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Peter J. Henning
Wayne State University, peter.henning@wayne.edu

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Sarbanes-Oxley Act § 307 and Corporate Counsel: Who Better to Prevent Corporate Crime?

Peter J. Henning†

INTRODUCTION

The Sarbanes-Oxley Act¹ was a reaction to spectacular corporate failures that were traceable to fraudulent accounting mixed with naked greed. Statutes enacted as a reaction to unfolding events are rarely well-conceived, and like many laws adopted in response to discrete events, the Act reflects almost a “shoot-first-ask-questions-later” approach that allowed for quick political gain. Has the Sarbanes-Oxley Act curbed corporate crime? Although it is too early to tell, at least initially the law has added significant costs to the operation of virtually every publicly traded corporation and created an extensive cottage industry of consultants and law firm practice groups offering to guide companies in complying with the statute.

Since its adoption in July 2002, more corporate misconduct has come to light. In March 2003, HealthSouth Corporation fell prey to many of the same accounting problems that led to the demise of Enron and WorldCom. The company’s former CEO, Richard Scrushy, was the first person charged with violating the certification provisions of the Act.² In December 2003, Parmalat SpA, a large Italian conglomerate, fell quickly into bankruptcy after the revelation that a purported $4.8 billion bank account in a

† Professor of Law, Wayne State University Law School.
2. See Carrick Mollenkamp & Chad Terhune, Scrushy Indicted on Fraud Charges, Wall St. J., Nov. 5, 2003, at A3 (“Mr. Scrushy, 51 years old, is the first chief executive at a major company to be charged with violating Sarbanes-Oxley since it was enacted last year in the aftermath of investor outrage at a wave of corporate scandals.”).
Cayman Island bank was, with the help of a scanner and color printer, little more than a figment of senior management's imagination.\(^3\)

While many provisions of the Sarbanes-Oxley Act address the minutiae of reforming corporate boards and auditing at publicly traded companies, one provision addressed specifically to lawyers is largely aspirational: section 307.\(^4\) That provision requires the Securities and Exchange Commission ("SEC" or the "Commission") to adopt rules "requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof)." Added to the Sarbanes-Oxley Act as a floor amendment by the Senate, § 307 was designed to enlist lawyers in the cause of preventing corporate crime. Senator Jon Corzine argued in support of adding the provision that "we cannot overlook the role corporate lawyers, the lowest common denominator, can play in addressing abuses and ensuring that our markets have integrity."\(^5\)

The SEC took up the cause of enlisting lawyers in the battle against corporate crime by proposing rules to implement § 307 that went beyond the limited requirement of attorney reporting within the corporation. In addition to the requisite "up-the-ladder" reporting procedure,\(^6\) the Commission proposed a "noisy withdrawal" rule that would compel corporate counsel to withdraw from representing

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3. See Alessandra Galloni, Scandal at Parmalat Broadens; Staff May Have Destroyed Files, Wall St. J., Dec. 29, 2003, at A1 ("Prosecutors believe the fraudulent Bank of America response [confirming a $4.8 billion account balance] was created in Parmalat's main offices in Collecchio by scanning Bank of America's logo into a computer, printing it out and then passing the sheet of paper several times through a fax machine to make it look authentic").
5. 148 Cong. Rec. S6556 (daily ed. July 10, 2002) (statement of Sen. Corzine) (emphasis added). Senator Enzi stated along similar lines, "It seemed only right there ought to be some kind of an ethical standard put in place for the attorneys as well. All of the people who are involved should be looking at a new way of doing business." Id. at S6554 (statement of Sen. Enzi).
the corporate client if the company's management did not respond appropriately to the lawyer's report of possible misconduct. The proposed rule would enjoin the attorney to "withdraw forthwith from representing the issuer" and "give written notice to the Commission of the attorney's withdrawal, indicating that the withdrawal was based on professional considerations...".

The response from the organized bar to the "noisy withdrawal" proposal was swift and vituperative. References to the hoary role of lawyers as protectors of the innocent and the last bastion of independence from the all-powerful state were brought out to assail the Commission's proposal. An oft-repeated criticism of the proposed rule was the purported unseemliness of the government's attempt to enlist counsel as an agent working against the interests of the lawyer's client—another "cop on the beat." In response to such persistent criticism, the SEC shelved the "noisy withdrawal" rule to study the issue further.

The idea of having corporate counsel disclose the reasons for withdrawing from representation triggered such a strong reaction because of the perceived invasion of the confidential relationship between a lawyer and client. The audience for that report—the SEC and the investing public—would interpret any disclosure of lawyer withdrawal as significant, and potentially catastrophic, for the corporation's future. The pressure on the corporation and its former lawyer to disclose otherwise confidential communications would be enormous, raising significant concerns about the lawyer-client relationship. It is not hard to see why the reaction to the "noisy" aspect of the proposed rule was so strong, and why rhetoric asserting a threat to the oldest of the legal privileges resonated.

The flaw in the SEC's proposed rule was that it coupled "noisy" with "withdrawal." Lawyers are not "gatekeepers" in the same way accountants have a duty to

the investing public to ensure that a company conveys accurate information. Compelling disclosure to the public of a lawyer's withdrawal from representation imparts a gatekeeper role that can create more confusion in the market than clarity. The noise is largely superfluous to the goal of preventing corporate crime, while withdrawal is an important step toward removing lawyers from the process that can lead to criminal conduct. Unfortunately, the Commission missed its chance to fulfill the congressional mandate of § 307 and take an important step in preventing future corporate crimes when it failed to require attorneys to withdraw from representation if a client persists in misconduct.

Lawyers are often critical to the operation of the corporation, and one would be hard-pressed to find a significant business decision that did not involve some consultation with legal counsel. It is this continuing role as an advisor to the corporation that can give lawyers leverage to stop corporate wrongdoing if they—and their firms—are required to withdraw from representation once the company (and its officers) disregard proper legal advice and either continue to engage in misconduct or refuse to rectify the effects of illegal acts. Withdrawal can be a potent tool because it signals the corporation and other lawyers that they must tread carefully.

While the Sarbanes-Oxley Act addressed some of the problems that led to the wide-scale corporate frauds practiced by Enron and the like, § 307 was one of the few provisions of the law designed to prevent, or at least mitigate the effect of, the next round of misconduct by corporations and their senior management. To carry out this goal, I argue that the SEC should mandate that a lawyer withdraw from all representation of the corporation if the lawyer determines that senior management or the board of directors is not responding appropriately to the up-the-ladder report of significant wrongdoing by the corporation and its officers. The importance of complete withdrawal is the signal it sends to the company's managers and, perhaps more importantly, to the next
lawyer (and law firm) hired to represent the company, because that first lawyer most likely will have to be replaced and the reasons for withdrawal investigated.

The SEC's "noisy withdrawal" rule requires the corporation to disclose the reasons for the first attorney's withdrawal, and that is a key component to making withdrawal effective as a means to prevent corporate crime. Any time a client seeks new counsel to replace its previous lawyer should be a warning to the new lawyer to tread carefully by, at a minimum, ascertaining why the first lawyer withdrew. In representation of a corporate client, the new attorney should consult with the first lawyer to ensure that the corporate client is acting appropriately in relation to the subject of the representation. The disclosure required of the company must include the first lawyer's reasons for withdrawing, even if the corporation disagrees with him, so that new counsel has complete information before undertaking the representation.\(^8\)

There are at least two potentially significant problems with mandating lawyer withdrawal. First, the rule may create a "race to the bottom" by encouraging corporations to hire weak lawyers, either initially or after the first lawyer withdraws. There is some merit to this argument, especially in light of the decline in the means to police the conduct of lawyers through malpractice actions and securities fraud litigation. Yet, there is always the risk that a lawyer will accommodate a client's wishes regardless of the propriety of the request. If a corporation wishes to maintain a reputation for integrity, and, just as importantly, if the lawyer is concerned about his or her standing as an ethical professional, then the likelihood of

\(^8\) The SEC's "noisy withdrawal" rule does not deal directly with a corporation that refuses to disclose to the new lawyer the reasons why its prior counsel withdrew. If a company refused to make that disclosure, and if it were to invoke the requirement of client confidentiality to prevent the first lawyer from speaking to the second lawyer, then that second lawyer should not be permitted to represent the company. A corporation should not be permitted to flaunt the rule and still benefit from legal counsel.
brazen lawyer-shopping will be lessened, although not eliminated. One can take some comfort in the fact that it is unlikely a group of lawyers will advertise themselves as the "Counsel of Last Resort," but I certainly do not exclude the possibility.

Second, a mandatory withdrawal rule may create a "race to the top" in the sense that a lawyer, especially in-house counsel, can use the withdrawal requirement strategically to force the corporation to accede to the lawyer's demand, i.e., blackmail. That lawyers may act strategically is not far-fetched, and this is certainly a possibility under a mandatory withdrawal rule. Eliminating the "noisy" element of the rule lessens the efficacy of blackmail, and to the extent it remains a possibility, it is like many ethical rules that could be used by a lawyer to the disadvantage of the client.° The requirement of complete withdrawal from all representation of the corporate client further limits the possibility of blackmail. For outside counsel, withdrawal may include a number of different matters involving the firm, while for the in-house lawyer it would necessitate resignation. The financial impact of mandatory complete withdrawal should limit use of the rule as a means to advance the lawyer's personal interests at the expense of the corporate client.

Can lawyers prevent corporate crime? Lawyers were not the cause of the misconduct at Enron and the like, and it is questionable whether counsel could have prevented the crimes that occurred. The financial shenanigans at Parmalat apparently involve the company's long-time outside counsel, Gian Paolo Zini, as one of the architects of the fictitious transactions.° Section 307 will not ensure that a lawyer can—or will—stop corporate misconduct,

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9. For example, the client confidentiality rule permits a lawyer to reveal confidences in a fee dispute, and a threat to reveal damaging information could be used to prevent a client from disputing a bill.

much less refuse to participate in it, any more than the ethical prohibition on misleading the court and opposing counsel does not prevent the destruction of evidence or obstructing an investigation.\textsuperscript{11} A mandatory complete withdrawal rule, however, can give corporate counsel leverage to make it much more difficult for corporate managers to engage in wrongdoing by raising the cost to the corporation of retaining new counsel, and by signaling the possibility of misconduct to potential successors.

The corporate crimes that occurred at Enron and Parmalat are not common events like petty thefts and domestic violence, which occur every day. The effect of corporate crime is significant because of the scale of the enterprise, which can involve thousands of employees, millions (even billions) of dollars of capital, and investors from every walk of life. Unlike street crimes, lawyers are there from the beginning of corporate crimes, and so they should be enlisted in the effort to prevent it from happening. A mandatory complete withdrawal rule does not threaten the confidentiality of the attorney-client relationship, and it is unlikely a corporation would simply forego legal counsel to avoid the possibility that its lawyer will withdraw at some later point. If mandatory complete withdrawal means some managers pursuing a high-risk—and potentially illegal—course of conduct will be more likely to avoid seeking the advice of counsel because of this rule, then all the better—maybe they will not do as good a job committing the crime and will be caught before causing significant harm to investors and the public.

\textsuperscript{11} The SEC recently entered into a settlement with Banc of America Securities LLC ("BAS") in which the company and its former outside counsel "continued to provide the [SEC Enforcement Division] staff with inaccurate information concerning the availability of documents and the status of BAS’s production." In the Matter of Banc of America Securities LLC, Securities Exchange Act Release No. 49386 (March 10, 2004). BAS agreed to pay a civil penalty of $10 million. One would hope its former outside counsel, who is unnamed in the administrative action, will be the subject of a similar disciplinary proceeding.
I. RAISING QUESTIONS ABOUT THE ROLE OF CORPORATE COUNSEL

Consider the following discussion about the role of a corporation’s lawyers in misconduct perpetrated by officers and directors:

I venture to assert that when the history of the financial era which has just drawn to a close comes to be written, most of its mistakes and its major faults will be ascribed to the failure to observe the fiduciary principle, the precept as old as holy writ, that “a man cannot serve two masters” . . . . Yet those who serve nominally as trustees, but relieved, by clever legal devices, from the obligation to protect those whose interests they purport to represent, corporate officers and directors who award to themselves huge bonuses from corporate funds without the assent or even the knowledge of their stockholders . . . financial institutions which, in the infinite variety of their operations, consider only last, if at all, the interests of those whose funds they command, suggest how far we have ignored the necessary implications of that principle. The loss and suffering inflicted on individuals, the harm done to a social order founded upon business and dependent upon its integrity, are incalculable. There is little to suggest that the Bar has yet recognized that it must bear some burden of responsibility for these evils. But when we know and face the facts we shall have to acknowledge that such departures from the fiduciary principle do not usually occur without the active assistance of some member of our profession . . . .

One might read these words and assume the speaker described the sorry state of affairs after the demise of Enron and WorldCom, the revelation of insider dealings at Tyco and Adelphia, or perhaps even the chicanery that caused the downfall of Parmalat. In fact, the speaker was Justice Harlan Fiske Stone when he gave the keynote address at the dedication of the Law Quadrangle at the

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University of Michigan in June 1934. The financial calamity of which he spoke involved the financial deceptions leading up to the Great Crash in October 1929, conduct which in turn sparked the extensive federal regulation of the securities markets through the Securities Act of 1933 and the Securities Exchange Act of 1934.

The future Chief Justice's lament seventy years ago about the role of lawyers in the corporate misdeeds of his day was echoed by Judge Stanley Sporkin in 1990, in a case involving, inter alia, the fraudulent sale of notes to investors through Lincoln Savings & Loan, which was controlled by Charles Keating. In considering the role of the professionals advising Lincoln Savings in a course of conduct that involved questionable, if not deceptive, disclosures to regulators, the judge stated:

Keating testified that he was so bent on doing the "right thing" that he surrounded himself with literally scores of accountants and lawyers to make sure all the transactions were legal. The questions that must be asked are: Where were these professionals, a number of whom are now asserting their rights under the Fifth Amendment, when these clearly improper transactions were being consummated? Why didn't any of them speak up or disassociate themselves from the transactions? Where also were the outside accountants and attorneys when these transactions were effectuated? What is difficult to understand is that with all the professional talent involved (both accounting and legal), why at least one professional would not have blown the whistle to stop the overreaching that took place in this case.\(^\text{13}\)

Rather than answer the question, lawyers remained largely above the fray, refusing to reconsider the role of counsel to corporations by fighting efforts to impose requirements to monitor the conduct of corporate clients.\(^\text{14}\)

Lawyers relied on the traditional principles of independence—that a lawyer is not responsible for the misdeeds of a client—and confidentiality—that the relationship of a lawyer and client necessitates the strictest possible adherence to the protection of attorney-client communications regardless of the nature of the client—to resist any effort to impose an obligation on counsel to stop or at least report the misconduct of a corporate client.15

Efforts to regulate the conduct of corporate counsel present at, and who participate in, securities fraud by the corporation did not originate in the Sarbanes-Oxley Act. On three occasions, the SEC sought to hold corporate counsel responsible for the misdeeds of a client that took place in full view of the lawyers and, indeed, implicated them in the securities violations. In SEC v. National Student Marketing Corp.,16 the SEC brought an injunctive action against the law firm advising a company involved in a merger. The Commission established that the law firm was aware of information related to the company that should have been disclosed prior to the vote on the transaction, but failed to do anything to delay the closing of the deal or to insist that the company make the requisite disclosure. The district court found that the counsel’s “silence was not only a breach of this duty to speak, but in addition lent the appearance of legitimacy to the closing.”17 Nevertheless, the court refused to issue an injunction

failures resulting from corporate fraud, pressures mount to revise the rules to make lawyers and accountants better monitors—or at least less amiably cooperative enablers—of managers’ misconduct. The lawyers and accountants sometimes lose a point or two, but their professional organizations and lobbies usually succeed in thwarting the reforms.”

15. See Ann Maxey, SEC Enforcement Actions Against Securities Lawyers: New Remedies vs. Old Policies, 22 Del. J. Corp. L. 537, 541 (1997) (Objections by the bar to SEC regulation of the conduct of corporate counsel “center on [the] views that the SEC's actions are an unwarranted interference with the lawyer-client relationship and the bar's independence.”). Professor Maxey notes that “[a]rguments in favor of professional independence ring with a certain bravado in light of the bar's failure to develop and enforce professional guidelines for transactional lawyering, in general, and securities lawyering in particular.” Id. at 578.


17. Id. at 713.
against the attorneys prohibiting future violations of the federal securities laws, stating that "[t]he Court is confident that they will take appropriate steps to ensure that their professional conduct in the future comports with the law." The bar weighed in against the SEC's position in the case, which may explain why the court refused to issue an injunction and expressed its confidence in the lawyers.

In *In re Carter and Johnson*, the SEC staff brought an administrative proceeding against lawyers for aiding and abetting a corporation's violations in failing to disclose the company's precarious financial situation while it was issuing securities; indeed, the company refused to take the advice of its lawyers to make the necessary disclosure, after which the lawyers did nothing. The Commission found that the lawyers were drawn into the fraud and used "as a shield to avoid the pressure exerted by the banks toward disclosure. Such a role is a perversion of the normal lawyer-client relationship, and no lawyer may claim that, in these circumstances, he need do no more than stubbornly continue to suggest disclosure when he knows his suggestions are falling on deaf ears." Nevertheless, the Commission refused to impose an administrative sanction because it found that it had never before articulated standards for lawyer conduct in representing a corporation and therefore "no finding of unethical or unprofessional conduct would be appropriate."

The SEC's efforts to regulate the conduct of corporate counsel was strongly opposed by the bar, effectively causing

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18. Id. at 716.
19. See Susan P. Koniak, When the Hurlyburly's Done: The Bar's Struggle with the SEC, 103 Colum. L. Rev. 1236, 1249 (2003) ("It is difficult to overstate the vehemence of the bar's reaction to the SEC complaint [in *National Student Marketing*]; references to the return of King George were commonplace, and the rhetoric suggested that the liberty of all Americans was at stake.") (hereinafter Koniak, Bar's Struggle).
21. Id. at *29.
22. Id. at *30.
the Commission's staff to back away from regulating the conduct of lawyers practicing securities law. Nevertheless, the SEC's enforcement staff tried again a few years later in *In the Matter of Kern* to obtain an order directing compliance with the securities laws against a lawyer who served as a director of a corporation to which he was also its principal outside counsel. Although an administrative law judge found that Kern had caused the company to violate the disclosure requirements of the securities law, the full Commission refused to issue the order because it found that it did not have the statutory authority to do so.

In these cases, the organized bar strongly opposed the SEC's enforcement efforts to define a standard of conduct for corporate counsel. In the face of such opposition, the

23. See Simon M. Lorne & W. Hardy Callcott, Administrative Actions Against Lawyers Before the SEC, 50 Bus. Law. 1273, 1300-1301 (1995) ("The SEC's early enforcement actions against lawyers proved highly controversial among both practitioners and academic commentators. Indeed, the controversy over those cases became so heated as to affect the Commission's ability to carry out its statutory mandates, which, both in the area of disclosure and enforcement, depend on a certain degree of cooperation and trust between the Commission (and its staff) and the private securities bar."). The controversy ended when the Commission's General Counsel, Edward Greene, stated in a speech that the SEC would not pursue disciplinary proceedings against a lawyer unless a federal court first found that the lawyer had violated the securities laws, which would necessarily find that the lawyer acted with scienter in the violation. Id. at 1304.


25. Id. at *4 ("Section 15(c)(4) should not now be construed to authorize an administrative remedy of this nature."). The Commission staff initiated the action under § 15(c)(4) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(c)(4), which provides:

> If the Commission finds, after notice and opportunity for a hearing, that any person subject to the provisions of section 78l, 78m, 78n of this title or subsection (d) of this section or any rule or regulation thereunder has failed to comply with any such provision, rule, or regulation in any material respect, the Commission may publish its findings and issue an order requiring such person, and any person who was a cause of the failure to comply due to an act or omission the person knew or should have known would contribute to the failure to comply, to comply, or to take steps to effect compliance, with such provision or such rule or regulation thereunder upon such terms and conditions and within such time as the Commission may specify in such order.

26. See Maxey, supra note 15, at 538 ("the organized bar has done little to establish standards of conduct useful to securities lawyers. The bar has not hesitated, however, to focus its resources on resisting the SEC's attempts to
Commission largely backed down, sending a clear message: The SEC would not police lawyers to ensure that they keep corporate clients from engaging in wrongdoing. With that approach, it is easy to see how lawyers for companies could put on the blinders necessary to permit them to continue to represent clients engaged in potentially illegal conduct by not asking any questions and doing the client's bidding without knowing all the relevant facts. At Enron, for example, no one, including both the company's in-house and outside lawyers, was willing to see a conflict of interest for what it was when the company's Chief Financial Officer, Andrew Fastow, engaged in a series of transactions that involved, at least in hindsight, naked self-dealing. An internal investigation of the transactions after the

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27. I do not want to give the impression that lawyers receive a complete free pass under the securities laws—they do not. The SEC brings cases against lawyers for aiding and abetting the securities law violations of their clients. For example, in SEC v. Fehn, 97 F.3d 1276 (9th Cir. 1996), the court held that "[b]ecause Fehn had a hand in editing the Form 10-Q's, and because he failed to properly advise [the CEO and the corporation] of the material omissions in the Form 10-Q's, instead submitting those forms to the SEC for filing, we conclude that Fehn lent the requisite 'substantial assistance' to violate the securities laws. Id. at 1293-94. Fehn is an action for a past violation, and not an effort to direct the conduct of lawyers to ensure that they prevent misconduct by the corporate client. Section 307 is designed to impose a duty on corporate counsel to take steps to prevent misconduct, which is much different from merely holding individual lawyers liable for their misdeeds that rise to the level of securities fraud. The law takes lawyers a step further by requiring action, and not simply permitting inaction that might not amount to a violation of the securities laws and thereby avoid any direct liability.

28. See Gordon, supra note 14, at 1203 ("The Enron lawyers, however, seemed mostly content with a system structured so that they were given very limited information and assignments of very limited scope, because the managers were determined to disclose as little as possible about their questionable transactions.").

29. See Susan P. Koniak, Corporate Fraud: See, Lawyers, 26 Harv. J.L. & Pub. Pol'y 195, 197 ("In short, it was Enron CFO Andrew Fastow's will (used in service of his interests) that was manifest on both sides of the 'negotiation.' All in all, these transactions were more like an eyelash-length, than an arms-length, negotiation.") [hereinafter Koniak, Corporate Fraud]; Ryan Morrison, Note, Turn up the Volume: The Need for "Noisy Withdrawal" in a Post-Enron Society, 92 Ky. L. Rev. 279, 288-289 (2003) ("Vinson & Elkins knew it was a breach of Fastow's fiduciary duties to engage in these deals, but the firm did not have the courage to do anything about it.").
company filed for bankruptcy determined that Enron had an obligation to disclose the "amount of [Fastow's] interest in the transaction(s), not just his income. The lawyers apparently searched for and embraced a technical rationale to avoid that disclosure. It appears that the in-house Enron lawyers and Vinson & Elkins agreed with these disclosure decisions . . ."30

It was against this background of bar opposition and SEC reticence to push further into policing the conduct of securities lawyers that § 307 emerged to give the Commission specific authority to regulate corporate counsel and a mandate to adopt effective rules of professional conduct. Senator Edwards offered an amendment to the Public Company Accounting Reform and Investor Protection Act of 2002—as the Sarbanes-Oxley Act was then named—to empower the SEC to apply its rulemaking authority to draft and impose a standard for corporate counsel to report wrongdoing by officers and employees to senior officials in the corporation and, if necessary, to the board of directors or its audit committee. Senator Edwards described the need for adopting a provision permitting the SEC to police the conduct of corporate counsel:

What we have seen some lawyers do, unfortunately, is different. We have seen corporate lawyers sometimes forget who their client is. What happens is their day-to-day conduct is with the CEO or the chief financial officer because those are the individuals responsible for hiring them. So as a result, that is with whom they have a relationship. When they go to lunch with their client, the corporation, they are usually going to lunch with the CEO or the chief financial officer. When they get phone calls, they are usually returning calls to the CEO or the chief financial officer. The problem is that the CEO and the chief financial officer are not the client. Their responsibility and the client they have to advocate for—and which they have

an ethical responsibility to advocate for—is, in fact, the corporation, not the CEO or the chief financial officer.

One of the most critical responsibilities that those lawyers have is, when they see something occurring or about to occur that violates the law, breaks the law, they must act as an advocate for the shareholders, for the company itself, for the investors. They are there and they can see what is happening. They know the law and their responsibility is to do something about it if they see the law being broken or about to be broken.

This amendment is about making sure those lawyers, in addition to the accountants and executives in the company, don't violate the law and, in fact, more importantly, ensure that the law is being followed.31

Section 307, adopted overwhelmingly by the Senate and ultimately included in the Sarbanes-Oxley Act, seeks to change how lawyers representing corporations should act in response to corporate wrongdoing. The provision is quite brief, requiring the SEC to set “minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers” which must include the adoption of a rule embodying the up-the-ladder reporting requirement.32 It is important to note that while the up-

32. 15 U.S.C. § 7245 (2002). The full text of § 307 provides:
Not later than 180 days after the date of enactment of this Act, the Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule—
(1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and
(2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another
the-ladder provision is one specified standard of professional conduct, § 307 clearly contemplates a grant of much broader authority to the SEC to set additional standards for attorneys representing corporations that issue securities to the public. Section 307 is the starting point, not the end of the discussion. To view the provision as simply an effort to enact a rather modest change in the ethical requirements of the profession misreads the ultimate purpose of the law: to ensure that lawyers work to prevent wrongdoing by impeding it once it is recognized.

II. THE SEC RESPONDS TO § 307

Section 307 specifically mandates the adoption of an up-the-ladder reporting requirement for corporate counsel. The SEC adopted a detailed rule that requires counsel to report a “material violation” that the person “reasonably believes” has occurred or is taking place to the company’s chief legal officer (CLO) or equivalent, or to the CLO and the company’s CEO “forthwith.”33 A material violation “means a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law.”34 This requirement is broader than policing violations of only the federal securities laws because it incorporates the state corporate law of fiduciary duty—commonly described as the duties of due care, loyalty, and candor—that reach an array of transactions that may not involve directly the capital markets or transactions in securities. The SEC can institute disciplinary proceedings under rule 102(e) of the Commission’s Rules of Practice for a violation of the rule

committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

33. 17 C.F.R. § 205.3(b).
34. Id. § 205.2(i).
that can result in an order suspending or barring an attorney from practicing before the Commission.\footnote{17 C.F.R. § 201.102(e).}

The reporting requirement is triggered when the attorney becomes aware of "credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur."\footnote{Id. § 205.2(c).} The Commission's definition of the up-the-ladder reporting trigger has been roundly criticized because the standard is almost incomprehensible. The prior draft of the rule required the attorney to report as "evidence that would lead an attorney reasonably to believe that a material violation has occurred, is occurring or is about to occur." The SEC asserted that the new definition "clarifies aspects of the objective standard that the Commission sought to achieve in the definition originally proposed," although it is difficult to see how this convoluted standard clarifies the law. The change incorporates both a subjective and objective standard, which the prior definition did not. Proving that the attorney acted unreasonably on both grounds will be difficult because the Commission's use of the double negative "unreasonable \ldots not to conclude" is hardly a comprehensible legal standard.\footnote{See Koniak, Bar's Struggle, supra note 19, at 1275 ("Law is also supposed to be capable of enforcement. Imagine trying to show that it was unreasonable, under the circumstances, for a prudent lawyer not to have concluded that a material violation of law had occurred, was occurring, or was about to occur. The double negative, of course, makes this difficult to do, as the rule slips away from you as soon as you try to think about it.").} Moreover, as Professor Hazen noted, "It is ironic that in drafting this standard, the SEC violated one of its own drafting principles. Specifically in its plain English requirements that apply to many SEC filings by public companies, the SEC admonishes against the use of double negatives."\footnote{Thomas Lee Hazen, Administrative Law Controls on Attorney Practice—A Look at the Securities and Exchange Commission's Lawyer Conduct Rules, 55 Admin. L. Rev. 323, 350 n.139 (2003).}
Regardless of the strengths or weaknesses of the up-the-ladder reporting rule, it does not break any new ground. The Commission’s position in *Student Loan Marketing* and *In re Carter and Johnson* has been that lawyers must report wrongdoing by the corporation and its officers to senior officials or, if necessary, the board of directors. Although the American Bar Association (ABA) rules for the profession were not as clear on the subject, after adoption of the Sarbanes-Oxley Act, the ABA amended Model Rule 1.13 in 2003 so that the rule largely incorporates the up-the-ladder reporting requirement.\(^{39}\)

39. See Report of the American Bar Association Task Force on Corporate Responsibility, 59 Bus. L. 145 (2003). The Task Force explained the changes to Model Rule 1.13(b) that incorporates more clearly the up-the-ladder reporting requirement:

Currently, Rule 1.13(b) requires a lawyer for an organizational client to act when the lawyer “knows” that a person within the organization is violating or intends to violate the law and is likely to cause substantial injury to the organization. The Task Force recommends that this prerequisite be revised to differentiate between knowledge of facts and evaluation of legal consequences. As under the current rule, the starting point of the recommended rule is subjective: the obligation to take action would arise only on the basis of the facts known to the lawyer. The proposed trigger for requiring action by the lawyer then proceeds to an objective test, namely, whether a reasonable lawyer who knows such facts would, in similar circumstances, conclude that the conduct in which a constituent is engaging or intends to engage constitutes a violation of law or duty to the organization that is likely to result in substantial injury to the organization. This standard recognizes that there is a range of reasonable conduct, and that a lawyer satisfies that standard by acting within that range. Moreover, it does not imply any duty on the lawyer’s part to investigate or inquire further as to information provided by a client or the client’s agent, or by a person to whom the lawyer has been referred by the client. Although the lawyer is under no duty to investigate or inquire, however, the lawyer may not simply accept such information at face value if to do so would be unreasonable in the circumstances.

The second substantive change to Rule 1.13(b) recommended by the Task Force addresses the lawyer’s obligation to report wrongdoing to higher authority in the organizational client. Currently, that rule identifies “reporting up” as a potential course of action when the lawyer has discerned an actual or threatened violation of law or violation of legal obligation to the organization, but the Rule imposes no clear obligation to pursue that course of action. The Task Force believes, however, that the Rule should more actively encourage such action, by requiring that the lawyer refer the matter to higher authority in the organization—including, if warranted, the organization’s highest authority—unless the lawyer
Both regulations reflect what should be the exercise of sound judgment in representing a corporation, that any misconduct by a corporation's agent or officer must be reported to senior management or the organization's highest authority, which is usually the board of directors. Any other response by corporate counsel is improper, and may entail substantial assistance to the wrongdoer that would subject a lawyer to criminal prosecution and an SEC civil enforcement action. The up-the-ladder reporting rule is a non-event for corporate counsel.

The next stage, however, is much more important, and much more controversial. In addition to the up-the-ladder reporting rule, the Commission proposed a second step if the response of the corporation's senior managers or its board was insufficient to rectify the problem: "noisy withdrawal." The SEC's proposal would have required an

reasonably believes that it is not necessary to do so.

Id. at 166-67.

40. The proposed "noisy withdrawal rule" provided:
(d) Notice to the Commission where there is no appropriate response within a reasonable time. (1) Where an attorney who has reported evidence of a material violation under paragraph 3(b) of this section rather than paragraph 3(c) of this section does not receive an appropriate response, or has not received a response in a reasonable time, to his or her report, and the attorney reasonably believes that a material violation is ongoing or is about to occur and is likely to result in substantial injury to the financial interest or property of the issuer or of investors:

(i) An attorney retained by the issuer shall:
(A) Withdraw forthwith from representing the issuer, indicating that the withdrawal is based on professional considerations;
(B) Within one business day of withdrawing, give written notice to the Commission of the attorney's withdrawal, indicating that the withdrawal was based on professional considerations; and
(C) Promptly disaffirm to the Commission any opinion, document, affirmation, representation, characterization, or the like in a document filed with or submitted to the Commission, or incorporated into such a document, that the attorney has prepared or assisted in preparing and that the attorney reasonably believes is or may be materially false or misleading;

(ii) An attorney employed by the issuer shall:
(A) Within one business day, notify the Commission in writing that he or she intends to disaffirm some opinion, document, affirmation, representation, characterization, or the like in a document filed with or
outside attorney who did not receive "an appropriate response" within a reasonable time to the report of a material violation, and who reasonably believed the violation "is likely to result in substantial injury to the financial interest or property of the issuer or of investors," to "withdraw forthwith from representing the issuer, indicating that the withdrawal is based on professional consideration." Further, the attorney must, within one business day, notify the Commission in writing of the attorney's withdrawal for "professional considerations" and to disaffirm any filing that the attorney believed contained false or misleading information. The proposed rule imposed an additional duty on the corporation, that "[t]he issuer's chief legal officer (or the equivalent) shall inform any attorney retained or employed to replace the attorney who has withdrawn that the previous attorney's withdrawal was based on professional considerations."

The proposed rule treated in-house counsel differently, however, by not requiring those lawyers to withdraw from representing their client because that would require them to quit their jobs. The Commission stated, "Requiring an in-house attorney employed by the issuer to resign when that attorney receives an inappropriate response to the attorney's reported evidence of an ongoing or impending material violation appears to be unreasonably harsh."41 In-house lawyers would, however, have to disaffirm any filings with the SEC that contained false or misleading information, requiring the "noise" without the withdrawal.

submitted to the Commission, or incorporated into such a document, that the attorney has prepared or assisted in preparing and that the attorney reasonably believes is or may be materially false or misleading; and

(B) Promptly disaffirm to the Commission, in writing, any such opinion, document, affirmation, representation, characterization, or the like; and

(iii) The issuer's chief legal officer (or the equivalent) shall inform any attorney retained or employed to replace the attorney who has withdrawn that the previous attorney's withdrawal was based on professional considerations.

Noisy Withdrawal Rule, supra note 7.

41. Noisy Withdrawal Rule, supra note 7.
The Commission explained its rationale for the “noisy withdrawal” rule: “[T]he proposed rule incorporates several corollary provisions that are not explicitly required by Section 307, but which the Commission believes are important components of an effective ‘up the ladder’ reporting system.” The SEC viewed the noisy withdrawal rule as protecting the corporation’s ultimate owners—the shareholders—when an attorney learned about corporate misconduct and the up-the-ladder reporting mechanism did not work to rectify the misconduct. The duty to report the reason for prior counsel’s withdrawal to the next lawyer would prevent the corporation from continuing a course of misconduct by retaining new attorneys who would not learn of the wrongdoing for at least some period of time or, even worse, by shifting the legal work in-house because those attorneys would be completely beholden to management.

The SEC invited comments to its proposed rules to implement § 307, and it received a deluge of objections focused largely on the “noisy withdrawal” provision. In response to those objections, the Commission’s final rule did not include the noisy withdrawal requirement, but it did invite comment on a slightly different type of noise that

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42. The Commission explained:
Requiring such “noisy withdrawal” appears appropriate to protect shareholders and investors, where the reported material violation appears likely to result in substantial financial injury to the issuer or investors, by effectively requiring an issuer’s directors to act and by virtually ensuring an immediate inquiry by the Commission if they do not.

Id.

43. The Commission stated:
The purpose of this paragraph is to avoid a situation in which successor attorneys are unaware that the previous attorney waved a red flag in withdrawing. Under such circumstances, an issuer engaged in fraud may shift work previously done by outside attorneys to its own in-house legal staff, over which it has more control, and it may take the successor attorneys some time to become aware of the evidence of material violations that led the previous attorneys to withdraw.

Id.

44. Comments on the proposed rules implementing § 307 are available at http://www.sec.gov/rules/proposed/s74502.shtml (last visited Dec. 1, 2004), and the site contains over 150 comments.
would require the corporation, rather than the lawyer, to report the lawyer's withdrawal because of the inadequacy of the response to an up-the-ladder report of a material violation.\textsuperscript{45} This new approach avoids having the lawyer make the disclosure, thereby skirting the problem of having attorneys disclose information that may reveal client confidences.\textsuperscript{46}

The bar's response to this proposal was just as negative, and the Commission has not taken any steps at this point to implement either form of reporting attorney withdrawal, nor has it mandated any withdrawal requirement for corporate counsel. The bar has defeated the SEC's attempt to give the rule any real teeth by keeping the entire process of attorney reporting private, and absolving corporate counsel from any responsibility to withdraw in the face of resistance to the up-the-ladder reporting by corporate management and directors.\textsuperscript{47}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{45} In releasing its final rule implementing § 307, the Commission stated: [W]e are also proposing and soliciting comment on an alternative procedure to the "noisy withdrawal" provisions. Under this proposed alternative, in the event that an attorney withdraws from representation of an issuer after failing to receive an appropriate response to reported evidence of a material violation, the issuer would be required to disclose its counsel's withdrawal to the Commission as a material event.

68 Fed. Reg. 6296, 6297 (Feb. 6, 2003); SEC Rel. No. 33-8185 (Jan. 29, 2003). The proposed rule states: "Where an attorney has provided an issuer with a written notice pursuant to paragraph (d)(1), (d)(2) or (d)(3) of this section, the issuer shall, within two business days of receipt of such written notice, report such notice and the circumstances related thereto on Form 8-K, 20-F, or 40-F (§§ 249.308, 220f or 240f of this chapter), as applicable." Proposed Rule 205.3(e), 68 Fed. Reg. 6324, 6337 (Feb. 6, 2003); SEC Rel. No. 33-8186 (Jan. 29, 2003).

\item \textsuperscript{46} Even if the client is required to disclose rather than the lawyer, that does not vitiate the problem with a rule that potentially compels the disclosure of privileged communications. The privilege protects both the lawyer and the client from having to reveal their communications that come within the privilege, while the attorney's duty to protect all client confidences is broader.

\item \textsuperscript{47} See Thomas Rose, Lawyers and Fraud: A Better Question, 43 Washburn L.J. 45, 58 (2003) ("It is hardly surprising, and no accident, that the SEC blinked on the 'noisy withdrawal' piece of its proposed rules. It will be interesting to see how the SEC ultimately decides this deferred question, although history suggests that the SEC will ultimately cede this normative space to the bar.").
\end{itemize}
\end{footnotesize}
To say that the legal profession reacted negatively to the proposed "noisy withdrawal" portion of the proposed rule is an understatement. The objections from the private bar focused largely on the SEC reporting requirement for withdrawing attorneys, and advanced two principal grounds: the need to protect lawyer-client confidentiality and interference with the lawyer-client relationship to guard against overreaching or misuse of power afforded by a lawyer independent of the government whose sole goal is representing the interests of the client. The rhetoric used to advance these positions was sometimes a bit overblown, and makes one wary whether the real interest was that of the lawyers seeking to thwart yet another effort at government regulation that would make them more accountable for the representation of corporate clients.

On the issue of whether the "noisy withdrawal" rule would violate the attorney-client privilege, former SEC Commissioner Joseph Grundfest argued that "[t]he requirement that attorneys specifically identify documents that have in the past been 'filed with or submitted to' the Commission and that are believed to be materially false or misleading again creates a clear conflict with established principles of attorney-client privilege that prohibit disclosure of past offenses and that rely on criteria that differ dramatically from those relied upon by the Proposed Rules." The law firm of Sullivan & Cromwell took a more aggressive approach, arguing that "the adoption of noisy withdrawal rules by the Commission would represent such a radical departure from the traditional standards of

48. See Marilyn Blumberg Cane & Sarah Smith Kelleher, Bring on 'Da Noise: The SEC's Proposals Concerning Professional Conduct for Attorneys under Sarbanes-Oxley, 28 Del. J. Corp. L. 599, 603 (2003) ("The hue and cry that followed the [Noisy Withdrawal] Rule was loud and immediate.").

behavior for attorneys and the expectations of their clients that it should be deferred until such time as the Commission has had the opportunity to undertake a more detailed examination of the issue and its implications.  

Law firms argued that the disclosure requirement of the proposed rule would cause the officers of corporate clients to reveal less information because of the fear of disclosure to the SEC. A group of seventy-seven law firms submitted a letter arguing that the rule would cause more harm rather than prevent corporate misconduct:

In the vast majority of cases counsel enjoy the confidence of their clients and, given access to the facts by their clients, succeed in persuading their clients to refrain from actions that harm the investing public. If clients are afraid to confide candidly and completely in their counsel and instead proceed without the advice of counsel, the public will inevitably be harmed in some cases when it need not have been. Or clients may be prompted to avoid cautious and prudent counsel, with the same result. The basic force for conformance of business conduct to legal norms is a strong and independent Bar that enjoys the trust and confidence of its clients.  

The law firms viewed the rule as one that would discourage communication rather than as a means to protect the corporate client. The theme of lawyer independence appeared in conjunction with the need for confidentiality as a basis to attack the "noisy withdrawal" rule. The Jones Day law firm asserted:

An attorney's overriding duty is that of zealous advocacy on behalf of the client, which includes advising the client as to

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51. Letter from 77 Law Firms, Dec. 18, 2002, available at http://www.sec.gov/rules/proposed/s74502/77lawfirms1.htm (last visited Nov. 1, 2004). One can express a certain amazement that seventy-seven law firms could agree on anything, but when a rule threatens the financial interests of the corporate bar, it may be easier to gain their assent.
possible violations of the law (including advice to the effect that the law has not been violated). To do this effectively an attorney must be apprised of the entire universe of information that bears on a client's given situation. Our legal system has long recognized the need for full and frank discussions between clients and attorneys. In fact, we believe that attorney-client counseling is the best means to prevent client misconduct. By requiring an attorney to withdraw and by making that withdrawal "noisy" (whether because the attorney must inform the Commission or the issuer must file a Form 8-K), Section 3(d) would impede full and frank discussions between attorneys and their clients.\footnote{52}{Letter from Jones Day, April 7, 2003, available at http://www.sec.gov/rules/proposed/s74502/jonesday040703.htm (last visited Nov. 1, 2004).}

Similarly, the group of law firms—now expanded to seventy-nine—argued against the Commission's rule requiring the corporation to disclose the withdrawal, rather than the lawyer, by asserting that "[t]he basic force for conformance of business conduct to legal norms is a strong and independent Bar that enjoys the trust and confidence of its clients," and so any form of public notice of withdrawal would undermine the very reason the corporate client retained the lawyer.\footnote{53}{Letter from 79 Law Firms, April 7, 2003, available at http://www.sec.gov/rules/proposed/s74502/79lawfirms1.htm (last visited Nov. 1, 2004). The analogy to the lawyer advocating the client's position in litigation has been criticized for misconstruing the role of corporate counsel who advise clients on a continuing basis outside of an adversarial proceeding. See Sean J. Griffith, Afterword and Comment: Toward an Ethical Duty to Market Investors, 35 Conn. L. Rev. 1223, 1230 (2003) ("If professional ethics are primarily influenced by norms of advocacy, which permit conduct going right up to the boundary of illegality, and it is very hard, as in the Enron and Lincoln transactions, to tell where those boundaries are, lawyers may indeed comply with their ethical duties while helping their clients to defraud regulators, tax collectors, creditors, customers, and investors."); John C. Coffee, Jr., The Attorney As Gatekeeper: An Agenda for the SEC, 103 Colum. L. Rev. 1293, 1294 (2003) ("This view of the lawyer as the client's shield against an oppressive state is no doubt right with respect to the role of the litigator, but the question remains whether his description of the attorney's role applies as well—or at all—to the securities attorney.") [hereinafter Coffee, Attorney As Gatekeeper]; Koniak, Bar's Struggle, supra note 19, at 1278-79 ("the bar claims that the state's law would prevent advisors—lawyers who facilitate client transactions before the fact and during a
The proposed rule drew similar criticisms from foreign bar associations that weighed in because the SEC's proposal covered some foreign lawyers who represent corporations whose securities are traded in the United States. The Japan Federation of Bar Associations stated that any form of "noisy withdrawal" would have the effect that "a client would be disincentivized from consulting freely with its attorney." 54 The Canadian Bar Association claimed that the proposed rule would "invade the special relationship of trust which must prevail between an attorney and his or her client." 55 The New Zealand Law Society stated:

Currently, lawyers and their clients can engage in vigorous confidential debate as to the appropriate course when faced with challenging factual circumstances. Yet under the proposed rules, such debate will be stifled if lawyers are perceived as in effect having a veto power through the threat of "noisy withdrawal" and the debate itself ultimately being made public, irrespective of whether the lawyer's opinion might subsequently be proved wrong. 56

If so many lawyers claim that "noisy withdrawal" would cause more harm than good by interfering in the lawyer-client relationship, don't they have to be right? There is, of course, a measure of self-interest in the bar's protestations about the proposed rule. Regulation of corporate lawyers through the state disciplinary apparatus is minimal, at best, and aside from the SEC there are no

viable regulators of securities and corporate lawyers.\textsuperscript{57} Along the same line, the Supreme Court’s decision in \textit{Central Bank} in 1994 rejected aiding and abetting liability as a basis for pursuing private rule 10b-5 securities fraud actions, largely removing the threat of damages actions by investors against lawyers and other professionals who advise corporations that issue securities.\textsuperscript{58} While lawyers are subject to malpractice claims, when the corporation is the client it is difficult to pursue a claim that involves legal advice to the company’s officers who commit wrongdoing on the corporation’s behalf. The lawyers can assert an \textit{in pari delicto} defense, arguing that the client’s wrongdoing—through the conduct of its officers or employees—means that the corporation’s “unclean hands” should prevent it from recovering for any malpractice by the lawyers in advising management or failing to notice their fraud.\textsuperscript{59}

\textsuperscript{57} See Koniak, Bar’s Struggle, supra note 19, at 1280 (“The state disciplinary systems lack the expertise in securities law, the staff, and the monetary resources to take on a major securities firm. They can’t do it and they don’t. Thus, when the bar says leave securities lawyers to the states, it means to leave them unregulated.”).

\textsuperscript{58} Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994). See Jill E. Fisch, \textit{The Scope of Private Securities Litigation: In Search of Liability Standards for Secondary Defendants}, 99 Colum. L. Rev. 1293, 1297 (1999) (“In Central Bank, the Supreme Court concluded that section 10(b) does not permit liability to be imposed upon those who aid and abet federal securities fraud. The decision came with little warning—courts and commentators had widely accepted the validity of aiding and abetting liability.”). The Supreme Court did recognize that lawyers and other secondary actors could be held liable as primary violators of § 10(b), but it did not explain what would be required for such liability. Central Bank, 511 U.S. at 191 (“The absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming all of the requirements for primary liability under Rule 10b-5 are met.”).

\textsuperscript{59} The Ninth Circuit, in FDIC v. O’Melveny & Myers, 969 F.2d 744 (9th Cir.), rev’d and remanded on other grounds, 512 U.S. 79 (1994), held that the FDIC, as the receiver for a failed thrift, could bring a malpractice action against the thrift’s outside counsel and auditor for failing to perform a “reasonable, independent investigation” despite the fact that the firm’s managers were largely responsible for the misconduct. Id. at 749. Where the malpractice claim involves conduct by the managers of the corporation, however, the attorneys can raise the equitable defense of \textit{in pari delicto} or “unclean hands” to argue that the corporation was
The noisy withdrawal rule, as originally proposed, would not require the reporting lawyer to reveal any specific confidential communications, only that the reason for the withdrawal and disaffirmation of corporate filings was due to the company's failure to respond adequately to the report of a material violation. This is similar to the withdrawal requirement for appointed counsel in criminal cases if a client intends to engage in illegal conduct, such as committing perjury or submitting falsified evidence. The revised rule requiring corporate disclosure of the withdrawal, rather than by the company's lawyer, takes the disclosure one step further from any problem with attorney confidentiality because a client does not act under any requirement to maintain secrecy. Moreover, while ABA Model Rule 1.6 permitted disclosure of client communications to prevent a future crime only if it involved death or substantial bodily harm, a majority of the states allow—but do not require—such disclosure to prevent a client from causing significant financial harm or to rectify the consequences of past harm if the lawyer's services were used to commit the harmful act. Indeed, the ABA revised Model Rule 1.6 in 2003, largely in response to both the Sarbanes-Oxley Act and calls for greater lawyer equally responsible for the harm and therefore cannot recover from the lawyers for its own misconduct, even if they were negligent. See, e.g., In re Dublin Securities Inc., 133 F.3d 377, 380 (6th Cir. 1997) (The trustee in bankruptcy for the corporation "admits in his complaint that the debtors' own actions were instrumental in perpetrating the fraud on the individuals choosing to invest in the Dublin Securities schemes. That pleading concedes, for example, that the debtors intentionally defrauded their investors. Such purposeful conduct thus establishes conclusively that the debtors were at least as culpable as the defendants in this matter.").

60. See Model Rules of Prof'l Conduct R. 1.16, cmt. para. 3 (1983) ("When a lawyer has been appointed to represent a client, withdrawal ordinarily requires approval of the appointing authority. See also Rule 6.2. Similarly, court approval or notice to the court is often required by applicable law before a lawyer withdraws from pending litigation. Difficulty may be encountered if withdrawal is based on the client's demand that the lawyer engage in unprofessional conduct. The court may request an explanation for the withdrawal, while the lawyer may be bound to keep confidential the facts that would constitute such an explanation. The lawyer's statement that professional considerations require termination of the representation ordinarily should be accepted as sufficient.").
accountability, to conform its rule to the majority and permit disclosure of confidential information by a lawyer whose client is committing or intends to commit a crime involving significant financial harm.\textsuperscript{61} The disclosure required by the noisy withdrawal rule was hardly unknown to lawyers, and was consistent with the practice of a majority of the states permitting lawyers to disclose far more than just the attorney's withdrawal from representation because of the client's financial misconduct.

Although the noisy withdrawal rule was neither radical nor an earth-shattering change in the lawyer-client relationship, as its opponents alleged, its adoption would alter the role of lawyers by giving them more of a "gatekeeper" function. The rationale offered by the SEC for seeking the noise that would accompany the attorney's withdrawal was that "[r]equiring such 'noisy withdrawal' appears appropriate to protect shareholders and investors . . . ."\textsuperscript{62} By viewing the rule as a means to protect investors, and not just the corporation that is technically the lawyer's client apart from its agents or owners, the Commission gave corporate counsel a larger public responsibility apart from the limited goals of the client.

Professor Coffee defines a "gatekeeper" as a "reputational intermediary who provide[s] verification and certification services to investors."\textsuperscript{63} Professor

\begin{quote}
\textsuperscript{61.} Model Rule 1.6(b) now provides:
A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary: . . .

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

(3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;

\textsuperscript{62.} Noisy Withdrawal Rule, supra note 7.

\textsuperscript{63.} John C. Coffee, Jr., Understanding Enron: "It's About the Gatekeepers, Stupid," 57 Bus. Law. 1403, 1404 (2002) [hereinafter Coffee, Understanding Enron]. Among those who qualify as a gatekeeper are accountants, securities analysts, those providing a fairness opinion on a transaction, and lawyers. Id.
\end{quote}
Hamdani provides a more restrictive definition of the term, limiting it to "parties who sell a product or provide a service that is necessary for clients wishing to enter a particular market or engage in certain activities." Although legal services are not mandated by law, unlike the requirement for certified financial statements provided by accountants for publicly traded companies, no corporation acts without regularly consulting legal counsel, and most have both in-house attorneys and retain outside law firms for legal advice. In that sense, lawyers provide a necessary service to corporate clients and can be made to serve the interests of both the corporation and third parties, such as investors and regulatory agencies.

The issue is whether imposing a gatekeeper role on lawyers representing corporations whose shares are publicly traded is a good idea. The fact that corporate counsel will not be completely "independent" to represent solely the wishes of the client is one oft-repeated criticism of the "noisy withdrawal" rule. Jones Day cited to the "attorney's overriding duty . . . of zealous advocacy on behalf of the client" as the basis for arguing that any disclosure was inappropriate, although that duty may not be appropriate for corporate counsel advising a client in transactional work. The American College of Trial Lawyers—in a fit of hyperbole—asserted that the proposed rule "would convert attorneys from representatives of their clients' interests into policemen who act against their clients' interests . . . ." Similarly, the American Corporate Counsel Association claimed that "if we move toward regulations that turn lawyers into cops on the beat, we will be making a decision to fundamentally change the lawyer-client relationship . . . ." Not to be outdone, the Chicago

65. Letter from Jones Day, supra note 52.
Bar Association opined that "[i]f the client must fear that its own counselor, to whom it would confide its most problematic concerns, may turn into its judge of no recourse, resulting in mandatory public disclosure, the client will hesitate to confide. Correspondingly, the attorney will hesitate to probe if she may become an auditor or police officer if she learns too much." 68

The "cop on the beat" criticism misapprehends the scope of the "noisy withdrawal" rule because lawyers, especially those representing corporations, police their clients in a number of ways to ensure that they comply with the law. At a minimum, a lawyer cannot counsel a client to commit a criminal or fraudulent act, 69 so the lawyer will act as a type of monitor overseeing the propriety of the corporate client's conduct, i.e., a type of auditor or cop. Turning the lawyer into a gatekeeper with a responsibility to report misconduct by a client by disclosing the fact of withdrawal could affect the quality of attorney-client communication in a corporation in some instances, but it is unlikely that corporate officers and directors can forego using attorneys because there is a possibility that they might have to withdraw from representation and disclose that fact. 70

69. Model Rules of Prof'l Conduct R. 1.2(d) (1983) ("A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyers knows is criminal or fraudulent").
70. Professor Coffee asserts that the only "chill" that the noisy withdrawal rule will have on attorney-client communications is in the situation when the corporate officer considers whether to seek legal advice from the company's lawyer after the conduct that may be a violation, not before. Unlike the ex ante consultation with counsel, once the act is complete, the officer cannot conform it to any legal requirements and will be more likely to try to cover up the conduct if it is potentially illegal, avoiding the lawyer who may have to report the violation. Coffee, Attorney As Gatekeeper, supra note 53, at 1307 ("it is the ex post inquiry by the client of the attorney that is most likely to be chilled."). Professor Koniak makes the same point, arguing that "corporate managers talk to lawyers. A strong rule on reporting client fraud would not make corporate confidences any more insecure than they already are, nor would it make corporate managers suddenly afraid to talk to lawyers." Koniak, Bar's Struggle, supra note 19, at
A rigid approach that rejects any form of disclosure by corporate counsel falls into the trap of viewing every attorney-client relationship as fundamentally equivalent. For example, the Conseil des Barreaux de L'Union Europeene [Council of the Bars and Law Societies of the European Union] (CCBE) takes the position in its "Statement of Position on Lawyers' Confidentiality" that citizens "must be able to seek advice as to what is right or wrong, legal or illegal. Such advice can only be sought if the citizen can be assured that his or her communication with the lawyer remains confidential."\(^\text{71}\) In fact, an attorney for a corporation does not have a client in the same sense that the criminal defense or estate planning lawyer has a single human client who is easy to identify and whose communications unquestionably will be protected from disclosure. Corporations operate through their human agents, and the attorney's job involves gathering information from various sources within the firm and evaluating the conduct and decisions of numerous actors. The disclosure sought by the "noisy withdrawal" rule arises in a limited context in which corporate counsel,


However, it becomes much more difficult to argue this outside the two areas of client waiver and danger to human life and health. In fact, I would argue that those are the only two areas where exceptions should usually be made. Outside those two areas, I tend—if that is possible once exceptions have already been made—to the absolute view of the professional secret. I do this not for the good of lawyers, but for the good of clients and the health of society overall. It does not seem to me that the areas of the fight against money-laundering or the fight against corporate misgovernance fall anywhere near the two exceptions I have already outlined. For those reasons, we in the CCBE are opposed to the extension of exceptions. We very much regret that governments have seen fit in recent years to extend their controls in these areas, and we will continue to struggle against such extensions, in these or future areas.

not an attorney for an individual, must make a limited disclosure about the lawyer's withdrawal due to wrongdoing by the agents of that client. 72

The problem with the noisy withdrawal rule is that it makes the fact of the lawyer's withdrawal an item for public disclosure to investors and the SEC, thereby triggering further scrutiny into the legal advice provided by counsel. It is that information, however, that is clearly within the protection of the attorney-client privilege, which is held equally by corporations and individuals. 73 In that sense, the noise from the withdrawal becomes a public event inviting third parties to decipher the reasons for the withdrawal for the cryptic "professional considerations" by asking, or even demanding in an SEC investigation, what information passed between the attorney and the corporation. As a signal, the noise does not provide much information, but it does create the impression that the attorney is a gatekeeper who should report information to the government and investing public, a role that does not fit comfortably with the confidential relationship between the attorney and client. The pressure on the company to waive its privilege will be enormous, and similarly the attorney may not be able to resist disclosure if the ethics rule in place permits, but does not mandate, disclosure of a pending or future financial crime or fraud.

The confidentiality attorneys must maintain is a fundamental part of the relationship between lawyers and clients, and is not something that should be easily discarded. Good arguments can be made that lawyers can be a valuable source of protection against corporate misconduct, but is the price to corporations for limiting the attorney-client privilege by mandating disclosure of the lawyer's withdrawal too steep? It is a close question because the benefits from requiring some disclosure could

72. See Coffee, Attorney As Gatekeeper, supra note 53, at 1307 ("the ultimate goal of the law is to achieve law compliance, not to maximize uninhibited communications between the attorney and the client. Client confidentiality is a means to an end, not an end in itself.").

be significant, yet the burden would be imposed on every corporation with publicly traded shares, including a large number of foreign issuers of securities whose attorneys operate under a different system.

At bottom, the goal of imposing a gatekeeper role on lawyers should be to protect investors and the public from corporate misconduct that may result in substantial financial losses. If that is the ultimate goal, then the type of disclosure sought by the SEC in the noisy withdrawal rule is not the only way to achieve that protection, and the cost to the attorney-client relationship by threatened revelation of confidential communications may be too great to justify the noise that would accompany the withdrawal. Without the public disclosure, can lawyers still be used effectively to prevent corporate misconduct by adopting the second half of the SEC’s proposed rule, the mandatory withdrawal requirement? The starting point for answering that question is to consider the nature of corporate misconduct that led to the adoption of §307 of the Sarbanes-Oxley Act and how lawyers play a role in the process by which corporations commit the types of financial crimes that have cropped up over the years.

III. CORPORATE MISCONDUCT AND THE ROLE OF COUNSEL

The corporate misconduct that led to the Sarbanes-Oxley Act was not particularly different from the types of crimes by corporations in earlier times. Over a decade ago, the so-called Savings & Loan crisis involved violations by corporate officers and directors making improper loans—often to favored borrowers or even themselves—in an attempt to grow their business and take advantage of an explosion in real estate values. In the 1980s, the misconduct of Drexel Burnham in the junk bond market involved various violations of securities law reporting requirements. In the 1970s, the collapse of Equity Funding involved accounting fraud that led to the largest insurance company collapse to that time. One gets the feeling that the only difference is the names of the players and,
occasionally, the types of rules violated by the corporations and their managers.

White collar crimes are quite different from the much more prevalent street crimes in both the complexity of the conduct and the immediacy of the harm. Unlike a robbery or battery, which usually takes place in a very short period, at an identifiable location, and with a human victim, white collar crimes are often a process that leads to a result that may be, but is not necessarily, criminal. For example, tax evasion involves the failure to report income or taking improper deductions that results in the underpayment of taxes. Numerous books, websites, and computer programs advise individuals how to pay less taxes, most of which are perfectly legal. When does legitimate tax planning cross over into improper evasion of taxes? Similarly, while it is inconceivable to ask whether the removal of money from a cash register while a gun is pointed at the store's proprietor is legal, the transfer of funds between a domestic and foreign bank may or may not be proper, depending on a variety of circumstances.

Within the category of white collar crime are the violations committed by corporations, which are often quite different from the violations perpetrated by individuals acting on their own. Some types of white collar crimes are solely for personal gain, such as the insider trading of Dr. Sam Waksal, former CEO of ImClone Systems. He sought to avoid the loss in his shares in the company when it revealed the status of its drug application with the FDA. Similarly, the conviction of Martha Stewart for making false statements related to her personal sale of ImClone Systems stock involved personal acts wholly unrelated to her position as CEO and chair of the board of Martha Stewart Living Omnimedia Inc. Similarly, some types of corporate crimes involve firms that are organized largely for illegal purposes, such as companies that operate boiler-rooms or advanced-loan fee schemes that are little more than shells for individual criminality.

The types of corporate crime that came to light in 2002 that led to the adoption of the Sarbanes-Oxley Act involved
a different type of misconduct in which the motive was not so much direct personal gain at the expense of individual victims, but more to protect and enhance the corporate enterprise and the position of the officers involved in the misconduct within the hierarchy of an ostensibly successful operation. In many cases, revelation of the various accounting and financial disclosure violations would have caused the companies to suffer significant losses in the market due to the pressure to provide consistent, and increasing, income and revenue. The accounting and financial violations alleged at companies like Enron, Adelphia, and WorldCom largely involved managers and directors who sought to maintain the corporate enterprise by bookkeeping and financial legerdemain. In the case of WorldCom, the pressure to meet the expectations of Wall Street led to improper accounting that is estimated to have involved fraudulent accounting totaling $10.6 billion, while its CEO had the company guarantee over $400 million in loans so he could acquire more stock.74

While one cannot ignore the large payouts to officers like Andrew Fastow of Enron as a motive for engaging in misconduct, the more common scenario for corporate crime involves a series of steps, often with fairly small amounts at issue in the beginning, that lead almost inexorably to the ultimate revelation of the misconduct because the violations get too large to control. Crimes by organizations usually start when managers cut corners or push to the edge of legal conduct in an effort to maintain revenue and profits. At some point, which is often imperceptible, the line into illegality is crossed and the scheme seems to take on a life of its own.

There is a rich literature on corporate crime, which I will not try to summarize here, that discusses the complexity of organizations and pressures within them to

74. Shawn Young, MCI Restatement Drops $74.4 Billion, Wall. St. J., March 15, 2004, at B2 (MCI restated its 2000 and 2001 income downward by $74.4 billion due to fraudulent accounting, and “[t]he fraud itself amounts to about $10.6 billion in moves that mostly padded earnings by artificially reducing expenses.”).
meet performance goals, especially when the firm suffers from potential profit and revenue loss. The pressure creates an environment ripe for corporate crime by the company's managers.  

To take one example, Professors Simpson and Piquero described the origins of corporate crime in this way:

> From an organizational perspective, then, corporate crime results when managers take organizational needs and pressures into account when solving business problems or when managers act in accordance with the dominant culture of the firm, subunit, or team in which they work. As Vaughan (1999:289) summarizes it, "Theorists uniformly hold that structures, processes, and tasks are opportunity structures for misconduct because they provide (a) normative support for misconduct, (b) the means for carrying out violations, and (c) concealment that minimizes detection and sanctioning." While some degree of self-interest may underlie offending decisions (Yeager & Reed 1998), corporate crime is "not reducible to individuals and their characteristics" (Tillman & Pontell 1994:1459) because the individual and the organization are symbiotic.

What is the role of the lawyer in this process? Professor Coffee describes corporate counsel as a "transaction engineer" who provides advice on how the corporation can structure its operations in a manner that

75. See Jennifer H. Arlen & William J. Carney, Vicarious Liability for Fraud on Securities Markets: Theory and Evidence, 1992 U. Ill. L. Rev. 691, 702-03 ("an agent generally will not commit Fraud on the Market so long as his future employment seems assured. When the firm is ailing, however, an agent's expectations of future employment no longer serve as a constraint on behavior. In this situation a manager may view securities fraud as a positive net present value project. Aside from criminal liability, in a last period the expected costs of fraud (civil liability and job loss) are minimal, while the expected benefits of fraud may have increased.").

76. Sally S. Simpson & Nicole Leeper Piquero, Low Self-Control, Organizational Theory, and Corporate Crime, 36 Law & Soc'y Rev. 509, 511 (2002). See Griffith, supra note 53, at 1242 ("Managers facing the failure of their business may thus prefer to take the risks, including the risk of legal liability, of lying to the markets than to suffer the more immediate consequences of the market's reaction to the truth—that is, the further decline of their share price and creditworthiness and the further degradation of their business prospects.").
meets both business needs and the requirements of law. The vast array of federal and state regulatory regimes that affect virtually every business, and especially the larger operations of publicly traded companies, makes the lawyer a vital player in corporate operations. Corporate counsel will be present at most steps in the process of a business decision, and will provide legal advice on an array of topics, including litigation risks, taxation, regulatory compliance, and the requirements of employment law, plus specialized topics that relate to the enterprise, such as intellectual property, foreign trade, or environmental law. For the larger corporations that use the public markets for their capital requirements, lawyers provide advice on the securities laws, especially the continuing periodic disclosure requirements. Lawyers are, quite simply, a fact of life for any firm, and especially for the publicly traded company operating in the current environment of close scrutiny of corporate conduct.

Lawyers interact with managers at all levels of the company in order to gather the requisite information to provide legal advice to the corporation. Moreover, managers often must seek out the lawyers to assist in formulating a business plan or monitor the company's compliance with applicable regulations in order to do their job properly. Unlike a company's auditor, which conducts an independent examination of the company's books to ensure that they were created properly, corporate counsel likely is involved in the corporation's business on a continuous basis and will have access to different types of information than the auditor. Corporate counsel cannot

77. Coffee, Understanding Enron, supra note 63, at 1405 & 1417 ("lawyers specialize in designing transactions to avoid regulatory, legal, and other costly hurdles, but seldom provide meaningful certifications to investors.").
78. See Coffee, Attorney As Gatekeeper, supra note 53, at 1307-08 ("the more the government pursues white-collar criminal prosecutions and punitive regulatory actions in the contemporary post-Enron environment, the more likely it is that corporate officers will consult counsel before acting.").
79. See Coffee, Understanding Enron, supra note 63, at 1405 ("the professional gatekeeper essentially assesses or vouches for the corporate client's own statements about itself or a specific transaction.").
detect all types of corporate misconduct, but there is a substantial likelihood that, at some point in the process, a lawyer will be asked to review a transaction or advise on how to structure it. In much the same way that the auditor may be able to detect fraud based on its review of the corporation's records and operations, so too the lawyer may have "credible evidence" that the company is moving across the line into illegality from the types of legal advice that is sought by the corporation or the reports provided by managers to the lawyer.  

80. The rule specifically exempts application to attorneys retained to advise the corporation about the issues raised in an up-the-ladder report. 17 C.F.R. § 205.3(b)(6)-(7) provides:

(6) An attorney shall not have any obligation to report evidence of a material violation under this paragraph (b) if:

(i) The attorney was retained or directed by the issuer's chief legal officer (or the equivalent thereof) to investigate such evidence of a material violation and:

(A) The attorney reports the results of such investigation to the chief legal officer (or the equivalent thereof); and

(B) Except where the attorney and the chief legal officer (or the equivalent thereof) each reasonably believes that no material violation has occurred, is ongoing, or is about to occur, the chief legal officer (or the equivalent thereof) reports the results of the investigation to the issuer's board of directors, a committee thereof to whom a report could be made pursuant to paragraph (b)(3) of this section, or a qualified legal compliance committee; or

(ii) The attorney was retained or directed by the chief legal officer (or the equivalent thereof) to assert, consistent with his or her professional obligations, a colorable defense on behalf of the issuer (or the issuer's officer, director, employee, or agent, as the case may be) in any investigation or judicial or administrative proceeding relating to such evidence of a material violation, and the chief legal officer (or the equivalent thereof) provides reasonable and timely reports on the progress and outcome of such proceeding to the issuer's board of directors, a committee thereof to whom a report could be made pursuant to paragraph (b)(3) of this section, or a qualified legal compliance committee.

(7) An attorney shall not have any obligation to report evidence of a material violation under this paragraph (b) if such attorney was retained or directed by a qualified legal compliance committee:

(i) To investigate such evidence of a material violation; or

(ii) To assert, consistent with his or her professional obligations, a colorable defense on behalf of the issuer (or the issuer's officer, director, employee, or agent, as the case may be) in any investigation or judicial or administrative proceeding relating to such evidence of a material violation.
If the lawyer has "evidence of a material violation"—admittedly a difficult standard to establish—then the up-the-ladder reporting requirement comes into play. The SEC's rule further permits, but does not require, an attorney to reveal confidential information to prevent an illegal or fraudulent act by the corporation "that is likely to cause substantial [financial] injury," to prevent a fraud upon the Commission in an investigation, or to "rectify the consequences of a material violation" that would cause a significant financial injury. This provision largely duplicates Model Rule 1.6(c), as amended by the ABA in the summer of 2003, and adds little to the ethical responsibilities of corporate counsel. Apart from the permissive disclosure provision, however, corporate counsel need do nothing further with regard to the corporate client who refuses to act appropriately in response to the material violation because the Commission dropped mandatory withdrawal along with the disclosure requirement of its proposed rule.

81. 17 C.F.R. § 205.3(d)(2) provides:
An attorney appearing and practicing before the Commission in the representation of an issuer may reveal to the Commission, without the issuer's consent, confidential information related to the representation to the extent the attorney reasonably believes necessary:
(i) To prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;
(ii) To prevent the issuer, in a Commission investigation or administrative proceeding from committing perjury, proscribed in 18 U.S.C. 1621; suborning perjury, proscribed in 18 U.S.C. 1622; or committing any act proscribed in 18 U.S.C. 1001 that is likely to perpetrate a fraud upon the Commission; or
(iii) To rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used.

82. The only difference between the SEC rule and Model Rule 1.6 is that the lawyer can disclose confidential information to prevent the corporation from committing perjury or making a false statement in an investigation, crimes which do not have a financial impact but affect the government's investigative authority.
By not mandating complete withdrawal, the Commission left corporate counsel to operate only under the ethical guidelines of the profession, which do not require that an attorney cease representing a client except in very limited circumstances. ABA Model Rule 1.16(1) requires an attorney to withdraw if "the representation will result in violation of the rules of professional conduct or other law...." While a lawyer may not counsel a client to commit an unlawful or fraudulent act under Model Rule 1.2, if a lawyer merely discovers misconduct by the corporate client but did not otherwise participate in it, then withdrawal would not be required. Similarly, if a lawyer, upon discovering misconduct, advised the client to remedy the situation by, inter alia, making proper disclosure to the SEC and the public, and the client refused, the lawyer would still not be required to withdraw because the representation is not a violation of law.83 Indeed, this was the very problem at the heart of the SEC's administrative action in In re Carter and Johnson that sought to hold the lawyers responsible when they knew of the corporate client's misconduct and simply stood by and did nothing.

Model Rule 1.16(b)(2)-(3) permits, but does not require, an attorney to withdraw from representation in the following circumstances: "(2) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent"; and, "(3) the client has used the lawyer's services to perpetrate a crime or fraud." As with the mandatory withdrawal rule, the circumstances that allow the attorney to terminate

83. The commentary to Rule 1.16 states, "A lawyer ordinarily must decline or withdraw from representation if the client demands that the lawyer engage in conduct that is illegal or violates the Rules of Professional Conduct or other law." Model Rules of Prof'l Conduct R. 1.16, cmt. 2 (1983). The Rule prohibits continued representation only when the client demands that the lawyer "engage in conduct that is illegal" but not when the lawyer could prevent the client from continuing a course of conduct that is illegal by withdrawing from the representation. In fact, Model Rule 1.16 says nothing about the propriety of continued representation in the more common situation in which the lawyer discovers client misconduct and the client refuses to rectify the situation or permit the lawyer to report the violation.
representation require that the attorney have been involved in the client's misconduct by providing legal representation.

The SEC's up-the-ladder rule imposes a broad reporting duty within the firm, triggered by the attorney's awareness of "evidence of a material violation" but without regard to the lawyer's involvement in the transaction or misconduct. By dropping mandatory withdrawal from its final rule, however, the Commission ensured that corporate counsel can, and usually will, do nothing more than report evidence of the material violation and then leave the matter to the client on what step, if any, to take next. Model Rule 1.16 gives only a narrow ground for withdrawal, even in the permissive context, and the up-the-ladder reporting requirement does little more than reflect the Model Rules. The rules adopted in response to § 307 are hardly a major step forward, and certainly do not address the requirement that the Commission adopt real minimum standards of professional conduct for corporate counsel.

IV. MANDATORY WITHDRAWAL

Would a mandatory lawyer withdrawal rule mean that corporations could not engage in serious misconduct in the future? The answer, of course, is no, because attorneys are not necessary to the commission of many types of corporate crimes. What the attorneys can provide is the patina of legality to transactions, and many companies defend their conduct by asserting that their counsel reviewed and approved a transaction or course of conduct. One of the more notorious examples of this occurred when Enron used its usual outside counsel, Vinson & Elkins, to investigate the then-anonymous complaint sent by Sherron Watkins, a mid-level executive, to Kenneth Lay, Enron's CEO, that raised substantial questions about the company's use of various financial vehicles and off-book transactions. The law firm gave the company a "clean bill of health" on the

issues raised by Ms. Watkins despite the limitations Enron placed on Vinson & Elkins's ability to conduct a real investigation of the allegations and the firm's own possible conflicts from their prior involvement in the transactions. The danger is that attorneys will turn a blind eye to what their clients are doing, and acquiesce in transactions or conduct that, step by step, takes the corporation across the line into illegality. Without a mandatory withdrawal rule, corporate counsel can delude themselves into the belief that as long as they do not directly participate in misconduct and, if it were ever discovered, make the necessary up-the-ladder report, they have fulfilled their duty and can comfortably defer to the choices made by the managers of the enterprise while continuing to represent the company.

A mandatory complete withdrawal rule puts teeth into the reporting requirement imposed by § 307 by requiring lawyers to monitor the company's response to the report and to measure whether the material violation has been addressed adequately. Lawyers will have to ask whether they can put themselves at risk of violating the rule by continuing to represent the corporate client. The power of the rule is the financial penalty it can impose on both the lawyer and the client by mandating withdrawal. Adopting

85. See Koniak, Corporate Fraud, supra note 29, at 209 ("Vinson should not have accepted this assignment. To say that the matters raised by Watkins were serious problems that warranted a full-fledged, all-out, independent investigation of potential wrongdoing related to Enron's financial shenanigans would have required it to criticize its own previous advice to the company and to open itself up to lawsuits and further scrutiny. The idea is ridiculous that an investigation conducted by Vinson, under these circumstances, would count to establish that Enron's management had fulfilled its fiduciary duty to investigate allegations of wrongdoing by the company and its agents made by a credible employee."); Gordon, supra note 14, at 1201 ("although lawyers may take on an assignment that limits the scope of their representation or asks them to accept some facts as given, they may not agree to such limits as will preclude them from competent and ethical representation."); Roger C. Cranton, Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues, 58 Bus. Law. 143, 164 (2002) ("The investigation required V&E to assess objectively, as if it had not been there at all, the soundness and propriety of its prior representation. Thus, the situation presented a serious conflict between Enron's presumed interest in an objective investigation and V&E's own interests.").
a mandatory withdrawal requirement would give lawyers a measure of leverage over their corporate clients if the response to the report of a material violation were insufficient. Moreover, if withdrawal proves to be required, the next lawyer will be alerted because the rule requires the company CLO to disclose prior counsel's reason was due to "professional considerations." This is a strong signal to the new lawyer to tread carefully and assess whether it is in that lawyer's best interest to undertake the representation. In addition, if the new lawyer agrees to represent the corporate client, the new lawyer will have leverage to demand an acceptable response to the conduct that triggered the withdrawal by the first attorney as a condition of representation.

While lawyers argued that the reporting requirement of the proposed rule infringed on their independence from outside interference in advising their clients, that independence also requires that corporate counsel be willing to stand up to the client by ceasing representation if the corporation's officers and directors refuse to respond appropriately in the manner the lawyers consider necessary to comply with the law. Imposing a mandatory complete

86. Mandatory complete withdrawal may also signal opposing lawyers to problems at the corporation if a law firm resigns from all representations of the company. This signal would be fairly weak, however, because even a statement by the company's counsel that the withdrawal is due to "professional considerations" would not indicate the particular matter involved. Nevertheless, it would alert others outside the corporation that there may be a significant issue related to corporate representation.

87. If a corporation refuses to make the requisite disclosure to its new counsel of the reasons for the prior attorney's withdrawal, and if it asserts its attorney-client privilege to prevent the first lawyer from discussing the reasons for the withdrawal with the new attorney, then the second lawyer should not be permitted to represent the company. The SEC's rule should address this situation directly to make it clear that successor counsel has an independent duty to investigate when it is retained due to a withdrawal under the rule. Corporations should not be permitted to take advantage of the mandatory withdrawal rule to rid itself of its first counsel and then keep the next lawyer ignorant. Such a course of conduct is the very type of situation § 307 is designed to combat by making the lawyers responsible for preventing a continuing course of misconduct by the corporation.

88. See Griffith, supra note 53, at 1231 ("a lawyer's professional judgment must be exercised independently of her clients. Lawyers must be independent of
withdrawal requirement can give corporate counsel some measure of power, at the risk of the having sanctions imposed on them by the SEC for not taking the necessary action, to ensure that corporate misconduct stops, or only continues at the price of not having legal counsel available to make it more difficult to detect and identify.\textsuperscript{9}

This approach does effect a change in the lawyer-client relationship by introducing a potential conflict between them, but the demand for independent, honest legal advice to corporate clients should be backed up by the hazard of withdrawal to ensure that companies do not continue down a path of criminality. Chief Justice Veasey of the Delaware Supreme Court urged corporate counsel to take their position as independent legal advisors seriously, urging that lawyers for corporations should not fear the responsibility to "just say no" to a board or management bent on a questionable or potentially reckless course of conduct. Just saying "no" poses great risks for the lawyer, particularly in terms of retaining a paying client, \textit{but that is one of the risks a professional must take.}\textsuperscript{90}

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\textsuperscript{9} This approach conflicts with the view of lawyers as acting solely on behalf of clients, and that the clients' wishes must always control unless they are illegal. See, e.g., W. William Hodes, Seeking the Truth Versus Telling the Truth at the Boundaries of the Law: Misdirection, Lying, and "Lying With an Explanation," 44 So. Tex. L. Rev. 53, 56 (2002) ("In the end, however, if both the objectives and the means are within the boundaries set by the law, and the moral dialogue has been a genuine one, not a paternalistic attempt by the lawyer to impose a personal moral judgment, then the client's decision will control—if for no other reason than that it is easier for a client to dismiss a lawyer than for a lawyer to 'fire a client' by withdrawing."). Professor Painter, on the other hand, argues that "lawyers cannot categorically deny moral responsibility for conduct of their clients." Richard W. Painter, The Moral Interdependence of Corporate Lawyers and Their Clients, 67 So. Cal. L. Rev. 507, 578 (1994). The mandatory withdrawal rule should ease the problem for lawyers concerned that they would be imposing their own views on their client by taking the decision whether to "fire" the client out of their hands.

A. The Race-to-the-Bottom Arguments

The reaction of the organized bar to the mandatory withdrawal aspect of the noisy withdrawal rule was almost uniformly negative, and the reasons break down largely into two categories. The first type of criticism, which I call the "race-to-the-bottom" arguments, essentially claim that the rule would discourage corporations from seeking good, conservative legal advice because they would not want to deal with the consequences of withdrawal if counsel's advice were not followed. Therefore, according to this position, companies will look for lawyers with lower standards so that there is no risk of withdrawal.

The American College of Trial Lawyers asserted that "requiring withdrawal and notification will effectively discourage issuers from retaining counsel who are conservative in the advice they render. . . . [A]n issuer will be tempted either not to consult outside counsel or to select counsel thought less likely to give cautious advice—and, in either case, to disclose to counsel fewer potentially troublesome facts." Jones Day argued that the "attorney cannot guarantee the conduct of a client. We believe, however, clients are far more likely to comply with the law

91. The Law Society of England and Wales pointed out that the mandatory withdrawal rule and the reporting requirement were consistent with the rules of the Law Society for English Solicitors, stating:

We have no objection to the proposal that an English solicitor should withdraw from representing an issuer that has committed a violation under SEC rules and failed to respond appropriately when this has been drawn to its attention. As we set out in our previous response, the Law Society's rules of professional conduct would require an English Solicitor to withdraw if he believed his client was in danger of committing an illegal course of action and if he had failed to prevent his client from doing so. There is nothing in our rules or in statutory provisions governing lawyers in England and Wales that would create difficulties if an issuer were required to notify the SEC that their lawyer had withdrawn.


92. Letter from the American College of Trial Lawyers, supra note 66.
when properly counseled by attorneys they trust and with whom they share all relevant information.\textsuperscript{93}

The argument against mandatory withdrawal on this count assumes that corporations always, or at least routinely, take the most aggressive approach possible and that the only thing standing between the company and rampant unlawfulness is the lawyer. That is inconsistent, however, with how most cases of corporate misconduct arise. It is not one decision or transaction that crosses the line into illegality; it is more likely to be a course of conduct that eventually takes the company into illegality. Moreover, as seen in the recent cases of corporate misconduct, the individual events leading to the ultimate violation may be arguably legal, up to a point and when viewed in isolation, and the violations accumulate over a period of time as the company makes improper accounting entries and misleading disclosures over a number of months or years.

If a corporation’s officers are determined to pursue a course of conduct that is clearly illegal, then they will not consult with any lawyer except one willing to join the misconduct, and will seek to hide the violations from all outside professionals who are not part of the scheme. If managers are intent on violating the law, then no rule imposed by the SEC will prevent that from happening. The mandatory withdrawal rule does not come into play at the outset, when the company enters into a transaction or makes a decision, but after the discovery of wrongdoing by the lawyer. When the report of that misconduct is made to the board or the CLO, and the company’s response is to reject the advice of the lawyer on how to proceed, only then does mandatory withdrawal become an issue. Requiring the lawyer to withdraw at that point, and mandating that the company provide successor counsel with the reasons for that withdrawal, is a means to ensure that corporations respond appropriately to serious misconduct, i.e., “evidence of a material violation.” What the mandatory withdrawal

\textsuperscript{93. Letter from Jones Day, supra note 52.}
rule does is make it harder for managers to continue misconduct by alerting them to the possibility that a choice to ignore corporate counsel will strip the company of any legal counsel because the successor counsel may be unwilling to undertake representation. The rule also takes the first corporate counsel out of the pattern of misconduct.\textsuperscript{94}

A corollary to the independence argument against mandatory withdrawal is the assertion that clients should have the right to choose their counsel, especially if that counsel is urging compliance with the law.\textsuperscript{95} The problem with this argument is that the client may wish to retain the attorney to prevent any further reports of wrongdoing and

\textsuperscript{94} A company could take a preemptive approach by firing counsel who makes the up-the-ladder report to avoid the withdrawal and related reporting requirement to new counsel. See Cane & Kelleher, supra note 48, at 611 ("there is no provision [in the Noisy Withdrawal Rule] that prevents an issuer from discharging the attorney before he can withdrawal, thereby avoiding the responsibility of disclosure."). The first lawyer could still withdraw from the representation by formally notifying the company of his view that termination is an inappropriate response, thereby signaling the new lawyer as to the potential problem. Moreover, new counsel should contact the prior attorney to discuss the status of the matter, and that can be a means to raise the issues regarding the up-the-ladder report. That said, to the extent a corporation wanted to hide its misconduct from counsel, it may be successful and the mandatory withdrawal rule will not ensure that lawyers will prevent a continuing course of misconduct. Of course, that is the flaw with every rule which can be ignored by a miscreant bent on violating the law.

\textsuperscript{95} See Letter from the American College of Trial Lawyers, supra note 66 ("Surely, continued representation up to that point [when the lawyer would be required to withdraw under Model Rule 1.16(a)(1)] ought to be preferable in the Commission's eyes to depriving the client of counsel who urges compliance with the law."); Letter from 79 Law Firms, supra note 53 ("If a client, even after the difficult stresses occasioned by a withdrawal, still wishes to retain the withdrawing lawyer or law firm, then we believe that option should be available."). This point was reiterated more recently by M. Peter Moser, an attorney with Piper Rudnick, at a hearing before the House Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises at a hearing on February 4, 2004, entitled "The Role of Attorneys in Corporate Governance." Mr. Moser stated, "Mandating lawyer withdrawal at all would deny lawyers the flexibility they need to counsel clients effectively on compliance with complex securities laws" (emphasis in original). Letter from M. Peter Moser to Hon. Michael G. Oxley and Richard Baker, Feb. 3, 2004, available at http://financialservices.house.gov/media/pdf/020404pr.pdf (last visited Nov. 4, 2004).
to contain information about allegations of misconduct from being passed on to new counsel, who may demand the same response as the first lawyer. The company ignores its counsel's advice, so it hardly seems effective to permit the corporation to continue to use that lawyer's services. The idea behind mandatory withdrawal is that the client has triggered the outcome by refusing to comply with the lawyer's advice on how the company should act, so the argument that the rule somehow deprives a corporate client of its right to choose its lawyer is nonsensical when it is the client that essentially puts the lawyer in the position of having to withdraw.

Along the same line, it is the required disclosure to successor counsel of the reasons for prior counsel's withdrawal that makes the rule effective because it forces the corporation to justify its reasons for rejecting the advice of its first lawyer. When the company discloses why its prior counsel had to withdraw from representation, it will be difficult, if not impossible, to hire new counsel without an acceptable explanation for its conduct and the reason for the disagreement with the first lawyer. There is a danger at this point that the corporation will seek out less conservative counsel and "buy" an opinion from the successor counsel that the company's conduct did not amount to a "material violation." That danger is inherent in the system, however, and the fact that a corporation may be able to entice new counsel into abiding by the company's view of its conduct does not mean that the mandatory withdrawal rule is flawed.

The rule counts on the new lawyer retained after the first lawyer's mandatory withdrawal to review the reasons for the withdrawal and to provide independent legal advice rather than simply being bought to render the opinion the company wants. The danger of companies shopping for the most favorable legal advice is always present, and the mandatory withdrawal rule does not exacerbate that problem. More importantly, the new lawyer, in the face of the prior withdrawal, will be on notice that the decision to represent the company after the prior mandatory
withdrawal—triggered by the corporate client’s refusal to accept that attorney’s legal advice—is likely to be scrutinized closely if there is an SEC investigation or private lawsuit raising questions about the transactions or conduct that caused the mandatory withdrawal. While the corporation’s attorney-client privilege will shield the legal advice given by both attorneys, at least initially, there is a risk that the second counsel could be found to have given faulty legal advice or even aided and abetted a securities law violation by the corporation, subjecting the second lawyer to a possible malpractice claim or securities fraud enforcement action.

Outside professionals have a reputation to maintain, and the incentive to act in accordance with the law justifies relying on attorneys asked to serve as successor counsel to ensure that the company acted properly in both its conduct and its response to the report of a “material violation” by the first lawyer. Although a possibility, it seems unlikely that a law firm would advertise itself to companies as the counsel that will say only what the corporation wants to hear, available to sell compliant legal opinions at www.noquestionsasked.com.

Another race-to-the-bottom argument is that mandatory withdrawal, especially if the law firm must withdraw from all representation of the issuer, will discourage reporting of a material violation to the senior management because of the “drastic economic consequences that might flow from such advice.” The point is a valid one, but the same is true of the conflict of interest rules and the prohibition on assisting a client in criminal or fraudulent conduct. Any rule that prohibits or limits the ability of a lawyer to represent a client has an economic effect. The lawyer may not want to trigger the up-the-ladder reporting requirement because it is uncomfortable to raise serious questions about the decisions or conduct of corporate managers, the people lawyers interact with on a daily basis, and may result in

96. Letter from the American College of Trial Lawyers, supra note 66.
the corporate client firing the lawyer. The mandatory withdrawal rule does not require that the lawyer cease representing the corporate client upon learning of the misconduct; that would be draconian and make it highly unlikely there would ever be such a report. Instead, the rule requires the lawyer to determine whether the corporation's response after the report will mitigate successfully the material violation, a later point at which the position of the parties will be much clearer and the facts will be available to evaluate the propriety of management's response to the report.

If management fails to respond in a way that satisfies the lawyer, then the lawyer will have to pay a price by withdrawing from representation. That withdrawal should be from all representation, to the extent practicable under limitations on withdrawal imposed by the courts or other adjudicatory body, because the lawyer-client relationship is fundamentally tainted by the corporation's refusal to act appropriately, at least in the lawyer's eyes. That lawyer (and law firm) should not provide legal representation to the corporate client if that client will not comply with the law. Law firms and in-house attorneys need to have

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97. For example, withdrawal in pending litigation usually requires leave of the court. If a case was in trial—or sufficiently close to trial—so that withdrawal would cause unnecessary delay, counsel would be able to continue the representation at the direction of the court.

98. One objection to the mandatory withdrawal rule was its failure to limit withdrawal to the representation that triggered the up-the-ladder reporting requirement to which the company did not respond appropriately. The problem with permitting a limited withdrawal would be identifying the matter that triggered the rule. While a law firm may represent a corporation in a number of different forums, the firm's representation in the corporate and securities area does not necessarily permit easy distinctions between different matters. For example, is representation on the issuance of a security distinct from representation on a corporate transaction in which there is a substantial conflict of interest that corporate counsel does not believe has been vetted sufficiently or that is harming the corporation? The matter may have to be disclosed in the securities offering, so the representation would have to be terminated outside just the limited transaction or litigation in which the "material violation" arose. See Cane & Kelleher, supra note 48, at 610 ("Due to the complexity and breadth of securities law, however, any matter related to the issuer may be related to a material violation; separating matters when an attorney may still participate will be extremely difficult."). The benefit of the rule is the simplicity of its approach,
sufficient credibility with the client to convince it to act appropriately in response to "evidence of a material violation." If they do not, then the goal of § 307 to prevent corporate crime is better served by having corporate counsel withdraw from all representation.\(^9\)

Along the same lines, the mandatory withdrawal rule imposes a potentially significant cost on the client because new counsel may be necessary for both the issues related to the material violation and other representations by the former law firm. The cost, however, is a result of the corporation's choice to reject the legal advice of the first corporate counsel that triggered the withdrawal.\(^10\)

**B. The Race-to-the-Top Arguments**

The second category, which I call the "race-to-the-top" arguments, rests on the assertion that the mandatory withdrawal rule gives the lawyer too much authority to enforce a particular view of the proper response to conduct that the corporation may not view as a "material violation" or that the violation that does not require the response the attorney seeks. This is a type of client autonomy argument—that the lawyer is only responsible for recommending a course of action to the client and, should the client choose to ignore that advice, then the lawyer must yield to the client's wishes. The lawyer could withdraw in this situation under ABA Model Rule 1.16(b)(4), which allows an attorney to cease representing a client if "the client insists upon taking action that the

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\(^9\) It is difficult to envision a corporation rejecting legal advice in one area while trusting the same lawyers in another situation, although in a large organization it may be possible to segregate the views of the corporate managers and maintain an attorney-client relationship.

\(^10\) See Cane & Kelleher, supra note 48, at 610 ("disclosure of the partial withdrawal of an attorney may mask significant violations by an issuer. Therefore, if an attorney is in a situation where he must withdraw, such withdrawal must be complete.").
lawyer considers repugnant or with which the lawyer has a fundamental disagreement." This is a permissive withdrawal, and the lawyer may choose to continue representing the client despite the "fundamental disagreement."

The American Corporate Counsel Association asserted that "[w]e do not support promulgating professional rules making lawyers responsible (and liable) for coercing clients to accept legal advice."101 The Federal Regulation Committee of the Securities Industry Association asked, "Why should a lawyer, operating from a perspective that may be narrower and less fully-informed than that of an independent audit committee or board of directors, be expected to decide whether the audit committee or board's exercise of its business judgment was correct, or whether some other steps were necessary to make the action 'appropriate'?"102 The Business Roundtable asserted that companies faced with the threat of withdrawal (and subsequent public disclosure) could effectively be compelled to acquiesce to their attorney's position—even if the board of directors disagrees in good faith with that position. In this regard, the alternative proposal [to have the corporation disclose the attorney's withdrawal] would replace the judgment of the board with the judgment of a single attorney.103

101. Letter from the American Corporate Counsel Association, supra note 67.
103. Letter from The Business Roundtable, April 8, 2003, available at http://www.sec.gov/rules/proposed/s74502/brt040803.htm (last visited Nov. 5, 2004). The American Bar Association made the same point with regard to any disclosure of the attorney's withdrawal, stating that "[a]s long as the matter has reached the proper level in the corporate governance structure through up the ladder reporting, the company, and not its attorney, should be entitled to make the disclosure decisions." Letter from the American Bar Association, April 2, 2003, available at http://www.sec.gov/rules/proposed/s74502/aba040203.htm (last visited Nov. 4, 2004).
This argument against mandatory withdrawal is the very problem the rule seeks to address. Lawyers have stood by while corporate clients continue to act or engage in transactions that the lawyer considers improper and even illegal. Section 307 requires the SEC to adopt "minimum standards of professional conduct" to change the culture of corporate representation so that lawyers will not accept the client’s decision as final, or accede to a client’s demands that a course of conduct continue despite the lawyer’s objections. Once again, this was the very problem the Commission tried to punish in *National Student Marketing* and *In re Carter and Johnson*, that corporate counsel could not just stand silent when the client insisted on acting in violation of the federal securities laws.

The assertion that the client ultimately should decide whether and how to respond to a report of wrongdoing ignores the ways in which a corporation’s culture can foster a mindset that can view any assertion of wrongdoing by corporate managers as a threat to the company that must be resisted at all costs. Professor Fanto has applied the social psychological theory of "groupthink" to argue that the senior management may resist efforts to correct or prevent wrongdoing by the corporation because "group members become uniform in their views and see only the positive, not the negative, about group attitudes and behavior." As a result, the group "will collectively discipline any member who fails to stand uniformly behind the group’s perspective and are dismissive, even contemptuous, of those outside the group and of views other than their own."  

Lawyers are not immune to being co-opted into a corporate culture that will not permit any claim of wrongdoing. Professor Langevoort notes that "lawyers are particularly prone to blind spots regarding their clients . . . . Their commitment is clear and public, and they are called upon frequently to articulate the

client's position—something that polarizes attitudes and beliefs, for the act of saying often strengthens belief.”

Professors Rhode and Paton viewed the conduct of the lawyers who advised Enron through the lens of cognitive psychology, concluding that “lawyers will often unconsciously dismiss or discount evidence of misconduct and its impact on third parties . . . . The more that counsel blends into the culture of corporate insiders, the greater the pressures of cohesiveness.”

The mandatory withdrawal rule is a small step toward empowering lawyers to stop, or at least impede, corporate wrongdoing by putting in place at least a small counterbalance to the inevitable pressure to fulfill the corporate client's wishes. The rule is designed to give them a measure of power that they might not otherwise have by making the corporation's decision to resist the lawyer's advice on how to respond to a “material violation” a costly one. Without mandatory withdrawal, lawyers may not have the authority to resist the decision-making power of corporate management to continue acting illegally. As the rule is currently written without the

107. See id. (“Rules requiring corporate lawyers to report corporate fraud can provide much needed support for those who would otherwise face enormous pressure to remain team players.”).
108. See DongJu Song, Note, The Laws of Securities Lawyer after Sarbanes-Oxley, 53 Duke L.J. 257, 287-88 (2003) (“To be sure, the sudden rebalancing of power between the lawyer and client may seriously disrupt their relationship, but Sarbanes-Oxley is here to stay, and managers are going to need lawyers at least as much as before the Act was passed. With their continued participation assured, the greater power of lawyers may effectively lead to precisely the desired result: increased compliance with the securities laws.”).
109. Without some external impetus to resist client wrongdoing about which the lawyer is aware, the lawyer may end up becoming a participant. See Richard W. Painter, Lawyers' Rules, Auditors' Rules and the Psychology of Concealment, 84 Minn. L. Rev. 1399, 1422 (2000) (“Lawyers who never would have facilitated the conduct that got their clients into trouble to begin with (and who even advised against the illegal conduct), when deciding how to cut their losses, may help conceal the client's violations and take other risks that a 'rational' lawyer would not.”). Although one would expect that the ethical provision in Model Rule 1.2
mandatory withdrawal requirement, unless corporate counsel's powers of persuasion are sufficient to sway a client to act in the way the attorney considers proper, the corporation can ignore the legal advice without any cost, at least until the misconduct is exposed.\textsuperscript{110} That is hardly an effective measure to prevent corporate crime, at least as envisioned by the proponents of § 307.

A related argument against mandatory withdrawal is that an in-house attorney may use the rule to resist disciplinary action by the corporate employer. The Association of Corporate Counsel, in testimony before a House subcommittee, stated that since the adoption of the up-the-ladder rule there has been "a marked increase in the number of threatened lawyer whistleblower actions in response to a negative performance review or a disagreement with the CLO's more informed judgment about the merits of an allegation brought forward by a junior attorney."\textsuperscript{111} The adoption of the mandatory withdrawal rule would give an attorney in that situation even greater power to assert the employer is acting improperly, but the requirement of complete withdrawal would also limit the rule's utility for in-house counsel as a means to threaten the corporation. If an in-house lawyer were to allege improperly that there is "evidence of a material violation" and the corporation refuses to respond appropriately, then the mandatory complete withdrawal rule would require the person to resign from the corporation. It may be that the attorney would be terminated anyway, but a complete withdrawal rule prohibiting lawyers from counseling clients to engage in misconduct would be sufficient, the mandatory withdrawal rule would give be an added measure to ensure that the lawyer resist, rather than join, a corporate client's wrongdoing.

\textsuperscript{110} See Coffee, Attorney As Gatekeeper, supra note 53, at 1303 ("The major difference between current law and a noisy withdrawal obligation is that today an attorney could arguably stand aside and not object when the issuer made a disclosure violation of which the attorney was aware but did not actively assist.").

imposes a cost on both the attorney and the corporation that should limit improper use of the rule to advance the personal interests of an attorney at the expense of the corporate client.

This does raise a related concern about the effect of a mandatory complete withdrawal rule on in-house counsel. The Commission's "noisy withdrawal" rule treated "outside attorneys" and "in-house attorneys" differently by exempting an attorney employed by the corporation from having to withdraw—which would effectively mean resigning from employment—because such a requirement "appears to be unreasonably harsh." The SEC is right that the effect of a mandatory withdrawal rule normally would impose a greater hardship on the in-house lawyer because that person does not have a diversified practice to fall back on and therefore may be unwilling to bring the material violation to the attention of management for fear of the consequences of starting the up-the-ladder reporting process. The bifurcated approach likely was a political move by the SEC because the "noisy withdrawal" rule was sure to be controversial and in-house lawyers would be certain to oppose it—probably quite vehemently—if it required them to resign in the face of an inappropriate response to a report of a "material violation."

The Commission's distinction drawn between outside counsel and in-house lawyers is not based on any analytical difference between the different types of practice, but rather one that appears to be based on human nature. The ethics rules do not recognize any such distinction, and the important rules on conflicts, candor, and withdrawal are uniform across the profession. Moreover, the economic effect of mandatory withdrawal will also be visited on outside counsel, especially if a substantial portion of the lawyer's or law firm's work is devoted to that corporate client. The rule does not take account of lawyers in that situation.

For the rule to be effective, and to limit the possibility that it may be used strategically by lawyers for personal benefits, it must require complete withdrawal from representation of the corporation. The cost will be high, especially for the in-house lawyer and the law firm that derive a substantial portion of their revenue from one company. Moreover, the effect of the resignation of an in-house lawyer may be much less than that of an outside law firm because the company may be able to shift around responsibilities for pending matters with ease. The rule does require that the corporation inform any successor counsel on the matter, whether in-house or an outside lawyer, of the reasons for the mandatory withdrawal.

If the relationship reaches the point where the corporation refuses the lawyer’s considered legal advice in how to respond to a “material violation,” then is it beneficial for that lawyer to continue representing such a company? A rule that imposes little or no cost on the attorney and the client naturally will appeal to both sides; that is the current state of affairs with the up-the-ladder reporting requirement as the only obligation for lawyers who discover wrongdoing by the corporation. Section 307 is a broader mandate to use lawyers to prevent future corporate crime that requires rules that are costly to the participants but will benefit investors and the public by reducing the likelihood or extent of corporate misconduct.

CONCLUSION

"NOTHING IS EASIER THAN SELF-DECEIT. FOR WHAT EACH MAN WISHES, THAT HE ALSO BELIEVES TO BE TRUE."\textsuperscript{113}

I wonder whether the debate about “noisy withdrawal” is much ado about nothing. Even if required, would lawyers really make the disclosure such a rule mandates, and would they push their position to the point where they would have to withdraw from representing the corporation,

\textsuperscript{113} Demosthenes.
especially a large client that pays its bills in a timely fashion? Surely lawyers can hit upon a way to avoid finding "evidence of a material violation," especially when the SEC's definition of the phrase is so convoluted that it will be nearly impossible to prove that an attorney breached the standard.

The reaction of the bar to the "noisy withdrawal" rule had overtones of the kind of self-deceit about the need for changes that will occur in any group of professionals faced with responding to demands for adjusting how they practice their chosen profession. When the ABA considered changing Model Rule 1.6 to permit—but not require—an attorney to disclose a client's use of the attorney's services to commit a fraud, a former president of the organization attacked the change as an attempt "to barter away a piece of our soul to gain public approval."114 It is a little hard to see how the very modest change in the rule would somehow tear apart the legal profession or fundamentally alter the lawyer-client relationship. The rhetoric of the slippery slope or, even worse, the demand to mount the parapet to resist the encroaching barbarians makes it easy to view the reaction of the bar as self-serving.115 Even more troubling is that the ABA adopted the change to Model Rule 1.6 by a vote of 218-201; a switch of only nine votes would have reversed the outcome and squarely placed the ABA in the role of obstructing change.

The rhetoric has succeeded, however, and the "noisy" aspect of the rule appears dead in the face of the claimed invasion of the attorney-client privilege and the sanctity of the lawyer-client relationship. The "withdrawal" portion has become entangled in the same wave of opposition and may be equally moribund. It should not be cast adrift,


115. ABA President-elect Robert Grey, in opposing the change to Rule 1.6, stated, "This is not the proper time to bow to threats by others who seek to regulate us." Id.
however, because the real benefit of mandatory complete withdrawal is the leverage it gives to attorneys who will not look for loopholes but will adhere to the rule. The lawyers need the support of a rule that will help them to change how a corporation acts when they discover a “material violation” and, if necessary, withdraw from representation when they cannot obtain the necessary response from the corporate client. The rule makes life difficult for corporate counsel by requiring a measure of honesty in reporting a violation up the ladder with full knowledge of the consequences if the corporation refuses to respond appropriately.

Mandatory complete withdrawal and the required disclosure to successor counsel can make lawyers more effective in preventing or impeding corporate crimes because the rule makes it significantly more difficult for the corporation to continue a course of conduct without considering the consequences. Much like the public disclosure sought by the Commission, withdrawal is a signal, only to a more limited audience: the corporation and the new lawyer. The rule relies on that second attorney to be as ethical as the first lawyer, and to refuse to accept the corporate client if there is “evidence of a material violation” and a refusal to act appropriately.

Mandatory withdrawal and disclosure to successor counsel may cause corporate managers to avoid the company’s lawyer, or to withhold information about possible misconduct, because the lawyer cannot be controlled by the corporation due to the requirements of the rule. Good! Lawyers generally do a fine job of advocating on behalf of their corporate clients and explaining how the law does not apply to them. It may be that such knowledge and representation facilitates corporate misconduct by making it more difficult to expose and easier to explain, at least for a time. I suspect that if a mandatory complete withdrawal and disclosure to successor counsel were in effect, corporate managers would be more likely to seek help from their lawyers and to disclose information about possible misconduct to their counsel.

116. See Coffee, Attorney As Gatekeeper, supra note 53, at 1296 (“imposing gatekeeper obligations on attorneys is likely neither to chill socially desirable client communications nor to reduce attorneys’ influence over their clients, but may actually increase attorneys’ leverage over their most intransigent clients.”).
withdrawal rule causes managers to avoid consulting with lawyers, then they will not do as good a job and either will be caught sooner or will be less effective in their misconduct. What better use for corporate counsel than to encourage legal conduct and, when confronted with evidence of misconduct, make the up-the-ladder report and demand that the violation be corrected or prevented. If the corporate client will not act appropriately, then the client needs to be fired and, if necessary, forego the services of the legal profession.