

THE LAWYER AS GATEKEEPER: IS THERE A NEED FOR A WHISTLEBLOWING SECURITIES LAWYER? RECENT DEVELOPMENTS IN THE US AND AUSTRALIA

*By Christoph Pippel**

Introduction

Our lives begin to end the day we become silent about things that matter.¹

Where were the outside ... attorneys when these [clearly improper] transactions were effectuated? What is difficult to understand is that with all the [legal] professional talent involved ... why at least one professional would not have blown the whistle to stop the overreaching that took place.²

The list of corporate scandals is familiar: Enron, WorldCom, and Adelphia in the US³ and HIH and One.Tel in Australia.⁴ The failures of auditors and securities analysts as 'gatekeepers' are well-known⁵ and have led to the dissolution of Arthur

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- * Christoph Pippel, LL.M. Rechtsanwalt (Germany), Mallesons Stephen Jaques Sydney. The author wishes to thank Professor John Farrar for his support and Gavin Davis, Bond LLB graduate spring 2005, for editing this article.
- 1 Anne Trimmer, Whistleblowing: What it is and what it might mean for incorporated legal practices [2004] *Law Society Journal* 66, 69 (reporting that Enron handed out note pads with inspiring quotes to its employees, this one from Martin Luther King Jr.).
- 2 Henry H. Rossbacher, Whistleblowing and the American Experience: Has Anything Changed? [2003] 24 *The Company Lawyer* 152, 153 (quoting Judge and former SEC Director of Enforcement Stanley Sporkin who is referring to the US corporate scandals in the Savings & Loan industry in the 1990s).
- 3 Penelope Patsuris, The Corporate Scandal Sheet [2002] Forbes.com (reporting Enron's restatements of over US\$ 1 billion; Worldcom's improperly booked funds of US\$ 3.3 billion; Adelphia's founding family collecting US\$ 3.1 billion in off-balance sheet loans) at <<http://www.forbes.com/home/2002/07/25/accountingtracker.html>> visited 10 April 2004.
- 4 Michael De Martinis, Do Directors, Regulators, And Auditors Speak, Hear, And See No Evil? Evidence From The Enron, HIH, And One.Tel Collapses [2002] 15 *Australian Journal of Corporate Law* 66, 70-8; See Report of the HIH Royal Commission, The Failure of HIH Insurance Part 2 at 3.7 (reporting losses of \$3.6 billion and \$5.3 billion) at <<http://www.hihroyalcom.gov.au/finalreport/Chapter%203.HTML>> visited 10 April 2004.
- 5 Paul von Nessen, Corporate Governance in Australia: Converging with International Developments [2003] 15 *Australian Journal of Corporate Law* 189, 190; John C. Coffee, Jr., Understanding Enron: 'It's about the Gatekeepers, Stupid' [2002] 57 *The*

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Anderson, one of the world's largest (so-called 'Big Five') accounting firms and a massive legal settlement of US \$1.4 billion by some of the leading securities firms.⁶ In principle, 'gatekeepers' are 'independent professionals who serve investors by preparing, verifying, or assessing disclosures [and corporate documents] and who are thus in a position to prevent corporate misconduct by withholding their consent.'⁷ Although the party that it watches typically pays the gatekeeper as watchdog, the gatekeeper's credibility is founded on the fact that it is pledging its reputational capital.⁸

Reforms in Corporate Governance around the world have focussed primarily on the strengthening of independent directors, introduction of audit committees and reforms concerning the audit profession.⁹ However, the securities lawyers and commercial law firms who advised the fallen corporations have overwhelmingly avoided the spotlight despite the fact that some of the top-tier firms were involved

Business Lawyer 1403 (stating that 'the question is not why did some managements engage in fraud? But rather why did the gatekeepers let them?').

- 6 The Australian Financial Review, 17 March 2004 at 8 (reporting the major banks have so far paid US \$1.65 in settlements to resolve charges they have favoured some clients, compared with US \$1.4 billion in last year's settlement with investment banks over research conflicts).
- 7 John C. Coffee, Jr., The Attorney as Gatekeeper: An Agenda for the SEC [2003] 103 *Columbia Law Review* 1293, 1297; See also Reinier Kraakman, Gatekeepers: The Anatomy of a Third party Enforcement Strategy [1986] 2 *The Journal of Law, Economics & Organization* 53.
- 8 Richard W. Painter & Jennifer E. Duggan, Lawyer Disclosure of Corporate Fraud: Establishing a Firm Foundation [1996] 50 *The SMU Law Review* 225, 239 (observing that the attorney's reputation in the legal profession is particularly sensitive to an allegation of improper professional conduct, and a lawyer who has been sued or named as a respondent in a SEC disciplinary proceeding has a lot more to worry about than monetary loss).
- 9 In the US: *Public Company Accounting Reform and Investor Protection Act 2002* (the 'Sarbanes-Oxley Act') at <<http://www.sarbanes-oxley.com>> and NYSX Corporate Governance Code at <http://www.nyse.com/p1021232175378.html?displayPage=http%3A%2F%2Fgoogle.nyse.com%2Fsearch%3Fsite%3Dnyse%26output%3Dxml_no_dtd%26client%3Dnyse%26proxystylesheet%3Dnyse%26filter%3D0%26restrict%3D%26getfields%3Ddescription&q=corporate%20governanceCode> visited at 10 April 2004; in Australia: CLERP 9 – Audit Reform and Corporate Disclosure Bill 2003 at <<http://parlinfoweb.aph.gov.au/piweb/Repository/Legis/Bills/Linked/04120300.pdf>> and the Australian Stock Exchange's: Principles of Good Corporate Governance and Best Practice Recommendations of 2003 at <http://www.asx.com.au/about/CorporateGovernance_AA2.shtm> visited 10 April 2004; See also OECD/World Bank, Corporate Governance Roundtables 2004 at <http://www.oecd.org/document/9/0,2340,en_2649_37439_2048457_1_1_1_37439,00.html> visited 10 April 2004.

in allegedly criminal or at least, from a legal perspective, highly risky transactions.¹⁰

This article tries to explore to what extent the securities attorney can or should serve as a gatekeeper with 'guardian-like responsibilities to investors who rely upon the disclosures [and transactions] that the securities attorney typically prepares or at least reviews.'¹¹ The spotlight will be on the question of whether corporate lawyers, particularly securities lawyers, should blow the whistle in cases of suspected financial fraud, i.e. reporting (potential) illegal or illegitimate practices of the client's employees and management either up to higher authorities within the corporation or as a last resort to regulatory bodies outside the corporation.¹²

The article is organized as follows: Part II will discuss the failure of Enron's lawyers and the legal and ethical situation for corporate and securities lawyers prior to the *Sarbanes-Oxley Act 2002*.¹³ Then the new role of the securities lawyer in the US under section 307 of the *Sarbanes Oxley Act of 2002* will be assessed which requires a mandatory up-the-ladder reporting of violations of the law and authorises the US Securities and Exchange Commission ('SEC') to set standards of professional conduct for securities attorneys ('Part 205'). The focus will be on the

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- 10 Otis Bilodeau, Enron Report Casts Harsh Light on Lawyers [2002] LegalTimes.com (reporting that in Re Enron at least three major law firms, namely Andrews & Kurth, Vinson & Elkins, Kirkland & Ellis issued false 'true sale' opinions) at <<http://www.law.com/jsp/article.jsp?id=1032128629756>> visited on 10 April 2004; see Hearing on Enron Energy Services Corporate Responsibility Before the Senate Subcommittee on Consumer Affairs, Foreign Commerce and Tourism of the Senate Committee on Commerce, Science and Transp., Cong. [2002] (statement of Joan Claybrook, President, Public Citizen, testifying that American investors have lost US\$ 7 trillion in investments since March 2000 and arguing that lawyers and accountants drive corporate fraud) at <<http://commerce.senate.gov/hearings/071802claybrook.pdf>> visited 10 April 2004; see Susan P. Koniak, The Lawyer's Responsibility to the Truth: Corporate Fraud: see, Lawyers [2003] 26 *Harvard Journal of Law & Public Policy* 195, 227 (stating that 'no major corporate transaction goes forward without a lawyer's okay; no securities documents get filed without a lawyer's review; and no private placement memoranda are issued without a lawyer's input, if not a lawyer's drafting them herself.').
 - 11 John C. Coffee, Jr., The Attorney as Gatekeeper: An Agenda for the SEC [2003] 103 *Columbia Law Review* 1293, 1295.
 - 12 See Terrey Morehead Dworkin, Whistleblowing, MNC's and Peace [2003] 35 *Vanderbilt Journal of Transnational Law* 457, 461 (defining whistleblowing as 'the disclosure by organisation members of illegal, immoral or illegitimate practices under the control of their employers to persons that may be able to effect action').
 - 13 Public Company Accounting Reform and Investor Protection Act 2002 (the 'Sarbanes-Oxley Act') <<http://www.sarbanes-oxley.com>> visited 10 April 2004.

recent introduction of Part 205 which apart from up-the-ladder reporting proposed a controversial 'noisy withdrawal' provision.¹⁴

In Part III the Australian position towards the role of the Whistleblowing corporate lawyer will be highlighted. In particular, the new Whistleblowing provisions under CLERP 9 for in-house counsel¹⁵ will be discussed followed by an assessment of the proposed Anti-Money Laundering Bill,¹⁶ which will impose obligations on corporate lawyers to report suspicious transactions to a regulatory body (AUSTRAC).

Part IV presents a comparative analysis where recommendations for future developments are given, in particular the introduction of a mandatory up-the-ladder reporting requirement in Australia and an internal control system for corporations as well as law firms. Finally, Part V concludes that if securities and corporate lawyers fulfil their role as independent and critical gatekeepers to the corporate client then there is no need for Whistleblowing (in the sense of reporting out).

The US Perspective: The Role of the Securities Lawyer

No client, corporate or individual, however powerful, ... is entitled to receive, nor should any lawyer render, any service or advice involving disloyalty to the law, whose ministers we are ... or deception or betrayal of the public. The lawyer ... advances the honour of his profession and the best interests of his client when he [advises on] exact compliance with the strictest principles of moral law.¹⁷

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- 14 Lance Cole, Revoking our Privileges: Federal Law Enforcement's Multi-Front Assault on the Attorney-Client Privilege (And Why It Is Misguided) [2003] 48 *Villanova Law Review* 469, 594 (reporting that under the SEC proposal, outside counsel who do not receive an appropriate response from the company when reporting a violation internally are required to effect a so-called 'noisy withdrawal' by withdrawing from the representation and disaffirming any submissions to the SEC that they have participated in preparing and that are tainted by the violation, which essentially amounts to whistleblowing).
- 15 CLERP 9 – Audit Reform and Corporate Disclosure Bill 2003, Proposed s 1317AA at <<http://parlinfoweb.aph.gov.au/piweb/Repository/Legis/Bills/Linked/04120300.pdf>> visited 10 April 2004.
- 16 Homepage of the Attorney General's Department, Anti-Money Laundering Law Reform, Issues Paper 5: Legal Practitioners – Accountants – Company & Trust Service Providers, pages 7-10 at <<http://www.law.gov.au/www/agdhome.nsf/HeadingPagesDisplay/laundrying?OpenDocument>> visited 10 April 2004.
- 17 Robert W. Gordon, A New Role for Lawyers? The Corporate Counselor After Enron [2003] 35 *Connecticut Law Review* 1185, 1208 (citing the American Bar Association's first Canon of Ethics 1908 § 32).

In our corporate world today ... executives and accountants work day to day with lawyers. They give advice on almost each and every transaction. That means when executives and accountants have engaged in wrongdoing, there have been some folks at the scene of the crime – and generally they are the lawyers.¹⁸

Pre Sarbanes-Oxley: The Securities Lawyer as a ‘Hired Gun’?

The deep involvement of securities and corporate lawyers in the recent corporate scandals has been intensively scrutinised and requires a rethinking of the role of corporate lawyers as mere ‘amoral technicians’ and ‘hired guns’.¹⁹

Enron and Lawyer Involvement

In December 2001, Enron, Wall Street’s seventh largest corporation, filed for Chapter 11 bankruptcy, the largest in United States history.²⁰ Corporate and securities lawyers were involved in all of the complex transactions (the ‘high-risk transactions’) used by Enron to ‘cook its books’:

The Role of Enron’s Lawyers

The wrongdoing of Vinson & Elkins, one of Enron’s main law firms, amounted to issuing false ‘true sale opinions’ with respect to the establishment of various Special Purpose Entities (‘SPEs’)²¹ that formed the basis for the deceptive

18 Senator John Corzine, the former chief executive of Goldman Sachs, one of the two principal draftsmen of Section 307 (‘Rules and Professional Responsibilities for Attorneys’) of the Sarbanes-Oxley Act of 2002, 148 Cong. Rec. S6556; See also Ryan Morrison, Turn up the Volume: The Need for ‘Noisy Withdrawal’ in a Post Enron Society [2003/2004] 92 *Kentucky Law Journal* 279, 311 (reporting that the ABA instituted a Task Force on Corporate Responsibility in response to Enron, which acknowledged that ‘attorneys representing and advising corporate clients bear some share of the blame for [the] failure [of the system of corporate governance]’).

19 Thomas Ross, Lawyers and Fraud: A Better Question [2003] 43 *Washburn Law Journal* 45, 48.

20 Ryan Morrison, Turn up the Volume: The Need for ‘Noisy Withdrawal’ in a Post Enron Society [2003/2004] 92 *Kentucky Law Journal* 279, 291 (reporting that Enron’s market value plummeted in one year from US\$ 77 billion to US \$500 million).

21 Sean J. Griffith, Towards an Ethical Duty to Market Investors [2003] 35 *Connecticut Law Review* 1223, 1236 (reporting that SPE’s allow the sponsoring company to omit the SPE’s assets and liabilities from its financial statements. The relevant accounting rules require that at least a three percent equity interest is held by an independent outside investor and prohibit direct or indirect control of the SPE by the sponsoring company. Enron formed SPE’s without the required outside investment, instead engineering a series of sham transactions to disguise intra-corporate loans as the required outside investment, while control was exerted by the Enron’s CFO or other Enron employees. This led to a situation that allowed Enron to move over US\$ 1 billion off its books).

accounting.²² However, it is important to note that Vinson & Elkins' behaviour was reflected by many other major law firms, which while not directly engaging in fraudulent behaviour, may well have crossed the line to improper professional conduct.²³

The Role of the Banks' Lawyers

J.P. Morgan, Citigroup, Merrill Lynch and other major banks set up SPEs of their own and entered into fictional transaction circles with Enron through their SPEs, enabling Enron to receive loans as trading revenue and its promise to prepay the banks later on (with interest) as trading liabilities to conceal debt.²⁴ Accountants 'cannot book such circles as sales without two legal opinions, a true-sale opinion and a non-consolidation opinion'.²⁵ However, legal opinions from the various banks

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- 22 Michael L. Fox, To Tell or Not To Tell: Legal Ethics And Disclosure After Enron [2002] *Columbia Business Law Review* 867, 876 (referring to the Powers Report which is the result of a thorough investigation into Enron's failure: 'Management and the Board relied heavily on the perceived approval by Vinson & Elkins of the structure and disclosure of the transactions [discussed in this report]. Enron's Audit and Compliance Committee, as well as in-house counsel, looked to it for assurance that Enron's public disclosures were legally sufficient. It would be inappropriate to fault Vinson & Elkins for accounting matters, which are not within their expertise. However, Vinson & Elkins should have brought a stronger, more objective and more critical voice to the disclosure process').
- 23 Sean J. Griffith, Towards an Ethical Duty to Market Investors [2003] 35 *Connecticut Law Review* 1223, 1238 (reporting that Kirkland & Ellis represented various SPEs which were supposed to serve as hedges for Enron, were capitalised and refunded with Enron's stock when on the edge of failure and commenting that 'this [referring to the hedging] one may not do under the most basic rules of accounting, indeed, under the most basic rules of capitalism. One issues stock to raise capital. One then uses the capital to do business and generate income. One cannot skip this step and enter the capital stock directly into income').
- 24 *Re Enron* complaint naming J. P. Morgan Chase, Citigroup, Merrill Lynch, Credit Suisse First Boston, Canadian Imperial Bank of Commerce (CIBC), Bank America, Barclays Bank, Deutsche Bank and Lehman Brothers as key players in a series of fraudulent transactions that ultimately cost shareholders more than \$25 billion at <<http://www.ucop.edu/news/enron/art408.htm>> visited 10 April 2004; Robert W. Gordon, A New Role for Lawyers?: The Corporate Counselor After Enron [2003] 35 *Connecticut Law Review* 1185 (describing the transaction circle: The SPE would contract to buy that commodity from Enron in the same time while Enron, in turn, would agree to buy the commodity from the banks for an increased price which included the interest rate if Enron were borrowing directly from the banks. Then the banks – through their SPE's – 'pre-paid' Enron for the commodities which never left Enron's possession).
- 25 Susan P. Koniak, Corporate Fraud: See Lawyers [2003] 26 *Harvard Journal of Law & Public Policy* 195, 197 (reporting that the 'First Interim Report of the court-appointed examiner for the Enron bankruptcy proceedings makes clear that the accountants sought out and relied on the guidance of lawyers when trying to determine if certain transactions should be booked as sales or something else. Enron had to provide

outside counsel and from Enron's lawyers approved of the round-and-round deals and thus provided a cover of legitimacy.²⁶

Conclusion

Most of the law firms involved in Enron's high-risk transactions represent top-tier law firms with the best legal talent and not just a few 'bad apples' or 'renegades'.²⁷ Why did securities and corporate lawyers approve of such apparently highly risky transactions and not blow the whistle to the boards of directors or the SEC?

On the one hand the Pre-Sarbanes-Oxley legal framework did not severely threaten such high-risk lawyer behaviour and on the other hand the American Bar Association's ('ABA') ethical Professional Model Rules supported the perception of lawyers as adversarial advocates or hired guns barring disclosure of confidential information to prevent financial fraud.

No Need for Whistleblowing: A Fraud – Free Zone?

The Legal Framework

At the extreme, the culpability of those lawyers who contributed to the frauds and breaches of fiduciary duties seems clear: When lawyers 'knowingly and intentionally participate in and facilitate clients' wrongful acts they have crossed the line.'²⁸ That said, the legal framework and the enforcement practice against securities lawyers provided for a fraud-free zone:

Andersen with two legal opinions from its outside counsel in order for Andersen's accountants to sign off on the accounting treatment of the transactions.')

26 Robert W. Gordon, A New Role for Lawyers?: The Corporate Counselor After Enron [2003] 35 *Connecticut Law Review* 1185, 1203 (observing that the Bankruptcy Examiner stated that the only common characteristics in most of the Selected Transactions that support the sale characterization are the express terms of the document); See Susan P. Koniak, Corporate Fraud: See Lawyers [2003] 26 *Harvard Journal of Law & Public Policy* 195, 202 (reporting that another condition that the trades could not meet was that each SPE had to be 'independent' from its respective bank because Citigroup's and J.P. Morgan's entities were funded and under the complete control of their sponsoring banks. In J.P. Morgan's case a law firm set up, ran, and served as a trustee for J.P. Morgan's entity Mahonia).

27 Susan P. Koniak, Corporate Fraud: See Lawyers [2003] 26 *Harvard Journal of Law & Public Policy* 195, 226.

28 Mark A. Sargent, Lawyers in the Perfect Storm [2003] 43 *Washburn Law Journal* 1, 31.

Fraud under the Securities Exchange Act 1934

The *Securities Exchange Act of 1934* ('Act') includes multiple anti-fraud provisions.²⁹ But in 1974, the Supreme Court reversed a forty-year trend of federal decisions, which had granted investors an implied right to sue.³⁰ One commentator aptly summarized the following twenty years, 'the common theme [of the cases] seemed to be that plaintiffs always lost.'³¹ Furthermore, one key decision, *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.* disposed of private actions against securities lawyers for aiding and abetting securities frauds.³² Attorneys were now only liable as primary violators, i.e. where they could be identified as the author of deceptive conduct in the communication to the investor.³³ However, outside counsel seldom has a direct role in any of the corporation's statements or misstatements that may form the basis for securities fraud suits.³⁴

SEC Enforcement – Rule 102(e)

Since 1935, the SEC has had the power under Rule 102(e) of its Rules of Practice to suspend or disbar attorneys from appearing or practising before it if they had engaged in improper professional conduct.³⁵ However, since the 1980s the SEC required judicial conviction for violation of federal securities laws or state ethical laws before initiating Rule 102(e) proceedings against lawyers.³⁶ In addition,

29 Assaf Hamdani, Gatekeeper Liability [2003] 77 *Southern California Law Review* 54, 113.

30 Gary J. Aguirre, The Enron Decision: Closing The Fraud-Free Zone On Errant Gatekeepers? [2003] 28 *Delaware Journal of Corporate Law* 447, 466.

31 Gary J. Aguirre, The Enron Decision: Closing The Fraud-Free Zone On Errant Gatekeepers? [2003] 28 *Delaware Journal of Corporate Law* 447, 470.

32 *Central Bank* 511 U.S. 164, 191 [1994] (citing fear of vexatious litigation which would frustrate business activity).

33 *Central Bank* 511 U.S. 164, 191 (any person or entity, including a lawyer [...] who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable [...]); See Hearing on Enron Energy Services Corporate Responsibility Before the Senate Subcommittee on Consumer Affairs, Foreign Commerce and Tourism of the Senate Committee on Commerce, Science and Transp., Cong. [2002] (statement of Joan Claybrook, President, Public Citizen, noting that both Vinson & Elkins and Kirkland & Ellis have cited *Central Bank* in their Motions to Dismiss) at <<http://commerce.senate.gov/hearings/071802claybrook.pdf>> visited 10 April 2004.

34 David J. Beck, The Legal Profession at the Crossroads: Who will write the Future Rules Governing the Conduct of Lawyers Representing Public Corporations? [2003] 34 *St. Mary's Law Journal* 873, 893.

35 17 C.F.R. § 201.102(e) (2003).

36 Jill E. Fisch and Kenneth M. Rosen, Is There a Role For Lawyers in Preventing Future Enrons? [2003] Working Paper Series at 13-4 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=367661> visited 10 April 2004; See also Michael A. Perino, How Vigorously Will The SEC Enforce Attorney Up-The-

empirical evidence shows that state bar authorities have not enforced ethics rules against large commercial law firms, because they are under-staffed, under-funded and lack the necessary expertise in securities law and complicated financial transactions.³⁷ These conditions had the effect of virtually eliminating SEC disciplinary proceedings against lawyers.

Conclusion

The collective impact resulted in a nearly non-existent risk of liability for securities and corporate lawyers when advising clients in high-risk, potentially fraudulent securities schemes.

ABA Model Rules: Corporate Lawyers as Zealous Advocates

Traditionally, the rules governing the professional conduct of attorneys were adopted by the states, often in line with the ABA Model Rules of Professional Conduct ('ABA Rules'), and promulgated by the highest state courts.³⁸ ABA Rule 1.2(d) of 2002 states: 'A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.'³⁹

Can Securities and Corporate Lawyers be Gatekeepers?

All corporate lawyers charged with involvement in the corporate scandals maintain that their role was to 'help the client realize its goals and desires, recognizing as hard limits only the bounds of the law, as the most ingenious

Ladder Reporting Rules? An Analysis Of Institutional Constraints, Norms, And Biases [2003] Working Paper Series at 9-10 (reporting that the SEC under pressure from the bar formulated its position in the that it would only bring Rule 102(e) proceedings against attorneys 'if the alleged misconduct was a violation of established ethical rules at the state level and had a direct impact on the Commission's internal processes [...]') at

<http://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID480502_code132597.pdf?abstractid=480502> visited on 10 April 2004.

37 John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC* [2003] *103 Columbia Law Review* 1293, 1303 (citing then SEC Chairman Harvey Pitt in his 2002 speech before the American Bar Association in which he expressed frustration over 'the generally low level of effective response we receive from state bar committees when we refer possible disciplinary proceedings to them').

38 David J. Beck, *The Legal Profession at the Crossroads: Who will write the Future Rules Governing the Conduct of Lawyers Representing Public Corporations?* [2003] *34 St. Mary's Law Journal* 873, 907.

39 ABA Model Rules of Professional Conduct 2002 at page 7
<<http://www.law.onu.edu/ModelRules2002.pdf>> visited 10 April 2004.

interpretations they can construct of fact and law that are most favourable to their client's position.⁴⁰ This is the corporate lawyer as the zealous adversary-advocate in criminal proceedings (or 'hired gun').⁴¹ In one of the few systematic surveys to date, only two percent of sampled lawyers recalled giving advice with regards to the 'public interest' while seventy-five percent claimed never to have encountered a serious ethical conflict with any client during their entire career.⁴²

The hired gun model or total commitment model has been the dominant influence on state ethics rules⁴³ despite calls for the gatekeeper model.⁴⁴ In summary, the view of the corporate lawyer as a hired gun does not include gatekeeper responsibilities to the client-corporation, investors or the public.

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- 40 Robert W. Gordon, A New Role for Lawyers?: The Corporate Counselor After Enron [2003] 35 *Connecticut Law Review* 1185, 1204.
- 41 Christine Hurt, Counselor, Gatekeeper, Shareholder, Thief: Why Attorneys Who Invest in Their Clients in a Post-Enron World Are 'Selling Out', Not 'Buying In' [2003] 64 *Ohio State Law Journal* 897, 937; Sean J. Griffith, Towards an Ethical Duty to Market Investors [2003] 35 *Connecticut Law Review* 1223, 1229.
- 42 Robert F. Cochran, Jr., Deborah L. Rhode, Paul R. Tremblay, Thomas L. Shaffer, Client Counselling and Moral Responsibility [2003] 30 *Pepperdine Law Review* 591, 607.
- 43 Jill E. Fisch & Kenneth M. Rosen, Is There A Role For Lawyers In Preventing Future Enrons? [2003] Working Paper Series at 9
<http://papers.ssrn.com/sol3/papers.cfm?abstract_id=367661> visited 10 April 2004; See also ABA Task Force on Corporate Responsibility, Final Report [2003] page 22, 23 ('Lawyers [...] are not gatekeepers [...]. An [...] alternative view of the lawyer as an enforcer of law may tend to create an atmosphere of adversity, or at least arm's length dealing, between the lawyer and the client's senior executive officers that is inimical to the lawyer's essential role as a counsellor promoting the corporation's compliance with law') at <http://www.abanet.org/buslaw/corporateresponsibility/final_report.pdf> visited 10 April 2004.
- 44 John C. Coffee, Jr., The Attorney as Gatekeeper: An Agenda for the SEC [2003] 103 *Columbia Law Review* 1293, 1299 (observing that prominent securities lawyers have long endorsed the idea that they owe a duty to the public, classically stated in 1974 by A.A. Sommer, Jr., a long-time leader of the securities bar and an SEC Commissioner: 'I would suggest that in securities matters (other than those where advocacy is clearly proper) the attorney will have to function in a matter more akin to that of an auditor than that of an attorney. This ... means he will have to exercise a measure of independence that is perhaps uncomfortable if he is also close counsellor of management in other matter, often including business decisions. It means he will have to be acutely cognizant of his responsibility to the public who engage in securities transactions that would never have come about were it not for his professional presence. It means that he will have to adopt the healthy scepticism toward the representation of management which a good auditor must adopt. It means that he will have to do the same thing the auditor does when confronted with an intransigent client - resign').

Securities and Corporate Lawyers are not Adversary-advocates

The role of the criminal lawyer, however, must be distinguished from the advisory role of the securities lawyer, except when involved in adversarial proceedings with the SEC.⁴⁵ In the adversarial setting it is justified zealously to defend the client, because the 'opposing party's attorneys, the judge, and the jury all operate as potential checks against abuse.'⁴⁶ On the other hand, these checks are all non-existent when a corporate lawyer is acting in an advisory role for a client and being asked to determine the legality of the client's contemplated actions.⁴⁷ One of the major functions of the securities lawyer is to assess objectively and critically whether the proposed transactions meet legal standards.⁴⁸ However, when corporate lawyers look forward to a 'hypothetical role as counsel in adversary proceedings and the arguments they would make in that role,'⁴⁹ their advice may result in actual non-disclosure and even violations of the law (because in court they would argue to have satisfied the most minimal standard possible and might even get away with it).⁵⁰

Securities and Corporate Lawyers as Gatekeepers

It remains true that securities and corporate lawyers are different from the classic gatekeepers, such as auditors and securities analysts who owe their main duties to investors and must play a quasi-adversarial role towards their client.⁵¹ By contrast, securities and corporate lawyers play contrasting roles as advocates, transaction engineers and gatekeepers, with obligations running to the client and to a lesser extent to the investing public.⁵² In procedures before the SEC their

45 DongJu Song, *The Laws Of Securities Lawyering After Sarbanes-Oxley* [2003] 53 *Duke Law Journal* 257, 286.

46 Susan P. Koniak, *When the Hurlyburly's Done: The Bar's Struggle with the SEC* [2003] 103 *Columbia Law Review* 1236, 1276.

47 Robert W. Gordon, *A New Role for Lawyers?: The Corporate Counselor After Enron* [2003] 35 *Connecticut Law Review* 1185, 1204.

48 Roger C. Cramton, *Enron And The Corporate Lawyer: A Primer on Legal And Ethical Issues* [2002] 58 *The Business Lawyer* 143, 147.

49 Robert W. Gordon, *A New Role for Lawyers?: The Corporate Counselor After Enron* [2003] 35 *Connecticut Law Review* 1185, 1205.

50 Roger C. Cramton, *Enron And The Corporate Lawyer: A Primer on Legal And Ethical Issues* [2002] 58 *The Business Lawyer* 143, 173 - 175 (quoting economic historian Peter Temin referring to the recent corporate scandals, 'everybody did this. The people who got in trouble are those who are most at the edge. Enron didn't get caught. Enron got so far out on the edge that it fell off').

51 Mark A. Sargent, *Lawyers in the Perfect Storm* [2003] 43 *Washburn Law Journal* 1, 17; See Larry Cata Becker, *The Duty To Monitor: Emerging Obligations Of Outside Lawyers And Auditors To Detect And Report Corporate Wrongdoing Beyond The Federal Securities Laws* [2003] 77 *St. John's Law Review* 919, 952.

52 Christine Hurt, *Counselor, Gatekeeper, Shareholder, Thief: Why Attorneys Who Invest in Their Clients in a Post-Enron World Are 'Selling Out', Not 'Buying In'* [2003] 64 *Ohio State Law Journal* 897, 925 (observing that the corporate attorney acts as

duty as advocates is zealously to defend the corporate client.⁵³ When acting as transaction engineers they design and ‘accomplish client goals, such as raising capital through structured finance, [and] making a public offering of securities.’⁵⁴ Ideally, as reputational intermediaries and as gatekeepers, securities lawyers pass independent, objective judgment on the validity of securities disclosures and transactions.⁵⁵ Their relationship with the client is therefore both, one of trust and confidence and one that can be ‘adversarial’ (when advising against a certain transaction).⁵⁶

The Attorney-Client Privilege: Duty of Confidentiality v Disclosure?

Closely connected with the hired gun approach is the attorney-client privilege, which in principle bars a lawyer from disclosing confidential information.⁵⁷ Under

‘counsellor, a wordsmith, negotiator, transaction cost engineer, a reputational intermediary, and a gatekeeper’); Sean J. Griffith, Towards an Ethical Duty to Market Investors [2003] 35 *Connecticut Law Review* 1223, 1224 (observing that as gatekeepers and transaction engineers, business lawyers design relationships between the users of capital, the firms, and holders of capital, the investors, so that in this way just as litigators fulfil a public function as ‘officers of the Court’, business lawyers have a role in the administration of the markets); this view is not undisputed: Thomas Ross, Lawyers and Fraud: A Better Question [2003] 43 *Washburn Law Journal* 45, 52 (stating that as a general principle the lawyer should place his client’s interests ahead of others); ABA Task Force on Corporate Responsibility, Final Report [2003] page 22, 23 (“Lawyers [...] are not gatekeepers [...]”) at <http://www.abanet.org/buslaw/corporateresponsibility/final_report.pdf> visited 10 April 2004.

53 DongJu Song, The Laws Of Securities Lawyering After Sarbanes-Oxley [2003] 53 *Duke Law Journal* 257, 286.

54 Sean J. Griffith, Towards an Ethical Duty to Market Investors [2003] 35 *Connell Law Review* 1223, 1225; Christine Hurt, Counselor, Gatekeeper, Shareholder, Thief: Why Attorneys Who Invest in Their Clients in a Post-Enron World Are ‘Selling Out’, Not ‘Buying In’ [2003] 64 *Ohio State Law Journal* 897, 925 (noting that the transaction cost engineer function is closely related to the reputational intermediary function of the corporate attorney).

55 Robert W. Gordon, A New Role for Lawyers?: The Corporate Counselor After Enron [2003] 35 *Connecticut Law Review* 1185, 1194 (quoting one of Enron’s tax advisors, speaking of the company’s complex tax-avoidance transactions, ‘The government is not going to like these deals. People can disagree on what works within the written rules [...]. If you know the rules you don’t have to break the rules, you just use them. That’s what lawyers and accountants do’).

56 Sean J. Griffith, Towards an Ethical Duty to Market Investors 35 *Connecticut Law Review* 1223, 1225 (stating that the responsibility of securities lawyers for the current crisis may arise from these tensions in their dual role as gatekeepers and transaction engineers which parallels the conflict between accountant-as-auditor and accountant-as-consultant).

57 Irma S. Russell, Keeping The Wheels On The Wagon: Observations On Issues Of Legal Ethics For Lawyers Representing Business Organizations [2003] 3 *Wyoming Law Review* 513, 526.

the 1983 version of ABA Rule 1.6, which was in force until 2003, attorneys were under a strict duty of confidentiality and barred from disclosure of confidential information to prevent economic injuries.⁵⁸

Crime-Fraud Exception: A Duty to blow the Whistle?

An important limitation on the attorney-client privilege is that it should not be available to shield communications in the furtherance of a future crime or fraud if the lawyer knows of the criminal intent of the client ('crime-fraud exception').⁵⁹ 'The obvious flaw of knowledge-based standards, however, is that they provide gatekeepers with no incentives to scrutinize client conduct even when detecting misconduct is relatively easy.'⁶⁰ Although, contrary to the ABA Model Rules, the Ethical Rules in forty-one states⁶¹ permit disclosure of client confidences to prevent a client from committing criminal fraud, Whistleblowing by lawyers to the authorities has always been extremely rare.⁶²

58 The 1983 version of Model Rule 1.6 states:

'Confidentiality of Information:

- (a) A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraph (b).
- (b) A lawyer may reveal such information to the extent the lawyer reasonably believes necessary:
 - (1) prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm; or
 - (2) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client [...].'

59 Lance Cole, Revoking our Privileges: Federal Law Enforcement's Multi-Front Assault on the Attorney-Client Privilege (And Why It Is Misguided) [2003] 48 *Villanova Law Review* 469, 494; David J. Fried, Too High a Price for Truth: The Exception to the Attorney-Client Privilege for Contemplated Crimes and Frauds [1986] 64 *North Carolina Law Review* 443, 461-69 (discussing controlling court decisions concerning requisite showing of criminal intent to negate attorney-client privilege).

60 Assaf Hamdani, Gatekeeper Liability [2003] 77 *California Law Review* 53, 104.

61 Lisa H. Nicholson, A Hobson's Choice For Securities Lawyers [2002] 16 *Georgetown Journal of Legal Ethics* 91, 137 (reporting that nine states allow disclosure of confidential information to prevent non-criminal fraud, while only two mandate it).

62 Roger C. Cramton, Enron And The Corporate Lawyer: A Primer On Legal And Ethical Issues [2002] 58 *The Business Lawyer* 143, 157; Lisa H. Nicholson, A Hobson's Choice For Securities Lawyers [2002] 16 *Georgetown Journal of Legal Ethics* 91, 138 (reporting that lawyers' misunderstanding was based on their exposure to Model Rule 1.6's disclosure restrictions, which is by far the greatest subject of scholarly debates and serves as the basis of every practitioner's legal instruction).

A Behavioural Analysis: Who is the Client?

Model Rule 1.13 specifically addresses the corporate counsel's duty to the corporate entity and allows reporting to the board of directors when detecting financial fraud.⁶³ However, when working for a corporate client, 'outside counsel are often caught between the politics of business managers and the legal department, [as well as] the long-term objectives of the board of directors and the short-term objectives of management.'⁶⁴ Moreover, securities and corporate lawyers' day-to-day responsibilities largely involve reporting to and pleasing corporate management.⁶⁵ This results in the identification of corporate and securities lawyers with their managerial clients and creates behavioural biases that limit the lawyers' capacity to perceive danger signals of (potential) fraud.⁶⁶ It follows that reporting up to the board of directors rarely occurred.

Assessment

In sum, before the *Sarbanes-Oxley Act* neither disclosure of (potential) financial fraud nor deterrence of a client's financially and legally risky behaviour was encouraged. Corporate lawyers often confused management with the real client, the corporation, and refrained from reporting violations up to the board. Disclosing client fraud, i.e. reporting out, was subordinate to the 'constitutional norm' of maintaining confidentiality.⁶⁷

63 Irma S. Russel, Keeping the Wheels on the Wagon: Observations on Issues of Legal Ethics for Lawyers Representing Business Organizations [2003] 3 *Wyoming Law Review* 513, 531.

64 Christine Hurt, Counselor, Gatekeeper, Shareholder, Thief: Why Attorneys Who Invest in Their Clients in a Post-Enron World Are 'Selling Out', Not 'Buying In' [2003] 64 *Ohio State Law Journal* 897, 924.

65 David J. Beck, The Legal Profession at the Crossroads: Who will write the Future Rules Governing the Conduct of Lawyers Representing Public Corporations? [2003] 34 *St. Mary's Law Journal* 873, 880 (quoting one commentator as saying: 'We have the perverse situation in which the lawyer who represents a publicly held corporation is selected and retained by, and reports to and may be fired by, the principal officers and directors of the corporation – who are not his clients').

66 Robert Prentice, Enron: A Behavioral Autopsy [2003] 40 *American Business Law Journal* 417, 428-33; Thomas Ross, Lawyers and Fraud: A Better Question [2003] 43 *Washburn Law Journal* 45, 53-4 (observing that the pattern of the corporate scandals is this essential failure of entity representation); Stephen M. Bainbridge, The Tournament At The Intersection of Business And Legal Ethics [2003] Working Paper Series, page 18 at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=429304> visited on 10 April 2004.

67 Susan P. Koniak, The Law Between The Bar And The State [1992] 70 *North Carolina Law Review* 1389, 1456 (arguing that client confidentiality and zealous advocacy are 'constitutional' norms for lawyers – core values which are treated as nearly inviolable).

The Sarbanes Oxley Act – Closing the Fraud-free Zone?

Section 307 of the Act (Rules of Professional Conduct for Attorneys) was motivated by two basic concerns. First, 'lawyers had played a nontrivial role in facilitating corporate misconduct and [second,] the bar associations had blocked legal ethics reforms intended to discourage lawyers from doing so.'⁶⁸ For the first time the SEC has now authority to regulate directly the professional conduct of attorneys in the public interest and for the protection of investors, requiring up-the ladder reporting in case of suspected securities law violations.⁶⁹ Pursuant to Section 307 of the Act, on 23 January 2003 the SEC adopted Part 205 of the Rules of Practice establishing standards of professional conduct for attorneys who appear and practise before the SEC on behalf of issuers.⁷⁰

Rule 205.3(b): Up-the-Ladder Reporting

The Rule

205.3(b) requires a securities attorney to report a material violation of the applicable law to the CLO and/or CEO and describes when a securities attorney is obliged to report that evidence further up-the-ladder within the corporate client, ultimately to the board of directors.⁷¹ A material violation is defined as a material

68 Stephen M. Bainbridge, *The Tournament At The Intersection of Business And Legal Ethics* [2003] Working Paper Series, page 8.

<http://papers.ssrn.com/sol3/papers.cfm?abstract_id=429304> visited on 10 April 2004.

69 Section 307 reads:

'[...] 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 [...] requiring the attorney to report the evidence to the audit committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.'

70 SEC, *Implementation of Standards of Professional Conduct for Attorneys*, effective on 5 August 2003 (hereinafter the 'SEC Rules') at <<http://www.sec.gov/rules/final/33-8185.htm>> visited on 10 April 2004.

71 s 205.3(b) SEC Rules provides:

'Duty to report evidence of a material violation. [...]

(3) Unless an attorney who has made a report [...] reasonably believes that the chief legal officer or the chief executive officer of the issuer has provided an appropriate response within a reasonable time, the attorney shall report the evidence of a material violation to:

(i) The audit committee of the issuer's board of directors;

breach of an applicable federal or state securities law, a material breach of fiduciary duty, or similar violation of any federal or state law.⁷² Rule 205.3(a) emphasises that outside attorneys' professional and ethical duties run to the corporation itself, and not to the persons with whom the attorney regularly interacts, such as general counsel, individual officers, managers or directors. The SEC has the authority to subject an attorney to the civil penalties and remedies for a violation of the federal securities laws.⁷³

Assessment

The Triggering Standard: 'Requiring the Mind to Do Flips'?

s 205.2(e) provides for the triggering standard:

Evidence of a material violation means credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur.

Criticism

The adopted standard has been criticised as being incomprehensible because of the double negative.⁷⁴ Moreover, the wording may still leave room for individual, discretionary judgment by the attorney because of the use of words, such as 'credible' and 'material'.⁷⁵ Therefore, critics opine that the standard is unlikely to guide lawyers' behaviour and will pose enforcement difficulties.⁷⁶

(ii) Another committee of the issuer's board of directors consisting solely of directors who are not employed, directly or indirectly, by the issuer [...]

(iii) The issuer's board of directors [...].'

72 James D. Cox, United States Securities Laws Enter New Terrain: Corporate Governance And Attorney Responsibilities After Sarbanes-Oxley [2003] 77 *Australian Law Journal* 293, 297.

73 s 205.6 SEC Rules (Sanctions and Discipline).

74 Susan P. Koniak, The Lawyer's Responsibility to the Truth: Corporate Fraud: See, Lawyers [2003] 26 *Harvard Journal of Law & Public Policy* 195, 230 (noting that the double negative 'requires the mind to do flips').

75 Mark A. Sargent, Lawyers in the Perfect Storm [2003] 43 *Washburn Law Journal* 1, 42; Stephen M. Bainbridge and Christina J. Johnson, Managerialism, Legal Ethics, And Sarbanes-Oxley § 307 [2003] Working Paper Series, page 24 (observing that 'prudent attorney' and 'reasonably likely' may allow for professional concerns and other conflicts of interest to skew the lawyer's assessment, minimizing the chances that the potential violation would be reported up) at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=434721> visited 10 April 2004.

76 George M. Cohen, Testimony before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Committee on Financial Services, Hearing on The Role of Attorneys in Corporate Governance, February 4, 2004 (noting that the

Evaluation

The double negative wording reflects the SECs struggle trying to impose an objective ('should have known') standard.⁷⁷ This is because, a subjective standard would not profoundly change the current situation as corporate lawyers 'tend to see no evil' - in part due to their behavioural biases.⁷⁸ Therefore, the objective standard aims at forcing corporate lawyers to 'see' corporate misconduct and at preventing lawyers from turning a blind eye. The use of legal terms, such as 'evidence', and the definition of a material violation are likely to provide for guidance and expand the narrow scope of the crime-fraud exception.

Chilled Attorney-Client Communications?

Criticism

The main concern by commentators is that corporate managers will exclude lawyers from their most sensitive discussions, especially when pursuing an aggressive, high-risk course of conduct ('chill-effect').⁷⁹ Corporate managers may be tempted to distribute the legal work among a large number of law firms, creating a compartmentalization that prevents any lawyer from understanding the whole picture.⁸⁰ Thus the net result may be that 'lawyers might have less of an opportunity to influence their clients' actions positively towards law compliance than they do now.'⁸¹

standard would be a nightmare to enforce because of the burden of proving two negatives) at
<http://www.law.virginia.edu/home2002/html/news/2004_spr/cohen_testimony.htm>
visited on 10 April 2004.

77 Susan P. Koniak, The Lawyer's Responsibility to the Truth: Corporate Fraud: See, Lawyers [2003] 26 *Harvard Journal of Law & Public Policy* 195, 230.

78 Thomas Ross, Lawyers and Corporate Fraud: A Better Question [2003] 43 *Washburn Law Journal* 45, 54 (stating that lawyers might participate in financial fraud without a cognitive awareness of the nature and consequences of their actions).

79 Jill E. Fisch & Kenneth M. Rosen, Is There A Role For Lawyers In Preventing Future Enrons? [2003] Working Paper Series at 45
<http://papers.ssrn.com/sol3/papers.cfm?abstract_id=367661> visited 10 April 2004.

80 Robert W. Gordon, A New Role for Lawyers?: The Corporate Counselor After Enron [2003] 35 *Connecticut Law Review* 1185, 1193 (reporting that Enron spread out its legal work to over 100 law firms, so that even its own General Counsel had no means of controlling or supervising all of the legal advice the company was receiving, because the different divisions all had their own lawyers and outside firms).

81 Mark A. Sargent, Lawyers in the Perfect Storm [2003] 43 *Washburn Law Journal* 1, 42.

Evaluation

The chill-effect argument presumes that managerial high-risk behaviour or even fraud could proceed without lawyer involvement. Prof Koniak convincingly argues that the facts in numerous securities fraud cases suggest otherwise.⁸² This is because 'securities lawyers working on complex transactions usually know exactly what their clients are doing because it is their advice that makes [the transaction] possible.'⁸³

Most importantly, reporting up-the-ladder confirms that the lawyer's loyalty and service is owed to the corporation as the client (and not management). Finally, reporting up does not entail reporting out (to the SEC or another authority) so that there is no breach of confidentiality to the client and no threat of regulatory involvement.⁸⁴

A Qualified Legal Compliance Committee to Avoid Chill-Effects?

Under Rule 205.3(c) a securities attorney may report violations to a Qualified Legal Compliance Committee ('QLCC'), which can be established by the corporate client, and is then exempted from further up-the-ladder reporting.⁸⁵ The QLCC may be the issuer's audit committee and must otherwise consist of at least one member of the issuer's audit committee, and two more non-executive, independent directors.⁸⁶

It is noteworthy, that the ABA's Task Force on Corporate Responsibility recommended periodical meetings between general outside counsel and a legal

82 Susan P. Koniak, *When the Hurlyburly's Done: The Bar's Struggle with the SEC* [2003] 103 *Columbia Law Review* 1236, 1253.

83 Mark A. Sargent, *Lawyers in the Perfect Storm* [2003] 43 *Washburn Law Journal* 1, 33.

84 See s 205.3(b):
'[...] By communicating [a material violation up-the-ladder] an attorney does not reveal client confidences or secrets or privileged or otherwise protected information related to the attorney's representation of the issuer.'

85 205.3(c) SEC Rules provides:
'Alternative reporting procedures for attorneys retained or employed by an issuer that has established a qualified legal compliance committee.
(1) [...] the attorney may, as an alternative to the reporting requirements of paragraph 205.3(b) of this section, report such evidence to a qualified legal compliance committee, if the issuer has previously formed such a committee. An attorney who reports evidence of a material violation to such a qualified legal compliance committee has satisfied his or her obligation to report such evidence and is not required to assess the issuer's response to the reported evidence of a material violation [...].'

86 s 205.2(k) SEC Rules.

audit committee outside the presence of other managers and inside directors.⁸⁷ Such a system would 'allow corporate lawyers to bypass managers without creating the risk of retaliation that might result from sporadic reporting up.'⁸⁸ In combining the ABA's recommendation with Rule 205.3(c) the establishment of a QLCC to which the corporate attorney has to report on a regular basis could minimize the potential chill-effect.

Cost Benefit Analysis

Costs: Implementation, Over-reporting and Business v Legal Judgment?

The SEC has estimated that the establishment of a QLCC for public companies would result in at least US \$1.5 million per year.⁸⁹ Moreover, due to the risk of potential liability attorneys may resort to over-reporting, i.e. report all possible information related to actual, likely or even improbable wrongdoing.⁹⁰ Furthermore, securities and corporate lawyers are frequently asked for opinions that combine business, legal and even moral judgments effectively going beyond mere technical legal advice.⁹¹ The conservative attorney might choose to report up differences in business judgment fearing that they might be looked upon as legal improprieties at a later time.⁹²

87 ABA Task Force on Corporate Responsibility, Final Report [2003], page 32, 38 (the fact that the general counsel is expected to make disclosure to the board about significant legal compliance issues may persuade the CEO to take corrective action or personally report such issues directly to the board) at <http://www.abanet.org/buslaw/corporateresponsibility/final_report.pdf> visited 10 April 2004.

88 Jill E. Fisch & Kenneth M. Rosen, Is There A Role For Lawyers In Preventing Future Enrons? [2003] Working Paper Series at 56 (noting that the periodic reporting requirement would have to be extended to outside lawyers, which could report to the general counsel) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=367661> visited 10 April 2004.

89 SEC Rules Part IV: Cost and benefits (reporting costs based on monitoring, review, and investigating while expecting 20% of issuers to form a QLCC).

90 Jill E. Fisch & Kenneth M. Rosen, Is There A Role For Lawyers In Preventing Future Enrons? [2003] 48 *Villanova Law Review* 1097, 1126-7; Stephen M. Bainbridge and Christina J. Johnson, Managerialism, Legal Ethics, And Sarbanes-Oxley § 307 [2003] Working Paper Series, page 25 at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=434721> visited 10 April 2004.

91 James A. Cohen, Lawyer Role, Agency Law, and the Characterization 'Officer of the Court' [2000] 48 *Buffalo Law Review* 349, 406 (observing that, while the lawyer's duty of candor allows the lawyer to discuss the matter broadly, exploring options from many perspectives, it does not permit the imposition of the lawyer's values or moral on the client).

92 Jill E. Fisch & Kenneth M. Rosen, Is There A Role For Lawyers In Preventing Future Enrons? [2003] Working Paper Series at 47 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=367661> visited 10 April 2004.

In sum, the result would be a 'classic noise problem (too much information to be processed by the recipients)' which merely increases the workload and reduces the qualitative significance of reporting up.⁹³ For lawyers, the rule could have an adverse effect on malpractice insurance premiums, which may lead to an increase in the cost of lawyer services to issuers.⁹⁴

Benefits: Reducing Fraud & Enhancing Lawyer's Independence?

The reporting up-the-ladder requirement gives attorneys leverage in the face of aggressive management and may at the same time serve as a deterrent. It will require business lawyers 'to function as a type of early warning system for independent directors who might otherwise, due to their limited involvement in day-to-day corporations, fail to identify problems.'⁹⁵ Thus the information flow within the corporation, as the real client, will be improved.⁹⁶ Moreover, the existence of the up-the-ladder obligation may spur the creation of internal control systems within law firms for identifying potential client wrongdoing with more levels of review promoting independent judgment.⁹⁷ In seeking to maintain quality, law firms could create a 'quality control office and staff it with experienced [semi-retired] partners who would have the necessary credibility with

93 Jill E. Fisch & Kenneth M. Rosen, Is There A Role For Lawyers In Preventing Future Enrons? [2003] 48 *Villanova Law Review* 1097, 1127; Stephen M. Bainbridge and Christina J. Johnson, Managerialism, Legal Ethics, And Sarbanes-Oxley § 307 [2003] Working Paper Series, page 25 at

<http://papers.ssrn.com/sol3/papers.cfm?abstract_id=434721> visited 10 April 2004.

94 SEC Rules Part IV: Cost and benefits (noting that insurance companies estimate an increase of 10% although s 205.7 clarifies that no private right of action exists based on (non-) compliance with the rules and s 205.6(c) exempts lawyers reporting in good faith from liability).

95 Jill E. Fisch & Kenneth M. Rosen, Is There A Role For Lawyers In Preventing Future Enrons? [2003] Working Paper Series at 22

<http://papers.ssrn.com/sol3/papers.cfm?abstract_id=367661> visited 10 April 2004.

96 John Gibeaut, Fear and Loathing in Corporate America: Big Business's Public Tribulations Have led to Skeptical Juries, New Laws and In-House Lawyers' Working to Tighten Compliance [2003] 89 *The A.B.A. Journal* 50, 54 (A survey of the ACCA conducted in 2002 showed, that '49 percent of in-house lawyers reported that they are kept out of the loop on some important financial and accounting developments while 68 percent agreed that accounting and financial fraud would decline if in-house lawyers had greater access to ... the board').

97 Mark A. Sargent, Lawyers in the Perfect Storm [2003] 43 *Washburn Law Journal* 1, 38.; See also John C. Coffee, Jr., The Attorney as Gatekeeper: An Agenda for the SEC [2003] 103 *Columbia Law Review* 1293, 1304 (proposing - to avoid conflicts that compromise the attorney - to require 'a corporation [...] to use a different counsel for transaction engineering tasks that it used for gatekeeping responsibilities'); Robert W. Gordon, A New Role for Lawyers?: The Corporate Counselor After Enron [2003] 35 *Connecticut Law Review* 1185, 1210 (calling for the establishment of a separate professional role for a distinct type of lawyer, the 'independent counsellor').

their peers in the firm ('smell-test').⁹⁸ To be sure, there may be additional costs, but auditors and broker-dealers already have similar and workable quality control systems in place.

It is of course questionable whether the establishment of a QLLC or the reporting up requirement would have prevented Enron. However, if there had been additional layers of objective review (in form of an independent QLLC and 'smell-test') at least the high-risk transactions would have been subjected to more objective and critical scrutiny. In the end, the social cost of 'exempting attorneys from gatekeeping responsibilities would result in unrestored investor confidence, leading to a higher cost of equity capital for corporate issuers, more reliance upon debt and resulting higher corporate leverage, and reduced economic growth.'⁹⁹

Proposed Rule 205.3(d): Noisy Withdrawal?

The Rule

The SEC originally also proposed a provision requiring a lawyer who has not received an appropriate response after reporting up-the-ladder and believes that the violation is ongoing to resign and to report the withdrawal to the SEC ('noisy withdrawal').¹⁰⁰

98 Roman Tomasic, Corporate Collapse, crime and governance – Enron, Andersen and beyond [2002] 14 *Australian Journal of Corporate Law* 1, 36.

99 John C. Coffee, Jr., The Attorney as Gatekeeper: An Agenda for the SEC [2003] 103 *Columbia Law Review* 1293, 1302.

100 Proposed s 205.3(d) SEC Rules provides:
'Notice to the Commission where there is no appropriate response within a reasonable time:

- (1) Where an attorney who has reported evidence [...] 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 [...] that the attorney has prepared or assisted in preparing and that the attorney reasonably believes is or may be materially false or misleading [...].'

Criticism

Invading the Protection of the Attorney-Client Privilege?

A mandatory noisy withdrawal requirement collides with the duty of confidentiality under the traditional client–attorney privilege because it requires the reporting out of confidential information.¹⁰¹ Moreover, a mandatory noisy withdrawal provision threatens the independence of the bar by turning the securities and corporate lawyer into a ‘policeman always looking out for evidence of a material violation.’¹⁰² Therefore, the argument of a potential chilling effect on the client-attorney relationship cannot be as easily dismissed as in the case of the up-the-ladder reporting requirement within the client.¹⁰³

Beyond Congressional Mandate: Noisy Withdrawal ‘Dead’?

A great number of commentators have objected to the noisy withdrawal opining that the SEC does not have the statutory authority under the Act to require a mandatory noisy withdrawal.¹⁰⁴ After more than one year without any progress the issue seems dead due to intense lobbying by the ABA and even the joint-sponsor of *the Sarbanes-Oxley Act*, Michael G. Oxley, strongly rebuking the SEC for the noisy withdrawal provision.¹⁰⁵

Assessment

Noisy withdrawal, although much more controversial than up-the-ladder reporting, has a significant basis in legal academic and practice literature.¹⁰⁶ An up-the-ladder reporting requirement alone may not have much influence without

101 Lisa H. Nicholson, A Hobson’s Choice For Securities Lawyers [2002] 16 *Georgetown Journal of Legal Ethics* 91, 140.

102 George Fox, Legal Ethics – Sword or Straightjacket? [2003] 49 *Loyola Law Review* 251, 286.

103 Richard J. Writh & Matthew A. Swendiman, Faith, Dishonour and a Ladder – A Brief History of the Securities Attorney Conduct Standards [2003] *ALI – ABA Course of Study Materials* at 1, 10 (calling noisy withdrawal ‘professional suicide’).

104 Comments of Attorneys’ Liability Assurance Society, Inc., page 8; Comments of Frederick Lipman, page 1-3 at <http://www.sec.gov/rules/proposed/33-8186.htm#P86_8175> visited 10 April 2004.

105 Legal Week, Congress attacks SEC’s whistleblowing reforms: ‘Noisy withdrawal’ proposals look dead in the water after Oxley’s SEC attack, 2004, March 8 (reporting that Oxley said that the SEC clearly went beyond Congressional intent in proposing the noisy withdrawal mandate) at <www.legalweek.net/ViewItem.asp?id=18341> visited 10 April 2004.

106 DongJu Song, The Laws Of Securities Lawyering After Sarbanes-Oxley [2003] 53 *Duke Law Journal* 257, 277.

the threat of mandatory noisy withdrawal behind it.¹⁰⁷ The noisy withdrawal would act as a 'deterrent for fraudulent management and give attorneys the necessary leverage to direct corporate managers and passive boards to comply with their legal and fiduciary duties.'¹⁰⁸

However, it seems that independent directors would generally not ignore the lawyers' report verified by the QLLC if only out of fear of director liability.¹⁰⁹ Furthermore, on 12 August 2003 the ABA's House of Delegates approved an amendment to ABA Rule 1.6 to permit a lawyer to reveal confidential client information if the client is using the lawyer's services to commit a crime or fraud that would cause financial harm to others (the 'Amendment').¹¹⁰ Even though the wording is permissive, the ABA now effectively requires disclosure in cases of ongoing fraud because Model Rule 4.1(b) says that a lawyer 'shall not knowingly fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by rule 1.6.'¹¹¹

For the first time, there is now a consistent approach that clarifies the lawyer's position because the Amendment acknowledges the corporate lawyer's duty to third parties, i.e. investors in the case of financial fraud. In sum, there seems to be no need for a mandatory noisy withdrawal requirement.

107 Mark A. Sargent, *Lawyers in the Perfect Storm* [2003] 43 *Washburn Law Journal* 1, 41.

108 Ryan Morrison, *Turn Up the Volume: The Need for 'Noisy Withdrawal' in a Post Enron Society* [2003/2004] 92 *Kentucky Law Journal* 279, 315.

109 Susan P. Koniak, *When the Hurlyburly's Done: The Bar's Struggle with the SEC* [2003] 103 *Columbia Law Review* 1236, 1274.

110 Model Rule 1.6(b) reads:

'A lawyer may reveal information relating to the presentation of a client to the extent the lawyer believes reasonably 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 results from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services.'

at <http://www.abanet.org/cpr/mrpc/new_rule1_6.pdf> visited 10 April 2004.

111 George M. Cohen, *Testimony before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Committee on Financial Services, Hearing on The Role of Attorneys in Corporate Governance, February 4, 2004* (observing that the ABA now effectively requires disclosure in cases of ongoing fraud because Model Rule 4.1(b) says that a lawyer 'shall not knowingly fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by rule 1.6.') at <http://www.law.virginia.edu/home2002/html/news/2004_spr/cohen_testimony.htm> visited on 10 April 2004.

Better Approaches: Increasing the Spectre of Civil Liability?

There can be no doubt that the conduct of attorneys is influenced by the fear that their rendition of legal services will result in civil liability.¹¹² Many professors have, therefore, called for a Congressional enactment of an aiding and abetting liability provision under the anti-fraud provisions of the federal securities laws that would legislatively overrule *Central Bank*.¹¹³ Others have called for a negative assurance certificate by the securities lawyer (the 'Field Marshall of the disclosure process')¹¹⁴ which would certify the accuracy of the client's disclosures.¹¹⁵ Such certification could trigger aiding and abetting liability enforceable by the SEC.¹¹⁶

However, empirical studies of deterrence strongly suggest that, 'all other things being equal, increased monitoring (which increases the chances that unlawful activities will be detected) have a greater deterrent impact than enhanced

112 David J. Beck, *The Legal Profession at the Crossroads: Who will write the Future Rules Governing the Conduct of Lawyers Representing Public Corporations?* [2003] 34 *St. Mary's Law Journal* 873, 912; See also Donald C. Langevoort, *Where were the Lawyers? A Behavioural Inquiry into Lawyers' Responsibility for Clients' Fraud* [1993] 46 *Vanderbilt Law Review* 75, 115 (observing that 'if we are unsatisfied with the perceived incidence of attorney complicity in client fraud, then some tinkering with legal incentives is necessary').

113 Asaaf Hamdani, *Gatekeeper Liability* [2003] 77 *Southern California Law Review* 53, 115; Mark A. Sargent, *Lawyers in the Perfect Storm* [2003] 43 *Washburn Law Journal* 1, 40; Susan P. Koniak, *When the Hurlyburly's Done: The Bar's Struggle with the SEC* [2003] 103 *Columbia Law Review* 1236, 1279; Roger C. Cramton, *Enron And The Corporate Lawyer: A Primer On Legal And Ethical Issues* [2002] 58 *The Business Lawyer* 143, 182.

114 John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC* [2003] 103 *Columbia Law Review* 1293, 1312 (reporting that the auditor certifies the firm's financial results, and under SOX senior management now has to certify that the financial information in periodic reports filed with the SEC fairly presents the firm's financial condition, while the securities analyst must now certify that its recommendations reflect the analyst's own personal views).

115 John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC* [2003] 103 *Columbia Law Review* 1293, 1313 (reporting that in most public underwritten offerings, issuer's counsel delivers an opinion to the underwriters - the 'negative assurance' opinion - stating that it is not aware of any material information required to be disclosed that has not been disclosed).

116 Jill E. Fisch & Kenneth M. Rosen, *Is There A Role For Lawyers In Preventing Future Enrons?* [2003] Working Paper Series at 52 (reporting that company officials took the certification process and the risk of personal liability very serious prompting them to take the maximum amount of time to investigate and review the documentation and consulting with their professional advisors in order to ensure that the financial statements were in order).

<http://papers.ssrn.com/sol3/papers.cfm?abstract_id=367661> visited 10 April 2004.

sanctions.¹¹⁷ Thus, it seems more important to focus on the issue of enhancing lawyers' independence and ensuring effective monitoring.

Conclusion

Up-the-ladder reporting will be effective if securities lawyers begin to perceive themselves as gatekeepers and independent critical advisors. As outlined above the establishment of a QLLC (and a periodic reporting obligation on general counsel) would strengthen the independence of securities attorneys. Outside securities and corporate lawyers must take care not to become too economically intertwined with their clients to maintain the necessary independence.¹¹⁸

The benefits of loyal disclosure (of potentially devastating fraud) within the corporation outweigh by far the costs. In addition, up-the-ladder reporting may encourage internal quality control systems within large law firms. A mandatory noisy withdrawal provision seems unnecessary at present.

The Australian Perspective

Corporate lawyers contributed to the 1980s 'decade of greed' by failing to speak out against frauds, misleading conduct and shady deals. Much corporate crime would not be possible without the support that professional advisors, such as corporate lawyers, provide to those who engage in fraudulent corporate behaviour.¹¹⁹

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- 117 Michael A. Perino, How Vigorously Will The SEC Enforce Attorney Up-The-Ladder Reporting Rules? An Analysis Of Institutional Constraints, Norms, And Biases [2003] Working Paper Series at 7 at <http://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID480502_code132597.pdf?abstractid=480502> visited on 10 April 2004.
- 118 Christine Hurt, Counselor, Gatekeeper, Shareholder, Thief: Why Attorneys Who Invest in Their Clients in a Post-Enron World Are 'Selling Out', Not 'Buying In' [2003] 64 *Ohio State Law Journal* 897, 930-9 (stating that attorneys are becoming too economically intertwined with their clients because of law firms taking and even demanding equity stakes in the client in return for professional services thus losing the necessary independence); See Jill E. Fisch & Kenneth M. Rosen, Is There A Role For Lawyers In Preventing Future Enrons? [2003] Working Paper Series at 20 (reporting that Enron was Vinson & Elkins' largest client, generating about 7% of the law firm's revenue and more than 20 former Vinson & Elkins lawyers took jobs in Enron, including John Derrick, who became Enron's General Counsel. As a result, not only were Vinson & Elkin's revenues tied to Enron's financial success but Enron's inhouse counsel was faced with partly scrutinizing its own transactions) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=367661> visited 10 April 2004.
- 119 Roman Tomasic, Corporate Collapse, Crime and Governance – Enron, Andersen and beyond [2002] 14 *Australian Journal of Corporate Law* 1, 15; See also Trevor Sykes, *The Bold Riders* [Allen and Unwin, Sydney, 1994] at 1-2 (reporting that the collapses included Australia's largest industrial group (Adelaide Steamship), the ninth largest

Lawyers, whether inside or outside the corporation, are often viewed by business people as deal killers [and] referred to snidely as the 'Department of Profit Prevention'.¹²⁰

Legal Framework for Corporate Lawyers

Corporate lawyers' behaviour is to a large extent regulated by the *Corporations Act 2001 (Cth)*,¹²¹ but guided by the Law Council of Australia's revised Professional Conduct and Practice Rules of March 2002 (the 'Conduct Rules').¹²²

Legislation

The Corporations Act

The Corporations Act aims to deter actions by persons who directly or indirectly facilitate corporate crime by reliance upon the concept of involvement in a contravention of the Act, including aiding, abetting, counselling or procuring.¹²³ Section 79 *Corporations Act (Cth)* prohibits turning a blind eye to a client's contravention of the Act and provides for an objective (should have known) standard.¹²⁴

Fundraising

S 728 *Corporations Act (Cth)* prohibits a person from offering securities under a disclosure document if it contains a misleading or deceptive statement or omits

enterprise in the nation measured by revenue (Bond Corporation), nearly half the brewing industry (Bond Brewing), all three major commercial television networks (Bond Media, Qintex, Channel 10), Australia's largest car renter (Budget), the second largest newspaper group (Fairfax), Victoria's largest building society (Pyramid); and Australia's largest textile group (Linter) so that in sum total write-offs and provisions by banks and financiers amounted to \$28 billion).

120 Christine Parker, *The Emergence of the Australian Compliance Industry* [1999] *Australian Business Law Review* 178, 189 (quoting Prof E Spangler).

121 Christine Parker and Paul Redmond, *Teaching Good Corporate Lawyering* [1999] *Flinders Journal of Law Reform* 97, 101 (observing that the two most important categories of work for corporate lawyers are general advisory work on the details of legislation affecting company practices (including the Corporations Act, the practice of the ASIC, particular areas of regulatory law) and the design of systems to ensure compliance with these regimes, and work on legal transactions, such as fundraising and mergers and acquisitions).

122 Law Council of Australia, *Model Rules of Professional Conduct*, March 2002 at <<http://www.lawcouncil.asn.au/policy/1957352449>> visited on 10 April 2004.

123 s 79 *Corporations Act*.

124 Ken Robson, *Ken Robson's Annotated Corporations Act s 79* [7 ed. CCH Australia Limited, 2002] page 154-5.

information required by the fundraising provisions.¹²⁵ Securities lawyers can be liable for compensation according to s 729(1) No 6 *Corporations Act (Cth)* if they are 'involved in the contravention'.¹²⁶

Assessment

In spite of the fact that corporate lawyers are potentially caught by this sweeping provision, few seem to fall victim to it.¹²⁷ This may also be due to the fact that the courts have held that accessory liability requires 'a level of participation beyond knowledge'.¹²⁸ Although the relevant participation threshold may be regarded as satisfied by the 'mere' involvement in the preparation of a disclosure document that is issued to the investing public¹²⁹ there still remains the problematic issue of how to prove actual knowledge on the securities lawyer's side as outlined in the context of the US.

Enforcement by ASIC?

Not one case brought by ASIC under the Corporations Act and similar legislation in 2002-2003 involved lawyer's misconduct.¹³⁰ While this may indicate that there exists no (detectable) improper behaviour by corporate lawyers, it is also a sign that the main focus of ASIC is on company directors' misconduct and not on the supervision of lawyers.

Client-Lawyer Privilege: A Duty of Disclosure?

The lawyer-client relationship has been characterised as a 'relationship of confidence which is based in an amalgam of contract and equity stemming from the particular relationship of lawyer and client'.¹³¹

There is no privilege if a lawyer assists a client to commit a crime or fraud regardless of whether or not it is an ongoing activity or a future activity.¹³² When

125 Phillip Lipton and Abraham Herzberg, *Understanding Company Law* [11 ed. Sydney: Lawbook Co., 2003] page 168.

126 See s 79 Corporations Act.

127 Roman Tomasic, Corporate Collapse, Crime and Governance – Enron, Andersen and beyond [2002] 14 *Australian Journal of Corporate Law* 1, 15.

128 For the security law context: *NRMA Ltd & Ors v Morgan & Ors* (1999) 31 ACSR 435, 794 per Giles J (who stated that knowledge of the essential facts alone is not sufficient to establish accessorial liability and that 'only in unusual circumstances would an advisor incur accessorial liability').

129 *Heydon & Ors v NRMA Ltd & Ors* [2000] NSWCA 374, 436.

130 ASIC, Fighting Fraud and Misconduct, Annual Report 2002-2003 at <[http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/annual_report2002-03.pdf/\\$file/annual_report2002-03.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/annual_report2002-03.pdf/$file/annual_report2002-03.pdf)> visited on 10 April 2004.

131 Professional Ethics, Client Confidentiality and Conflict of Interest [July 2002] *Proctor - Queensland Law Society* at 30.

the corporate lawyer has knowledge that the client intends to commit a crime or a fraud the disclosure (reporting out) of such information to protect third parties from physical or financial harm will not amount to a breach of confidentiality.¹³³ However, only if serious bodily harm or death is imminent then the lawyer should reveal the client's confidences.¹³⁴

Conduct Rules and State Implementation

The conduct of (corporate) lawyers is guided by the Model Rules of Professional Conduct and Practice, which were adopted by the Law Council of Australia in March 2002, and subsequently implemented nationwide. Breach of the corresponding State Conduct Rules may result in disciplinary proceedings by the respective self-regulatory body and have liability implications.

Conduct Rules

Part 1: Relations to the Client

Confidentiality

Aside from the specific rules for the advocacy and litigation context, the Rules spell out five situations in which disclosure of confidential information is permissible, although not mandatory.¹³⁵ Conduct Rule 3.1.3 states that 'the practitioner [may disclose] information in circumstances in which the law would probably compel its disclosure, despite a client's claim of legal professional privilege, and for the sole purpose of avoiding the probable commission or concealment of a serious criminal offence'. Nationwide criminal fraud is a serious offence and would thus fall under the exception of Rule 3.1.3. However, the permissive wording of the Rules retains room for a solicitor's personal judgment.¹³⁶

132 Gino Evan Dal Pont, *Lawyers' Professional Responsibility in Australia and New Zealand* [2 ed. LBC Information Services, 2001] page 245; See also Ysaiah Ross, *Ethics in Law: Lawyers' Responsibility and Accountability in Australia* [3 ed. Sydney: Butterworths, 2001] page 365 ('some prima facie evidence is required to displace the claim of privilege – not just allegations of crime, fraud or that the powers have been exercised for illegal purposes'); s 125 *Uniform Evidence Act 1995* ('the privilege is lost where it relates to the furtherance of the commission of a crime or fraud').

133 Ysaiah Ross and Peter MacFarlane, *Lawyers' Responsibility and Accountability – Cases, Problems and Commentary* [2 ed Butterworths, 2002] page 328.

134 Ysaiah Ross, *Ethics in Law: Lawyers' Responsibility and Accountability in Australia* [3 ed. Sydney: Butterworths, 2001] at 366 (citing New South Wales Bar association, Annual Report (1981) at 12).

135 The most obvious exceptions are: Rule 3.1.1 (client authorisation), Rule 3.1.4 (where confidentiality has been lost), Rule 3.1.5 (obtained from a non-confidential source).

136 Conduct Rule 31.1: Disclosure Requirements; See Sarah Gaden, *Professional Conduct – The New Rules* [February 2004] 78 *Law Institute Journal* 46, 47.

Who is the Client?

The client is defined as the person for whom the practitioner is engaged to provide legal services for a matter.¹³⁷ Surprisingly, there is no reference to the corporation as a client.¹³⁸ The complications for a lawyer's skills and ethics 'that may arise when the client is a complex organisation and the lawyer [themselves] part of a large, bureaucratic law firm structure are not addressed.'¹³⁹

Part 2: Litigation and Advocacy

The specific advocacy and litigation Conduct Rules [16.2 – 16.5] impose a higher standard of confidentiality on the practitioner. This corresponds with the duty zealously to defend the client when appearing in Court.

Assessment

The Conduct Rules would cover disclosure of confidential information in case of suspected financial fraud. As seen above, there is no general legal obligation that would compel the disclosure of financial fraud, even less so in case of suspected fraud. A duty to disclose confidential information seems to exist only in the case of substantial bodily harm.

Assessment

There exists a legal framework that prohibits securities lawyers from knowingly assisting their clients in committing financial fraud. However, such cases will be rare as corporate lawyers almost never intentionally assist a client's fraud. Nevertheless s 79 *Corporations Act (Cth)* seems to function as a major deterrent for corporate lawyers.

On the other hand, there seems to be no obligation under the Conduct Rules to blow the whistle when discovering a potential fraud of a corporate client. In sum, disclosure of confidential information in the case of suspected criminal fraud is possible but there is no clarification where the corporation is the client. To be sure,

137 Conduct Rules: Definitions 'client'.

138 Stan Ross, Corporate Lawyer Whistleblowing [1998] *Law Institute Journal* 27; See Tom Middleton, The Solicitor's Duty of Confidentiality to a Company [August 1990] *Queensland Law Society Journal* 283, 287.

139 Christine Parker and Paul Redmond, Teaching Good Corporate Lawyering [1999] *Flinders Journal of Law Reform* 97, 98 (observing that guidance for corporate lawyers on how to untangle difficult issues such as to whom within a corporate entity their loyalty is owed, what responsibility legal advisors have for corporate actions, including those that eventually cause social harm, or, how to make normative judgments about the goals of social and economic regulation is amiss).

the issue of how to deal with potential fraudulent activity of corporate clients is certainly a 'live issue'.¹⁴⁰

A New Role for the Corporate Lawyer?

CLERP 9 - Audit Reform and Corporate Disclosure Bill 2003

Whistleblowing for In-house Counsel

Part 9.4AAA of CLERP 9 deals with the protection of whistleblowers and will apply to in-house lawyers, as employees of the corporation.¹⁴¹ Furthermore, as it is not unusual in larger companies to have a solicitor appointed to the board,¹⁴² such directors will be covered as well. To the extent that incorporated legal practices are regulated by the *Corporations Act* the Whistleblowing provisions will apply to solicitor directors and solicitor employees.¹⁴³

140 Virginia Shirvington, *Turning a Blind Eye: Professional Liability and Responsibility* [2001] *Law Society of New South Wales* at 4 (reporting that the NSW Ethics Section receives well over 2000 ethics inquiries per year of which one per week will be categorised as 'assisting fraudulent activity') at <http://www.lawsociety.com.au/uploads/filelibrary/1026011027453_0.7673626048745086.pdf> visited 10 April 2004.

141 Part 9.4AAA - Protection for Whistleblowers, Proposed s 1317AA reads:
'Disclosures qualifying for protection under this Part:
(1) A disclosure of information by a person (the disclosure) qualifies for protection [...] if
(a) the discloser is:
(i) an officer of a company; or
(ii) an employee of a company; [...] and
(b) the disclosure is made to:
(i) ASIC; or
(ii) the company's auditor or member of an audit team [...]; or
(iii) a director [...] of the company [...]
(c) [...]
(d) the discloser has reasonable grounds to suspect that the information indicates that:
(i) the company has, or may have, contravened a provision of the Corporations legislation; or
(ii) an officer or employee of the company has, or may have, contravened a provision of the Corporations legislation; and
(e) the disclosure makes the disclosure in good faith [...].'
at <<http://parlinfoweb.aph.gov.au/piweb/Repository/Legis/Bills/Linked/04120300.pdf>> visited 10 April 2004.

142 Vicki Waye, *The Corporation and Legal Professional Privilege* [1997] 8 *Australian Journal of Corporate Law* 1, 30.

143 Anne Trimmer, *Whistleblowing: What It Is and What It Might Mean for Incorporated Legal Practices* [2004] *Law Society Journal* 66, 68.

Triggering Standard

There is an objective standard ('reasonable grounds to suspect a breach of the *Corporations Act*') and up-the-ladder-reporting as well as reporting out to ASIC or the audit team is allowed.¹⁴⁴ However, the wording is permissive not mandatory.

Protection of Whistle Blowers

A whistle blower will have protection against criminal and civil liability, the enforcement of contractual remedies (e.g. confidentiality clauses), liability for defamation and termination of contract.¹⁴⁵ There is also protection from retaliatory action and victimisation.¹⁴⁶ It is believed that protection of whistleblowers will encourage employees, including in-house counsel, to speak out against (potential) fraud.¹⁴⁷

Enhanced Accessory Liability

Under CLERP 9 it is now also a specific offence to be involved in a contravention of the Continuous Disclosure Requirements¹⁴⁸ and ASIC can pursue that offence using the civil penalty provisions.¹⁴⁹ However, this may encourage professional advisers 'to distance themselves from the decision making process made by disclosing entities under the Continuous Disclosure Requirements [because] case law suggests that the more distant the relevant person is from the disclosure decision the stronger their legal position'.¹⁵⁰

144 CLERP 9 – Audit Reform and Corporate Disclosure Bill 2003, Part 9.4AAA - Protection for Whistleblowers, Proposed s 1317AA(1)(b) and (d).

145 CCH Australian Corporate News, CLERP 9: Audit Reform and Corporate Disclosure, 22 October 2003, 221, 226-7.

146 CCH Australian Corporate News, CLERP 9: Audit Reform and Corporate Disclosure, 22 October 2003, 221, 227.

147 CLERP 9 - Audit Reform and Corporate Disclosure Bill 2003, Explanatory Memorandum, 4.321, page 64 at <<http://parlinfoweb.aph.gov.au/piweb/Repository/Legis/ems/Linked/04120301.pdf>> visited on 10 April 2003.

148 See Chapter 6CA Corporations Act; See also CLERP 9 Bill, Schedule 6, Part 1, Paragraph 1 and 2 which introduces a new section 674 (2A) and section 675(2A) of the Corporations Act.

149 CLERP 9 Bill, Schedule 6, Part 1, Paragraph 3 amends section 1317 E(1)(ja) of the Corporations Act.

150 Greg Golding & Natalie Kalfus, The Continuous Evolution of Australia's Continuous Disclosure Laws [2004] *Company & Securities Law Journal* (forthcoming).

Assessment

The Whistleblowing provisions enable the in-house lawyer and lawyers working in incorporated practices to uphold their professional conduct rules when faced with potential financial fraud.

On the other hand, because of the fact that in-house counsel is employed by its only 'client', there may be more pressure than on outside counsel to ignore potential fraudulent behaviour.¹⁵¹ Empirical research on the effectiveness of existing Whistleblowing legislation which is in force in several states and protects employees¹⁵² is not encouraging.¹⁵³ Also, the Whistleblowing provisions do not extend to disclosures under other regulatory regimes such as those overseen by APRA or the ACCC.¹⁵⁴

In sum, however, the Whistleblowing provisions as well as the enhanced liability provisions under CLERP 9 may serve as a potential deterrent for aggressive management.

Whistleblowing in the Context of Anti-Money Laundering

A mandatory Whistleblowing requirement for business lawyers will be implemented under the forthcoming Anti-Money Laundering Bill 2004¹⁵⁵ in accordance with the international Financial Action Task Force's (the 'FATF') Revised Forty Recommendations.¹⁵⁶

151 Stan Ross, Corporate Lawyer Whistleblowing [September 1998] *Law Institute Journal* 27, 28.

152 ACT: *Public Interest Disclosure Act* 1994 (public sector disclosure only); NSW: *Protected Disclosures Act* 1994 (public sector disclosure); Qld: *Whistleblowers Protection Act* 1994 (limited private sector disclosure); SA: *Whistleblowers Protection Act* 1994 (public and private sector disclosure); Vic: *Whistleblowers Protection Act* 2001 (public sector disclosure).

153 Paul Latimer, Reporting Suspicions of Money Laundering and 'Whistleblowing': The Legal and Other Implications for Intermediaries and Their Advisers [2002] 10 *Journal of Financial Crime* 23, 25; George Gilligan, Whistleblowing initiatives – are they merely secrecy games and/or blowing in the wind? [2003] 24 *The Company Lawyer* 37, 40 (quoting David Knott, the then Chairman of ASIC, that despite existing misconduct reporting obligations - with regards to auditors - there were almost none such reports).

154 Anne Trimmer, Whistleblowing: What It Is and What It Might Mean for Incorporated Legal Practices [2004] *Law Society Journal* 66, 68.

155 Justice Department, Media Release: New take shape to strengthen fight against money laundering at <<http://www.law.gov.au/www/justiceministerHome.nsf/Web+Pages/DC02DC7B9E00BC83CA256EAF000690A2?OpenDocument>> visited 21 June 2004.

156 The FATF is an intergovernmental body, consisting among others of the OECD members, entrusted with the development of domestic and international policies against money laundering and terrorist financing at <http://www1.oecd.org/fatf/AboutFATF_en.htm#What%20is> visited on 10 April 2004.

Suspicious Transactions Reporting – Reporting Out

Legal practitioners will be subject to anti-money laundering reporting obligations where they are instructed in, provide advice on, prepare or carry out a range of activities that involve financial and corporate transactions.¹⁵⁷ Ongoing customer due diligence and, in particular suspicious transactions reporting to AUSTRAC,¹⁵⁸ until now reserved for financial institutions under the *Financial Transactions Reporting Act 1988*, will be extended to business lawyers.¹⁵⁹ The client-lawyer privilege will be narrowly confined to legal advice and will not apply to communications relating to business or financial advice.¹⁶⁰

Assessment

Suspicious transaction reporting will impose a mandatory Whistleblowing obligation on business lawyers (in the form of reporting out confidential information to AUSTRAC based on mere suspicion). The potential threat to the client-lawyer privilege has caused uproar from the legal profession in Europe, the US, and other FATF Member States.¹⁶¹ However, at least with regard to the EU Member States, such as the UK, suspicious transaction reporting requirements for

157 Attorney-General's Department, Anti-Money Laundering Reform, Consultation Issues Paper 5: Legal Practitioners, Accountants, Company & Trust Service Providers 2004, page 9 at <<http://www.ag.gov.au/aml>> visited 10 April 2004.

158 AUSTRAC is Australia's anti-money laundering regulator and specialist financial intelligence unit which receives all suspicious transaction reports <<http://www.austrac.gov.au/about/index.htm>> visited on 10 April 2004.

159 Attorney-General's Department, Anti-Money Laundering Reform, Consultation Issues Paper 5: Legal Practitioners, Accountants, Company & Trust Service Providers 2004, page 9 (Issue 2.2: Professional advisers will have an ongoing obligation to monitor suspicious transactional activity including making suspicious transaction reports) at <<http://www.ag.gov.au/aml>> visited 10 April 2004.

160 Attorney-General's Department, Anti-Money Laundering Reform, Consultation Issues Paper 5: Legal Practitioners, Accountants, Company & Trust Service Providers 2004, page 11 at <<http://www.ag.gov.au/aml>> visited 10 April 2004.

161 Council of the Bars and Law Societies of the European Union, Joint Statement by the international legal profession on the fight against money-laundering (signed also by the Bars of the US and Japan):

'(5) We are seriously concerned that, in the effort to stamp out money laundering, the values recognised in international and constitutional laws of professional confidentiality and trust and independence of the bar are not receiving adequate consideration. On behalf of our clients, we can accept neither inroads into professional confidentiality and our duty of loyalty to clients, nor obstacles in access to justice. We believe that efforts to undermine these values will be subject, in a number of countries, to successful constitutional challenge.'

at <http://www.ccbe.org/doc/En/signed_statement_030403_en.pdf> visited 10 April 2004.

business lawyers have been implemented.¹⁶² Moreover, internal control and compliance models will have to be implemented in accordance with the Revised Forty Recommendations which will have an estimated impact in compliance costs of at least AUS \$100 million for the legal profession in the UK alone.¹⁶³

Suspicious transaction reporting by lawyers has been historically very low in countries that already have such mandatory Whistleblowing provisions.¹⁶⁴ This result seems to reflect the inherent conflict between the duty of confidentiality and loyalty to the client and the lawyers' duty of honesty and candour to the public. In this context it seems noteworthy that similar legislation has been declared unconstitutional in Canada based on the threat to the independence of the bar and the client lawyer privilege and was subsequently repealed.¹⁶⁵

Conclusion

The implementation of broad Whistleblowing provisions (in form of reporting out) applying to corporate in-house lawyers and others involved in financial services will achieve little without rethinking the role of the corporate lawyer in a wider perspective. If corporate lawyers fulfil their gatekeeping responsibilities and render independent advice there will be generally no need for reporting out of confidential information.

162 Council of the Bars and Law Societies of the European Union, Implementation of the EU Money Laundering Directive 2001/97/EC (the Directive imposes suspicious transaction reporting obligations on the business lawyers and is implemented in all EU Member States) at <http://www.ccbe.org/doc/En/mld_implementation.pdf> visited on 10 April 2004.

163 The UK Treasury (Financial Services), Full Regulatory Impact Assessment – Money Laundering Regulations 2003, page 14 at <http://www.hm-treasury.gov.uk/media//4ADBC/fullriamlr03_80.pdf> visited on 10 April 2004.

164 FATF, Report on Money Laundering and Terrorist Financing Typologies 2003-2004, page 24 (reporting that in jurisdictions, which have extended the obligation to report suspicious transactions to independent legal and financial professionals, it found that less than two percent of reports dealing with solicitor or notary involvement were made by the professions themselves) at <http://www1.oecd.org/fatf/pdf/TY2004_en.PDF> visited 10 April 2004; The UK Treasury (Financial Services), Full Regulatory Impact Assessment – Money Laundering Regulations 2003, page 11 (reporting that 0,5% of suspicious transaction reports were filed by solicitors) at <http://www.hm-treasury.gov.uk/media//4ADBC/fullriamlr03_80.pdf> visited on 10 April 2004.

165 Federation of Law Societies of Canada, Money-Laundering Chronology of Events, July 2003 (outlining the steps taken by the legal profession in Canada since 1998 to challenge the requirement that lawyers report confidential information of their clients to the federal government and the sweeping successes in all Courts across Canada) at <http://www.flsc.ca/en/committees/litigation_chronosum.asp> visited 10 April 2004.

Comparative Analysis:

Need for Compulsory US-style Up-the-Ladder Reporting

In Australia, the introduction of compulsory up-the-ladder reporting within the corporate client should be embraced. It emphasizes the important fact that the duties of the securities lawyer are first and foremost owed to the corporation as the real client. Therefore, in-house and outside counsels who become aware of facts that strongly suggest that an agent of the corporate client is involved in securities fraud must inform the board as the highest authority.

Compulsory reporting up provisions will encourage the implementation of compliance models inside the corporation and of additional levels of review inside large law firms. Rather than fearing the possible results of reporting up programs, corporate clients should implement such programs as part of good corporate governance and law firms should embrace 'smell-test' procedures to enhance independent and if necessary critical rendering of advice.

Need for Compulsory Outside Reporting – Noisy Withdrawal?

A mandatory reporting out provision, such as the noisy withdrawal, seems inadvisable given the potential negative impact on the client-lawyer relationship and the independence of the bar. Furthermore, empirical data suggests that lawyers will rarely report out to the regulatory authorities even when facing sanctions.

The Amendment to the US Model Rules as well as the Australian Conduct Rules ensure that discretionary whistle-blowing to the authorities, as the last resort, will be possible. This properly balances the lawyer's duty to the client and (legal and moral) responsibilities owed to investors and the public.

Threat to Client-Lawyer Relationship?

The up-the-ladder reporting requirement does not abuse the confidence and trust a corporate client should be able to place in its lawyer because confidential information does not leave the client-lawyer relationship. Conversely, up-the-ladder reporting protects the interest of the corporate client by ensuring that superior officers or the board of directors, as the highest authority, will be informed of vitally important circumstances and are able to take corrective action. In this context, regular reporting to a QLCC will reduce potential negative effects on the management-lawyer relationship.

The Securities Lawyer as Gatekeeper and Independent Advisor

The up-the-ladder reporting system will only function if lawyers use such communication avenues. Research has shown that most corporations ‘wish to be basically law-abiding to preserve the public legitimacy, and want “good” corporate lawyers to advise them on how to achieve that.’¹⁶⁶ Therefore, the corporate lawyer should be alert to the wider impact of a client’s proposed future conduct (‘preventive lawyering’).¹⁶⁷ There is a ‘pressing need for general counsels to act as the ‘lawyer-statesman’ instead of the narrow, technical lawyer.’¹⁶⁸

The new Whistleblowing provisions under CLERP 9 and in particular the up-the-ladder reporting provisions of the Sarbanes-Oxley Act support such preventive lawyering by providing corporate lawyers with leverage when faced with an aggressive management.

As Justice Brandeis put it:

If you are walking along a precipice no human being can tell you how near you can go to that precipice without falling over, because you may stumble on a loose stone [...]; [but] your lawyers [...] can tell you where a fairly safe course lies.¹⁶⁹

Need for Clear Professional Conduct Rules

There is a need for clear professional conduct guidelines which clarify the duties of securities and corporate lawyers to the corporation and the investing public. Two recent US surveys show that 75% of large law firm lawyers thought that it is appropriate to act as the ‘conscience of a client’ and 90% of corporate lawyers would seek to persuade a corporate client to cease violating the law and would also consider resigning, while 50% might take the matter to the firm’s shareholders or

166 Christine Parker and Paul Redmond, Teaching Good Corporate Lawyering [1999] *Flinders Journal of Law Reform* 97, 100.

167 Christine Parker and Paul Redmond, Teaching Good Corporate Lawyering [1999] *Flinders Journal of Law Reform* 97, 117 (observing that the tasks of corporate lawyers are changing from those of reacting and responding to outside pressures to the construction of plans for preventive maintenance).

168 The Economist, Article by Ben Heineman, General Counsel of General Electric, Where’s the Lawyer? March 20, 2004.

169 Roger C. Cramton, Enron And The Corporate Lawyer: A Primer On Legal And Ethical Issues [2002] 58 *The Business Lawyer* 143, 165 (citing Louis Brandeis); See also Mark A. Sargent, Lawyers in the Perfect Storm [2003] 43 *Washburn Law Journal* 1, 33 (noting that the ‘lawyer who becomes used to walking on the edge, and leaving the client to face the risk of liability, dulls his sensitivity to the permeability of the line between the legal and illegal, the moral and immoral, and becomes a blind man whose stock in trade is his own blindness’).

the relevant regulatory authority.¹⁷⁰ Remarkably, however, in both studies the corporate lawyers admitted that they rarely if ever put these beliefs into action.¹⁷¹ Promoting lawyers' ethical reflectiveness will improve business decisions by considering and addressing the potential ramifications on investors and on the public perception of the corporation. To be sure, such a view may come close to the rather impractical 'green lawyering' as proposed by Prof Luban in a provocative article in 1995.¹⁷² However, at a 'more modest level 'good' corporate lawyering should [always] be past practice lawyering.¹⁷³ There can be no doubt that it is necessary to implement an alternative to the hired-gun ethic which seems to dominate corporate lawyer's perception of their role. Such an ideal corporate lawyer would combine the aim of minimising cost and disruption of the company with effective realisation of the regulation's basic purposes and a sense of social responsibility.¹⁷⁴

Sir Gerard Brennan perhaps said it best:

... [B]ecause the moral purpose of much commercial law is known to or ascertainable by commercial lawyers alone, the moral lawyer becomes by default the moral as well as the legal advisor to the client. ... The commercial lawyer's duty cannot be restricted to [mere] legal advice, for then the moral decision – what ought to be done as distinct from what can lawfully be done – will not be addressed.¹⁷⁵

170 Christine Parker and Paul Redmond, Teaching Good Corporate Lawyering [1999] *Flinders Journal of Law Reform* 97, 100.

171 Christine Parker and Paul Redmond, Teaching Good Corporate Lawyering [1999] *Flinders Journal of Law Reform* 97, 100.

172 David Luban, The Social Responsibilities of Lawyers: A Green Perspective [1995] 63 *George Washington Law Review* 955 (stating that lawyers have substantial moral responsibilities to parties other than the client); but see Mark Sargent, Lawyers in the Perfect Storm [2003] 43 *Washburn Law Journal* 1, 26-7 (stating that 'it is... difficult, however, to ask a lawyer to serve two masters when the client is not acting wrongfully, and when the other "master" is so poorly defined. For this ethical reorientation to work, the "green" lawyer would have to resolve questions of definition (what is the public interest - or the third party interest - for which lawyer must also be advocates?), standard-setting (what consequences other than legality raise an issue for the lawyer?), balancing (how are client interests and public interests to be balanced?), and foreseeability (what should a lawyer do when the social consequences of a cause of action are murky or debatable in principle?)).

173 Christine Parker and Paul Redmond, Teaching Good Corporate Lawyering [1999] *Flinders Journal of Law Reform* 97, 118 (observing on page 105 that 'business ethicists and even management theorists have started to acknowledge the value of good corporate citizenship').

174 Robert Gordon, Corporate Law Practice as a Public Calling [1990] 49 *Maryland Law Review* 255, 277.

175 Sir Gerard Brennan, Commercial Law and Morality [1989] 17 *Melbourne University Law Review* 100, 104-106 (however Sir Gerard also added that 'the moral decision is not for the lawyer to make: the decision is for the client. [...] It is strongly arguable

Conclusion

History shows us that corporate scandals seem inevitably tied to corporations due to the fact that the separation of ownership and control inevitably produces substantial agency costs. Internal legal compliance systems inside large law firms as well as the implementation of a QLLC model combined with a regular reporting requirement may serve as means to prevent future corporate scandals, such as Enron.

Above all, securities lawyers need to keep in mind that they are not hired guns or amoral technicians. They are hired to provide independent and critical judgment to their corporate client, helping it to become as successful as possible, while ensuring that their client stays on a legally 'safe course'. In this task, the securities and corporate lawyers who advised Enron and the other bankrupt corporations were colossal failures. The lawyer who shies away from the obligation of providing candid and independent judgment, or even 'spins' the law in favour of his client's desires, fails more than his own conscience, he fails to fulfil his professional responsibility.

that a lawyer should not discharge himself from his retainer merely because his client refuses to take his moral advice').

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