The New World of Risk for Corporate Attorneys and Their Boards Post–Sarbanes-Oxley: An Assessment of Impact and a Prescription for Action

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INTRODUCTION

The Sarbanes-Oxley Act of 2002 (SOX) imposed myriad requirements on corporate boards and corporate attorneys.1 The Act was enacted in compliance with a Congressional mandate charging the Securities and Exchange Commission (SEC) with promulgating rules to prevent fraud in public companies.2 The corporate community, already rocked by the collapse of Enron and WorldCom, struggled to comply with these complex regulatory requirements, while simultaneously dealing with the aftermath of September 11, climbing out of the recession, and negotiating the conditions of the troubled world economy.3 In a post-SOX world, corporate counsel and other separate counsel for corporate committees must navigate shoals of risk for themselves and their clients.

Section 307 of SOX empowered the SEC to set “minimum standards of professional conduct” for attorneys.4 In response, the SEC adopted 17 C.F.R. § 205 to implement section 307 of SOX in February 2003.5 Despite the initial proposals by the SEC in November 2002, which included the requirement that attorneys report suspected violations out to the SEC (the so-called “noisy withdrawal” provision),6 part 205 does not actually include those more

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1. Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 1, 15, 18, 28 and 29 U.S.C.A.) [hereinafter Sarbanes-Oxley or SOX]; see also John C. Coffee, Jr., Regulating the Lawyer: Past Efforts and Future Possibilities: The Attorney as Gatekeeper: An Agenda for the SEC, 103 COLUM. L. REV. 1293, 1313 (2003) (discussing the attorney as an acceptable “gatekeeper” and the federalization of the attorney’s role in the SEC process). Coffee concludes by proposing that attorneys certify management’s discussion and analysis of financial conditions as being “true and correct in all material respects” and that they are unaware of any additional information “whose disclosure is necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.”


3. See generally Sarbanes-Oxley: Time to Step Up, BUS. WK., July 19, 2004, at 100 (discussing problems of corporations complying with SOX but suggesting they should “suck it up”); Judith Burns, Is Sarbanes Oxley Working?, WALL ST. J., June 21, 2004, at R8 (chronicling a generally supportive view of SOX by a number of business leaders but with a recognition that there “are still some areas that need work”).


controversial requirements. Instead, part 205 outlines a reporting “up the ladder provision.” This requires covered counsel to report to either the Chief Legal Officer (CLO) or, if the Board has an established Qualified Legal Compliance Committee (QLCC), to the QLCC. Part I of this Article discusses the reporting procedures of the “up the ladder” provision, which went into effect in August 2003. Part II of this Article discusses the noisy-withdrawal requirement, which was once again refloated for input in February 2003.

Part III of this Article discusses the American Bar Association’s response to the SEC changes. Part III also examines the American Bar Association’s revision of Model Rules 1.6 and 1.13 to permit lawyers to breach perceived client confidentiality obligations under certain circumstances. This section of the Article looks at how these changes would enable counsel to maintain professional standards when they were compelled to comply with SOX provisions to report “up the ladder.” Before adoption however, these changes were hotly debated. Part IV discusses how state bar associations responded in the wake of the Model Rule revisions as they decided whether to amend their rules of conduct in order for attorneys to accommodate the requirements of part 205. This Article will further discuss how there has been a lack of unanimity in this area.

Part V will then examine how the SEC has responded in kind to the various state bar challenges. The Article will next discuss, in Part VI, how corporations have operationalized SOX through the creation of qualified legal compliance committees (QLCC). Moreover, there has been a firestorm of debate surrounding the SOX regulations and Part VII will assess the controversy surrounding SOX and examines how SOX has been both criticized and welcomed by a wide range of counsel and corporations of varying size. Part VIII will open up the discussion by briefly evaluating how SOX in the United States has impacted other countries and Part VIII looks for evidence of a convergence between United States and other nations’ corporate regulation.

Moreover, domestically SOX has interesting implications on attorneys and general counsel as potential defendants in corporate criminal cases. Thus, Part IX will attempt to flesh out the interrelationship between the U.S. Sentencing Guidelines, and Corporate Compliance programs, as they related to the

8. Id.; see id. § 205.2(k) (discussing the definition of a qualified legal compliance committee).
10. See infra Part III.
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seminal case of Blakely v. Washington,\textsuperscript{13} in which the Supreme Court held that Washington State Sentencing Guidelines conflict with the U.S. Constitution’s Sixth Amendment right to trial by jury.

Finally, Part X will conclude the Article with recommendations to both streamline SOX as it is currently implemented and revise SOX in future legislation. Throughout this Article two questions persist: Will SOX actually deter the intended actions?; and Will the price be an acceptable one? With this Article we hope to contribute to the dialogue surrounding SOX and provide insight that will help to answer these crucial questions.

I. SOX AND THE SUBSEQUENT REGULATIONS

Enron filed for bankruptcy protection under U.S. laws on December 2, 2001.\textsuperscript{14} It was the largest company in the U.S. to utilize this process in what was a spectacular fall from the covers of national business magazines. Enron’s fall unleashed a flurry of study by regulatory agencies, culminating in the passage of SOX, which President Bush signed into law on July 30, 2002. The law was enacted without amendment by a vote of 423-3 in the House and 99-0 in the Senate.\textsuperscript{15} This history suggests that the usually lengthy deliberations which precede significant legislation did not occur and that now—some three years later—may be the appropriate time to reflect upon this hastily enacted and far-reaching legislation and subsequent regulations, which carry major ramifications for business, productivity, and competitiveness.\textsuperscript{16}

The SOX legislation was a dramatic response to numerous and mounting investor scandals.\textsuperscript{17} The goals summarized by one commentator are as follows:

\textsuperscript{13} 124 S. Ct. 2531, 2534-36, 2543 (2004). In Blakely the defendant pled guilty to kidnapping his estranged wife and the facts admitted in his plea, standing alone, supported a maximum sentence of 53 months; however, the judge imposed a 90-month sentence after finding the petitioner ‘acted with ‘deliberate cruelty,’ a statutorily enumerated ground for departure’” from the standard range. Id. at 2535. The Washington Court of Appeals affirmed, rejecting petitioner’s argument that the sentencing procedure deprived him of his “federal constitutional right to have a jury determine beyond a reasonable doubt all [the] facts legally essential to his sentence.” Id. at 2536. Because the facts supporting the petitioner’s exceptional sentence were neither admitted by petitioner nor found by a jury, the Court held that his sentence violated his Sixth Amendment right to trial by jury. Id. at 2543.

\textsuperscript{14} See Peter Behr, Ailing Enron Files for Chapter 11 Bankruptcy Protection, WASH. POST, Dec. 3, 2001, at A7.

\textsuperscript{15} JOHN BOSTELMAN, SARBANES-OXLEY DESKBOOK, Background—Twelve Months Leading up to the SOA, Vol. 1 (Practicing Law Institute 2004) (noting that some have shortened Sarbanes-Oxley to SOX and others to SOA).


\textsuperscript{17} See generally Corporate Scandals, ATLANTA J. CONST., Dec. 28, 2003, at 6Q; John Plender, Broken Trust, FIN. TIMES, Nov. 21, 2003, at 19; David Usborne, Scandals Put Wall St. Fat Cats in the
Make management more accountable
Increase required disclosures
Strengthen the authority and obligations of corporate gatekeepers and outsiders
Remove conflicts of interest of management, auditors, gatekeepers and advisors
Regulate auditors more strongly
Strengthen the SEC
Improve guidance about accounting standards. 

Unfortunately, the law did not take into account the cost or burden of these regulations or whether SOX was the most effective strategy to improve corporate accountability.

While much has been written about other sections of SOX, this Article focuses on the role of attorneys. Section 307, a very brief section of the Act added by the House Senate Conference Committee to the original Senate version of the bill, stated in part that “the Commission shall issue rules, in the public interest and for the protection of investors, setting forth the minimum standards of professional conduct for attorneys appearing and practicing before the Commission.” Section 307 specifically mandated that the attorney “report evidence of a material violation of securities law or breach of fiduciary duty or similar violation . . . to the chief legal counsel or the chief executive officer (or equivalent thereof).” This section also required some mechanism for follow-up if counsel did not detect an appropriate response.

When the SEC first proposed regulations to implement section 307 in November 2002, these proposed regulations were controversial because they included a “reporting out” obligation for attorneys under certain circumstances. However, on January 23, 2003, after a public comment period, the SEC adopted regulations which instead required “up the ladder” reporting by attorneys rather than “reporting out.” This version of the regulations was published on February 6, 2003, and became effective on August 5, 2003. However, the SEC allowed an additional comment period for the part of the


18. See BOSTELMAN, supra note 15.
19. See American Bar Association, Report of the American Bar Association Task Force on Corporate Responsibility (Mar. 31, 2003), available at http://www.abanet.org/buslaw/corporateresponsibility/final_report.pdf. Note, however, that costs as they were assessed in the report are unrealistic. For example, attorneys are listed as receiving $110 per hour but this is not a standard rate. But cf. Proposing Release, supra note 6. See generally BOSTELMAN, supra note 15, at 2-22 (discussing alternative approaches).
21. Id.
22. Id.
original proposal that was most controversial—the noisy withdrawal provision. In addition to the reconsideration of the “noisy withdrawal” proposal, the SEC also included a new alternative proposal wherein the attorney would notify the issuer and then the issuer would be obligated to inform the SEC.

The SEC’s adopted “up the ladder” reporting requirement for attorneys mandates that when an attorney “appearing or practicing before the Commission in the representation of an issuer, becomes aware of evidence of a material violation” such attorney shall “report such evidence to the issuer’s chief legal officer and its chief executive officer.” This requirement takes the language of SOX and translates this language directly into a regulation which clearly renders Congress’ intent. Regulation 205.2 resolves an issue that had troubled both U.S. and foreign attorneys by defining “appearing and practicing” before the Commission by excluding non-appearing foreign attorneys. The “up the ladder” requirement and the exclusion of non-appearing foreign attorneys demonstrate that the SEC was responsive to a number of concerns voiced through public comment when the regulations were first published in draft form. The SEC further defines evidence of a material violation to include “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.” Notwithstanding the double negative, the regulation clearly states that an attorney cannot ignore evidence or look the other way if a material violation has occurred.

As suggested earlier, the SEC regulations require an attorney not only to report material violations “up the ladder” but also to determine whether an “an appropriate response” is made by the chief legal officer (CLO). Regulation 205.2(b) defines three appropriate responses by the CLO “regarding reported evidence of a material violation.” First, the CLO might assert that there has been no material violation. Second, the CLO might report that there have been “remedial measures, including appropriate steps or sanctions to stop any material violations that are ongoing, to prevent any material violation that has

25. February Proposed Rule and Releases, supra note 16.
26. Id. at 6335.
27. 17 C.F.R. § 205.3(b).
28. Id. § 205.2(b)(1).
29. Id. § 205.2(a)(2)(ii).
31. 17 C.F.R. § 205.2(e).
32. Id. § 205.3(b).
33. Id. § 205.2(b).
34. Id. § 205.2(b)(1).
yet to occur, and to remedy or otherwise appropriately address any material violation that has already occurred and to minimize the likelihood of its recurrence.”\textsuperscript{35} Finally, the CLO might report that the issuer, through a board committee or a QLCC, has “retained or directed an attorney to review the reported evidence of a material violation and either” implement “remedial recommendations” or determine that there is a “colorable defense.”\textsuperscript{36} This recognizes that attorneys are not stripped of their ability to defend their client. Attorneys are not converted to SEC moles or informants except when there is no basis for reasonable belief in a “colorable defense.” Some commentators have argued that this is too big a loophole and that any attorney can make an argument of a defense in most instances.\textsuperscript{37}

If the attorney believes that the CLO has not made an appropriate response, part 205 requires the attorney to report further “up the ladder” to the audit committee, to another committee of the board, or to the board of directors.\textsuperscript{38} In fact, an attorney who believes reporting “up the ladder” will be futile may actually bypass the CLO and report directly to the audit committee, other committee, or the full board.\textsuperscript{39} On the other hand, if the corporation has previously formed a Qualified Legal Compliance Committee (QLCC), the attorney’s obligation to monitor the response to his report or report further “up the ladder” vanishes.\textsuperscript{40} The QLCC, as defined in 17 C.F.R. § 205.2(k), “[c]onsists of at least one member of the issuer’s audit committee . . . and two or more members of the issuer’s board of directors who are not employed, directly or indirectly, by the issuer and who are not[,] in the case of a registered investment company, ‘interested persons.’”\textsuperscript{41} Although the “noisy withdrawal” provision was not adopted, a QLCC has a responsibility to notify the SEC of a material violation under certain circumstances.\textsuperscript{42} However, once the attorney reports a suspected violation to the QLCC, the attorney’s obligation is finished.\textsuperscript{43} Thus, “[a]n 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.”\textsuperscript{44} The QLCC, then, relieves the attorney of some of the assessment and monitoring functions he would otherwise have.\textsuperscript{45}

\textsuperscript{35} 17 C.F.R. § 205.2(b)(2).
\textsuperscript{36} Id. § 205.2(b)(3).
\textsuperscript{37} See generally Public Comments, supra note 30.
\textsuperscript{38} 17 C.F.R. § 205.3(b)(3).
\textsuperscript{39} Id. § 205.3(b)(4).
\textsuperscript{40} Id. § 205.3(c)(1).
\textsuperscript{41} Id. § 205.2(k).
\textsuperscript{42} Id. § 205.2(k)(4).
\textsuperscript{43} 17 C.F.R. § 205.3(c)(1).
\textsuperscript{44} Id.
\textsuperscript{45} See id.
Although attorneys are not required to report to the SEC, the regulations specify that attorneys may divulge confidences to the SEC in the following situations:

An attorney appearing and practicing before the Commission in the representation of an issuer may reveal to the Commission, without the issuer’s consent, confidential information related to the representation to the extent the attorney reasonably believes necessary:
(i) To prevent the issuer from committing a material violation that is likely to cause substantial injury . . . ;
(ii) To prevent the issuer . . . from committing perjury . . . or committing any act . . . that is likely to perpetrate a fraud . . .
To rectify the consequences of a material violation . . . that caused, or may cause, substantial injury . . . .

In addition, regulation 205.6 attempts to insulate the liability of an attorney who decides to report out stating that “[a]n attorney who complies in good faith with the provisions of this part shall not be subject to discipline or otherwise liable under inconsistent standards imposed by any state or other United States jurisdiction where the attorney is admitted or practices.” More specifically, there is no private right of action against an attorney for his role in compliance or non-compliance with these regulations. Furthermore, 17 C.F.R. § 205.3(b)(10) offers protections for whistleblowers who are terminated because of exercising their responsibilities under SOX. However, for many attorneys, to turn on a client is a Hobson’s choice, and the whistleblower’s mantle offers little solace.

II. SEC’S PENDING PROPOSALS

A. Noisy Withdrawal and Alternative Proposals

In addition to issuing the regulations implementing section 307 discussed above, the SEC also issued two proposals for comment ending April 7, 2003. The first was a reissue of the November 2002 “noisy withdrawal” proposal and the second was a so-called “alternative proposal.” The “noisy withdrawal” proposal called for an attorney to withdraw representation of a client and to notify the Commission when there was “no appropriate response within a reasonable time” and when “the attorney reasonably believes a material violation is ongoing or about to occur and is likely to result in substantial injury

46. Id. § 205.3(d)(2).
47. Id. § 205.6(c).
48. 17 C.F.R. § 205.7(a).
49. Id. § 205.3(b)(10).
50. See generally Public Comments, supra note 30 (including comments from attorneys expressing concern about burdens regulations place on them).
51. See February Proposed Rule and Releases, supra note 16.
52. Id. at 6326-29.
to the financial interest or property of the issuer or of investors . . . ."\(^{53}\) This regulation makes a distinction between an attorney "retained" by an issuer versus one "employed" by an issuer. If he believes there has been no appropriate response, an attorney "retained" by an issuer must withdraw in writing based upon "professional consideration."\(^{54}\) The attorney must also notify the Commission within one business day and also disaffirm any document that may be "materially false or misleading."\(^{55}\) However, an attorney who is "employed" by the issuer must notify the Commission but does not have to withdraw from representation.\(^{56}\) The CLO does need to inform any subsequent attorney (either retained or employed) that the previous attorney withdrew based upon "professional considerations." When the violation is not ongoing,\(^{57}\) the attorney may withdraw and may give notice but is not obligated to do so.\(^{58}\) In this context, there is still an obligation to notify any replacement attorney.\(^{59}\)

As suggested earlier, however, if there is a QLCC provision, all responsibility shifts to the QLCC once the initial report of a material violation is made. Regulation 205.3(c)(1) relieves attorneys of additional responsibilities to monitor a response if the QLCC was notified. In addition, regulation 205.2(k)(4) provides that both individual members of the QLCC, as well as the committee as a whole, bear the responsibility and the authority to report to the Commission "in the event that the issuer fails in any material respect to implement an appropriate response that the qualified legal compliance committee has recommended the issuer to take."\(^{60}\)

In addition to the aforementioned "noisy withdrawal" proposal, the SEC also floated an "alternative" proposal which requires an attorney who finds substantial evidence of a continuing violation, and has not reported this violation to the QLCC, to notify the issuer of his withdrawal based upon "professional considerations."\(^{61}\) Under this proposal "the issuer shall within two business days of receipt of such written notice, report such notice and circumstances" to the SEC.\(^{62}\) Although this proposal also gives the attorney the option to follow-up with the Commission, such follow-up is not mandatory. However, this alternative proposal does contain an escape clause for attorneys which holds that "[a]n attorney shall not be required to take any action pursuant

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53. Id. at 6326.
54. Id. at 6326-27.
55. Id.
56. Id.
57. See id. at 6324.
58. See id. at 6327.
59. Id.
60. See 17 C.F.R. § 205.2(k)(4).
61. See February Proposed Rule and Releases, supra note 16.
62. Id. at 6329.
to... this section if the attorney would be prohibited from doing so by the order or rule of any court, administrative body or other authority with jurisdiction over the attorney. ... An attorney shall give notice to the issuer that, but for such prohibition, he or she would have taken such action... 

This escape clause suggests awareness that in some instances a state bar may curtail an attorney's actions. Just as the CLO has an obligation under regulation 205(d) to notify a replacement attorney that the previous attorney has withdrawn, the issuer also has such a notification obligation under this alternative proposal.

B. Status of Proposals

The SEC received 253 comments on these pending proposals and posted the comments on their website. The commentators included individual lawyers, large law firms, bar associations, law professors, foreign counsel, individual investors and corporate counsel. In general, the comments continue to raise concerns about the impact of "noisy withdrawal" on the attorney-client relationship. Prior to January 23, 2003, there were 166 posted responses on the November proposals. However six were misfiled or duplicates. Of the remaining posts, only 21, or 13%, supported the controversial "noisy withdrawal." After January 23, 2003, there were a total of 86 comments where 15, or 17%, did support "noisy withdrawal" while 59, or 68% did not support "noisy withdrawal." Forty-seven (47), or 55%, did not support the alternative proposal either while 20 or 23% did support the alternative proposal. Many comments generally supported the intent of the regulations but qualified their support because of certain definitional problems. Those who supported noisy withdrawal often were law professors, investors, or the AFL-CIO. Lawyers engaged in representing clients, including corporations, expressed real concern about the regulations and their impact on the attorney-client relationship.

63. Id. at 6328.
64. Id. at 6326.
65. Id. at 6328.
66. See Public Comments, supra note 30.
67. See id.
68. See id.
69. See id.
71. COMMENTS OF LATHAM & WATKINS LLP (Apr. 7, 2003), at http://www.sec.gov/rules/proposed/s74502/latham040703.htm; COMMENTS OF JONES DAY (Apr. 7,
Comments made by SEC officials underscore the SEC's viewpoint. For example, SEC Commissioner Harvey J. Goldschmid addressed the Bar Association of New York on Nov 17, 2003. He stated, "There is a broad consensus that lawyers should play a critical gatekeeping role in large public corporations." He reiterated that a lawyer's client is the corporation, not the particular individuals within the corporation. While this may always have been true, in fact, the corporation's CEO often hires counsel. Thus, it is not difficult to understand why counsel may have mixed loyalties, which may blur who the "client" actually is.

Reinforcing Commissioner Goldschmid's emphasis on the role of lawyers in preventing corporate fraud, SEC General Counsel Giovanni P. Prezioso spoke before the Business Law section of the ABA Spring meeting on April 3, 2004. Prezioso began remarks with a story about a lawyer for an IPO who discovered that a controlling number of directors were felons and the company refused to disclose that in the prospectus. The lawyer allegedly told the directors that unless this was addressed he would report the matter to the SEC at 4 p.m. the following day. His phone rang 5 minutes before the appointed hour and the directors had resigned.

Prezioso cited this story approvingly, and emphasized that "[w]hile much of the evidence is . . . anecdotal, we're hearing that the rules are in fact strengthening lawyers' abilities to serve their clients." Prezioso's comments were an illustration of the positive impact that the SEC believes SOX is having on corporate accountability. Prezioso also quoted Senator John Edwards, who at a Senate hearing on Sarbanes-Oxley stated:

If you are a lawyer for a corporation, your client is the corporation and you work for the corporation[,] . . . the shareholders, [and] the investors in that corporation; that is to whom you owe your responsibility and loyalty . . . . One of the most critical responsibilities that those lawyers have is, when they see something occurring or about to occur that violates the law . . . they must act as an advocate for the shareholders, for the company itself, for the investors . . . . This amendment is about making sure those lawyers, in addition to accountants and executives in the company, don’t violate the law and in fact, more importantly ensure, that the law is being followed.

Prezioso continued and elucidated the SEC's position on the controversial pending proposals by acknowledging that the Commission was "closely watching how lawyers are responding to the current rules . . . [including] monitoring how well individual lawyers comply with the new rules, as well as

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73. Id.
75. Id.
the extent to which the bar.... undertakes its own initiatives to address the concerns raised by Congress in enacting Section 307.\textsuperscript{77}

As Counsel Prezioso's comments indicate, the SEC appears to be taking a “wait and see” approach to the pending proposals. Given the overwhelmingly negative response to the January 2003 proposals, the SEC will probably not rush into a second phase of implementation at this time. When assessing the likelihood that these new regulations will keep corporate America honest, it is important to remember that while SOX imposes new obligations on attorneys, Rule 13(b)(2) of the Securities Exchange Act of 1934 had previously mandated that it was a civil and criminal violation for an officer or director of a public company or anyone else at their direction to improperly influence the company's auditors if such conduct could render the company's financial statements “materially misleading.”\textsuperscript{78} Yet, these provisions did not deter the rash of corporate malfeasance, and so the latest wave of new laws and regulations were triggered.

As of this writing, the SEC has taken no action on these proposals.

III. AMERICAN BAR ASSOCIATION RESPONSE

From the legal profession's point of view, the central issue raised by the SEC's adoption of 17 C.F.R. § 205 is the potential conflict between the importance of encouraging clients to be honest with attorneys as recognized public policy\textsuperscript{79} and part 205's mandate that attorneys function as gatekeepers who, in some situations, must reveal client confidences.\textsuperscript{80} The SEC insists that imposing a monitoring duty on securities attorneys also serves an important public policy consideration—protecting investors in public companies—and as a result, protecting the health of the U.S. economy.

Although the ABA, the professional watchdog of the legal profession, does not quarrel with the goal of protecting investors, the organization has been adamant about opposing the SEC's “noisy withdrawal” proposal, which would require attorneys to report client confidences to the SEC in more broadly-circumscribed areas than state bar associations permit. The legal profession views this proposal as an attack on the essence of attorney-client privilege.\textsuperscript{81}

\textsuperscript{77} Prezioso Remarks, \textit{supra} note 74.

\textsuperscript{78} \textit{Representations and Conduct in Connection with The Preparation of Required Reports and Documents}, 17 C.F.R. § 240.13(b)(2) (2003).

\textsuperscript{79} \textit{See} \textit{Model Rules of Prof'l Conduct} R. 1.6 (Discussion Draft 2003) (indicating that this tends to result in upholding the law); Coffee, \textit{supra} note 1 (summarizing the traditional argument that public policy should protect the confidentiality of attorney-client communications, since such protection encourages clients to be completely honest with their attorneys and thus maximizes the likelihood that the law will be obeyed and claiming that imposing gate-keeping duties on attorneys will dampen clients' willingness to communicate freely with attorneys and thus will undermine compliance with the law).

\textsuperscript{80} \textit{See} 17 C.F.R. § 205 (2003) (requiring that attorneys report evidence of a “material violation” up-the-ladder in a corporation and then monitor whether corporate authorities take appropriate action).

\textsuperscript{81} \textit{See} ABA Section of Corporations, Banking and Business Law, \textit{SEC Standard of Conduct for}
an attempt to prevent the SEC from enacting their pending proposals, the ABA has modified its suggested Model Rules of Professional Conduct to outline what this organization views as gatekeeping requirements that do not gut the concept of attorney-client privilege. These revised rules are essentially the same as the current SEC regulations. The revised rules require the attorney to breach client confidentiality to prevent or mitigate the effects of a financial crime. These rules also require that attorneys report perceived violations of law “up the ladder” within a company, but stop short of requiring the attorney to withdraw and report out to the SEC. An examination of these ABA rule changes reveals an organization that is attempting to be responsive to the SEC’s vision of the securities attorney’s role in protecting investors, while asserting its own right to protect its internal vision of attorney loyalty to a client. This is a balancing act that requires nuance and compromise, both of which can be found in the ABA’s proposed rule changes.

The ABA’s response to part 205 clearly represents a loosening of traditional strictures against revealing confidential information. The changes to the Model Rules were recommended by a Task Force charged with examining the ethical principles which should govern lawyers in the post-Enron world and were approved by the ABA House of Delegates. The recommended changes involve two ABA Model Rules: Rule 1.6 and Rule 1.13. In framing these rule changes, the ABA immediately concedes some ground on attorney-client privilege. By emphasizing that lawyers have personal consciences and that moral considerations play a role in an attorney’s decision to report corporate misdeeds, the ABA implies that securities attorneys have a moral duty to consider economic, social, and political factors which might adversely affect investors, rather than simply deferring to a traditional view of attorney-client privilege. However, while giving ground, the ABA also defends its own past stewardship of attorneys’ ethics by emphasizing that, prior to these revisions,
other Model Rules already required attorneys to act to protect the investor. Specifically, Model Rule 1.2(d) prohibits an attorney from assisting a client in committing a fraudulent act. In the face of a client who refuses to desist from the illegal activity, this rule requires the attorney to withdraw his representation of the client and even mandates "noisy withdrawal" in certain circumstances. Additionally, Rule 4.1 states that an attorney must not "fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client." Nevertheless, notwithstanding these original rules, the rule changes described below clearly shift the slant of the ABA Model Rules from protection of the corporate constituents with whom the attorney deals to protection of the corporation itself and its investors.

A. Model Rule 1.6

Rule 1.6 mandates that an attorney keep information which is relevant to that attorney's representation of a client strictly confidential. This rule, as originally written, allowed breach of confidentiality only in two very specific circumstances: (1) to prevent a client from committing a crime which the lawyer felt was likely to result in death or injury, and (2) to establish a defense for the lawyer himself in a criminal or civil matter. This very narrow circumscription of the right to divulge client confidences highlights the importance of the attorney-client privilege to the legal profession and emphasizes the legal community's public policy concerns about encouraging compliance with the law. Nevertheless, the August 2003 revision of this rule adds two more bases for legitimately divulging client confidences. In order to encourage corporate constituents to comply with laws designed to protect investors, the new rules permit the attorney to reveal client information to prevent use of his services to abet a crime which will harm the financial interests or property of another. Also, the attorney may divulge confidences to mitigate or rectify such financial harm after the fact. These additions highlight the emergence of financial crime prevention as an important part of the legal profession's public policy consideration.

While the original rule allowed attorneys to breach confidences only to

86. See Model Rules of Prof'l Conduct R. 1.2 (1983). Rule 1.2(d) requires that a "lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent." If necessary to avoid assisting a client commit a fraud, an attorney must withdraw and in some cases must notify third parties of his/her withdrawal and disaffirm documents.

88. See id. R. 1.6 (1983).
89. The ABA House of Delegates originally rejected any expansion of legitimate bases for revealing client confidences. See McCallum, supra note 84, at 2-3. They only approved inclusion of additional grounds for breaching confidence after the ABA Task Force on Professional Responsibility convinced delegates that the proposed changes would not gut the sanctity of the attorney-client privilege. Id.
90. See Model Rules of Prof'l Conduct R. 1.6 (amended Aug. 2003).
prevent physical harm, revised Rule 1.6 also allows an attorney to breach client confidence to prevent or mitigate financial harm and prohibits an attorney from allowing his services to be used in furtherance of such crimes. Permission to reveal confidences after a crime has been committed when the damage to be mitigated is financial and not physical represents substantial loosening of traditional strictures against revealing client confidences. This change, which circumscribes attorney-client privilege more tightly, clearly represents the ABA’s concession that securities attorneys must sometimes function as gatekeepers, responsible in part for preventing future corporate financial misconduct. These additions to Rule 1.6 were initially rejected by the ABA’s House of Delegates, likely because of this significant dilution of attorney-client privilege. However, upon the urging of the Task Force and after heated debate, the House of Delegates agreed to include prevention and mitigation of harm from financial crimes as legitimate reasons for divulging confidential information. However, as noted above, the ABA did not modify its rules to require attorneys to report out to the SEC in such situations, as did the originally-proposed “noisy withdrawal” proposal. By modifying its stance on attorney-client privilege to allow attorneys to take a more active role in preventing future Enrons, the ABA is outlining what it considers to be tolerable modifications to the concept of attorney-client privilege.

B. Model Rule 1.13

In revising Rule 1.13, the ABA further expands what it views as the permissible context within which attorneys may function as gatekeepers. As with Rule 1.6, however, this revision appears meant to stave off the ultimate SEC demand for “noisy withdrawal.” Rule 1.13 establishes that the organization, not the officers or other constituents with whom securities attorneys deal are, in fact, the clients of securities attorneys. Establishing this fact allows the ABA to permit securities attorneys to divulge limited information in carefully defined situations without compromising attorney-client privilege. If the organization, not the constituent, is the attorney’s client,

91. See McCallum, supra note 84 (demonstrating how Ethics 2000 Committee encouraged ABA to pass model rule changes).

92. See Proposing Release, supra note 6 (requiring attorneys to withdraw from representation, report such withdrawal to the SEC, and disaffirm relevant documents when corporate authorities fail to respond to attorney reports of violations); 17 C.F.R. § 205 (2003) (implementing final rules which do not require “noisy withdrawal”). These rules require an attorney to withdraw when corporate authorities do not respond to a report in a timely fashion but they do not require the attorney to report his/her withdrawal to the SEC or disaffirm documents. Id. Rather, the issuer must report the attorney’s withdrawal and the circumstances surrounding this withdrawal in a public filing. See id.

93. See Model Rules of Prof’l Conduct R. 1.13 (amended Aug. 2003) (stating that “a lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.”). This rule establishes that the attorney’s ultimate loyalty is to the corporate entity, not to the officers with whom the attorney is dealing. Id.
then the traditionally protected attorney loyalty is owed to the organization, not to the constituents. The recent changes to this rule eliminated wording which seemed to discourage reporting suspicions of financial crimes up the ladder. The changes elaborate possible extenuating circumstances and outline less severe options for action.\(^9\) In contrast, revised Rule 1.13 outlines a reporting scheme which actually requires securities attorneys to report up the ladder within a company and further allows them to report out to the SEC in specifically defined circumstances, but stops short of requiring external reporting as was required by the SEC’s originally proposed “noisy withdrawal” requirement.

In matters relating to an attorney’s representation of an organization, revised Rule 1.13 requires that the attorney shall report up the ladder as far as the highest authority within a company\(^9\) when an officer or other employee of the company “is engaged in action, [or] intends to act or refuses to act in a manner... [which] is a violation of a legal obligation to the organization... , and is likely to result in substantial injury to the organization... .”\(^9\) Another addition to this rule states that an attorney who is discharged or who withdraws because of actions taken to comply with this rule “shall proceed... to assure that the organization’s highest authority is informed of the lawyer’s discharge or withdrawal.”\(^9\) By emphasizing that the attorney’s ultimate loyalty is to the company, these revisions illuminate the ABA’s shift from protecting the corporate constituent to protecting the company and its stockholders. In addition, the revised rule adds wording which requires that the attorney monitor the response to his report of misdeeds.\(^9\) If the highest internal authority fails to act to protect the best interests of the organization, the revised rule states that the attorney “may reveal information relating to the representation” to an outside authority, even if other sections of the ABA Model Rules seem to prohibit this.\(^9\) Thus, the revised rules move the ABA much closer to the SEC on the gatekeeping issue. However, revised Rule 1.13 clearly leaves the final

\(^9\) See Model Rules of Prof’l Conduct R. 1.13 (1983). Before the 2003 revision of this rule, Rule 1.13 held that an attorney who knows of a material violation which could likely cause substantial injury to the corporation “shall proceed as is reasonably necessary in the best interest of the organization.” However, the original rule then stipulated that “in determining how to proceed any measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization.” By striking these words, revised Rule 1.13 shifts the focus to protecting the investor. See Model Rules of Prof’l Conduct R. 1.13 (amended Aug. 2003).


\(^9\) See id.

\(^9\) See id. R. 1.13(c)(2) (amended Aug. 2003). The revision of this rule states that a lawyer “may... reveal information relating to the representation whether or not Rule 1.6 permits such disclosures, but only if, and to the extent, the lawyer reasonably believes necessary to prevent substantial injury to the organization.” Id.
This revised rule also emphasizes that permission to breach attorney-client privilege is still strictly limited to attorneys functioning in specific roles. For example, the new rule also adds a provision which emphasizes that reporting out is not permitted when an attorney is representing an organization to investigate or defend an alleged violation of the law.\textsuperscript{101}

By modifying Rule 1.6 and 1.13 to require that securities attorneys report up the ladder within client organizations and in certain instances report out, the ABA is accepting the SOX mandate that securities attorneys act as internal gatekeepers. These changes constitute acquiescence to the wishes of Congress and an attempt on the part of the ABA to compromise with the SEC. The ABA rules do not, however, sanction mandatory "noisy withdrawal." That is, the changes to the Model Rules do not require an attorney to withdraw and inform the SEC although they do permit him to do so. Thus, the ABA makes significant concessions while attempting to preserve attorney independence and its own prerogative to police the legal profession. If the SEC, on the other hand, decides to adopt its pending proposal on "noisy withdrawal," a faceoff with the ABA is likely.

The insistence on independence can be seen throughout the ABA's revised rules. In every instance, the rules preserve the attorney's right to make reasonable judgments. The attorney reports up only when he determines that such reporting is "reasonably necessary in the best interest of the organization."\textsuperscript{102} Even if the attorney sees wrongdoing, the Model Rules permit him to refrain from reporting up if the attorney "reasonably believes that it is not necessary in the best interest of the organization to do so."\textsuperscript{103} Thus, while narrowing the distance between the SEC's vision of the attorney's role in preventing corporate scandals and the profession's traditional vision of its optimal role, the revised rules still insist on the attorney's right to make reasonable decisions about an appropriate course of action based on the facts as the attorney sees them. The revised Model Rules, then, represent continued insistence on the attorney's right to make independent decisions rather than mindlessly following mandates from an outside agency. In this regard, the rule changes attempt to hold the line against the SEC.

However, the balancing act is again made clear in the ABA's comments on its revised rules. After emphasizing attorney independence in the rules themselves, these comments seem to warn against abuse of this independence. Specifically, in the Comment to Rule 1.13 the ABA states that "knowledge can

\textsuperscript{100} See id. R. 1.13 (amended Aug. 2003).
\textsuperscript{101} See id. R. 1.13(d) (amended Aug. 2003).
\textsuperscript{102} Id. R. 1.13(b) (amended Aug. 2003).
\textsuperscript{103} Id.
be inferred from circumstances, and a lawyer cannot ignore the obvious.”  

Further, these comments spell out specifically what factors an attorney should consider when determining what action to take. Interestingly, these comments emphasize that, when an attorney represents a government agency, his assessment of a course of action should be qualitatively different from when he represents a private company. In the ABA’s view, when public business is involved, the balance between preserving confidentiality and preventing or rectifying wrongdoing should be tilted more heavily toward the prevention of harm to the public. In these comments, the ABA is clearly trying to negate the possible negative consequences of the attorney-independence stressed above, while emphasizing that attorneys have an obligation to be mindful of the public’s interest. Revised Rule 1.13 stresses an attorney’s right to make independent judgments, but, at the same time, the ABA’s interpretation of this rule spells out what a “reasonable” judgment entails, thus discouraging attorneys from hiding from the duty to act. Here, the ABA’s stress on its continuing function as a professional watchdog for lawyers implies that outside agencies need not interfere in the policing of the legal profession.

C. Criticism of ABA Action

As with all such compromises, the ABA’s revisions of its Model Rules have evoked criticism on both sides. While these changes do accept that securities attorneys should perform some gatekeeping functions, some detractors have found that these changes are not as extensive as they would like, while other critics are displeased because they have found that the revisions breach the integrity of attorney-client privilege more than they would prefer. In effect, this carefully balanced ABA response may illustrate why the ABA may not be the appropriate body to craft rules to mandate attorney’s compliance with SOX. In effect, the ABA is a private, guild-like organization whose allegiance is clearly to the legal profession. In effect, this reality creates a conflict of interest which perhaps compromises protection of the public interest against massive corporate fraud. To complicate this matter, each

104. Id. R. 1.13 cmt. 3 (amended Aug. 2003).
105. See id. The ABA’s comments state that “the lawyer should give due consideration to the seriousness of the violation and its consequences, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters, and any other relevant considerations.” Id.
106. See id. R. 1.13 cmt. 9 (amended Aug. 2003). The ABA postulates that, “in a matter involving the conduct of government officials, a government lawyer may have authority . . . to question such conduct more extensively than that of a lawyer for a private organization in similar circumstances. Thus, when the client is a governmental organization, a different balance may be appropriate between maintaining confidentiality and assuring that the wrongful act is prevented or rectified for public business is involved.” Id.
107. See Coffee, supra note 1, at 1303 (arguing that the private status of the ABA means that its allegiance is to its members rather than the public, leading the organization to be less aggressive about enforcement).
individual state bar association sets its own rules of conduct which may or may not conform to the ABA’s Model Rules. While auditors and analysts are both regulated by independent organizations that are external to the profession and whose sole duty is to protect the public interest, attorneys are not regulated by any such board. Thus, critics point out that SEC regulation, which is arguably more objective than ABA regulation, may be more necessary in the case of attorneys than of auditors and analysts.

Critics of the ABA’s protective stance feel that securities attorney is synonymous with gatekeeper. Thus, a more objective body, like the SEC, might, absent political pressures, diminish the emphasis on an attorney’s independent judgment and impose more restrictive requirements on securities lawyers. These critics would argue this more objective agency would more explicitly acknowledge that standards for securities attorneys should be very different from standards for litigators because securities attorneys act in many ways like auditors, at minimum reviewing financial disclosure on which investors rely. These standards might, in fact, include “noisy withdrawal” and the review of attorney certification of financial results.

On the other hand, others within the legal profession clearly intend to protect attorney-client privilege regardless of the effect on the public interest. These critics feel that the ABA has done undesirable damage to attorney-client privilege in its attempt to protect the public interest. Thus, the President of the New York State Bar Association states that the revised Model Rules strike at “one of the ‘core values’ of the legal profession—lawyer-client confidentiality.” Predictably, such critics emphasize that trust is essential to the attorney-client relationship and that expanding the situations where this trust can be breached is intolerable and unnecessary. These critics also object to the attorney’s increased license to report up and out under the revised Model

108. See id. at 1303. As a result of Sarbanes-Oxley, auditors are now regulated by the Public Company Accounting Oversight Board. Securities analysts are regulated by the National Association of Securities Dealers and the New York Stock Exchange, both of which are monitored by the SEC. Id.

109. See id. at 1299. The author argues that Sommer’s definition of the securities attorney’s ethical responsibilities actually describes accurately the functions of a gatekeeper. These characteristics include “(1) independence from the client; (2) professional skepticism of the client’s representations; (3) a duty to the public investor; and (4) a duty to resign when the attorney’s integrity would otherwise be compromised.” Id.

110. See id. at 1296. Coffee believes that securities attorneys already perform some gatekeeping functions and that “the differences between attorneys and auditors are less fundamental and more marginal than opponents of the SEC’s proposed noisy withdrawal standard have recognized.” Id.

111. See id. at 1310. Coffee believes that the SEC could require attorneys to “take reasonable steps to insure the accuracy of statements made in documents that they prepare.” Such action by the SEC runs counter to the common practice in the legal profession of relying on clients’ assertions rather than making any effort to corroborate these assertions. Id.

112. See Press Release, The New York State Bar Association, Vote By American Bar Association To Turn Lawyers into ‘Snitches’ Is Not Necessary (Aug. 19, 2003), available at http://www.nysba.org [hereinafter Snitches]. New York State Bar Association President Thomas Levin stated, “The very foundation of a lawyer’s relationship with a client is based on trust. This proposal would permit lawyers to violate that trust, and is unacceptable.” Id.
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Rules.\textsuperscript{113} This line of criticism actually echoes in some ways the ABA’s own strategy in responding to the SEC mandate. Both emphasize that individual state bar codes already include provisions which adequately protect the public and both insist on the right of state bar associations to regulate the local practice of law.\textsuperscript{114} These critics also emphasize that “few states have disclosure rules as extensive as those proposed by the ABA.”\textsuperscript{115}

Whether the ABA or the challengers of its prerogatives are correct about the degree to which the public interest should supersede attorney-client privilege turns on how much compromise of this sacred legal tradition is actually necessary to protect the public interest.

IV. STATE BAR ASSOCIATIONS’ RESPONSE

Clearly, the revised ABA rules have provoked dissent within the legal establishment and will probably result in continuing skirmishes over states’ rights. Meanwhile, whether the SEC accepts the ABA concessions and drops its interest in “noisy withdrawal” will most probably be determined by the degree to which state bar associations conform their rules of professional conduct to the ABA’s Model Rules. Early response suggests that state bars will not rush to embrace ABA revisions. Individual state rules of professional conduct mirror the ABA’s original Model Rules which reflect more accurately the importance that state bar associations place on attorney-client privilege.\textsuperscript{116}

\textsuperscript{113} See id. Levin argues that the New York Bar Association’s rules are sufficient to protect the public interest and that the revised ABA Model Rules are unnecessary.

\textsuperscript{114} See id. Levin asserts that New York is not likely to adopt the ABA’s revised Model Rules. This corroborates Coffee’s view that the existence of independent state bar associations lessens the effectiveness of the ABA as a regulatory body. Id.

\textsuperscript{115} Id.

\textsuperscript{116} See Letter from the Corporations Committee Business Law Section, State Bar of California, to Giovanni P. Prezioso, Esq., General Counsel, Securities and Exchange Commission (Aug. 13, 2003), at http://www.ethicsandlawyering.com/Issues/files/CalSeclettertoSEC.pdf [hereinafter Prezioso Letter]; INTERIM FORMAL ETHICS OPINION ON THE EFFECT OF SARBANES-OXLEY REGULATIONS ON WASHINGTON ATTORNEYS’ OBLIGATIONS UNDER RCP’S (adopted by WSBA Board of Governors on July 26, 2003), available at http://www.wsba.org [hereinafter Ethics Opinion]; Snitches, supra note 112. California attorneys object to the expansion of the area of permissible violation of client confidence, emphasizing that California rules prohibit attorneys from divulging client confidences because such a guarantee is fundamental to the successful operation of the justice system. See Prezioso Letter, supra. The California State Bar Association feels that loosening this prohibition could cause harm both to the attorney and to his client. Id. The Washington State Bar Association stresses that Washington lawyers are only permitted to reveal client confidences to prevent commission of a crime or to obey a court order. See Ethics Opinion, supra. The WSBA warns Washington attorneys not to disregard Washington state rules in an effort to comply with SEC regulations. Id. The State Bar Association of New York states that New York state rules are adequate to protect the public interest and that the ABA’s revisions in response to the SEC’s regulations will have no effect in New York. See Snitches, supra note 112. President of the Texas Bar Association, Guy Harrison, states, “[h]istorically, and in the best interest of our clients as well as the general public, lawyers have not been perceived as ‘certified public attorneys. Our responsibility has been to our clients, with specific rules that apply if our opinions and/or advice are known by us as being intended to be relied upon by third parties or the public in general. Our responsibility is and should continue to be to zealously represent our clients. We are not and should not be expected to be whistleblowers, corporate policeman, or graders of the accountant’s school papers.”
At the core of the states' resistance to the revised Model Rules is the fact that, while recognizing that the organization, not the constituent, may be the attorney's client, individual state bar codes nevertheless favor attorney-client confidentiality over the public interest. As mentioned above, state bar associations emphasize that local codes already contain provisions that loosen attorney-client privilege to protect the public interest. These codes often allow attorneys to disavow oral or written representations which the attorney subsequently learns to be false. In addition, these codes allow an attorney leeway, when he acquires knowledge that a crime may be committed, to report up the ladder to the highest internal authority and/or to withdraw from representation. However, while the SEC and ABA require these actions in specific situations, most local codes do not. In fact, several states specifically prohibit revelation of client confidences in such circumstances.


117. See N.Y. STATE BAR ASSOC. LAWYER'S CODE OF PROF'L RESPONSIBILITY, Discipl. R. 5-109 §1200.28 (2002), available at http://www.nysba.org/Content/NavigationMenu/Attorney_Resources/Lawyers_Code_of_Professional_Responsibility/LawyersCodeOfProfessionalResponsibility.pdf. While recognizing that "the lawyer is the lawyer for the organization and not for any of the constituents," the New York State Code outlines actions an attorney may take to prevent a constituent from committing a violation which could cause substantial injury to the organization. Id. These actions include reporting internally to the highest available authority or withdrawing from representation. Id.

118. See id. Discipl. R. 4-101 §1200.19A. This code stipulates that a lawyer may reveal "confidences or secrets to the extent implicit in withdrawing a written or oral opinion or representation previously given by the lawyer and believed by the lawyer still to be relied upon by a third person where the lawyer has discovered that the opinion or representation was based on materially inaccurate information or is being used to further a crime or fraud." Id.

119. See CAL. RULES OF PROF'L CONDUCT R. 3-600 (2005), available at http://www.calbar.ca.gov/calbar/pdfs/ethics/2005_Pub_250_RPC.pdf (stipulating that an attorney "may take actions as appear to the [attorney] to be in the best lawful interest of the organization."); N.Y. STATE BAR ASSOC. LAWYER’S CODE OF PROF’L RESPONSIBILITY, supra note 117, at EC 4-7 (insisting that "a lawyer is afforded the professional discretion to reveal the intention of a client to commit a crime and the information necessary to prevent the crime and cannot be subjected to discipline either for revealing or not revealing such intention or information").

120. See CAL. RULES OF PROF’L CONDUCT, supra note 119, R. 3-600; Ethics Opinion, supra note 116. California holds that, even in the face of a material violation, which may cause substantial injury to the organization, "the member shall not violate his or her duty of protecting all confidential information as provided in Business and Professions Code section 6068 . . . ." Id. Washington requires that "a lawyer shall not reveal confidences or secrets relating to representation of a client unless the client consents after consultation," except to prevent a crime or to comply with a court order. See Ethics Opinion, supra note 116.

121. See Prezioso Letter, supra note 116. Washington Rules of Professional Conduct [RPCs] do not allow disclosure of a civil violation if that violation does not rise to the level of a crime. See Ethics Opinion, supra note 116. Moreover, the State Bar of California stresses that a California attorney may report to the highest internal authority or may resign. They do not have an obligation to go public to protect the public interest. See Prezioso Letter, supra note 116.

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Likewise, state codes often stress a series of responses to knowledge of criminal intent which stop short of reporting up the ladder, such as asking a client to reconsider a course of action. Thus, the emphasis in these codes, as in the original ABA Model Rules, appears to be on protecting the corporate constituent, rather than the corporate entity. For example, California’s rules emphasize that, even when the attorney has knowledge that a corporate constituent is about to take action which will cause substantial harm to the corporation, the attorney “shall not violate his or her duty of protecting all confidential information . . . .” While these rules then follow with attorney options for reporting potential misdeeds internally, they also stress that if the highest internal authority refuses to act on behalf of the corporation, the attorney may do nothing but exercise his right to resign. California also stipulates that an attorney must warn corporate constituents that the corporate entity, not the constituent, is the client, in situations where the constituent might otherwise reveal information which the attorney would be obliged to divulge to others.

In general, state rules of professional conduct do not presently recognize that the attorney has an obligation to act as a gatekeeper for the corporation even if the corporation, not the constituent, is the attorney’s actual client. These codes emphatically focus on protecting the specific corporate constituents with whom the attorney deals rather than focusing on protecting the corporation or its shareholders. In fact, state codes often emphasize that attorney-client privilege supersedes any gatekeeping function attorneys may have. California, for example, while recognizing the important role attorneys can play in upholding federal securities laws, adamantly insists that “that role does not make private attorneys an adjunct to the SEC in enforcing those laws.” Again, in specifically addressing attorney-client privilege when the client is a corporation, the California Rules of Professional Conduct state that “the public policy behind the attorney-client privilege requires that an artificial person be given equal opportunity with a natural person to communicate with its attorney, within the professional relationship, without fear that communication will be made public.” Here, the California Bar’s position fails to recognize the possibility of a conflict of interest between specific corporate constituents and corporate shareholders. Rather, the California Bar assumes that loyalty to the corporate officer with whom the attorney is in physical contact is the primary concern. This is clearly in conflict with the positions of the SEC and the more

122. See, e.g., N.Y. STATE BAR ASSOC. LAWYER’S CODE OF PROF’L RESPONSIBILITY DISCIPLINARY, supra note 117, R 5-109 [§1200.28].
123. See CAL. RULES OF PROF’L CONDUCT R., supra note 119, 3-600(B).
124. See id. R. 3-600(B), (C).
125. See id. R. 3-600(D).
126. See Prezioso Letter, supra note 116.
127. Id.
reluctant ABA, who are both seeking to shift the slant from protecting corporate constituents to protecting the corporate entity itself, as well as the shareholders. In this same context, state response to the ABA's revised Model Rules tends to stress the harm that violating attorney-client confidentiality can cause to the attorney and to the client, rather than the harm that can be caused to the shareholder or to the American economy.\(^\text{128}\)

While most states have been silent about the revised ABA Model Rules, the bar associations in some major states remain more invested in their traditional vision of attorney-client confidentiality than in the mission mandated for attorneys by Sarbanes-Oxley and the SEC.\(^\text{129}\) Not surprisingly, given the discrepancy between state codes and the SEC mandate, these states are attacking part 205 and, by implication, the ABA's revised Model Rules. Some are promising to press the issue of the SEC's right to interfere with local ethics rules in court.\(^\text{130}\) They argue that, to the extent part 205 contradicts individual state Rules of Professional Conduct, the state rules must prevail. Further, some attorneys argue that, since part 205 allows, but does not require, reporting out, there is really no conflict between the SEC rules and state bar codes, which do not permit external disclosure. Attorneys in such states would be bound to follow state ethics rules and keep the client's confidences, but would not, in the process, actually be violating part 205.\(^\text{131}\) Several key states claim that, because there is not yet any case law specifically upholding these particular SEC regulations, state bars are under no legal obligation to honor them, and therefore attorneys practicing in their jurisdictions may obey the SEC rules only at their peril.\(^\text{132}\)

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\(^\text{128}\) *Id.* The Prezioso letter points out that if an attorney reveals confidential information, that information may become available in a civil or criminal case, resulting in harm to the client. *Id.* Likewise, it warns that attorneys who rely on the SEC's promise to protect whistleblowers from disciplinary proceedings may suffer harm if the SEC is found not to have the legal authority to offer that protection. *Id.*


\(^\text{130}\) See, e.g., Prezioso Letter, *supra* note 116. The California Bar Association states that "the California Bar has no power to declare a state statute unenforceable unless or until an appellate court so rules . . . the SEC's authority to adopt these rules is untested and may be successfully challenged." *Id.*

\(^\text{131}\) See Ethics Opinion, *supra* note 116. The Washington Bar Association states that "to the extent that the SEC Regulations authorize but do not require revelation of client confidences and secrets under certain circumstances, a Washington lawyer should not reveal such confidences and secrets unless authorized to do so under the RPCs." *Id.* Washington attorneys emphasize here that part 205 outlines broader areas where breach of confidentiality is permissible than do the Washington RPCs. *Id.* Since part 205 does not require attorneys to breach confidences within these broader parameters, the Washington State Bar counsels Washington attorneys to adhere to the narrower circumscription of attorney-client privilege found in the Washington RPC. *Id.* The State Bar further warns that, if Washington attorneys breach confidentiality in areas not allowed by the RPCs, this will not make them immune from state disciplinary action, regardless of the "good faith" protection afforded by part 205. *Id.*

\(^\text{132}\) See Prezioso Letter, *supra* note 116; Ethics Opinion, *supra* note 116; Harrison Opinion, *supra* note 116. California asserts that the SEC's authority to adopt regulations 205.3(d) and 205.6(c) is
of professional conduct even though part 205 immunizes attorneys against such prosecutions of "good faith" efforts to comply with part 205.\textsuperscript{133}

In the absence of specific case law, dissenting states further claim that there is no evidence that Congress intended to give the SEC the power to effect such a massive intrusion into the affairs of the legal profession. These critics point out that courts have struck down other SEC regulations because there was no evidence of Congressional intent.\textsuperscript{134} They further note that Congressional intent is critical to determining this issue since the SEC, an administrative agency, only has the power "to adopt regulations to carry into effect the will of Congress as expressed by the statute."\textsuperscript{135} When examining the SOX statute, the advocates of states' rights point out that Congress empowers the SEC merely to set forth "minimum standards" for attorneys who practice before the Commission.\textsuperscript{136} They feel that this wording does not "invest the SEC with broad authority to permit lawyers to disclose client secrets and then immunize or otherwise protect those lawyers who do."\textsuperscript{137} In fact, one critic points out that "on three or four separate occasions, members of Congress specifically asked if [the bill] would require corporate lawyers to report to the SEC and were told no."\textsuperscript{138} To these critics, vesting the SEC with this power without a more substantial basis in the statute would in essence be undermining the legislative process to the detriment of states' rights.\textsuperscript{139}

\textsuperscript{133.} See 17 C.F.R. § 205.6(c) ("An attorney who complies in good faith with the provisions of [part 205] shall not be subject to discipline... under inconsistent standards imposed by any state... where the attorney is admitted or practices."). \textit{But see} Prezioso Letter, \textit{supra} note 116; Ethics Opinion, \textit{supra} note 116.  


\textsuperscript{135.} Manhattan Gen. Equip. Co. v. Comm'r, 297 U.S. 129, 134 (1936) (noting example of case in which court struck down SEC's rulemaking authority); \textit{see also} Prezioso Letter, \textit{supra} note 116. The California Bar cites lack of evidence of Congressional intent as a likely basis for future challenges to part 205. \textit{Id.}  

\textsuperscript{136.} \textit{See} Sarbanes-Oxley Act, 17 C.F.R. § 307 (2002). While this section addresses the "public interest" and "protection of investors," it only authorizes establishment of "minimum standards" which does not necessarily have to be construed to mean such expansion of the right of attorneys to breach client confidentiality. \textit{Id.}  

\textsuperscript{137.} Prezioso Letter, \textit{supra} note 116.  

\textsuperscript{138.} \textit{See} Sue Reisinger, \textit{States’ Rights All Over Again}, \textit{CORP. COUNS.}, Nov. 2003, at 24, \textit{available at LEXISNEXIS} Library, \textit{CORP. COUNS.} file. Reisinger quotes Michael O'Sullivan, who reviewed documents associated with SOX and stated that members of Congress asked several times whether this legislation would require corporate counsel to report to the SEC and attorneys were told no. \textit{Id.}  

\textsuperscript{139.} \textit{Bus. Roundtable}, 905 F.2d at 413 (holding that allowing the SEC to act in a way that moves beyond Congressional intent "would circumvent the legislative process that is virtually the sole protection for state interests").
Not only do critics find a lack of evidence that Congress intended the SEC to require breaching of client confidentiality, they also claim that Congress gave no evidence of intent to preempt state laws.\textsuperscript{140} Historically, when Congress does not specifically address the preemptive effect of a new law on existing state laws, that silence is taken to evidence a lack of Congressional intent to supersede existing laws.\textsuperscript{141} However, these critics emphasize that in this case, although Congress did not mention any intent to supersede existing laws, the SEC wrote regulations which claimed this preemptive power. States’ rights advocates see this as an unwarranted inflation of power by an administrative agency. Given this reality, these critics feel certain that, when challenged in courts, the SEC rules will be struck down under the mandate of the Administrative Procedure Act, which holds that a reviewing court must invalidate any agency rule which exceeds that agency’s authority.\textsuperscript{142}

While this aggressive defense by some state bar associations might be dismissed as simply being prototypical resistance to change, such dismissal will likely fade as the new reality of the SOX mandate becomes part of the corporate culture, the core of these state arguments seems unlikely to lose its power to mobilize attorneys. To many attorneys, the SEC rules represent an outside attack on a central tenet of their profession and a mandate that they change their view of themselves as primarily loyal to their clients. Ceding this battle means ceding their right to self-determination and admitting the inadequacy of their self-regulation. To a number of attorneys such a concession would also signal an admission that attorneys might be at least partially culpable in the financial scandals that have recently rocked the U.S. economy.

Given this reality, attorneys may well be loath to accede to the SEC mandate without a serious legal fight. Whether most states follow the ABA’s lead and concede all but the most onerous SEC requirement—"noisy withdrawal"—may well depend on the outcome of this legal fight. Since attorneys may be forced, as the Washington position makes clear, to choose between obeying SEC part 205 or obeying local Rules of Professional Conduct, this fight may well begin when an attorney makes a choice that results in his prosecution by a state bar association.

\section*{V. SEC’S RESPONSE TO STATE CHALLENGES}

The SEC has responded to these state challenges by outlining legal
precedents that suggest that the Commission does indeed have the authority to supersede state laws, even though specific case law on these regulations has not yet been established. Specifically, the Commission emphasizes that the Supreme Court has consistently affirmed that, when a federal agency enacts rules of conduct which conflict with existing state rules of conduct, the federal agency’s rules prevail. The SEC cites *Sperry v. State of Florida*143 where the Court held that the regulations of the U.S. Patent Office governing who could prosecute patent applications superseded the rules of the Florida Bar.144 State critics have pointed out, however, that in this case Congressional intent was clear. Congress had expressly granted the patent office the power to make these specific regulations long before they were challenged by the Florida Bar.145 These critics believe that the facts of *Sperry* are in direct contrast to the lack of established Congressional intent for Sarbanes-Oxley to empower the SEC to enact far-reaching rules about attorney-client privilege. In contrast, proponents of SOX disagree, pointing out that because “Congress gave [the SEC] broad authority to set minimum standards of conduct for attorneys practicing before it,” states who challenge part 205 in court will lose.146

The SEC responds to the state bars’ claims that rules which forbid such disclosure can prevail without triggering a conflict and subsequent preemption since part 205 permits, but does not require, external reporting by citing another Supreme Court Case. This case, *Fidelity Federal Savings and Loan Ass’n v. de la Cuesta*,147 holds that a conflict between a federal regulation and a state regulation “does not evaporate because the [federal] regulation simply permits, but does not compel” what state law prohibits.148 Here, the Court states that, if a state law removes the flexibility of choice permitted by a federal law, a conflict does exist and the federal law will prevail.149

In response to state attacks on the SEC’s grant of immunity from state

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144. *See generally id.* The State of Florida enjoined a non-lawyer from preparing and prosecuting patent applications before the U.S. Patent Office because, under Florida law, his action constituted the unauthorized practice of law. *Id.*
145. Prezioso Letter, *supra* note 116. The California State Bar points out three differences between *Sperry* and the SEC’s implementing regulations for part 205. *See id.* First, Congress derived its power to establish a patent office directly from the U.S. Constitution, second, Congress subsequently expressly gave the Commissioner of Patents the power to determine who could act as patent agents. *Id.* Finally, at the time of the *Sperry* decision, the use of lay patent agents was routine. *See id.*
146. *Special Report: Corporate Governance, Broward Daily Bus. Rev.*, Sept. 29 2003, at 18, *available at LEXISNEXIS Library, Broward Daily Bus. Rev.* file. Richard Painter, a law professor at the University of Illinois who defends the SEC regulations, posited that the SEC knew that only a minority of states had rules that prohibited attorneys from reporting out. *Id.* Painter stressed that, given this fact, the only reason the SEC would issue these rules would be for the purpose of preempting minority state rules. *Id.* This point does not, however, address the core issue of whether or not the SEC actually had the power to enact these rules. *See id.*
148. *Id.* at 155.
149. *See id.*
prosecution to attorneys who comply with part 205, the Commission cites several other legal precedents. *Barnhart v. Walton*\(^{150}\) holds that a federal agency’s interpretation of its own regulation is afforded judicial deference.\(^{151}\) Since the issue of whether an attorney has acted in a “good faith” effort to comply with part 205 requires an interpretation of an SEC regulation, the SEC maintains that its definition of “good faith” must be accepted by states that wish to prosecute attorneys for violating state bar rules in an effort to comply with part 205.\(^{152}\) Further, the SEC warns that state attempts to define “good faith” differently from the SEC to justify prosecution of complying attorneys will fail,\(^{153}\) since *City of New York v. FCC* \(^{154}\) holds that federal agency regulations preempt any state regulation that “frustrates the purposes” of the regulation. Consequently, any prosecution of a complying attorney will be construed as an attempt to thwart the purpose of a preemptive federal regulation.\(^{155}\)

While the SEC has marshaled a convincing battery of legal precedent to bolster the legitimacy of part 205, the states have counterarguments and, as suggested above, this battle will undoubtedly be fought in the courts. Assuming that the SEC can demonstrate Congressional intent to empower the Commission to narrow the reach of attorney-client privilege, the SEC will most likely prevail in this legal battle because of the extensive precedent for federal preemption of state laws. The Commission will likely point out that the instances in which part 205 conflicts with state ethics rules will be few since this regulation only applies to instances where attorneys are practicing before the SEC. The Commission feels then that the vast majority of client confidences will not be affected by this SEC mandate. However, in reality, if states revise their local ethics rules to mirror the ABA’s revised rules, attorneys who do not practice before the SEC will also have increased latitude to reveal

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151. Id.
152. Letter from Giovanni P. Prezioso, General Counsel, U.S. Securities and Exchange Commission, to J. Richard Manning, President, Washington State Bar Association, and David W. Savage, President-Elect, Washington State Bar Association (July 23, 2003), available at http://www.sec.gov/news/speech/spch072303gpp.htm (maintaining that *Barnhart*, 535 U.S. at 217, upholds the agency’s power to define “good faith” and prohibits states from redefining this concept for their own purposes, but not addressing whether or not the SEC actually had the power to grant attorneys immunity at all) [hereinafter Manning Letter].
153. Id. (pointing out that under *City of New York v. FCC*, 486 U.S. 57, 64 (1988), the SEC’s definition of “good faith” will preempt any attempt by the states to redefine “good faith” in a way that subverts the purpose of part 205).
154. City of New York v. FCC, 486 U.S. at 64.
155. Manning Letter, supra note 152 (warning that under *City of New York*, any attempt by a state to discipline an attorney for breaching state rules of professional conduct in a good faith attempt to comply with part 205 will be viewed as an attempt to frustrate the purpose of the SEC regulation). The Washington State Bar Association warns that Washington lawyers must obey state RPC’s rather than part 205, while the SEC asserts that any disciplinary hearing, regardless of the result, would be seen as an attempt to subvert the SEC’s grant of immunity for “good faith” efforts to comply with part 205. Id. The SEC stresses its right to preempt state RPC’s. Id.
client confidences since the ABA Model Rules do not limit this permission to attorneys practicing before the SEC.\(^{156}\) Thus, the motivation is strong for some states to maintain the attorney-client privilege intact and to fend off outside interference with their profession. The ABA will likely exert pressure on dissenting state bar associations to forgo litigation and accept the compromises contained in its revised Model Rules on the premise that such compromises are the best way to protect attorney-client privilege from the most loathsome attack—the "noisy withdrawal" requirement. As suggested earlier, the resolution of this struggle may well turn on how effective the ABA is as the arbitrator of this conflict between the right of attorneys to keep client confidences and the public interest in honest corporations.

VI. ATTORNEY RESPONSE TO SOX: THE FORMATION OF THE QLCC

Like the ABA and state bar associations, corporate attorneys in the workplace have to respond to the changes wrought by SOX. Many professionals envision a sea of change for attorney behavior. One attorney noted: "In the end... amendments to the ABA ethical code could in fact change the way lawyers behave—because lawyers who don’t report wrongdoing could wind up as defendants in shareholder suits. The new language about being able to breach confidentiality... becomes ‘You really better.’"\(^{157}\)

An interview with Ben Heineman, former-GE General Counsel and now senior vice-president for law and public affairs, suggests the difficulty facing counsel after SOX by asking, "[I]s it really possible to be both an independent counsellor [sic] and a business partner, a lawyer and a member of the management team?"\(^{158}\) Although Heineman believes that attorneys can and do perform this balancing act, his description of the task at hand highlights the difficulty of so doing.\(^{159}\) In his view, general counsel should be involved in everything from creating a "culture of compliance and integrity" to engaging in public debate and fighting the current cynicism about business.\(^{160}\) Thus, counsel’s already complex job has become even more so.

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156. Robert T. Markowski, SEC Rules May Bump Up Against State Ethics Rules, CHI. DAILY L. BULL., Aug. 29, 2003, at 6 (pointing out that, while the SEC rules clearly apply to lawyers who represent clients before the SEC, these rules "also apply to any attorney who has provided any advice to his or her client 'in respect of' federal securities laws or regulations regarding any document that the attorney 'has notice' will be filed with the SEC or incorporated by reference into an SEC filing."). Many attorneys who do not consider themselves to be SEC practitioners may be surprised to find that they are now subject to the SEC's new rules of conduct. Markowski's point illuminates state fears that the SEC's intrusion into the territory of client confidentiality may indeed be the top of a slippery slope. Id.


159. See id.

160. Id.
One specific area of potential difficulty for counsel under SOX involves whether or not to recommend formation of a Qualified Legal Compliance Committee (QLCC). The fact that an attorney's obligation is to the company and not to the individual CEO or CFO who hires him complicates this decision. One attorney, at a major Boston law firm, commented that he had not recommended that any clients form a QLCC, and he would not recommend forming a QLCC unless the SEC adopted the "reporting out" procedure. He thought that most counsel would not want the extra layer "interfering" between the CEO/CLO and counsel. However, several legal scholars have expressed a different more cynical view of the QLCC decision. Professors Jill Fisch and Caroline Gentile suggest that attorneys may be tempted to further their own self-interest and recommend a QLCC despite a perceived disadvantage to the corporation.

What has been the actual practice of corporations? Have they utilized the QLCC form? Two surveys suggest that attorneys are not vigorously lobbying for the creation of QLCCs, although the surveys reveal a trend toward using audit committees as QLCCs. One survey conducted July 2003 by the American Society of Corporate Secretaries highlighted this trend. Of the respondents in this survey, 11 indicated that they had formed a QLCC, 108 indicated that they had not and 100 did not answer the question. When asked if, in the absence of a QLCC, the full board would receive reports of alleged violations, 26 responded yes, 59 responded no and 132 did not answer. On the other hand, when asked if the audit committee would receive such reports when there was no QLCC, 87 responded yes, 5 responded no and 125 gave no answer. These results, while clearly not definitive, do suggest that in the post-SOX corporate world there is no quick movement to form a separate QLCC but there is a discernible pattern of using audit committees to serve the function of QLCCs.

Another survey of 176 companies by the Corporate Counsel showed similar results. Of these respondents, 84.8% reported that they had no intention of forming a QLCC but might reconsider if the SEC adopts a "reporting out"

161. Interview with partner at Boston law firm (July 14, 2004) (on file with authors).
165. Id.
166. Id.
167. See The Corporate Counsel.net, "Reporting Up" and QLCC Survey Results (Final), at http://www.thecorporatecounsel.net/survey/july03_total.htm (last visited Mar. 15, 2005).
Of the 15.2% who reported that they had formed a QLCC, 14% said that the audit committee functioned as the QLCC, while 1.2% said that the governance/nominating committee was their QLCC. Again, this survey suggests that attorneys are not putting great weight behind suggestions to begin forming QLCCs. However, as suggested above, these surveys were not exhaustive and certainly many of the large companies have gone ahead and established QLCCs. In fact, the corporate charters of many large companies include QLCCs. Thus, at least some large corporations appear to see a benefit in establishing a QLCC.

168. Id.
169. Id.
Johnson Controls:

**Authority/Responsibility**
The Committee shall have the authority and responsibility to do the following:

- Inform the issuer’s CLO and CEO of any report of evidence of a material violation.
- Determine whether an investigation is necessary regarding any report of evidence of a material violation by the issuer, its officers, directors, employees or agents and, if it determines an investigation is necessary or appropriate, to:
  - Notify the audit committee or the full board of directors;
  - Initiate an investigation, which may be conducted either by the CLO or by outside attorneys; and
  - Retain such additional expert personnel as the committee deems necessary; and
- At the conclusion of any such investigation, to:
  - Recommend, by majority vote, that the issuer implement an appropriate response to evidence of a material violation; and
  - Inform the CLO, CEO, and the board of directors of the results of any such investigation under this section and the appropriate remedial measures to be adopted.
- Acting by majority vote, to take all other appropriate action, including the authority to notify the Commission in the event that the issuer fails in any material respect to implement its recommendations.

**Procedures**

1. Notify the public and employees of the availability of the QLCC for reporting on the Corporation’s website and Hotline.
2. Assure QLCC reports are segregated and confidentially reported directly to the Chair of the Audit Committee.
3. Assure that the report is entered into a log of such reports and all records are maintained until the matter is resolved by the QLCC.

*Effective July 2003*

As with advising formation of QLCCs, law firms have not totally changed the way they do business in other areas post-SOX. For example, the SEC reported that when Speigel, Inc. withheld adverse financials, its counsel, law firm Kirkland & Ellis advised the company that it would be breaking the law.

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However the firm did not withdraw and did not notify the SEC. Will SOX change the way attorneys perceive their obligations? Commentator Mike France noted:

[M]any of the highly paid corporate attorneys in America all but ignore the spirit of tax, corporate, and securities law. Instead, they are often linguistic Houdinis who specialize in hypertechnical arguments as to why their client’s rat poison meets the five-part test for being apple pie. Many corporate law firms have a “business ethos that does not appeal to a larger sense of right and wrong but instead defines itself solely in terms of technical compliance.”

France further explains:

This legal climate is making it a lot harder than it should be to throw executives in jail. And that, in turn, is forcing lawmakers to try to prevent future wrongdoing by devising increasingly detailed regulations governing how businesspeople, auditors, lawyers, and analysts should behave. Witness the Sarbanes-Oxley Act, a bureaucratic nightmare that is spawning a whole new industry in compliance software. Rather than force hundreds of managers to cut through red tape, it would make a lot more sense to put the few genuinely bad apples behind bars. But to do that the lawyers are going to have to be held more accountable for the advice they give.

Clearly, the need to maintain the balance between conforming to SEC regulations and effectively representing people who hire counsel makes this a difficult time to be corporate counsel. Although well-paid, attorneys face many dilemmas. Mark Belnick, recently acquitted counsel of Tyco, argued successfully that he believed he was doing nothing wrong and that his bonus was not “hush money” for his silence about Tyco CEO L. Dennis Koszlowki’s misdeeds. However, the fact that he had to make this argument at all underscores the new accountability and increased exposure for counsel. This elevated responsibility results from the fact that corporate counsel now operates within the federalization of responsibility. Evidence from the news suggests

172. Paul Rice & Peter White, Should They Whistle While They Work, LEGAL TIMES, Jan. 26, 2004, at 60 (suggesting that attorneys consult a shareholder board, not the SEC, when counsel has problems correcting wrongdoing).

173. Mike France, Close the Lawyer Loophole, BUS. WK., Feb. 2, 2004, at 70 [hereinafter Lawyer Loophole] (quoting law professor William H. Widen); see also Mike France, Can Law Profs Consult—And Keep Their Distance?, BUS. WK., Feb. 2, 2004, at 71 [hereinafter Law Profs]. France notes that some ethics experts are also willing to be employed to help assist in defense of law firms. Professors John Coffee, Geoffrey Hazard, Jr., and Charles Wolfram have reportedly assisted Vinson & Elkins in their handling of Enron legal matters.


175. Compare Former Tyco Attorney Acquitted, L.A. TIMES, July 16, 2004, at C3, with Kris Hundley, Enron’s Survivors Anticipate CEO’s Fate, ST. PETERSBURG TIMES, Feb. 19, 2004, at 1A (quoting Jeffrey Skilling’s lawyer and Enron’s former COO Bruce Hiler: “If a COO can’t rely on the dozens of experts who review and recommend transactions, then no COO should go to work tomorrow, because they may find themselves indicted.”). See also Mary Flood, The Fall of Enron, HOUS. CHRON., Feb. 17, 2004, at A1; Mike France, Art, Science, Crapshoot, BUS. WK., Mar. 29 2004, at 86, 88 (quoting Professor Alan Dershowitz: “The first rule of committing a crime in America is always [do so] with someone more important than you—so you have somebody to turn in. If you are Mr. or Mrs. Big then you have nobody you can offer.”).

176. See France, Law Profs, supra note 173.

177. But cf. Coffee, supra note 1 (commenting that “this essay by no means advocates the
that some counsel have responded to this responsibility. Sidley Austin reportedly withdrew from representing a corporation and reserved the right to report to the SEC. This is a clear difference from typical pre-SOX behavior. For example, prior to SOX, Vinson and Elkins apparently had no difficulty defending Enron's accounting behavior and even enlisted distinguished professional ethicists to support their position and to try to dissuade the courts from proceeding against them as well. However, in spite of some evidence of change, we should not expect SOX alone to dramatically alter the way counsel perceives his obligations.

Yet, in cases where counsel accepts the responsibility mandated by SOX, the corporate attorney can play a significant role both in preventing and identifying misconduct as well as in preventing harm to the corporation which ultimately affects the shareholders. For example, counsel's conduct reportedly persuaded the federal prosecutors not to indict HealthSouth along with its CEO Richard Scrushy. Similarly prosecutors opted not to indict Merrill Lynch because of actions of its counsel. However, the number of corporate attorneys who actually choose to accept this responsibility to curb corporate fraud remains to be seen.

VII. ASSESSMENT OF SOX

While everyone agrees that investor confidence was severely shaken by the recent scandals and needs to be restored, the verdict is out on whether SOX is the means to achieve that goal. SOX has no doubt changed the corporate landscape of management. The law firm Foley & Lardner recently published a survey called, "The Cost of Being Public in the Era of Sarbanes Oxley." It concluded that for companies with under $1 billion dollars in revenue the costs of sustaining as a public company increased 130% through fiscal year 2003. Furthermore, these were not merely one-time costs; rather, the survey showed that these costs appear to be continuing and may even be increasing. This is particularly true of director compensation. The survey also noted that the

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180. See France, Law Profs, supra note 173.
181. Orland, supra note 178 (suggesting counsel saved HealthSouth corporation from indictment just as counsel did for Merrill Lynch through its cooperation). See generally France, Law Profs, supra note 173 (discussing the conflicts lawyers themselves face and quoting Harvard Law School Professor Andrew Kaufman criticizing professors John Coffee, Geoffrey Hazard, and other law professors who take paying clients); remarks of Orland, supra note 179.
182. Orland, supra note 178.
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problem was not only escalating costs but also the unpredictability of the costs which include lost productivity as well.184

In addition to cost, the survey found that 67% of respondents found the governance and disclosure reforms for public companies too strict, which represented an increase of 12% over the 55% who so responded in 2003.185 The focus of much of the concern was section 404, or the certifications required by the CEO.186 As a result of these concerns, 21% of respondents (up from 13%) were considering going private and 13% were considering selling or merging the company.187 These concerns may ultimately have a widespread effect on which companies choose to go public. Recent figures seem to confirm this turning away from the IPO process. In 1999 and 2000 the average annual sales of a company with an IPO was $15 million; in contrast, between 2002 and 2004 the average was $164 million.188 While it is difficult to lay the reason for this change at the feet of SOX, it is clear that SOX and its progeny constitute one of the factors. The fact that post-SOX regulations are partly to blame for the move away from public companies is borne out by the results of another survey, which found that “59[ ]% viewed overregulation as a significant risk . . . to the growth of their companies—far more than viewed global terrorism . . . as posing major risks.”189 Also, the costs of these compliance efforts weigh heavily on the small company.190 Brent Longnecker, president of Longnecker & Associates, a Houston Consulting Firm, verified that this is a significant problem for small companies: “Any company under $100 million in revenues has to be asking itself whether it’s worth it to stay public.”191 The SEC seems to

184. Id.
185. Id.
186. Id.
187. Id.; see Emily Thornton, A Little Privacy, Please, Bus. Wk., May 24, 2004, at 74. See generally Sarbanes-Oxley: Time To Step Up, Bus. Wk., July 19, 2004, at 100 (noting that “CEOs say that the cost of compliance is onerous. Yet it is hard to see much impact. Earnings are at record levels, and many companies have billions in cash. Moreover, implementing Sarbanes-Oxley is mostly a one-time cost. Once the compliance structures are in place, annual costs should fall.” Also noting that only 5% of 500 big corporations surveyed are in compliance with the required financial controls.).
188. See Thornton, supra note 187.
190. See id. (quoting Michael Dell of Dell Computer: “For big, established companies that already do the right thing, it is no big thing.” But he also passed along a song being circulated on the Internet about a supposed chief executive who has nightmares about being led away in handcuffs. “I really miss the good old days, when I told my board what to do,” he sings. “Now my audit committee is slapping me silly. Got the Sarbanes-Oxley blues.”) (internal quotations omitted); but see Anne Field, Some Private Companies Embrace Tougher Rules, N.Y. Times, July 15, 2004, at C6 (providing that some small companies are trying to incorporate SOX changes in governance to help the company be more profitable by incorporating outside directors who have new perspectives and can help grow the business and also help them get ready to be acquired).
191. Melinda Ligos, When Going Public May Not Be Worth It, N.Y. Times, June 3, 2004, at C7 (telling the story of a company that went public in 2001 with 35 employees and $10 million in revenue and later determined that it would cost $400 thousand to comply with SOX. “The decision to return to private status ‘became a no-brainer,’ Mr. Huzenlaub said. ‘We were pouring all of our resources into
have heard these complaints and has established a committee to examine the
effects of SOX on smaller companies in December 2004.192

The CEO of the New York Stock Exchange, John Thain, expresses the
same reservations about SOX despite his agreement with the objective of
improving investor confidence.193 He notes several persistent issues associated
with SOX: (1) the costs of compliance a significant increase over operational
costs pre-SOX;194 (2) the decline in the listing of foreign companies on the
exchange as a result of the foreign companies reluctance to pay additional
amounts to comply with SOX;195 and (3) the increase in anti-business litigation
and class-action lawsuits. Thain implies that SOX could accelerate these
trend.196 He stresses the importance of balance in these reforms:

[W]e do not want America's most promising and successful companies to start
pulling back from our capital markets. We need to find a better way. In matters of
governance and regulation we should be guided by an equivalent of the Hippocratic
Oath, "Do no harm." We need to strike a balance between the costs of increased
time and resources devoted to compliance, and the incremental benefits they will
produce in terms of transparency and governance. We at the NYSE would be
willing to bring together a representative sample of listed companies to discuss
these rules and the cost-benefit of the new requirements. Let the principles of
Sarbanes-Oxley remain intact, but at a price that makes sense to the economy.197

In addition to concerns about costs and over-regulation, another previously-
noted concern is the effect of these regulations on the attorney-client privilege
post-SOX. As discussed earlier, post-SOX requirements include the request by
SEC investigators for a limited waiver of attorney client privilege during
investigations.198 While such a waiver has not been unequivocally required at

Committee to Examine Impact of Sarbanes-Oxley Act on Smaller Public Companies, Release No. 2004-
193. Thain, supra note 191.
194. Id.
195. Compare id., with Paul Volcker & Arthur Levitt, Jr., In Defense of Sarbanes-Oxley, WALL ST.
J., June 14, 2004 (estimating that he has seen no impact on foreign company listing and referring to the
Foley & Lardner survey previously, stating how a number of public companies are considering going
private).
196. Thain, supra note 191. But see Volcker & Levitt, supra note 195 (discussing a cost benefit
analysis of SOX and comparing the costs with investor losses stating, “we must not forget that the U.S.
markets are the best in the world because they are the best regulated”).
197. See Thain, supra note 191; see also Norris, supra note 189.
198. Burns, supra note 3 (providing General Counsel Logan Robinson’s discussion on not adopting
the reporting-out procedure because when you use a limited waiver when turning something over to the
SEC, this could then be used by third-parties against you); see also Bob Sherwood, How Safe Is It to
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this point, the regulations create a climate where counsel may be pressured to waive privilege. Such pressure would create a very difficult predicament for the corporate attorney.

However, not all experts are so negative about SOX. For example, John Coffee of Columbia University argues persuasively that attorneys can be gatekeepers. He argues that the SEC should go further and require attorney certification that any material is not “misleading.” He states, “[I]n this light such a negative certification requirement would simply mandate for the 1934 Act periodic filings what is already done by the private insurers in the primary market for 1933 Act disclosure documents.” Coffee suggests a second certification is advisable stating that the attorney “believed adequate disclosure had been made.” Coffee dismisses state bar associations as neither effective nor comprehensive in regulating and policing attorney conduct and heartily welcomes SOX as a step in the right direction.

Similarly, Paul Volcker, the former Federal Reserve Chairman, defends SOX as well. He dismisses the cost of regulation argument by suggesting that companies have been remiss in not having adequate controls in the first place. He notes how many companies have had to correct their financials in recent years. Volcker also emphasizes the benefits of regulation:

Countries are emulating our reforms—from the new combined Code in the U.K. to Germany’s new Kodex of best practices—and as a result, we are strengthening the global economy, not being defeated by it. . . . While there are direct money costs involved in compliance, we believe that an investment in good corporate governance, professional integrity and transparency will pay dividends in the form of investor confidence, more efficient markets, and more market participation for years to come.

It is early in the history of SOX to assess its impact. However, if the goal is to maintain markets in which investors are fully confident that the financial statements are accurate and reliable, then making explicit what has always been an attorney’s implicit obligation is an important step. What is more difficult to pointed to “US investigators’ offers of leniency if corporations waive their right to attorney-client privilege and hand over confidential material when they are under suspicion.” Id. Fleck also states that “many believe that [waiving attorney-client privilege] offers the companies ‘Hobson’s Choice’—they can either waive their right or be pilloried for failing to cooperate.” Id. But see Burns, supra note 3 (giving examples where many individuals were more positive about the impact of SOX).

199. Coffee, supra note 1.
200. Id.
201. Id. at 1313.
202. Id. at 1314.
203. Id. at 1316. Coffee states that despite the shortcomings of the “guild-like regulation by state bar associations” something short of the “federalization of . . . ethics” is necessary. Id. He concludes with a quotation: “To paraphrase Clemenceau, professions are too important to be left to the professionals.” Id. It is ironic that Coffee has taken this aggressive stance and yet also has been hired to defend such professionals.
204. Volcker & Levitt, supra note 195 (commenting on possibility that European companies might not want to be listed in U.S. as turning out not to be true). But see Thain, supra note 191.
205. See Volcker & Levitt, supra note 195; see also Sherwood, supra note 198.
assess is the impact of the burden of regulation on development and growth. Surely sclerotic government regulation hampers business growth. SOX does not obviously fall into that category but, if it deters public offerings, or deters foreign companies from listing on the New York Stock Exchange, SOX may damage the U.S. economy in the long run.

VIII. INTERNATIONAL DIMENSIONS

It is not surprising in the globalized interdependent business world of today that changes in the United States might reverberate in Europe and Asia. As one writer for the Financial Times noted:

In an apparent attempt to head off stricter SEC regulation, the American Bar Association in August relaxed its ethics rules to allow, rather than require, lawyers to blow the whistle on clients if they discover corporate misdeeds.

... Richard Fleck, corporate partner at Herbert Smith, the London based law firm... points to US investigators' offers of leniency if corporations waive their right to attorney-client privilege and hand over confidential material when they are under suspicion... The winds of change have blown across the Atlantic too...[and] the U.K. government has made it clear... that the need to tackle terrorism and organised crime must override legal privilege in some circumstances...206

Thus, the discussion in the United States described in earlier portions of this Article continues internationally as legal privilege, once considered sacrosanct, is being eroded on both sides of the Atlantic in the name of necessity. In essence, this erosion of attorney-client privilege signals a shift from rigid adherence to the principle of privilege in safeguarding individual rights to an emphasis instead on safeguarding societal rights.

However, not surprisingly, there are differences between the U.S. and the European approach to the issues of poor corporate governance and resulting loss to the shareholders. The U.S. response to the problem was the passage of SOX and the subsequent regulations. Interestingly, Tony Tassell of the Financial Times explained that, outside the U.S., SOX is "widely derided as a hurried, overly-legalistic response to the unfolding corporate scandals."207 In fact, the U.S. approach is in direct contrast to the European approach to the problem which is described as a "'soft law' model—requiring companies to comply or to explain with an evolving set of principles of best practice rather than laying down inflexible, limiting legislation."208 Twenty-three European-Union countries plus Turkey and Switzerland have enacted such corporate

206. See Sherwood, supra note 198.


208. See id.; see also Bosses Behind Bars, ECONOMIST, June 12, 2004, at 59 (“Outside America, short custodial sentences remain the norm. The typical sentence for fraud in England is four years, and almost never more than ten... In Germany, the maximum sentence for serious fraud is ten years, though most people get less.”).
governance codes in the past few years. For example, in July 2002 Italy adopted il Codice di Autodisciplina delle società quotate rivistato, the Italian corporate governance code. Similarly, Germany passed the Corporate Governance Kodex in February 2002, which was amended in May 2003; Sweden adopted the Swedish Code of Corporate Governance in December 2004; and also in December 2004, Belgium published a corporate governance code.

Many of these Codes were modeled or inspired by the Organisation for Economic Co-Operation and Development (OECD) Principles of Corporate Governance first adopted in 1999 and updated in 2004. The Principles are non-binding and, as the authors say in the Preamble, “their purpose is to serve as a reference point.” There are six principles in the framework, which primarily stress transparency, disclosure and absence of conflict of interest. Although it would be easy to be cynical about the impact of purely advisory principles, it is useful to remember the history of the OECD’s work on anti-bribery and the important role it has played through its enactment of the Convention in Combating Bribery of Foreign Public Official in International Business Transactions. The Agreement effectively criminalized bribery of public officials in international business transactions, thereby encouraging international economic cooperation and demonstrating the OECD’s efficacy in international business affairs.

The European Union considered how Europe as a whole should respond to the passage of SOX, as well as Europe’s own corporate scandals. On May 21, 2003 the European Commission issued a report entitled “Communication from the Commission to the Council and the European Parliament (Modernising Company Law and Enhancing Corporate Governance in the European Union -
A Plan to Move Forward).218 In this report, the Commission concluded that:

There is little indication that the development of a European corporate governance code as an additional layer between principles developed at the international level and codes adopted at national level would offer significant added value. In that respect, the Commission notes that corporate governance is now at the forefront of the activities of the OECD, which recently decided to revise its corporate governance principles of 1999 with the aim of adopting a modernised version of these principles in 2004.

...A self-regulatory market approach, based solely on non-binding recommendations, is clearly not always sufficient to guarantee the adoption of sound corporate governance practices. Only in the presence of a certain number of made-to-measure rules, markets are able to play their disciplining role in an efficient way. In view of the growing integration of European capital markets,... respect to a few essential rules and adequate coordination of corporate governance codes should be ensured.219

At present, the European Commission is moving ahead with a number of proposals to increase disclosure through the annual report, strengthen shareholders’ rights and modernize the board of directors.220 Progress has been agonizingly slow. The European Union has chosen to use the nonbinding recommendation format rather than regulation or directive.221 This means simply that the European Commission recommends that member states take the suggestion and craft it into national law. On October 6, 2004, two recommendations were enacted. The first addressed independent directors as well as disclosure requirements.222 The second recommendation on the same day sets out guidelines on directors’ pay, disclosure, and shareholder approval.223 The Commission also proposed a directive on company law to simplify the formation, maintenance, and alteration of companies’ capital.224 As


219. Id. at 12.

220. Id. at 12-26.


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the Commission’s release stated:

Stakeholders find some aspects of the current legal capital regime under the Second Company Law Directive too inflexible and costly. To remedy this, the new proposal would enable Member States, under certain conditions, to eliminate specific financial reporting requirements and to facilitate specific changes in share ownership. It would also bring into line across the EU the basic element of legal procedures for creditors when capital is reduced.\(^{225}\)

The choice of the Directive means that while a member country has a defined period of time to implement its own law, it is mandatory and the EU could bring enforcement proceedings if the country fails to do so. The EU also instituted a European Corporate Governance forum which had its first meeting in January 2005.\(^{226}\) Its purpose is “to encourage the coordination and convergence of national codes...”\(^{227}\) Additionally, the EU called for applications for an Advisory Committee on Company Law and Corporate Governance that will offer “technical advice on implementation of the 2003 Company Law and Corporate Governance Action Plan.”\(^{228}\) However, all of these measures are dramatically different from the U.S. approach under SOX and the SEC regulations. It remains to be seen whether the E.U. sticks with this less intrusive tact and whether individual countries opt to exceed what is suggested.

Separate countries have also independently enacted other laws, which may have initially been motivated by an attempt to address terrorism but have other applications as well, just as RICO was initially adopted in the United States as a tool against organized crime but was then subsequently used against business people.\(^{229}\) For example, a new law in the U.K., the Proceeds of Crime Act, will require “lawyers, as well as accountants and those providing financial services—to report to authorities whenever they find, suspect, or even ought to suspect that a client is engaged in money-laundering.”\(^{230}\) The implications of

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\(^{226}\) Id.

\(^{227}\) Id.

\(^{228}\) Id.


this new law are staggering. One commentator noted:

Divorce lawyers were left reeling by a judgment this month from Dame Elizabeth Butler-Sloss, Britain's most senior family judge, that the Act requires them to report even the smallest tax evasion—such as paying tradesmen or nannies in cash. Divorce solicitors leapt on the “ludicrous” implications of turning them into tax spies, warning that divorces could be complicated if a spouse threatened to reveal tax evasions to force a higher settlement.231

This British law no doubt chills the attorney-client relationship. One commentator tried to capture the extent of concern noting “a Spanish bullfighter buying a house in England might do well to avoid a British solicitor.”232

It is not surprising that the legal developments in the U.S. are reverberating around the world. Corporate scandals have not been confined to the United States. Countries realize that without investor confidence in the markets, capital will flow elsewhere and so while there is not rapid convergence of law, there are developments suggesting that countries may be watching the U.S. and the results closely. Regardless of whether the laws converge, issuers of securities in the United States will have to comply with SOX even if they are based in Europe. Thus there may be standardization of practice even without convergence of national laws. However, at least one commentator has predicted that “change is coming” to the Continent in terms of regulation.233 Efforts to monitor these developments have already commenced. The European Corporate Governance Institute and the American Law Institute convened the first of a series of conferences July 2004 in Brussels, which brought together Harvey Goldschmid, SEC Commissioner; Alexander Schaub, Director General of the EU Internal Market; Mario Draghi, managing director of Goldman Sachs International; and leading professors from the U.S. and the E.U. to discuss corporate governance and related issues.234 Whether the legalistic approach taken by the U.S. or the principle-based approach favored by Europe is more effective in terms of costs and results will not be known for at least several years.

IX. INTERRELATIONSHIP BETWEEN SENTENCING GUIDELINES, COMPLIANCE PROGRAMS, AND SOX

In Sentencing Reform Act of 1984, Congress directed the U.S. Sentencing

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231. Sherwood, supra note 198.
232. Id. (discussing the concerns of Paul Marshall, a British commercial attorney, with respect to the expansion of attorney reporting requirements and the effect such requirements might have on attorney-client privilege).
234. European Corporate Governance Institute, at http://www.eegi.org/tcgd (citing the establishment of the Transatlantic Corporate Governance Dialogue, which was created to bring together high-ranking, world leaders to discuss corporate governance).
Commission, an independent commission in the judicial branch, to put forth sentencing guidelines for use in federal sentencing proceedings. In 1987 the first sentencing guidelines were promulgated by the Commission and in 1991, after the creation of organizational sentencing guidelines, the guidelines went into effect. The Sentencing Commission, in 1995, attempted to revise the guidelines to the extent that they affect cocaine offense sentences, but Congress was not amenable to such changes. In an effort to further restrict judicial discretion in sentencing, Congress subsequently passed the PROTECT Act in 2003, which contains the Feeney Amendment. The Feeney Amendment attempts to limit the extent to which federal judges may depart downward from the sentencing guidelines.

The Federal Sentencing Guidelines have spawned an entirely new “compliance industry” for American companies. Before SOX, many corporations already had “Compliance Programs” in place to both monitor compliance with the law and provide a mechanism to report wrongdoing to authorities. These compliance programs were not only instituted because of ethics concerns, but also because if corporations have Compliance Programs, under the Federal Sentencing Guidelines the existence of such programs reduces both criminal fines and sentences. Further, companies realized that, if they had an “Ethics Officer” to monitor compliance, it could reduce their liability should irregularity be uncovered. As a result, the Ethics Officer Association formed and now boasts over 900 members. After SOX, the necessity for these programs became more imperative since SOX expands the ways in which corporate officers and attorneys can incur liability and thus be subject to these Sentencing Guidelines.

In the post-SOX world, the Sentencing Guidelines have created great disparities that seem patently unfair. Corporate employees who find themselves guilty of violating any of the myriad regulations implementing SOX may find themselves victimized by these disparities. For example, a principal architect of


237. See Borges, supra note 236; Laurie P. Cohen & Gary Fields, Legal Quagmire: High Court Ruling Unleashes Chaos Over Sentencing, WALL ST. J., July 14, 2004, at A1. See generally United States Sentencing Commission, at www.ussc.gov (last visited Mar. 17, 2005). Not all judges follow the Sentencing Guidelines. For example, the CFO of Health South received a 6-month house arrest sentence rather than the 5-year term recommended by prosecutors. See Bosses Behind Bars, supra note 208 (“[T]he Commission keeps a record of those judges who depart downwards, prompting fears that Congress, which must endorse all federal judicial nominations, may block the promotion of judges who do not toe the government’s line.”).


239. See generally Ethics Officer Association, at http://www.eoa.org/AboutEOA.asp.
a corporate fraud who pleads guilty may receive a 5-year sentence but an underling who believes he is innocent, but who is convicted, may receive a 20-year term based upon the financial loss to the shareholders. An example of this scenario can be seen in the widely publicized trial of Jamie Olis, a midlevel executive, who received a 24-year prison sentence. His sentence was quintupled because of the $100 million loss of the corporation.

Complicating the picture, the Supreme Court ruled on May 1, 2004, in Blakely v. Washington, that judges, in sentencing defendants, cannot use information not heard by the jury or admitted by the defendant during trial, thereby invalidating Washington State’s sentencing guidelines. This ruling has now raised questions about the validity of the similar Federal Sentencing Guidelines. Several judges subsequently ruled that Blakely applies to federal courts, thus undermining Federal Sentencing Guidelines. However on August 2, 2004, the Supreme Court, signaling the necessity of addressing this issue, agreed to review two lower court decisions, Booker and Fanfan, on October 4, 2004, the opening day of the term. These cases raised issues about judges increasing penalties under the Sentencing Guidelines and whether that rendered the entire sentencing schema unconstitutional in violation of the Sixth

240. Adam Liptak, Sentencing Decision's Reach is Far and Wide, N.Y. TIMES, June 27, 2004, at 16; see Bosses Behind Bars, supra note 208.

241. See Bosses Behind Bars, supra note 208 (discussing the fact that even though Olis did not directly financially gain for his part in the scheme in which he was convicted of participating, because the total loss was $100 million Mr. Olis’s sentence quintupled to 24 years).

242. 124 S. Ct. 2531 (2004); see also Peter Grant, Adelphia Sentences Look Thorny: Defense Hopes to Exploit Recent High Court Ruling; Mistrial for Michael Rigas, WALL ST. J., July 12, 2004, at A3. This article discusses the impact of the Blakely case on Rigas’s sentencing, determining that Rigas should get minimal jail time but:

In the Adelphia case, the statutory maximum term is five years for conspiracy, 10 years for securities fraud and up to 30 years for bank fraud, meaning John and Timothy Rigas, each convicted of 23 counts of conspiracy and fraud, would still get long prison sentences, despite the Blakely decision. Id.

In United States v. Croxford, 324 F. Supp. 2d 1255 (D. Utah 2004), Federal District Court Judge Paul Casell ruled that, as in Blakely, sentencing guidelines are “unconstitutional.” See Laurie P. Cohen & Gary Fields, Judge Rejects Federal Rules on Sentencing, WALL ST. J., July 1, 2004, at B1 (noting, however, that Congress can solve the problem by enacting a higher maximum ceiling and by doing so, it would be within judges’ discretion to give the maximum, thereby ensuring that judges would not exceed maximum sentencing guidelines as they must now); see also Bosses Behind Bars, supra note 208 and accompanying text. See generally Cohen & Fields, supra note 237.


Amendment right to trial by jury.245

The Supreme Court announced both decisions on January 12, 2005. In Freddie Booker's case, the judge had imposed a 30-year sentence rather than a 21-year sentence when he found additional facts that Booker had 566 more grams of cocaine than was presented to the jury.246 The Seventh Circuit found that the sentence violated the Sixth Amendment in concert with the holding in Blakely.247 The Supreme Court affirmed and remanded.248 Fanfan was charged with "conspiracy to distribute and to possess with intent to distribute at least 500 grams of cocaine."249 His sentence would have been 78 months.250 The judge conducted a hearing and found additional evidence that Fanfan was an "organizer" and that he had cocaine powder as well as 261.6 grams of crack.251 These additional findings could have moved the sentence to "fifteen or sixteen years instead of the five or six years authorized by the jury verdict."252 However, the judge refused to enhance the sentence.253 The government appealed and also filed a writ of certiorari before judgment. The Supreme Court found that the "Sixth Amendment is violated by the imposition of an enhanced sentence under the United States Sentencing Guidelines based on the sentencing judge's determination of a fact [other than a prior conviction] that was not found by the jury or admitted by the defendant."254

Justice Breyer wrote the opinion of the court on the issue of whether the Sentencing Guidelines are mandatory. He stated:

...finding the provision of the federal sentencing statute that makes the Guidelines mandatory, 18 U.S.C.A. § 3553(b)(1) (Supp. 2004) incompatible with today's constitutional holding, we conclude that this provision must be severed and excised... So modified, the Federal Sentencing Act...makes the Guidelines effectively advisory. It requires a sentencing court to consider Guideline ranges...but it permits the court to tailor the sentence in light of other statutory concerns as well...."255

The Supreme Court vacated and remanded the decision from the lower court regarding Fanfan's case.256 Thus, Fanfan could be sentenced in light of the trilogy of Booker, Fanfan, and Blakely. These rulings will have great impact as defendants like Jamie Olis appeal their sentences.

247. See Booker I, supra note 244.
248. See Booker II, supra note 246.
249. Booker II, 125 S. Ct. at 747.
250. Id.
251. Id.
252. Id.
253. Id.
254. Id. at 757.
255. Id.
256. Id. at 769.
In a development parallel to the *Blakely* firestorm, in April 2004 the U.S. Sentencing Commission made "standards for compliance and ethics programs more stringent." On May 1, 2004 these more stringent standards, which directly impact corporate violators of SOX-related regulations, were submitted to Congress and in November 2004, without Congressional disapproval, they became effective.\(^{257}\) Many believe that the Sentencing Guidelines, which were already tough, in conjunction with these more stringent standards, are now patently unfair.\(^{258}\)

In the revised Guidelines, the Commission stipulated that under certain circumstances, a company may need to waive attorney-client privilege in order to lower its culpability score and receive favorable treatment for cooperation, such as a penalty fine reduction. Thus, these Guidelines exacerbate the pressures on attorneys to waive attorney-client privilege for the supposed benefit of the client.\(^{259}\) Although the revisions explicitly state that waiver is not a prerequisite for lowering an organization’s culpability score, the government’s emphasis on the need to self-report makes the pressure to waive privilege implicit. In fact, the revised guidelines state that there may be instances in which “waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization.”\(^{260}\) When the government declares something to be necessary, failure to do so may land you in the situation in which Jamie Olis found himself—facing over 20 years.

Now that the Supreme Court has declared mandatory Sentencing Guidelines unconstitutional, some of the threat of punishment under SOX regulations may be diminished. If first offenders do not face the specter of quintuple punishment based on financial loss to the company, but instead, failure to comply triggers probation for a first offender, then executives and attorneys may be less concerned about the operation of SOX.

**X. RECOMMENDATIONS AND CONCLUSION**

SOX represents the U.S. Congress’ efforts to make companies and those who operate them more accountable to society. Many argue the costs of SOX are minimal compared to the costs of not doing something to insure the validity of financial reporting. Paul Hodgson, of Corporate Library, was quoted as


\(^{258}\) See *Bosses Behind Bars*, supra note 208 ("Frank Bowman of Indiana University, whose ideas helped shape those guidelines, now says they are arguably ‘too tough.’") (also noting the problem that 97% of all criminal convictions come from plea bargains and the Sentencing Guidelines increase the pressure to plea).


\(^{260}\) USSG, *supra* note 11.
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stating, "Ask the stockholders of Enron if they'd rather pay the total expenses to the company for implementing Sarbanes-Oxley or if they'd rather have lost their life savings. . . . I think they'd rather pay that amount of money to keep it honest."261 Yet, the scheme is one of regulation and layers of reporting and certification.

The ramifications of SOX are innumerable. It could be dubbed the "Attorneys' Full Employment Act" because its impact may lead to diverse constituencies within the company seeking separate counsel. This multiplication of attorneys and additional layers of counsel belies the fundamental question—how does counsel manage the nuanced and complicated roles of both advisor and enforcer? Failure to negotiate these roles may lead to personal liability for the attorney as well. Los Angeles District Attorney Steve Cooley, has create a special unit devoted to pursuing lawyers.262 This sends a message to all about the perils of interpretation of the attorney's responsibility to "zealously represent 'the client'" within the bounds of the law.

There are a number of actions the SEC could take that would further the goals of SOX and improve its efficacy. First, to make the existing regulations more user-friendly, the SEC should "clean up" the existing language in the SEC regulations implementing SOX. SOX was supposed to use simple language, as did Senator Edwards, but the SEC language is anything but simple. For example, the definition of material violation contains two negatives which makes analysis unnecessarily muddled.263

Second, to make these regulations more effective, the SEC should close the major loophole in the existing regulations and separate the obligation to report "up the ladder" from the colorable defense argument.264

Additionally, the SEC should not make the regulations regarding implementation any more stringent before a comprehensive examination of the effect of the current regulations has been completed. At a minimum, the SEC should not implement the "noisy withdrawal" provision at this time. Rather, the business world and the government should examine the data regarding the costs to firms of complying with SOX after a year or two. Based on the results of that examination, the SEC should decide whether or not it is economically feasible to continue with the SOX regulatory scheme as it is currently administered.

In conjunction with the above examination, a separate inquiry should be conducted to determine the effect of SOX on the overall U.S. economy. For example, an inquiry should be conducted into how SOX has affected the number and size of companies who choose to go public. The SEC should use

262. France, Lawyer Loophole, supra note 173.
263. 17 C.F.R. § 205.2(e) (2005); see Koniak Letter, supra note 70 and accompanying text.
264. See Koniak letter, supra note 70 and accompanying text.
the results of this investigation, in addition to the results of the investigation into the cost of SOX to firms, to thoroughly analyze the reasonableness of their current regulatory scheme.

Finally, the gap between theory and practice must be closed. While the ECGI's call for a joint U.S.-Europe conference is useful, such a forum will not effectively focus on the specific effects of SOX regulations on the U.S. legal and business community. Thus, an exclusive U.S. symposium should be convened. This symposium should pull together academics, who seem to enthusiastically support SOX and its progeny, with practitioners who are currently trudging through its implementation. The symposium should consider the very specific day-to-day effects on practitioners, particularly attorneys, who have to work under the current regulations. The SEC should also consider the results of this discussion when evaluating the effectiveness of their current regulations.

SOX has been in effect for three years now; the implementing regulations have been in effect for two years. Clearly, as this Article shows, there are already enough significant issues with the implementation of this law to mandate an examination of its effects on the economy, public companies, and individual practitioners. Both Congress and the SEC must responsibly monitor the results of their actions to date before moving forward with new regulations. Such is their duty to the American public whose national and personal economies are intimately entwined with the effects of SOX and its accompanying regulations.