

This Is a Fine Mess You've Gotten Me Into: The Revolution in the Legal Profession

By C. Evan Stewart

You say you want a revolution,
Well, you know . . .
We all want to see the plan.¹

In the direct aftermath of the corporate scandals that marred the beginning of this decade (e.g., Enron, WorldCom, Adelphia, etc.), a number of people (mostly legal academics, some politicians, as well as a few others) believed that if lawyers had somehow acted as better “gatekeepers,” the foregoing crises in capitalism could have been avoided.² This belief led to Section 307 being added to the Sarbanes-Oxley Act pretty much as an afterthought. As drafted, it appeared to be a fairly innocuous legislative initiative (seemingly just requiring that lawyers live up to pre-existing standards set forth in ABA Model Rule 1.13). For better or for worse, however, Congress also mandated that the Securities and Exchange Commission weigh in on what capital markets lawyers’ duties should be; and the SEC did not shrink from that mandate—indeed, the Commission, by its own admission, went well beyond the language of Section 307.³

Federalizing lawyer conduct for the first time in American history, the SEC, *inter alia*, changed professional obligations vis-à-vis confidentiality/disclosure, withdrawal of work product, withdrawal of representation, what constitutes the appropriate standard for lawyer knowledge of client wrongdoing/conduct, as well as ratcheting up the sanctions to be imposed upon lawyers not complying with these new obligations and standards.⁴ Not content to stop there, the Commission then used its bully pulpit to have the American Bar Association abandon many of its prior positions, so as to bring the ABA’s Model Rules into line with the SEC’s new standards.⁵

As I have previously written,⁶ the foregoing has fundamentally changed the nature of a lawyer’s relationship with her client. Rather than merely revisiting that analytical ground, however, this article will look at the *reality* of where we now find ourselves—here in the fourth year of the post-Enron era.

Barbarians Within the Walls of the City

The initial reality is that we live in a regulatory era where the watchword is “cooperation”—governmental entities from the Department of Justice on down have taken to issuing their own guidelines as to what constitutes cooperation.⁷ What does this mean vis-à-vis the

attorney-client relationship? At least two significant ramifications immediately come to the fore.

First off is that governmental agencies now routinely “ask for” (a/k/a demand) a waiver of attorney-client privilege and attorney work product. Besides the not insignificant facts that (1) this cooperation tack is basically surrendering up your client in the hope the government will not kill it (literally), and (2) such waivers can leave a corporation virtually defenseless in civil litigation that is either concurrent or soon to be filed,⁸ one other message is sent by such waivers—a message to corporate employees.

If there is a reasonable presumption that most highly paid executives are intelligent and rational, then one aspect of the revolution in the legal profession can be well illustrated. Any corporate officer who remembers that the three principal witnesses against Frank Quattrone in his criminal trials were senior lawyers from Quattrone’s corporation is more likely than not to conclude that interacting with such folks is not rational behavior.⁹ And, of course, lawyers attempting to interact with and extract information from future Mr. Quattrones will have to do so subject to the ethical guidelines more popularly known as the “Corporate Miranda Warning”—i.e., advising corporate personnel that they are not clients and that the corporation may decide to turn over anything told to lawyers representing the corporation. Not to be further discouraging, but when this warning must be given differs from state to state. In New York, it must be given to employees at a very early stage—when it “appears that the organization’s interests may differ” from those of the individual.¹⁰ In light of all the foregoing roadblocks and hurdles, how likely is there to be a strong, vibrant attorney-client relationship within corporations, one designed to help companies ascertain key facts and make informed legal and business decisions?¹¹

The other ramification to corporate “cooperation” is that corporations, besides being expected to get rid of any personnel implicated in the bad acts (alleged or real), are also now being expected to violate corporate law and their own by-laws by denying individuals their rights to advancement/indemnification; without such rights, few individuals can afford to defend themselves

(something that pleases most prosecutors). Both the Justice Department and the SEC have taken public stances on this issue.¹² Even more aggressive has been the New York State Attorney General.¹³

Advising corporate clients on how to deal with this difficult choice—violate the law (and their by-laws) or fail to cooperate—will, if nothing else, prove to be a lively challenge (one not taught in law school). And watching the expressions of corporate officers who may, or may not, be impacted by such decisions will bring home to all concerned that corporate counsel really and truly do have only one client.¹⁴

The Knights Who Say Ni

In February 2004, the head of New York's Investment Protection Bureau stated that "we are living in a completely new regulatory world," and that the Attorney General "would not hesitate" to go after lawyers and/or law firms that were aware of, and approved, "improper" mutual fund trading. Not to be outdone, the head of the SEC's Enforcement Division later announced that "you can expect to see one or more actions against lawyers who . . . assisted their clients in engaging in illegal late trading or market timing arrangements that harmed mutual fund investors," and that the SEC would be looking to sue both in-house and outside lawyers who helped clients conceal mutual fund trading practices or who "prepared, or signed off on, misleading disclosures regarding [their clients'] conditions."

What is wrong with that? Well, plenty. Most fundamentally, the conduct at issue was either widely known and does not *today* constitute illegal conduct ("market timing"), or the conduct was never deemed to be illegal (as a number of prominent law firms so advised clients) prior to the New York Attorney General's attempted criminalization of it in September of 2003 by use of New York's Martin Act ("late trading").¹⁵ Notwithstanding this, if these important regulators are to be believed, it appears that lawyers may soon be under the gun for failing, for example, to predict that activity relating to an obscure provision of the Investment Company Act of 1940 (as interpreted by the SEC staff in 1968), about which there had never been a criminal prosecution or an SEC regulatory enforcement proceeding ("late trading"), could give rise to a felony.¹⁶

And this assault is not limited to mutual fund lawyers. In the aftermath of Sarbanes-Oxley, the Commission has named lawyers as respondents or defendants in more than 30 proceedings.¹⁷ Some of these are fairly unremarkable, insofar as they deal with conduct that (under any regime) would be considered unacceptable professional conduct—e.g., an in-house counsel backdating contracts, engaging in financial fraud, keep-

ing material information from outside lawyers and the SEC staff.¹⁸

Less clear cut is the recent aiding and abetting case brought against a General Re Corp. assistant general counsel.¹⁹ The gravamen of the Commission's action is that the General Re lawyer 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 in-house lawyer knew of AIG's alleged fraud is unclear, as is what he could/should have done in his "gatekeeper" function to prevent *another* company from engaging in fraud. As this case is litigated, all lawyers (in-house and outside) should keep a vigilant watch.²⁰

A Steamrolled "Profession"?

What has been the legal profession's response to the revolution in lawyer roles vis-à-vis clients, lawyers' liability,²¹ etc.? Some, like the Black Knight in *Spamalot*, have not yet thrown in the towel.

One prominent example is the position of the state bars of Washington and California. When the SEC promulgated its regulations under Section 307, it stated that it did not intend to pre-empt conflicting or inconsistent state laws governing lawyer conduct, so long as those state laws met the minimum standards of the SEC's rules and regulations! One of the key provisions of those rules and regulations is the *permissive* disclosure of client confidences in order to (a) prevent a material violation of the securities laws which is likely to cause substantial financial injury; (b) prevent perjury or the perpetration of a fraud upon the Commission; or (c) rectify a material violation of the securities laws which caused (or may cause) substantial financial injury and which involved use of the lawyer's services.

Such disclosure(s), according to the state bars of Washington and California, would be directly contrary to those states' laws which bar lawyers from disclosing confidences. The California and Washington bars further told the SEC that they did not view things as settled because the Commission's disclosure rules (a) were contrary to sound and well-established public policy; (b) would hurt both clients and lawyers; (c) were unenforceable (unless a high state court ruled them to be enforceable); (d) may not pre-empt the field; and (e) may be successfully challenged in future litigation. The Commission fired back responses to the effect that (i) the rules and regulations mean what they say and (ii) no state licensed lawyers should proceed on the basis that the rules and regulations do not apply to them. Since this "eyeball-to-eyeball" exchange, neither side has yet blinked.²² Stay tuned!

A somewhat more timid response has come from the American Bar Association. Faced with the undeniable withering of the attorney-client privilege, the ABA established a task force on the subject in October of 2004, and thereafter held numerous hearings. In June of last year, the task force delivered its report, recommending that the ABA adopt resolutions (i) expressing strong support for the privilege and work product doctrine, and (ii) expressing opposition to the government's actions undermining those privileges.²³ That's telling 'em!

Perhaps most interesting is the ultimate work product of the New York State Bar Association Committee on Standards of Attorney Conduct. After nearly three years of study, that Committee (on September 30, 2005) issued "Proposed New York Rules of Professional Conduct." Of greatest relevance to the subject of this article, the broad-based Committee did not propose adoption of the sweeping changes in disclosure of client confidences enacted by the SEC (and later the ABA).²⁴ And while the Chair of the Committee expects a "contentious debate" when the New York State Bar formally considers the proposed rules,²⁵ it is striking that New York—even in the face of the SEC's public challenge to Washington and California—appears to be standing with those states. The Committee's principled position on this key issue may well have profound consequences for the legal profession.

Conclusion

Over 30 years ago, Simon Rifkind—a great lawyer and leader of the bar—wrote that:

One solution that has been proposed for [the ethical problems faced by lawyers] finds one in loud opposition. That is the attempt to convert the lawyer routinely into an informer against his client.

When it is stated in this simplistic form, our revulsion is instantaneous, if not instinctive. . . . The merest suggestion that the lawyer become a stool pigeon against his client fills us with abhorrence. . . .

. . . Access between attorney and client, uncensored and uninhibited, is indispensable to the independence of the bar; and the independence of the bar is a condition precedent to a free society and a democratic government.²⁶

Fast forward to 2006, however, and what filled Rifkind with "instantaneous" and "instinctive" "revul-

sion" is now federal law. An illustration that crystallizes how far we have come is to imagine the fate of an in-house lawyer at Enron in 2000 charged with preparing various SEC disclosure documents—assuming Section 307 were applicable. If the in-house lawyer failed to exercise permissive disclosure and reveal wrongdoing to the SEC and/or withdraw her work product, she would face a career-ending enforcement proceeding. Her defense could not be based upon a lack of actual knowledge of what Mr. Fastow et al. were up to, because the knowledge standard has been changed by the SEC—from actual knowledge to an objective standard (i.e., what she should have known). If that is not a scary scenario, it is not clear what is!

Where the revolution under way in the legal profession will come to rest—especially in the context of client confidences, obligations and relationships—remains unclear. Maybe, as John Lennon sang: "it's gonna be all right." But then again, maybe not.

Endnotes

1. The Beatles, *Revolution*, on *The White Album* (Capitol Records 1968).
2. See, e.g., Roger Cramton, George Cohen & Susan Koniak, *Legal and Ethical Duties of Lawyers After Sarbanes-Oxley*, 49 Villanova L. Rev. 725 (2004). As I have elsewhere noted, there is no evidence (at least in the public record) that changing lawyer disclosure obligations, etc., would have had an impact on any of these corporate scandals. See C. Evan Stewart, *Holding Lawyers Accountable in the Post-Enron Feeding Frenzy*, BNA Securities Regulation & Law Report (September 30, 2002).
3. See C. Evan Stewart, *Sarbanes-Oxley: Panacea or Quagmire for Securities Lawyers?* N.Y.L.J. (2003).
4. See C. Evan Stewart, *The SEC and the Lawyer-Client Relationship: A Revolution in the Making*, Compliance Reporter (February 9, 2004). (As of the time of this article, the SEC has still not resolved the status of its highly controversial Noisy Withdrawal and Noisy Withdrawal Lite proposals.) See *id.*
5. See Jonathan Glater, *Bar Association in a Shift on Disclosure*, N.Y. Times, August 13, 2003 at A12; see also C. Stewart, *Liability for Securities Lawyers in the Post-Enron Era*, 35 Rev. Sec. & Com. Reg. 171 (September 11, 2002) (review of prior ABA votes against such positions). One area where the ABA did not make a change was the requirement of "actual knowledge" (as opposed to the SEC's adoption of the so-called objective standard—i.e., what a reasonable lawyer should have known).
6. See *supra* nn. 3 & 4. And it is not just me. See *Corporate Counsel Have Heightened Duties to Respond to Insider Wrongdoing*, BNA Lawyers' Manual on Professional Conduct 143 (March 22, 2006).
7. The New York Stock Exchange is the most recent promulgator on this score. See S. Merrill, *NYSE Chief of Enforcement on Sanctions, Investigative Cooperation*, N.Y.L.J. (2006).
8. See C. Evan Stewart, *Corporate Investigations: The Good, the Bad and the Ugly*, N.Y.L.J. (2006). More troubling than waiver of the privilege is waiver of "core" attorney work product. Even in the face of such waivers (or even more egregious conduct), a few courts have been reluctant to pass on such "core" work product to private plaintiffs' lawyers. See *In re Kidder Peabody Securities Litigation*, 168 F.R.D. 549 (S.D.N.Y. 1996) (no waiver of "core"

- work product even when it was used as a “sword” and a “shield”); *Crowe Countryside Realty Association Co. v. Novare Engineers Inc.*, R.I., No. 2004-204-M.P. February 1, 2006) (no waiver of “core” work product even when it was shared with a testifying expert). Whether a lawyer should act in the hope of drawing one of these judges would be highly questionable professional judgment.
9. Mr. Quattrone has had two trials so far; and with the March 20, 2006 reversal by the Second Circuit of his conviction after the second trial, he may well face a third. Most corporations routinely require that employees cooperate with counsel as a condition of employment. Future Mr. Quattrones may well meet that requirement by having the corporation’s lawyer deal directly with their personal lawyers; whether such “cooperation” will facilitate quite the same level of helpful information seems doubtful.
 10. The A.B.A.’s Model Rule 1.13 (which many states have adopted) contemplates such a warning being given much later in the investigatory process—“when the lawyer knows or reasonably should know that the organization’s interests are adverse” to the individual’s.
 11. As the U.S. Supreme Court has made clear, that is the principal rationale for having the attorney-client privilege in place within corporations. See *Upjohn v. U.S.*, 449 U.S. 383 (1981). The government today is taking this to new highs (or lows) by bringing on prosecutions against corporate employees who lie to corporate lawyers, based upon the theory that is the equivalent of lying to government officials. See C. Evan Stewart, *Corporate Investigations: The Good, the Bad and the Ugly*, N.Y.L.J. (2006). See also *U.S. v. Singleton*, Cr. No. H-04-514-55 (S.D. Tex. 2006).
 12. See F. Hafetz & T. Sivitz, *Corporate Indemnification and Legal Expenses*, N.Y.L.J. (2006). The U.S. Deputy Attorney General has stated that federal prosecutors should weigh “whether the corporation appears to be protecting its culpable employees and agents . . . through the advancing of attorney’s fees.” The former head of the SEC’s Enforcement Division, in one of his last public statements before leaving office, said: “If an individual can look to his/her employer to pay the freight, what good have we done?” See J. Emshwiller & K. Scannel, *Merrill Faces Issues of Enron Legal Fees: To Pay or Not to Pay?*, *The Wall Street J.* May 11, 2005 at C1.
 13. See, e.g., *Spitzer v. Soundview Health Center* (N.Y. Sup. Co.), N.Y.L.J. 18, col. 3 (January 27, 2005) (court rejected NYAG’s motion to compel officers to furnish a bond to guarantee repayment in order to obtain advancement of fees); C. Mullenkamp, *Sihpol Seeks Legal Payment of Fees*, *Wall Street J.*, October 24, 2004 at C9 (individual forced to sue former employer when NYAG objected to advancement of fees).
 14. Large staffs of in-house lawyers are a reality of today’s corporate world. And while ethically the one client rule is clear (and correct), it is more than a bit odd that these highly trained professionals have been turned into potential everyday adversaries of the business colleagues they have been hired to work with and advise. See Geoffrey Miller, *From Club to Market: The Evolving Role of Business Lawyers*, 74 *Fordham L. Rev.* 1105 (2005); Deborah DeMott, *The Discrete Roles of General Counsel*, 74 *Fordham L. Rev.* 955 (2005).
 15. As a key member of the Attorney General’s team once observed, the Martin Act is “one of the broadest anti-fraud statutes ever devised, at least in a democratic society.” Eric Dinallo, *Prosecuting Securities Fraud from a New York Perspective*, 5 *N.Y.U. J. Legis. & Pub. Policy* 41, 43 (2001).
 16. Or, even worse, in the case of “market timing,” failing to predict that conduct that was well-known (and that even *today* is not illegal) could give rise to a felony, with such failure constituting grounds for sanctioning lawyers.
 17. See Roberta Karmel, *Financial Fraud Cases Against In-House Counsel*, N.Y.L.J. (2006).
 18. See *In re Steven Woghin*, Securities Exchange Act Release No. 50653 (November 10, 2004); *SEC v. Computer Associates International, Inc.*, Litigation Release No. 18892 (September 22, 2004).
 19. See *SEC v. Ferguson et al.*, No. 06 Civ. 0778 (S.D.N.Y.).
 20. The Justice Department subsequently (February 2006) went the SEC one better, bringing 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. Another important case to watch is the criminal action going forward against, *inter alia*, an in-house lawyer at KPMG, which involves a multi-headed tax shelter controversy; the in-house lawyer’s criminal liability is premised upon his role in reviewing the specific shelters and their documentation. That the government never determined such shelters to be infirm at the time of the lawyer’s involvement seems to be of no moment. See Robert Weisberg & David Mills, *A Very Strange Indictment*, *Wall Street J.*, October 12, 2005 at A16. Another issue in that criminal litigation is the governmental pressure on KPMG not to advance fees for their former employees. See *supra* nn. 12 & 13.
 21. Beyond the scope of this article is the important attack on *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994) by the plaintiffs’ bar. *Central Bank* barred aiding and abetting liability under section 10(b) of the 1934 Act. Since then, the plaintiffs’ bar has aggressively litigated one of the issues left open by the Supreme Court: that professionals (such as lawyers and accountants) should be held to the same standard of accountability for fraud in money damages suits as their clients. See C. Evan Stewart, *Liability for Securities Lawyers in the Post-Enron Era*, 35 *Rev. Sec. & Com. Reg.* 171 (2002).
 22. This conjures up the image utilized by Secretary of State Dean Rusk in the 1962 Cuban Missile Crisis with the Soviet Union. Dean Rusk, *As I Saw It*, 237 (Norton 1990). One state that has “blinked”—in favor of the SEC’s disclosure rules—is North Carolina. See North Carolina State Bar Ethics Comm., Formal Op. 2005-9 (January 20, 2006) (lawyers barred by state law from disclosing client confidences may disclose them pursuant to the SEC’s Sarbanes-Oxley standards).
 23. See *ABA is Urged to Express Opposition to Government Incursions on Privilege*, *BNA Lawyers’ Manual on Professional Conduct* 303 (June 15, 2005).
 24. Notwithstanding the active participation of some of the legal academics who championed Section 307, the Committee was leavened with numerous highly experienced legal professionals who know how difficult it is to have clients confide in lawyers, even with a certain (and unassailable) privilege.
 25. See *NYSBA Panel Issues Reporting Proposing Adoption of Model Rules in New York*, *BNA Lawyers’ Manual on Professional Conduct* 532 (October 19, 2005).
 26. 30 *The Record* 534, 541 (1975).

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