also an Adjunct Professor of Law at Fordham and Brooklyn Law Schools, and a Visiting Professor at Cornell University.

In the direct aftermath of the corporate scandals that rocked the dawn of the Millennium (e.g., Enron, WorldCom, Adelphia, Tyco, etc.), a number of folks (mostly legal academics, some politicians, as well as a few others) believed that if only lawyers had somehow acted as better “gatekeepers” of the capital markets, the foregoing crises in capitalism could have been avoided.[1] This belief led to Section 307 being grafted on to the Sarbanes-Oxley legislation in 2002, pretty much as an afterthought. Section 307, as written, appeared to be a fairly innocuous Congressional initiative--the legislation, on its face, required lawyers to live up to pre-existing standards set forth in ABA Model Rule 1.13 (the so-called “chain-of-command” review process).[2] Congress also mandated that the Securities and Exchange Commission should thereafter “explain” what Congress in fact meant by enacting Section 307.

The SEC and Section 307.

Acknowledging that it was adopting an “expansive view” of the mandate given it by Congress for interpreting Section 307, the SEC in late 2002 put forward a number of far-reaching proposals in its first release for comment (over 90 pages, single-spaced), including: (i) federalizing lawyer conduct for the first time in U.S. history; (ii) establishing a requirement that a lawyer (if not satisfied with the corporate response to his or her concerns) withdraw, inform the Commission of that withdrawal, and disaffirm any implicated documents submitted to the SEC upon which he or she worked (a “noisy withdrawal”); (iii) creating sets of circumstances whereby a lawyer would be ***allowed*** to disclose client confidences to the SEC with respect to ongoing or past activities (while asserting that such communications would not constitute a waiver of the privilege);[3] (iv) appearing to establish attorney obligations to comply with Section 307 based upon an “objective” standard of knowledge (i.e., what a “reasonable” lawyer would have done), as opposed to what had ***always*** been the standard for judging attorney conduct--“actual” knowledge; (v) requiring lawyers to document their compliance with the statute in order to avoid sanctions; and (vi) subjecting attorneys to a full panoply of sanctions under the Securities Exchange Act of 1934 for, ***interalia***, negligent conduct.

The SEC's first release was met with a flurry of comment and criticism. After reviewing what had come in over the transom, the SEC then published its “final” release at the end of January 2003. This “final” document--about half the size of the first release--became effective in mid-2003. It was publicly depicted as “modifying,” “scal[ing] back,” or “eas[ing] off” the Commission's first release.[4] As we will see, that was not really the case.

Noisy Withdrawal vs. Noisy Withdrawal 'Lite.'

The SEC's “noisy withdrawal” proposal brought on the greatest amount of reaction, most of it negative. The proposal not only went far beyond the obvious scope of Sarbanes-Oxley (as the SEC itself acknowledged), it also:

- reflected confusion between the professional responsibility concepts of withdrawal, noisy withdrawal, and the disclosure of client confidences to third parties;
- was inconsistent with current practices as to lawyers' confidentiality obligations in and amongst the great majority of states (which for more than 200 years had exclusive responsibility for attorneys' professional responsibility obligations);[5]
- in fact, constituted a radical departure not only from then-existing attorney obligations;[6]
- would provide for a liability whipsaw for lawyers (i.e., liability to clients and shareholders if you noisily withdrew and you were wrong; liability to third parties and regulators if you did ***not*** noisily withdraw and you were wrong--in short, a heads I lose, tails you win proposition);[7]

- would provide an obvious incentive for the most able and experienced lawyers to decline to represent clients in "close" questions;[8]
- would create a breach to the attorney-client privilege and lawyers' ethical duties of client confidentiality; and
- would lead to less, rather than more, corporate compliance with the law.

Based upon perhaps some (if not all) of the foregoing concerns, the Commission beat a strategic retreat (of sorts). The SEC put the noisy withdrawal proposal on hold, and issued a new proposal in its stead.

The new proposal (dubbed by some "noisy withdrawal lite") was exactly the same as its predecessor, with one exception: instead of the attorney contacting the SEC to rat out the client, it would now be the client's (corporation's) obligation to report the attorney's withdrawal and to disaffirm the attorney's work product. By this masterful or cynical (or both) maneuver, the Commission took off the table what it thought was at the center of most of the organized bar's earlier protests (i.e., attorneys would not be exposed under the "noisy withdrawal lite"). At the same time, however, the new proposal did not address the more important public policy issue posed by its predecessor: whether "noisy withdrawal lite" would lead to less, or more, corporate legal compliance.

In my professional experience, most highly paid corporate executives are intelligent and rational. If that is true, it is highly doubtful that merely changing who rats them out to the SEC--shifting it from the general counsel to the chief financial officer, for example--would have a material (or otherwise) impact upon their willingness to seek out advice from skilled and able legal experts on difficult questions.

This was the state of play almost five years ago. Since that time, the Commission has not put into force either noisy withdrawal or noisy withdrawal lite. Also since that time there have not been any publicly reported actions by an attorney consistent with noisy withdrawal or noisy withdrawal lite (or some corporate trainwreck that could have been avoided by either).[9] Perhaps the SEC's "caution" in this space has been warranted?

The SEC's Other 'Modifications' of Section 307.

While the SEC did not move forward with either "noisy withdrawal" proposal, its final rules under Section 307 responded to other comments/critiques and incorporated a number of amendments to its first release. Those relating to the scope of this article included:

- clarifying that lawyer knowledge would in fact be governed by an "objective" standard (as opposed to the historically used, actual knowledge standard);
- withdrawing the requirement that lawyers document their compliance to protect against regulatory liability;
- stating that Section 307 (in the SEC's view) would not constitute a private right of action against lawyers (independent of Section 10b-5 claims);
- acknowledging that the SEC does not have the authority to effect a selective waiver of the attorney client privilege;
- announcing that Section 307 does not preempt conflicting or inconsistent state law governing lawyer conduct, so long as the states meet the minimum standards of the SEC's rules and regulations; and
- clarifying that, with respect to **permissive** disclosure: (i) instead of lawyers being permitted to disclose a client's "illegal" act (current, prospective, or past), disclosure would now be permitted where there is (or was) a "material violation" [a defined term which is far broader]; and (ii) as to the organized bar's opposition to expanding lawyers' disclosure obligations to the SEC [by way of **permissive** disclosure], the SEC pronounced there had "been ample discussion" on that subject and that the matter was now closed.[10]

Not content to stop there, the SEC also used its significant leverage to "jaw-bone" the American Bar Association later that year into abandoning its prior positions on **permissive** disclosure of client confidences, so as to bring the ABA's Model Rules into line with the SEC's new standards.[11]

Enforcement and Section 307.

In the aftermath of the SEC's action(s), I frequently used the following hypothetical in public presentations to illustrate the dangers of Section 307, especially to inside lawyers:

> Suppose you had received a call in 1999 from a headhunter who offers you the perfect job--a senior inhouse position at one of the country's cutting-edge companies, whose executives are frequently in the news as being brilliant and innovative; the stock options you

will receive will alone make you very wealthy; and the job is right in your professional sweet spot--you will be their associate general counsel in charge of all the company's securities disclosure documents filed with the SEC (e.g., 10-K). The company's name? Enron.

Fast forward five years, and you are sitting in a drab conference room at the SEC's headquarters in Washington. A young SEC enforcement lawyer is taking your deposition, and is concentrating her energies on why you did nothing to alert the Commission (or anyone else) that the numerous securities filings you filed on behalf of Enron were fraudulent and led to the downfall of that company. Your defense: neither Andy Fastow (the CFO) nor anyone else in charge of Enron's financials told you of the various shenanigans.

Is that a good defense? Probably not according to Section 307, as interpreted by the SEC. Remember: actual knowledge is not the standard by which you would be judged (with 20-20 hindsight); it is now what a reasonable lawyer should have known.

This is not a mere hypothetical. In 2007, the SEC brought a civil lawsuit in Houston, charging that two very senior Enron lawyers (the former general counsel, and the former associate general counsel in charge of securities filings) committed, ***interalia***, securities fraud that led to/contributed to the demise of the company. Among the wrongful conduct it is alleged that the inhouse Enron lawyers "knew or were reckless in not knowing" that the company's SEC filings were materially misleading.[12] The Commission seeks disgorgement, civil penalties, and director/officer bans.

The foregoing hypothetical-into-reality is not the only aggressive position the SEC has taken against corporate lawyers recently. The Commission has also brought a case against a General Re Corp. assistant general counsel.[13] The charge? That he helped American International Group (AIG) commit accounting fraud by participating in the creation of a structure for two alleged sham/riskless transactions (and by drafting transaction documents). Whether the General Re lawyer knew of AIG's alleged fraud is unclear; equally unclear is what he could/should have done in his "gatekeeper" function to prevent ***another*** company from engaging in fraud.[14] The Justice Department subsequently went the SEC one better, bringing on a criminal case against the General Re lawyer; according to the indictment, the lawyer's crime is that he knew the transactions were wrong, but thought only AIG could get into trouble. This amazing trial started on January 7, 2008.[15] Stay tuned for the results!

Besides the ***Enron*** and ***General Re/AIG*** cases, the SEC in the post-Enron era has named lawyers as respondents or defendants in a multitude of proceedings.[16] Some of these have been fairly unremarkable cases--they would have (or at least should have) been brought irrespective of the new standards required by the legislation (as interpreted and implemented by the Commission). For example, where an in-house lawyer back-dated contracts, engaged in financial fraud, and kept material information from outside lawyers and the SEC staff, no one is likely to contend that such conduct is "close" to any line.[17]

Other enforcement actions, however, are perhaps not so benign. They include cases: (i) where an inhouse attorney was initially wrong (as a matter of law) in determining the nature and extent of what needed to be disclosed and disclaimed on the company's website regarding research reports;[18] (ii) where bond counsel for a school district gave an unqualified legal opinion as to the tax-exempt statue of certain bonds, an opinion that was subsequently determined to be wrong;[19] (iii) where an inhouse lawyer improperly advised his company that it could issue certain options without certain required disclosures;[20] and (iv) where an inhouse lawyer, who ultimately blew the whistle on his employer's misconduct, was held to have failed to inform the board of important information regarding decision-making by the CEO (regarding subsequent misconduct) at an earlier period in time, and such failure caused a misleading disclosure document.[21]

These four cases would seem to be at odds not only with recent sentiments publicly expressed by SEC Chairman Cox,[22] but also with the SEC's seminal decision in ***In re Carter and Johnston***.[23] There, the SEC staff wanted two experienced lawyers sanctioned for aider and abettor liability. The record evidence was that their "difficult" client refused to adopt their disclosure advice, and instead submitted materially false documents reflecting its financial condition (while the lawyers "stood by" and "allowed" that to occur). The Commissioner rejected the staff's recommendation(s) because it found "no awareness or the intent element of the offense of aiding and abetting." The Commissioners also opined as to the proper threshold for "unethical or improper conduct":

> Significant public benefits flow from the effective performance of the securities lawyer's role. The exercise of independent, careful and informed legal judgment on difficult issues is critical to the flow of material information to the securities markets. Moreover, we are aware of the difficulties and limitations attendant upon that role. In the course of rendering securities law advice, the lawyer is called upon to make difficult judgments, often under great pressure and in areas where the legal signposts are far apart and only faintly

discernable.

> If a securities lawyer is to bring his best independent judgment to bear on a disclosure problem, he must have ***the freedom to make innocent--or even, in certain cases, careless--mistakes without fear of legal liability*** or loss of the ability to practice before the Commission. Concern about his own liability may alter the balance of his judgment in one direction as surely as an unseemly obeisance to the wishes of his client can do so in the other. While one imbalance results in disclosure rather than concealment, neither is, in the end, truly in the public interest. Lawyers who are seen by their clients as being motivated by fears for their personal liability will not be consulted on difficult issues.[24]

Just as Groucho Marx once memorably asked: “Who are you going to believe--me, or your own eyes?”, the foregoing is not a lot of help in trying to pick (or judge) where the boundaries are for what the SEC is going to deem unacceptable lawyer conduct. About the only helpful hint is to remember that hindsight is not a fun way for others to view lawyer conduct after a corporate/legal trainwreck.[25]

Preemption and Section 307.

As noted above, the Commission (without any sense of irony or humor) opined in its final release that Section 307 does **not** pre-empt conflicting or inconsistent state law governing lawyer conduct, so long as the states meet the minimum standards of the SEC's rules and regulations. Of course, that would actually equate to pre-emption. The SEC also added a “good faith” provision--a lawyer might be shielded from federal securities law sanctions if the lawyer, acting in accord with inconsistent state disciplinary standards, “complies in good faith” with the SEC's rules and regulations.

In July of 2003, the Washington State Bar Association (WSBA) promulgated a “proposed interim formal opinion,” in which the WSBA warned Washington licensed lawyers that complying with the SEC's permissive disclosure standards would likely conflict with the state's applicable ethical standards and that such conduct could therefore get said lawyers into disciplinary hot water with the WSBA. The WSBA also cautioned its state licensed lawyers not to take much comfort in the SEC's “good faith” safe harbor.[26]

Shortly before the WSBA formally approved the opinion, the SEC's general counsel wrote a public letter to the WSBA's officials on July 23, 2003.[27] In his letter, the Commission official: (i) urged the WSBA not to approve the opinion; (ii) argued that Supreme Court precedent was such that Washington State's rules--insofar as they might be inconsistent with Section 307--would be pre-empted;[28] and (iii) warned the WSBA not to frustrate (or attempt to frustrate) the “good faith” safe harbor.

Rather than dissuade the WSBA, the SEC general counsel's letter prompted the Corporations Committee, Business Law Section, of the State Bar of California to issue its own challenge to the SEC. By a letter dated August 13, 2003, the California Committee: (i) made clear that California does not allow lawyers to disclose client confidences; (ii) expressed numerous policy considerations in favor of its state's law and rules (e.g., undergirds the attorney-client relationship, encourages greater law enforcement, disclosing client confidences can have serious consequences to lawyers and clients, etc.); (iii) opined that it was unclear whether the SEC had the authority to adopt the permissive disclosure provisions of Section 307; (iv) further opined that those provisions of Section 307 did not pre-empt the state's laws and rules; and (v) expressed that the California Bar had no authority to refuse to enforce California's statutes on the basis of federal pre-emption unless (and until) a California appellate court had so ruled.[29]

Since the foregoing to and fro, there has been no “meeting of the minds” between and amongst Washington, California, and the SEC. Where do the other states stand on the issue of pre-emption? Well, one state--North Carolina--has publicly agreed with the SEC on the pre-emption issue.[30]

Most other states have tended to shy away from a direct confrontation with the Commission. After the ABA's Model Rules were changed to bring them into line with Section 307's strictures on disclosure of client confidences, a number of states undertook their own reviews to see what they should do. Perhaps not surprisingly, the results reflect a wide disparity of approaches.

Certain states have adopted the ABA Model Rules without substantive change.[31] A number of other states have tinkered with some of the “chain-of-command” review process and attorney disclosure obligations.[32] Another group of states simply have chosen to follow the old version of the Model Rules (both as to chain-of-command and lawyer

disclosures);[33] while some states have not changed their prior chain-of-command process, as well as their idiosyncratic views of lawyer disclosure obligations.[34] Finally, certain states have tinkered with (or rejected) the Model Rule's chain-of-command process, and have also not adopted the corresponding disclosure provisions.[35]

The most significant of this last group of states is New York. After almost five years of work, on November 3, 2007, the New York State Bar Association's House of Delegates approved sweeping amendments to New York's Code of Professional Responsibility. In full awareness of the SEC's position on pre-emption, the Delegates (and the bar group that drafted the amendments) declined to adopt, ***entoto***, the Model Rules' chain-of-command approach, and explicitly rejected the Model Rules' disclosure provisions.[36]

So what is a lawyer to do in the face of all this conflict and uncertainty? At a minimum, lawyers need to be sure as to the position of the states in which they hold their law licenses. Beyond that, caveat counselor, because woe to the first lawyer who is the guinea pig in the test of wills between the SEC and one of the states that has chosen to chart its own course.[37]

Conclusion.

In the five years since Sarbanes-Oxley came upon us, capitalism has neither been ruined, nor has it been saved. Rather, our capital markets have generally gone on pretty much as before (albeit with additional costs).[38]

Can the same be said for the legal profession? My qualified answer is: sort of, in the short term (maybe). While the legal profession has in fact undergone a revolution by dint of Section 307,[39] its total impact has yet to be felt. The SEC enforcement actions detailed above give a glimpse into what the future holds. At the same time, however, the states have been slow/reluctant/opposed to embracing the new standards of conduct and disclosure obligations. It also seems that lawyers (conservative people that we are, uneager to embrace change) have not fully awoken to how the game has been changed; and it further appears that a number of lawyers believe (mistakenly) that Section 307 does not apply to them, since they do not consider themselves "securities" lawyers.

Some of the other currents swirling around (the pendulum having swung just a bit back toward the middle, as discussed above) have perhaps made it a somewhat less difficult environment in which to practice law without getting us or our clients into trouble.[40] But make no mistake, there is no going back from what Section 307 hath wrought. Lawyers not fully wary of the traps that lie ahead will only have themselves to blame.[41]

[1] ***See***, ***e.g.***, Roger Cramton, George Cohen, and Susan Koniak, "Legal and Ethical Duties of Lawyers After Sarbanes-Oxley," 49 ***Villanova L. Rev.*** 725 (2004). There is, however, no evidence (at least in the public record) that had lawyers in fact been better "gatekeepers," there would have been any positive preventative impact on any of these corporate scandals. ***See*** C. Evan Stewart, "Holding Lawyers Accountable in the Post-Enron Feeding Frenzy," 34 ***BNA Sec. Reg. & L. Rep.*** 1587 (September 30, 2002).

[2] In its current version, ABA Model Rule 1.13 reads, in pertinent part:

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

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

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

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

then the lawyer may reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.

[3] Under the SEC's first iteration of its “permissive” disclosure standard, lawyers ***may*** disclose client confidences: (i) to prevent an “illegal” act (where there is/will be substantial financial injury); (ii) to reveal an “illegal” act (where there is substantial financial injury by an issuer or a fraud on the SEC); or (iii) to rectify an “illegal” act (where an issuer used the lawyer's services). The “illegal” act requirement was subsequently amended. ***Seeinfra*** note 10 and accompanying text.

[4] The SEC itself took the view that its final release had been “significantly modified” as a result of the comments it had received.

[5] A number of the academic advocates of Section 307 (and its expansive “reading” by the SEC) had argued that the states (pre-2003) had had a fairly uniform set of rules governing lawyers' disclosure obligations (both mandatory and permissive). Unfortunately, that contention was based upon an inaccurate review/analysis of the states' wide disparities in those areas. ***See*** C. Evan Stewart, “Caveat 'Reformers': Lessons ***Not*** to Be Learned from Enron's Collapse,” 34 ***BNA Sec. Reg. and L. Rep.*** 310 (February 25, 2002).

[6] To the extent there had been ***any*** authority to support the notion of a “noisy” withdrawal up to that point, certain commentators had looked to Comment 15 to ABA Model Rule 1.6 as constituting some basis for a “noisy” withdrawal option. As pointed out in ABA Op. 92-366, however, comments to the Model Rules have no weight or force. Furthermore, the ABA House of Delegates--both before and after the creation of Comment 15--had specifically voted down a “noisy” withdrawal option.

[7] ***Compare,e.g.***, ***Chem-Age Indus. Inc. v. Glover***, 652 N.W.2d 756 (S.D. 2002) ***withParker v. M&T Chems. Inc.***, 566 A.2d 215 (N.J. Super. 1989).

[8] Such a result would be directly at odds with what the SEC had previously identified as critical to ensuring greater legal compliance by clients. ***SeeIn re Carter and Johnson***, 47 S.E.C. 471, Fed. Sec. L. Rep. (CCH) ¶ 82-847 at 84, 145, 84-167, and 84-172-173 (February 28, 1981). In that same year, the U.S. Supreme Court came to the exact same result/conclusion, when it extended the attorney-client privilege to all corporate employees, justifying that step on the ground that full and candid communications between lawyers and their business colleagues/clients are essential to ensuring effective compliance with the law. ***SeeUpjohn v. United States***, 449 U.S. 383 (1981). For a full vetting of these two decisions and their interaction, see C. Evan Stewart, “Liability for Securities Lawyers in the Post-Enron Era,” 35 ***Rev. Sec. & Comm. Reg.*** 171 (September 11, 2002). For more on ***Carter and Johnson*** itself, ***seeinfra*** notes 23 and 24, and accompanying text.

[9] One former SEC enforcement lawyer (now in private practice) has argued that the accounting problems involving Spiegel Inc. could have been avoided if the SEC's noisy withdrawal provision had been in play. ***See*** R. McTague, “Spiegel Examiner Says Noisy Withdrawal Would've Helped Bring Wrongdoing to Light,” 19 ***ABA/BNA Lawyers' Manual on Professional Conduct*** 542 (September 24, 2002). Upon review of the written investigation which has been made public, however, that judgment seems questionable (at best). In none of the speeches by SEC officials on this topic has there been citation to any real-life situations. ***Seeinfra*** note 18 (speeches of Messrs. Cox and Prezioso).

[10] ***Seesupra*** note 3.

[11] ***See*** Jonathan Glater, “Bar Association in a Shift on Disclosure,” ***N.Y. Times*** A12 (August 12, 2003); ***seealso*** C. Evan Stewart, “Liability for Securities Lawyers in the Post-Enron Era,” 35 ***Rev. Sec. & Comm. Reg.*** 171 (September 11, 2002) (review of prior ABA votes against such standards). One area where the ABA did not “cave” was the requirement of an attorney's actual knowledge (vs. the SEC's adoption of the objective standard--i.e., what a reasonable lawyer should have known).

[12] ***See*** Judith Burns, “SEC Charges 2 Former Enron Lawyers,” ***Wall Street Journal*** A9 (March 29, 2007). ***Seealso*** SEC Litigation Release No. 20058 (March 28, 2007). This past summer, the two lawyers moved to dismiss the suit on, ***interalia***, statute of limitations grounds. Those motions are ***subjudice***.

[13] ***SeeSEC v. Ferguson, et al.***, No. 06 Civ. 0778 (S.D.N.Y). ***Seealso*** SEC Litigation Release No. 19552 (February 2, 2006)

[14] ***SeeSchatz v. Rosenberg***, 943 F.2d 485 (4th Cir. 1991).

[15] ***See*** Lynnley Browing, “Buffett Is Named as a Witness in the Fraud Trial of 6 Insurance Executives,” ***New York Times*** C4 (December 4, 2007). Another trail-blazing set of parallel cases by the SEC and the Justice Department are criminal and civil charges brought on against Joseph Collins, a partner of Mayer Brown LLP. Both cases (brought in the Southern District of New York) charge Collins (a corporate lawyer) with aiding and abetting financial fraud by his former client, Refco Group Ltd. Collins is alleged to have handled numerous transactions that were fraudulent and to have submitted several false disclosure documents to the SEC. ***See*** SEC Litigation Release No. 20402 (December 18, 2007). According to the Justice Department, Collins was not merely a legal adviser whose client disregarded his advice, but that he “instead played an active and crucial part in perpetrating the Refco fraud.” ***See*** Mark Hamblett, “Attorney Faces Refco Fraud Indictment.” ***New York Law Journal*** 1 (December 19, 2007). When (if) this gets to trial, the nut will be whether, in fact, the government can prove Collins knew of Refco's precarious financial condition and fraudulently concealed it (as opposed to papering deals and disclosure documents in the manner of most outside lawyers--without access to hidden financial data).

[16] In fact, 30 lawyers were named in the two years after Sarbanes-Oxley's passage alone. ***See*** Stephen M. Cutler, “The Themes of Sarbanes-

Oxley as Reflected in the Commission's Enforcement Program," UCLA School of Law, September 20, 2004 (available at http:/www.sec.gov/news/speech/spch092004smc.htm) (predicting more actions against lawyers).

[17] ***SeeIn re Steven Woghin***, Securities Exchange Act Release No. 50653 (November 10, 2004); ***SEC v. Computer Associate International Inc.***, SEC Litigation Release No. 18892 (September 22, 2004). This case is notable, however, insofar as it also relates to criminal prosecutions of Computer Associates executives based upon the theory that lies told to outside lawyers engaged in an internal investigation into the company's affairs constituted the equivalent of lying to government officials (which is a felony). ***See*** C. Evan Stewart, "Corporate Investigations: The Good, the Bad and the Ugly," ***New York Law Journal*** (March 27, 2006).

[18] ***SeeIn re Taglich Brothers, Inc. and Richard C. Oh***, Securities Exchange Act Release No. 50388 (September 15, 2004). This particular action (and the others cited above) would seem inconsistent with SEC Chairman Cox's recent pronouncement that none "of the actions we have brought against lawyers have been for giving bad advice. Rather, our actions against lawyers have focused on the lawyer's actual conduct." ***See*** Address to the 2007 Corporate Counsel Institute, March 8, 2007 (available at http://www.sec.gov/news/speech/2007/spch030807/cc.htm). At the same time, they would be consistent with some prior litigations instituted by the Commission. ***SeeS.E.C. v. National Student Marketing, Inc.***, 457 F. Supp. 682 (D.D.C. 1978) (attorneys liable as aiders and abettors for giving incorrect legal advice at the closing of a corporate transaction). And they would also be consistent with a prior public statement by the SEC's general counsel. ***See*** Remarks before the Spring Meeting of the Association of General Counsel, April 28, 2005 (available at http://www.sec.gov/news/speech./spch042805gpp.htm) (In that speech, Giovanni Prezioso said, inter alia: "[I]f a lawyer makes a legal judgment about an issue that cannot fairly be viewed as immaterial and fails to inform anyone else at the company of the potential legal risks--in other words, if the lawyer doesn't advise anybody about anything--it will be more difficult to argue that the lawyer played a purely advisory role.").

[19] ***SeeIn re Ira Weiss and L. Andrew Shupe II***, Securities Exchange Act Release No. 50235 (August 24, 2004).

[20] ***SeeIn re Google, Inc. and David C. Drummond***, Securities Act Release No. 8523 (January 13, 2005).

[21] ***SeeIn re John E. Isselmann, Jr.***, Securities Exchange Act Release No. 2108 (September 23, 2004). In this case, the lawyer was on notice that the law prohibited the unilateral elimination of benefits for Japanese employees (and knew that a decision had been made to eliminate those benefits in the future); but neither the board nor the auditors were aware of the plan and its legal infirmities. When the CEO actually attempted to eliminate those benefits, however, the lawyer blew the whistle. ***See*** Tamara Loomis, "SEC Gores GC in Sarbanes-Oxley Dust Up," ***Legal Times*** (January 24, 2005).

[22] ***Seesupra*** note 18.

[23] 47 S.E.C. 471, Fed. Sec. L. Rep. (CCH) ¶ 82,847 (February 28, 1981).

[24] ***Id***. at 84,145. In my view, this opinion is the most nuanced and sensible approach by any court or regulator concerning the dilemmas facing a lawyer with a difficult client. In large measure this is undoubtedly the case because the author of the Commission's opinion was Stephen J. Friedman, a highly distinguished securities lawyer in private practice who well understood the complexities inherent in this set of issues. ***Seealso*** Hemmer, "Resignation of Corporate Counsel: Fulfillment or Abdication of Duty," 39 ***Hastings L.J.*** 641 (1988). Interestingly (or perhaps curiously), I was recently on a panel sponsored by the ALI-ABA (January 11, 2008), in which a high-ranking SEC official opined that ***Carter and Johnson*** was still good law.

[25] And it is not only securities lawyers who need fear for their professional lives. ***See*** J. Cooper and W. Vodra, "New Questions About Guilty Pleas in Purdue OxyContin Case," 5 ***BNA Pharmaceutical Law & Industry Report*** (September 7, 2007) (company executives, including general counsel, plead guilty to violating federal misbranding law, based upon the corporation's misconduct, notwithstanding that each individual officer specifically denied knowledge of the facts giving rise to corporate liability).

[26] ***See*** Washington Interim Formal Ethics Opinion 197 (available at http://www.wsba.org/lawyers/ethics/formalopinions/ethicsopinion197.htm) (2003).

[27] ***See*** July 23, 2003 letter of Giovanni Prezioso (available at http://www.sec.gov/news/speech/spch072303gpp.htm).

[28] ***CitingSperry v. State of Florida***, 373 U.S. 379 (1963); ***Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta***, 458 U.S. 141 (1982). As the SEC itself noted when it implemented its final rules "interpreting" Section 307, however, there was substantial pushback from the organized bar as to whether the SEC had in fact been authorized by Congress to pre-empt state law. Both the ABA and the Association of the Bar of the City of New York, for example, took issue with the SEC's assertion of federal pre-emption.

[29] The following year, the Committee published an article embellishing these positions. ***See*** "Conflicting Currents: The Obligation to Maintain Inviolate Client Confidences and the New SEC Attorney Conduct Rules," 32 ***Pepp. L. Rev.*** 89 (2004).

[30] ***See*** North Carolina Formal Ethics Opinion 2005-9 (2006). Interestingly, Washington State did amend its professional responsibility code in

2006, bringing it into substantial compliance with the new model rules promulgated by the ABA. ***See*** "Washington State Overhauls Ethics Rules, Adopting MJP, Updates from ABA Models," 75 ***U.S.L.W.*** 2085 (August 15, 2006).

[31] ***E.g.***, Alaska, Arizona, Arkansas, Connecticut, Hawaii, Idaho, Indiana, Iowa, Louisiana, Massachusetts, Nebraska, South Carolina, and Vermont.

[32] ***E.g.***, District of Columbia, Maryland, Minnesota, North Dakota, Texas, Utah, and Virginia.

[33] ***E.g.***, Alabama, Colorado, Delaware, Florida, Georgia, Kansas, Kentucky, Michigan, Mississippi, Missouri, Montana, Nevada, New Hampshire, New Mexico, North Carolina, Oklahoma, Pennsylvania, Rhode Island, South Dakota, West Virginia, Wisconsin, and Wyoming.

[34] Both Illinois and New Jersey, for example, require ***mandatory*** disclosure in certain circumstances. ***See***, ***e.g.***, ***Balla v. Gambro Inc.***, 584 N.E. 2d 104 (Ill. 1991).

[35] ***E.g.*** Kansas, New York, and Ohio.

[36] ***See*** Joan Rogers, "New York State Bar Parts Ways with ABA on Disclosure of Fraud, Use of Screening," ***ABA/BNA Lawyers' Manual on Professional Conduct*** 587 (November 14, 2007). The recommended rules will take effect when approved by the four appellate divisions of the New York Supreme Court. The SEC has carefully monitored the New York State's ethics review process. ***See*** Michael Bologna, "Thomson Says Securities Lawyers Need to Show 'Professional Courage'," 39 ***BNA Sec. Rep. & L. Rep.*** 756 (May 14, 2007).

[37] Former SEC general counsel, Giovanni Prezioso, gave this advice to lawyers in an April 3, 2004 speech to the ABA's Section of Business Law:

"I would urge any lawyer who would like to make a disclosure under the Commission's rules, but who is concerned with a potential conflict with state bar rules, to consult with us, either directly or through counsel. We on the staff would appreciate the opportunity to work with a lawyer facing such a conflict, either in addressing the issues before state bar authorities or, if necessary, in court. My expectation is that the Commission would be favorably disposed to supporting attorneys seeking to rely on the preemptive effect of its rules."

(available at http://www.sec.gov/news/speech/spch040304gpp.htm).

[38] The cost impact of Sarbanes-Oxley had been much debated, but with little hard evidence. ***See*** C. Evan Stewart, "'Carnacking' the Future," ***New York Law Journal*** (February 15, 2007); C. Evan Stewart, "The Yin and Yang of Corporate Governance," ***New York Law Journal*** (October 11, 2005). What is clear is that, whatever the initial ramp up costs, companies are dealing with compliance costs in a much more efficient manner now. ***See*** "§404 Costs Continued to Fall in 2006, FEI Study Concludes," 39 ***BNA Sec. Reg. & L. Reg.*** 857 (May 28, 2007). The "poster child" of this issue has been Section 404, which requires public companies to demonstrate on an ongoing basis that they have sufficient internal controls to prevent fraud. The SEC has put off, and now put off again (through the end of 2008), the application of Section 404 to "smaller" public companies (those with a public float less than $75 million). ***See*** Malini Manickacasagan, "SEC Plans to Propose Further Delay for Small Company Section 404 Compliance," 39 ***BNA Sec. Reg. & L. Rep.*** 1962 (December 17, 2007).

[39] For a greater explication of this revolution, see C. Evan Stewart, "This Is a Fine Mess You've Gotten Me Into: The Revolution in the Legal Profession," ***NY Business Law Journal*** (Summer 2006).

[40] Some of these other "currents" pushing the pendulum back (at least a little) include: ***Arthur Andersen LLP v. United States***, 544 U.S. 696 (2005) (vacating Andersen's criminal conviction arising out of Enron's collapse); the December 2006 McNulty Memorandum (named after Deputy Attorney General Paul McNulty), which purportedly changed dramatically DOJ's policy on corporate cooperation (in my view, this document does not in fact represent a sea change in the government's prosecutorial tactics: ***see*** "'Carnacking' the Future," ***New York Law Journal*** (February 5, 2007)); ***U.S. v. Stein***, 435 F. Supp. 2d 330 (S.D.N.Y. 2006) (Judge Lewis Kaplan dismissed indictments of individuals after finding the government had improperly pressured their employer to cut off advancing legal fees); ***U.S. v. Stringer***, 408 F. Supp. 2d 1083 (D. Or. 2006) (Judge Ancer Haggerty dismissed indictments of individuals after finding that DOJ and the SEC had improperly whipsawed those individuals); ***Stoneridge Investment Partners LLC v. Scientific-Atlanta Inc.***, 522 U.S. ________, 2008 WL 123801 (January 15, 2008) (Supreme Court rejected plaintiffs' bar's attempted end-run around prior precedent to impose secondary aider-and-abettor liability).

[41] An additional trap not targeted in this article is the unauthorized practice of law trap, a trap which seems to catch an increasing number of lawyers. ***See***, ***e.g.***, "Court Split as to Whether UPL Rule Covers Practice in Federal Court in Licensing State," ***ABA/BNA Lawyers' Manual on Professional Conduct*** 432 (August 22, 2007); Scott Kilman & Joann Lublin, "Southfield's General Counsel Becomes Focus of Union Drive," ***Wall Street Journal*** B9 (August 16, 2006); "New ABA Survey of UPL Enforcement Finds Varied Findings, Predicts Increased Activity," ***ABA/BNA Lawyers' Manual on Professional Conduct*** 23 (January 12, 2005).

Copyright 2008, The Bureau of National Affairs, Inc.