CHAPTER 9

LAWYERS IN ORGANIZATIONAL SETTINGS: CORPORATE COUNSEL

A. INTRODUCTION

While ethical issues emerge for lawyers in all practice environments, the challenges facing lawyers in organizational settings are especially complex. Lawyers working in corporate contexts build relationships with clients that may not fit neatly within the traditional paradigm of a sole practitioner or a lawyer in a law firm representing individuals. For “in-house” counsel, unique ethical challenges and often different ethical obligations can arise.

More lawyers are facing these challenges, as practice as an in-house lawyer both becomes increasingly common and increasingly attractive as a career option. Companies have found it valuable to have dedicated legal expertise resident within their walls, with professionals who know both the law and the organization intimately. Hiring corporate counsel can also be far more cost-efficient than paying outside law firms on a case-by-case basis. For many lawyers, in-house practice can offer the combined attractions of interesting work, a lifestyle often perceived as more accommodating than that offered by private practice, greater job security, and significant financial reward through both substantial salaries and the chance to participate in the success of the company through compensation plans that include stock options or other incentives tied to company success.

Despite this shift towards greater numbers of corporate counsel and the transformation of their practice environment, increased public and scholarly attention to the ethical challenges facing corporate counsel is a relatively recent phenomenon. The spectacular financial scandals of the late 1990s and early 2000s, and the collapse in 2001 of what was then the world’s largest publicly traded corporation, Enron, in particular, led to both the most radical transformation of business law in the United States since the 1930s in the Sarbanes-Oxley Act of 2002\(^1\) and to changes in rules of professional conduct for American lawyers to respond specifically to what was seen as lawyer responsibility for failing to prevent the scandals from occurring. Canada has not been immune from corporate scandal, with home-grown examples of corporate fraud involving companies traded on stock exchanges in Canada in the late 1990s such as Bre-X Minerals, Livent and YBM Magnex. The implosion in 2001–2002 of Nortel Networks (which at the time had the largest market

\(^1\) Pub. L. 107-204.
capitalization of any publicly traded Canadian company), and of Sino-Forest (at the time Canada’s largest publicly traded forestry company) in 2011 both served as reminders that corporate scandal was not just an American phenomenon. Rules of professional conduct for lawyers in organizational settings were changed in Canada in the wake of the Enron scandal but, as will be detailed below, in significantly different ways than those changes made to rules in the United States.

One question that emerged on both sides of the border in the wake of these scandals was whether lawyers should be seen as “gatekeepers”, responsible for protecting the public against malfeasance by their corporate or organizational clients. This conception challenged the traditional understanding of lawyers as “zealous advocates” responsible for loyalty only to their clients. A number of issues specific to corporate environments flow from this clash of ideas. Should lawyers ever be responsible for reporting on their clients to a government agency or regulator? Should a lawyer ever be permitted to do so to prevent financial harm to investors or others? These questions are important for lawyers in all settings, but the consequences of decisions about them are especially acute for a lawyer who is “in-house”, working for a single corporate client or organization as its employee.

In addition, lawyers in corporate settings also face the challenges of maintaining independence and integrity as professionals while simultaneously functioning as employees of the organization they are advising. Lawyers working in-house are valued for their in-depth knowledge of the organization’s activities and culture, and aspire to become a “trusted advisor”. But to whom do they owe their loyalty? Who is the client? The senior executive to whom the lawyer might report will of course have responsibility for providing instructions, directions and often evaluations of the lawyer-employee’s performance (and related decisions about compensation), but in a corporate setting the “client” is the organization itself rather than the individual.

Lawyers working in corporate environments need to be especially careful when their advice and counsel is sought for business matters as well as legal ones. Do the usual rules of privilege and confidentiality apply? For in-house counsel in Europe, a 2010 decision of the European Court of Justice, discussed later in this chapter, reconfirmed the European perspective that in-house lawyers there lacked independence because of their employment relationships and therefore did not have privilege. Can an in-house lawyer give business advice? Should he or she? How is legal advice delineated from business advice, if at all? And what impact might that have on privilege?

Further complicating matters, many lawyers in corporate settings also function as “corporate secretaries” or “compliance officers”, sometimes while also serving as general counsel or lawyers for the organization, but often just as a member of the management team and not in a legal capacity. The wearing of multiple hats, and the transformation of the role of corporate secretary over the last decade, raise additional ethical concerns.

Finally, in-house lawyers have to be especially aware of the challenges to their independence, and the phenomenon described as “cognitive dissonance”. As many legal ethics experts have noted, in cases of client misconduct, law-
yers’ professional norms of client loyalty often conflict with personal norms of honesty and integrity. To reduce the “cognitive dissonance”, lawyers will often unconsciously dismiss or discount evidence of misconduct and its impact on third parties. This becomes even more of a problem when lawyers bond socially and professionally with other employees, including senior management. The more a lawyer blends into insider culture, the greater the pressures to conform to the organization’s cultural norms. That can in turn lead lawyers to underestimate risk and to suppress compromising information in order to preserve internal solidarity. In the long run, this dynamic can create problems for everyone: clients lose access to disinterested advice; lawyers lose capacity for independent judgment and moral autonomy; and the public loses protection from organizational misconduct. While this is a problem for all lawyers, the challenge is especially strong for corporate counsel. Although the financial and other consequences of terminating a relationship with a major client can be significant for lawyers in law firms, they pale in comparison to the consequences faced by an in-house counsel who is in essence walking away from his or her job and the attendant financial security. The pressures — personal and professional — are enormous.

This chapter provides an introduction to the important roles lawyers play in corporate organizations, together with an overview of the many ethical challenges they encounter. It then sets out the background to the Enron scandal and introduces the actions of lawyers in that debacle that led directly to moves by the United States Congress not only to directly legislate new rules for lawyers in organizational settings, but to give responsibility for policing that conduct to a government agency, the Securities and Exchange Commission. It considers the debate over whether lawyers should simply have to report malfeasance “up the ladder” within an organization, or engage in “noisy withdrawal” and report to authorities. The extent to which those changes have or have not been adopted in the Canadian context is also assessed. Finally, the problems of privilege, issues for lawyers functioning in multiple roles within an organization, and the European approach to privilege and independence for company lawyers are also introduced.

B. ETHICAL OBLIGATIONS OF CORPORATE COUNSEL

1. Introduction

Who are corporate counsel? What is their role? As you consider these two readings, reflect on whether the ethics issues you have studied so far apply generally to lawyers in all contexts, or whether special attention and special rules are required to address the particular corporate environments in which these lawyers are working.
… [C]orporate law practice continues to raise important and complex ques-
tions of professional responsibility that have implications for all lawyers. In
the most immediate and concrete terms, changes in corporate use of legal ser-
vice in the past twenty-five years or so have dramatically altered relation-
ships between law firms and clients, partners and associates, partners and
partners, and among law firms. Increased reliance on in-house legal depart-
ments has brought inside the corporation much work that previously served as
the foundation of long-term relationships between firms and clients. Corpora-
tions now tend to seek specialized expertise rather than general services from
outside counsel. They also exert more vigorous controls over how those ser-
vices are provided and how they are priced.

Aside from the importance of corporate practice for the ways in which mod-
ern legal services are provided, certain features of that practice are notable for
the important ethical issues that they raise. First are the complexities of repre-
senting an organization rather than an individual. That undertaking can be
especially challenging because ethical provisions for the most part implicitly
are premised on a relationship between an attorney and an individual client.
The lawyer who represents a corporation represents an abstraction: her client
is the corporate entity rather than any of the individuals who act on its behalf.
Such lawyers deal daily with managers and officials who are authorized to
speak for the corporation, yet they must not mistake those individuals for the
entity itself. Even in the normal course of events, actors in a large organiza-
tion may not be in full agreement on various matters. Lines of authority are
not always clear; the organization chart may obscure as much as reveal who
wields power and influence. The lawyer thus often must become familiar with
the dynamics of the bureaucratic milieu in order to discern just which actors
speak for the corporation on what issues.

The difficulty is compounded when there is reason to question whether an
official is acting in the best interests of the corporation. Ethical provisions,
along with the business judgment rule, suggest that the lawyer should defer to
the manager in most instances, even when she might have charted a different
course under the circumstances. That presumption of deference evaporates,
however, when the lawyer knows that a corporate official is violating a duty
to the entity or is acting illegally so as to threaten the corporation with serious
harm. The problem is that this transformative moment can be quite difficult to
recognize. One reason is that knowledge often is fragmented in large modern
organizations. Information sufficient to ensure that a lawyer “knows” of mis-
conduct may be scattered among several offices and people, no one of whom has the complete picture. It is tempting in such situations to conclude that one lacks the certitude necessary to challenge the corporate decisionmaker, even when such ignorance is the product of diligent avoidance of unpleasant facts.

In sum, it is increasingly the case that lawyers in many kinds of modern practice represent organizations rather than individuals. Such a phenomenon calls for a more sophisticated understanding of the organizational milieu and the distinctive ethical issues that it generates. Corporate lawyers have significant experience with such representation, and often are acutely aware of how little guidance ethical rules can provide in this setting. A focus on corporate practice thus can generate insights that are becoming important for an ever larger proportion of lawyers.

A second disjunction between corporate practice and ethical rules is the fact that the latter traditionally have been formulated primarily with the litigator in mind. Yet transactional work, a staple of corporate practice, raises questions that do not always fit easily within this paradigm. Should a party with whom the lawyer is negotiating a joint venture, for instance, be regarded more as an adversary or as a cooperative partner? The answer may be important in determining the attorney’s duty of confidentiality, as well as in identifying conflicts of interest that could arise from simultaneous or successive representation of other clients.

Similarly, should the fact that business negotiations typically take place outside the supervision of a court place a greater or lesser responsibility on lawyer and client to disclose information that other parties might regard as relevant to the negotiations? Litigation is marked by both judicial oversight and relatively stringent disclosure duties because of concern about the integrity of legal proceedings. By contrast, disclosure obligations are relatively relaxed in transactional settings, despite the absence of any constraining judicial involvement. They are based primarily on common law fraud standards, which in turn look to conventional expectations of typical parties engaged in negotiation. Yet reliance solely on such expectations as the touchstone of legality has the potential to create a downward spiral, as aggressive practices provoke even more aggressive responses. The cumulative effect may be to lower expectations of fair dealing, increase bargaining costs, and secure judicial validation of provisions formerly regarded as unenforceable. Corporate lawyers historically have had to navigate the transactional terrain with minimal guidance from ethical rules. This does not mean, however, that the ethical issues that arise in this form of practice are of negligible importance. Rather, it highlights the fact that law practice requires a cultivated sense of judgment that goes beyond mere rule compliance.

A third notable dimension of corporate practice is the fact that many corporate lawyers not only represent organizations, but are employed by them. The widely-noted rise in the visibility and prestige of inside counsel in the last two decades or so has fueled the continuing debate over the meaning of lawyers’
professional independence. Here again, corporate lawyers have firsthand experience with a growing phenomenon: the increasing number of lawyers who are employees in various types of organizations. To what extent is it possible to preserve a sense of identification with a distinct professional legal culture while being immersed in an organizational culture as well? Is it easier to invoke ethical constraints on company conduct if the lawyer is familiar with corporate operations and is regarded as a member of the “team?” Or does her dependence on a single client who is her employer tend to make her excessively deferential toward company officials?

Many lawyers and commentators suggest that in-house counsel are in a position to provide a unique combination of business and legal advice that helps the organization plan for, rather than simply react to, a tumultuous global economy. Rather than merely passing judgment on the legality of measures that management proposes, counsel help frame strategy with an eye toward anticipating and preventing legal issues from arising in the first place. This “proactive” approach to practice expands the boundaries of legal practice to include functions not traditionally characterized as strictly legal in nature. It also calls into question the traditional assumption that the client determines the ends of representation and the lawyer selects the means to achieve those ends. This dichotomy generally is an important premise of ethical rules, which conceptualize the lawyer as distant from the substantive objectives of the client. If in-house counsel do indeed become integrally involved in formulating company goals and structuring company operations, it may be unrealistic to insist they nonetheless remain legal technicians morally unaccountable for the consequences of those activities.

Another development in which corporate lawyers are the advance troops is the increasingly global nature of law practice. National boundaries pose no obstacle to modern corporate activity. A parent firm may be in one country, its subsidiaries in several others, and its joint venture partners or licensees in still others. Furthermore, its products and services may well be available in most countries around the world. Corporate counsel may have her office in New York, consult long-distance about Italian law with a subsidiary in Italy that is entering into a licensing agreement with a South African company, or travel to Japan to negotiate with a Japanese bank about financing for a project that will engage in manufacturing in several Asian countries and sell its products mainly in North America and Western Europe.

Aside from the need to master the interplay among the substantive legal provisions of the different jurisdictions that may assert an interest in such corporate activities, counsel also must navigate through a thicket of differing and sometimes conflicting rules that purport to govern the conduct of lawyers. There is no common set of ethical provisions that apply to lawyers engaged in cross-border practice. Indeed, there is no uniform definition of what constitutes the practice of law in various countries, or of what is permissible activity for foreign lawyers who are authorized to practice in a jurisdiction. Once
these threshold issues are resolved, the lawyer must determine which country’s ethical standards — and standards of malpractice liability — are applicable. An example of the striking differences that can exist between legal regimes is the Court of Justice of the European Communities’ decision that in proceedings brought by the European Commission the attorney-client privilege may not be invoked with respect to communications between a client and its in-house counsel. The difficulty of reconciling ethical obligations under different state regimes in the United States already creates unpredictability for the large number of lawyers engaged in multistate practice. That complexity is magnified exponentially in the arena of transnational practice, and corporate lawyers are the ones who increasingly must respond to it.

... The fact that corporate lawyers are strategically placed in positions of influence with respect to regulated activities has led some to maintain that they have an obligation to serve as “gatekeepers” who restrain misconduct or even “whistleblowers” who report it. Such roles are in tension with the notion that the attorney’s sole obligation is to the client, and the claim that self-regulation by the legal profession offers the best assurance of ethical legal practice.

This leads to a final feature of corporate law practice that has particular significance for ethical purposes. This is the fact that corporations are not simply private actors pursuing their own goals along with other interest groups in society. Rather, as Charles Lindblom has noted, a market-based economy delegates to corporations substantial authority over matters of wide-ranging social importance, such as employment, the availability of consumer goods, and investment decisions that determine how and when resources will be used. This arguably places the business firm at the intersection of private and public domains. In light of this, it is not surprising that the nature and purposes of the corporation have been fiercely contested questions since at least the latter part of the nineteenth century. The debate has taken on even greater urgency as sprawling global operations and the rapid emergence and obsolescence of new technology have intensified the dynamism of corporate enterprise at the dawn of the twenty-first century.

This generates special challenges for corporate lawyers because it requires that they play two roles that to some degree are in tension. The rapid pace of change in the corporate world demands that lawyers create new legal forms and arrangements to address unprecedented circumstances. Such creativity has always been necessary for those who represent corporations, from the lawyers who devised trusts and holding companies in the late nineteenth century to those who fashioned various “poison pills” to deter takeover activity a century later. As Michael Powell has observed, business lawyers create law “from the ground up” by developing novel legal structures and casting them in a vocabulary that confers on them the status of legitimate extensions of traditional legal categories. As activities outrun the legal paradigms meant to contain them, the alert lawyer exploits “loopholes” and pushes against the limits of the law in an effort to secure advantage for her client.
Yet the corporate lawyer must also be mindful that the integrity of the legal system is a form of social capital in a market society. A competitive economy requires cooperation and trust in order to flourish. Law cannot be seen merely in instrumental terms, as an obstacle to be overcome with the help of professionals who are trained to capitalize on its ambiguity. In such a world, “abiding by the ‘rule of law’ is only for wimps: the smart, powerful people opt out of law by means of lawyers, and thereby provoke others to do likewise.” It is difficult for legal and social norms in such a world to persist beyond the next shift in the balance of power. The effectiveness of law in a democratic polity depends heavily on voluntary compliance, and such compliance in turn requires the perception that law has at least some intrinsic normative force.

How corporate lawyers present legal provisions to their clients, and how far they are willing to push the letter of the law regardless of its spirit, cumulatively has the potential to have a profound effect on attitudes toward the legal system. Performance of this quasi-public role means that lawyers at times may have to prevail upon their clients to forbear from exploiting every possible legal advantage, for the sake of both the client’s long-term interest and that of society as a whole. The distinctive function and influence of business corporations in a market democracy thus means that the corporate lawyer’s work unavoidably has both private and public dimensions whose tensions are not always easily mediated.

PAUL D. PATON

“Corporate Counsel as Corporate Conscience: Ethics and Integrity in the Post-Enron Era”
[footnotes omitted]

The transformation of corporate, or in-house, counsel practice in recent years has rightly garnered considerable attention. Once considered by some to be the refuge of those unable to sustain the intense pressure of a private major firm practice, an in-house lawyer now occupies a privileged position in the “corridors of power.” The misperception of corporate counsel as lawyers lacking the “stern stuff required to fill the vast quotas of billable hours and sustain the great partnerships,” and occupying “the lesser part of our profession” is mercifully in decline. Moves of senior practitioners in Canada from private law firms to prominent general counsel positions at major Canadian corporations, as well as similar transitions at more junior levels, have signaled that corporate counsel positions are increasingly attractive as a career option for ambitious lawyers, and that in-house posts are providing both compensation and levels of sophistication sufficient to challenge the cream of the profession. Several American studies have tracked the transformation of the in-house stereotype over the last forty years: from a lawyer who, having been passed over for partner, left private practice to do “routine, repetitive corporate work, while everything interesting was farmed out to private firms” to a
near-total reversal, with corporate counsel managing major transactions, complex litigation, and hiring outside lawyers only on an as-needed basis. A seminal 1985 U.S. study asserted that a “new breed of general counsel has left this stereotype behind. Not only have the offices grown in size, but in importance as well. The General Counsel sits close to the top of the corporate hierarchy as a member of senior management.”

In a post-Enron era the tensions and demands on in-house lawyers to ensure compliance with new corporate governance rules and shifting internal and external requirements and expectations of regulators, directors, officers, shareholders, employees, pensioners, and creditors have made the role of in-house counsel an even more important and ethically complex one. This has prompted some caution amongst those considering a move in-house. Beyond simply managing litigation, the emphasis in ethics and compliance positions in-house has been described as “more strategic than tactical.” In-house counsel now have a role that extends beyond providing technical legal services and litigation management into matters at the heart of proper governance of organizations. Building on whatever experience they have ordinarily gained in a variety of private practice settings, in-house lawyers layer focused legal knowledge with the broader insight into a client or corporate environment that a perch inside an organization affords. That poses unique ethical challenges for lawyers seeking to maintain professional integrity within the confines and constraints of their corporate client, particularly as they typically occupy multiple roles within the organization.

The professional and ethical failings of those in-house counsel involved in the Enron scandal have been the subject of particular attention, but lawyers were involved in most of the major corporate scandals now synonymous with corporate governance reform in the United States — Tyco, Worldcom, Adelphia, Global Crossing, Qwest, Dynegy, Vivendi, Sprint and HealthSouth. These scandals are significant not only for the fact of internal and external lawyer involvement, but as the impetus behind major U.S. reforms, including a direction from the U.S. Congress in the Sarbanes-Oxley Act of 2002 to the Securities and Exchange Commission (SEC) to develop standards of professional conduct for attorneys …. The development of these standards has already had, and will continue to have, a significant impact on both U.S. and Canadian in-house lawyers.

Focusing on work in legal ethics that takes “account of the particular contexts in which lawyers practice” is both necessary and important. As one British study has noted, while “core values” “may survive at a symbolic level, their role as a starting point for the formulation of detailed rules of professional conduct may become more difficult to sustain as the discreet arenas which help shape ethical norms and form the context of regulation become increasingly diverse.”
Practicing with integrity in an in-house position, whether in the private or public sector, has always required special skill; but along with the advantages of the insider’s perspective come particular challenges. The fact of having one client — the corporation or the government — means that an in-house lawyer is particularly vulnerable when there is challenge from within the organization. Telling senior officers “no” to their proposed plans and schemes may be the right legal and ethical answer, but it can bring a particularly high price, especially if the lawyer finds that he or she has to exercise the ultimate professional recourse and withdraw from representation. Losing a major client in a law firm can have significant consequences, to be sure, but withdrawing from your one client as an in-house lawyer equates to a loss of status, income and employment, raising the ethical stakes for in-house practitioners that much further. Remaining ethical, independent, and professional in an in-house practice requires a level of personal sacrifice and dissociation from the company or the team not demanded of almost any other corporate player.

Yet the response of Canadian regulators to the challenges faced by in-house counsel has been inadequate, and merits review. In addition to providing the assistance of an imperative — a rule of professional conduct — to which in-house counsel might point when faced with client misconduct, the lesson of the United States experience has been that legislators and regulators are no longer content simply to permit the self-regulating legal profession autonomy when it comes to rectifying an obvious failing.

In introducing the amendment to Sarbanes-Oxley that directed the SEC to draw up “Rules of Professional Responsibility for Attorneys,” Senator John Edwards said that for “the sake of investors and regular employees, ordinary shareholders, we have to make sure that not only the executives and the accountants do what they are responsible for doing, but also that the lawyers do what they are responsible for doing as members of the bar and as citizens of the country.” Senator Mike Enzi said “[l]awyers have just as much responsibility as accountants and corporate executives to protect the best interest of the shareholder. It is not unreasonable to expect attorneys to play it straight with their clients, especially when we are talking about restoring corporate integrity.” While the perspectives of Senators Edwards and Enzi might be controversial (and, indeed, they are ones with which Canadian law firms and lawyers have vehemently disagreed), their comments signal that public representatives are no longer willing to let the profession determine for itself the boundaries of appropriate lawyer conduct where a greater public interest is identified. That has ramifications for the future of self-regulation of the legal profession as a whole.

NOTES AND QUESTIONS

1. Which features of the corporate environment are particularly important for lawyers working with and for corporate organizations? What impact does globalization have on the practice environment in which corporate counsel operate?
2. What strategies might an in-house counsel employ to reduce the pressure for compliance?

3. Is there a difference between the challenges faced by “in-house” lawyers and those faced by lawyers in law firms representing corporations? Should there be different ethics rules for lawyers in the separate environments, or one code for all?

Scenario One

You work as in-house counsel for an international oil and gas company. You discover that the corporate CEO has made “financing arrangements” with a foreign government that, if scrutinized, are essentially bribes to allow the company to obtain development rights. You suspect that the General Counsel (your direct boss) knows about the “financing arrangements” but that the Board of the company, and in particular the Board’s external directors, do not. You know that the bribes violate the United States’ Foreign Corrupt Practices Act, 15 U.S.C. §§ 78 dd-l and that that legislation applies to foreign issuers of U.S. securities, like your employer. They may also violate Canadian law. What do you do?

2. The Legacy of Enron for In-House Counsel

As noted earlier, the focus upon and transformation of the rules for lawyers in corporate settings flows directly from the spectacular financial scandals of the late 1990s and early 2000s. The collapse of Enron was a seminal event for corporations around the world, and many of the key changes to both corporate and securities laws generally and to the laws concerning lawyer conduct in particular can be traced to the chronology of events for that one company. The next excerpt provides an introduction to the corporate story of Enron, and to the conduct of the lawyers inside and outside the company prompting changes in the rules. As you consider this story, reflect on what you might have done had you been in the position of the junior lawyer within the company. How would you have acted if you had been faced with the same circumstances?

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“Lawyers, Ethics and Enron”
(2002) 8 Stan. J.L. Bus. & Fin. 1

[footnotes omitted]

Despite the risks of oversimplifying an extraordinarily complex saga, a brief summary of key facts is necessary to understand the role of lawyers involved with Enron. The company was formed in 1985 from a merger of Houston Natural Gas and Internorth. This merger created America’s first nationwide natural gas pipeline network. Over time, the firm’s business focus shifted from regulated transportation of natural gas to energy trading in an increasingly deregulated environment. During this evolution, top management ventured away from traditional approaches to the core business in order to generate higher financial returns. …
A Special Investigation Committee of Enron’s Board of Directors (the “Powers Committee”) was established in late October 2001 as the scandal was nearing the height of public exposure. Chaired by University of Texas School of Law Dean William Powers, Jr., the Committee concluded in its February 2002 report (the “Powers Report”) that as financial problems arose in operations outside its core energy business, Enron had used Special Purpose Entities (“SPEs”) or Special Purpose Vehicles (“SPVs”) and off-balance-sheet partnerships to enter into transactions generally considered too risky or controversial for ordinary commercial entities. These SPEs and partnerships were not consolidated with Enron’s other activities on Enron’s financial statements; as a result, Enron’s significant losses and debts could be concealed from public disclosure.

In hindsight, the rules governing accounting treatment of SPEs have become a key issue, underscoring the need for unbiased professional judgment by lawyers as well as by accountants. …

… Whether Enron’s SPEs should have been consolidated, and whether they ought to have been disclosed, were not only accounting issues but also key legal questions. For answers, Enron relied on assistance not only from accountants and auditors at [accounting firm Arthur] Andersen, but also from its in-house lawyers and outside counsel at Vinson & Elkins. These attorneys all played an important role in the process of drafting and certifying disclosure statements, and in advising whether the legal and accounting requirements governing SPEs and SPVs had been met.

The Powers Report noted that in some cases, transactions were designed specifically for the results they would produce on financial statements, not for legitimate economic objectives. Nor were the transactions adequately disclosed. Further, even though Enron’s public filings revealed the existence of Enron’s transactions with the partnerships, “the disclosures were obtuse, did not communicate the essence of the transactions completely or clearly, and failed to convey the substance of what was going on between Enron and the partnerships.” … The SPEs were terminated in September 2001, resulting in a surprise announcement that was the first public disclosure even hinting at the severity of the problems.

This announcement came on October 16, 2001, and marked the beginning of formal confirmations that matters had gone awry. Enron confirmed that it was taking a $544 million after-tax charge against earnings related to transactions with an investment partnership created and managed by Andrew Fastow, Enron’s former Executive Vice President and Chief Financial Officer, and by other Enron employees who worked with Fastow. About a month later, on November 8, 2001, Enron announced in an SEC filing that it was restating its financial statements for the years 1997 through 2001 because of “accounting errors relating to transactions with a different Fastow partnership … and an additional related-party entity.” The restatements reduced Enron’s reported
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net income by a total of $1.5 billion, reduced reported shareholder equity by over $2 billion, and shattered the confidence of the market and investors in the company. In November, Enron also revealed for the first time that it had learned that Fastow had received more than $30 million from two of the partnerships; other Enron employees involved in the partnerships had been enriched at Enron’s expense “in the aggregate, by tens of millions of dollars they should not have received.” On November 28, 2001, major bond rating agencies downgraded Enron’s debt to junk bond status. The company filed for Chapter 11 bankruptcy on December 2, 2001.

The Role of the Lawyers

On the basis of the facts now publicly available, lawyers’ activities in three contexts merit particular attention. The actions of Enron’s in-house counsel, Enron’s primary outside counsel Vinson & Elkins, and Andersen’s in-house counsel all raise important concerns.

A. Enron’s In-House Counsel

The role of Enron’s in-house counsel in structuring critical transactions and advising the firm on disclosure requirements reflects longstanding issues about conflicts of interest and professional independence. The Powers Report’s detailed references to these lawyers make clear their integral contribution to the creation and operation of the various partnerships and SPEs; to the negotiations between Enron and the partnership entities; and to the preparation of related-party proxy disclosure statements. In assessing that conduct, the Report criticized “an absence of forceful and effective oversight by Senior Enron Management and in-house counsel” in the failure to disclose meaningful information about the SPEs and the essential nature of the transactions in issue.

Of still greater concern was the Powers Report’s finding that one of the company’s in-house lawyers, Kristina Mordaunt, not only gave advice on the SPE transactions, but also invested her own money in one of the entities. She did so without obtaining the consent of Enron’s Chairman and CEO, in violation of Enron’s Code of Conduct. Mordaunt reportedly received $1 million in return for a $5,800 investment. That investment may also have violated bar disciplinary rules concerning conflicts of interest. The Powers Report itself notes, though, that Mordaunt later admitted that her participation in the SPE was an error in judgment and that “she did not consider the issue carefully enough at the time.”

By contrast, at least two Enron attorneys had serious concerns about the company’s financial conduct, but were stymied by other Enron lawyers or managers in efforts to respond. A case in point involves a September 2000 memo by an Enron North America attorney expressing concern about the possibility that “the financial books at Enron are being ‘cooked’ in order to eliminate a drag on earnings that would otherwise occur under fair value accounting.” More senior attorneys who received the memo did not believe the factual as-
assertions on which the memo’s conclusions were based, but conducted no investigation to verify their belief and took no further action. A second example involves an Enron attorney who reportedly asked the law firm of Fried Frank Harris Shriver & Jacobsen to review the legality of the partnerships and SPEs. After Fried Frank recommended that Enron halt the practice of using such structures, the Enron attorney sent written internal memoranda to company executives to the same effect. The failure by more senior counsel and by Enron executives to follow such advice, or to investigate its factual basis, suggests greater problems with the corporate culture — one that prized aggressive behavior, put a premium on risk and “valued appealing lies over inconvenient truths.”

B. Enron’s Outside Counsel: Vinson & Elkins

Of equal concern is the role of Vinson & Elkins lawyers, Enron’s primary outside legal counsel, in structuring transactions and providing legal advice on public disclosure documents. … Indeed, the Powers Report concludes that Vinson & Elkins provided advice and prepared documentation in connection with many of the [problematic] transactions. … It also assisted Enron with the preparation of its disclosures of related-party transactions in the proxy statements and the footnotes to the financial statements in Enron’s periodic SEC filings. Management and the Board relied heavily on the perceived approval by Vinson & Elkins of the structure and disclosure of the transactions. Enron’s Audit and Compliance Committee, as well as in-house counsel, looked to it for assurance that Enron’s public disclosures were legally sufficient. It would be inappropriate to fault Vinson & Elkins for accounting matters, which are not within its expertise. However, Vinson & Elkins should have brought a stronger, more objective and more critical voice to the disclosure process.

Vinson & Elkins’s leaders have denied that the firm acted improperly. In their view, outside lawyers may assist in a transaction that is not illegal and that has been approved by company management. In so doing, “the lawyers are not approving the business decisions made by the clients.” Yet not only is that an unduly circumscribed understanding of the lawyer’s ethical responsibilities, it also begs the question of who is the “client.” [T]he firm’s response also raises a question that has become central to debates over regulatory reform: when do lawyers have an obligation to bring dubious conduct to the attention of more senior management or the board of directors?

A related issue involves the responsibility of Vinson & Elkins when it was asked to investigate initially anonymous allegations by Sherron Watkins. In August 2001, Watkins, Enron’s vice president of corporate development, wrote an anonymous six-page memo to Kenneth Lay, Enron’s Chairman and CEO, detailing her concerns about the propriety of Enron’s disclosure statements and accounting treatment of the SPE and partnership transactions. Watkins recommended that Enron’s Chief General Counsel hire an independent law firm to investigate the transactions, and specifically advised against using Vinson & Elkins. As she noted, “(Can’t use V&E due to conflict —
they provided some true sale opinions on some of the deals).” In agreeing to take on this investigation, Vinson & Elkins placed itself in the position of evaluating its own work. The firm also agreed to highly restrictive limitations on the scope of its review, which further circumscribed the value of its advice. At a minimum, as most legal ethics experts have suggested, Vinson & Elkins’s lawyers should have discussed the possible conflict with Enron executives and directors and secured a written conflicts waiver. It is, however, by no means clear that a waiver would have solved the problem. Prevailing bar ethical rules prohibit lawyers from representation that would be “materially and adversely affected” by the lawyers’ own interests, unless the client gives informed consent and the lawyer reasonably believes the representation will not be adversely affected.

As it was, the nine-page report that the firm provided to Enron’s General Counsel on October 15, 2001 left much to be desired. Although Vinson & Elkins characterized its investigation as “preliminary,” the report recommended no additional scrutiny. After a notably inadequate review of the facts, the law firm’s report concluded that they did not “warrant a further widespread investigation by independent counsel and auditors.” Without meaningful discussion of the substance of the transactions at issue, the report primarily focused on their “bad cosmetics,” namely “a serious risk of adverse publicity and litigation.” To that end, Vinson & Elkins recommended “some response should be provided to Ms. Watkins to assure her that her concerns were thoroughly reviewed, analysed, and although not found to raise new or undisclosed information, were given serious consideration.”

Despite that recommendation, the Powers Committee was established just two weeks later to undertake precisely the sort of detailed investigation that Vinson & Elkins had found unnecessary. The Powers Committee retained a different law firm for assistance, and in February 2002 released a report of some 200 pages. That report criticizes Vinson & Elkins’s actions with respect to many aspects of the investigation. Because Enron’s General Counsel had instructed Vinson & Elkins that a detailed examination of the relevant transactions and discussions with accounting advisors need not be part of the law firm’s review, the “result of the V&E review was largely predetermined by the scope and nature of the investigation and the process employed.” By contrast, the Powers Report notes that its own investigation was able to identify the most serious problems at Enron only after making the detailed inquiries that Vinson & Elkins had agreed were unnecessary. In reaching that conclusion, Vinson & Elkins’s lawyers had interviewed only “very senior people” at Enron and Andersen, who “with few exceptions, had substantial professional and personal stakes in the matters under review.” So did Vinson & Elkins, given its advice on the events under scrutiny and its ties to the key players.

C. Andersen’s In-House Counsel

Nancy Temple, in-house counsel at Andersen, emerged as a key figure in Andersen’s demise, and her actions have been a controversial centerpiece in discussions of lawyers’ social responsibilities. As noted earlier, Andersen played
a crucial role in creating and auditing questionable investment vehicles, and in certifying Enron’s financial statements and public disclosures. Accordingly, Andersen’s documents regarding those matters could be critical to government investigators and civil litigants. The firm’s detailed document retention policies called for the destruction of all nonessential draft documents or conflicting documentation relating to an audit, including the e-mails, voicemail messages, and desk files of Andersen personnel working on the audit. The policy itself was not unusual; what created problems was the timing and manner of Temple’s calls for compliance with the policy.

Temple’s actions became the subject of a highly unflattering Congressional hearing in January 2002. Committee members were left incredulous by her characterization of actions concerning Andersen’s document retention and destruction as customary housekeeping duties. She admitted awareness, prior to October 8, of allegations by an Enron employee of inappropriate accounting procedures, as well as an investigation by Vinson & Elkins. She also admitted that between September 28 and October 12, she provided legal advice about specific documentation and retention issues. The SEC placed Enron under investigation in early October, and it confirmed that fact publicly in an October 22 press release. Temple’s notes from a conference call on October 8 anticipated that outcome: “Highly probable some SEC investigation.”

Despite her knowledge, Temple sent an email on October 12 to Andersen’s Houston practice director making reference to the firm’s document retention and destruction policy: “It might be useful to consider reminding the engagement team of our documentation and retention policy. It will be helpful to make sure that we have complied with that policy.” On October 23, David Duncan, Andersen’s lead engagement partner on the Enron audit, ordered his team to comply with Andersen’s policy and gathered all of the documents relating to Enron. Andersen officials later admitted that significant numbers of documents were shredded between this time and November 10. Media reports chronicled the accumulation of more than eighteen trunks and thirty boxes of documentary debris on only one of the days at one of the offices. Not until November 10, after the SEC had subpoenaed documents from Andersen concerning its Enron investigation and after Andersen had received a second subpoena in a related lawsuit, did Temple instruct the Enron engagement team “to preserve documents, computer files and other information relating to Enron.”

Andersen officers were clearly alert to problems with Enron in September 2001. By October 9, the accounting firm had retained lawyers at Davis, Polk & Wardwell (“Davis, Polk”) to “help with the complex issues that were going on in the third quarter.” Temple admitted that she had discussed documentation and retention issues with Davis, Polk as early as October 16. In testimony during a Congressional subcommittee hearing, Andersen’s Senior Executive, C.E. Andrews, initially disclaimed any expectation of litigation on October 9. However, a few minutes later, in response to a different question, Temple acknowledged that as soon as she was aware that Enron would be restating its
prior financials, she concluded that Andersen “would likely be sued.” Almost immediately thereafter, Andrews conceded that Davis, Polk had been hired “for purposes to help [Andersen] with the financial reporting and possible litigation.” Accordingly, a “reminder” about the audit firm’s document shredding policies in early October 2001 could plausibly be interpreted as encouraging destruction of background papers that might be relevant to its liability or to the regulatory investigation of its client.

In a televised interview on *Meet the Press*, Andersen’s CEO Joseph Berardino attempted to discount this possibility: “Nancy just told people to use their judgment. She did not instruct them to do anything, to my knowledge.” Yet despite the insistence that Temple had made no error, legally or ethically, Andersen fired David Duncan, its Enron team leader, for similar conduct. According to Andersen’s CEO, in the same interview, Duncan “displayed extremely poor judgment in the destruction of documents’ issue” after he learned of the SEC investigation. The attempt to scapegoat Duncan while exonerating Temple did not sit well with Congressional investigation. As the Subcommittee Chairman noted, “common sense gets a little lost here.”

In a *New York Times* article [after the conviction of Andersen for obstruction of justice], Stephen Gillers, a prominent legal ethics expert, defended Temple’s actions as “the kind of advice that lawyers routinely give.” Other ethics experts take a different view. Under the statutes and ethics rules of most jurisdictions, it is unethical to destroy documents if they are subject to discovery or relevant to a “clearly foreseeable” legal action. The facts currently available permit the inference that Temple knew or should have known that a proceeding was clearly foreseeable at the time that she reminded Andersen partners and employees about document retention policy. Her failure to clarify the need to preserve critical Enron-related materials was highly problematic. Her instructions on revising a characterization of financial disclosure was problematic as well, particularly if part of the motivation was her own self-interest in avoiding involvement in the government’s investigation. In any event, whether or not Temple violated bar ethical rules, it is troubling that so many lawyers, including ethics experts like Gillers, assumed that such actions are “routine.” If current norms and standards of conduct permit complicity in frustrating federal investigation, then reform initiatives are clearly appropriate.

NOTES AND QUESTIONS

1. Part of the Enron tale is the story of Enron attorneys who attempted to prevent the wrongdoing from occurring and/or continuing. Does the failure of those lawyers’ efforts suggest that it may be impossible for a lawyer to prevent an organization set on illegal/unethical behaviour? What strategies would be most likely to encourage reporting by subordinate lawyers? What obligations do senior lawyers have to respond to such reports or situations, if any?
2. In the article, Rhode and Paton note Stephen Gillers’ defence of Nancy Temple in the New York Times. Do you agree or disagree with Gillers’ assessment of her conduct?

3. Note that Temple was counsel to Arthur Andersen, an accounting firm. Do you think any relevant differences exist for a lawyer providing in-house legal advice to a partnership of other professionals, where there are no external shareholders and no corporate board? Is this lawyer’s circumstance ethically distinct from that of a lawyer working in a more traditional corporate context? Could Temple or someone working in a similar position legitimately rely on the professional ethics of the accountants for whom she worked to inform or modify her own ethical obligations?

4. Should Vinson & Elkins have accepted the retainer to investigate the allegations Sherron Watkins raised? Was Enron’s waiver of any conflict of interest enough? How does the alleged conflict here relate to that discussed in the Strother case in Chapter 5?

3. The American Response to Enron

The collapse of Enron spawned exploration of all levels and layers of activity inside and outside of the organization, as legislators and regulators attempted to find out what had gone wrong and how future catastrophes might be prevented. The United States Congress and the Securities and Exchange Commission made various and numerous legislative and regulatory changes to improve corporate governance.

While the accountability of auditors was especially important, lawyers working with corporations were not immune from scrutiny. Significant legal and regulatory changes to the ethical and other obligations of corporate counsel in the United States were introduced in 2002 and 2003. Specifically, the United States Congress passed the Sarbanes-Oxley Act. Described by Senator John Corzine as incorporating the "most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt", Sarbanes-Oxley was the culmination of a series of earlier and separate efforts in both the House of Representatives and in the Senate to respond to the Enron crisis and to restore investor confidence. In a remarkable show of unity, the Act cleared the House by a vote of 423-3 and, a few hours later, cleared the Senate by a vote of 99-0. It included a provision that obligated lawyers to report corporate fraud and rules that required the U.S. Securities and Exchange Commission to establish “minimum standards of professional conduct” for lawyers who practice before the Commission. These features had aroused little public debate or controversy when they first appeared (and passed unanimously) in an earlier iteration of what became Sarbanes-Oxley, despite vehement opposition from the American Bar Association.

Sarbanes-Oxley also obligated lawyers to report “evidence of a material violation of securities law or breach of fiduciary duty”, first to a company’s general counsel, then to its CEO and ultimately to its board of directors. The statute also directed the SEC to adopt rules to interpret and implement this legislation.
Legislative attention in the aftermath of Enron had focused first on independent auditors, then on employees, directors, investment dealers and consultants, together with boards of directors and audit committees. Sarbanes-Oxley contained sweeping reforms to corporate governance rules for all of these groups. Gradually the roles and responsibilities of lawyers engaged in corporate misconduct moved toward centre stage as well. An October 2002 U.S. Senate Committee Report on Financial Oversight of Enron highlighted the important role lawyers play as “gatekeepers”, particularly in public securities markets, and suggested that the “role of lawyers and law firms as gatekeepers should not be overlooked”.

The next section sets out the language of Sarbanes-Oxley relating to lawyer conduct. This is followed by the story of both the implementation of new rules by the SEC and the subsequent response by the American Bar Association with changes to its Model Rules of Professional Conduct. As you consider this material, reflect on whether lawyers should be seen as “gatekeepers”: are lawyers responsible for their clients’ conduct? Should they be?

**SARBANES-OXLEY ACT OF 2002**

Pub. L. 107-204

Sec. 307. Rules Of Professional Responsibility For Attorneys

Not later than 180 days after the date of enactment of this Act, the Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule —

1. requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and

2. if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.
Debates over where the balance between candor and confidentiality ought to lie are important for all professionals in corporate practice. The particular challenge for regulators and for the profession after Enron lies in resolving the choice between disclosure to public officials of corporate misconduct and the traditional requirement of loyalty to the organizational client. In the United States, there was a firestorm over Section 307 of the Sarbanes-Oxley Act of 2002 and the [Securities and Exchange Commission, or “SEC”] rule proposals implementing that legislation, and also in response to proposals and eventual changes to the [American Bar Association, or “ABA”] ABA Model Rules of Professional Conduct pertaining to the Organization as Client (MR 1.13) and Confidentiality (MR 1.6). In stark contrast, an amendment to the Rules of Professional Conduct in Ontario in March 2004 took place with virtually no public input or debate, with [the Law Society of Upper Canada] proceeding after having been prompted by a query from the [Ontario Securities Commission] about the need for the same type of rules on lawyer conduct as had been mandated for the SEC under Sarbanes-Oxley.

In contrast to the uncertainty created by other sections of the Sarbanes-Oxley Act of 2002, which introduced the most substantial reform of corporate governance in the United States in decades, Section 307 of the legislation has from the start been seen as clear, if extremely controversial. It has two dimensions. First, Section 307 of the Act instructs the SEC to adopt a rule of practice establishing “minimum standards of professional conduct” for lawyers “appearing or practicing before the Commission.” Second, the Section specifically directs the SEC to include a rule requiring all such lawyers to report evidence of fraud and other corporate misconduct in the companies they represent “up the ladder” to the company’s senior management, and if necessary, to the board of directors. The SEC published a proposed rule (Part 205) on November 21, 2002 and closed its comment period on December 18, 2002. The Act required the final rule on this section to be issued on or before January 26, 2003. On January 23, 2003, the SEC passed rules implementing Section 307 of Sarbanes-Oxley and published the rule text the following week.

Regardless of the contours of the final rule, the fact the SEC would begin regulating attorney conduct represented a significant shift away from deference to the self-regulatory tradition of the bar. It was also a signal that lawyers were attracting critical attention in the aftermath of Enron, and that legislators view the public interest to be best served by having lawyers more responsible to the public for their clients’ conduct. As Senator Michael Enzi, an accountant and a co-sponsor of the amendment to Sarbanes-Oxley that became Section 307 noted:
As we beat up on accountants a little bit, one of the thoughts that occurred to me was that probably in almost every transaction there was a lawyer who drew up the documents involved in that procedure. It seemed only right there ought to be some kind of an ethical standard put in place for the attorneys as well.

… The Rule casts a very wide net, defining “appearing and practising before the Commission” to include those “preparing, or participating in the process of preparing” essentially anything filed with or incorporated into any communication with the SEC. The definition also includes advising a party that something should not be filed with the Commission. The ABA criticized the definition as “inappropriately encompass[ing] non-securities specialists who do no more than prepare or review limited portions of a filing, lawyers who respond to auditors letters or prepare work product in the ordinary course unrelated to securities matters that may be used for that purpose, and lawyers preparing documents that eventually may be filed as exhibits.” Others criticized the Rule as not going far enough, by not including law firms as well as individual lawyers in the Commission’s disciplinary sights. They encouraged the SEC to broaden the scope to impute knowledge within law firms and hold the law firm responsible for the acts of its lawyers as agents of the law firm entity.

The fact that the definition also applies to foreign lawyers on an equal basis prompted additional cause for concern. In particular, the reporting requirements raised the spectre that foreign lawyers would be required to violate their domestic bar rules concerning privilege and confidentiality of client communications or risk breaching the SEC rules and possibly invite U.S. criminal sanction. The International Bar Association issued a strong call to the SEC to exempt non-U.S. lawyers from the proposed Rule. The ABA argued that “especially in the case of foreign attorneys, the extraordinary breadth of the term “appearing and practising” is likely to lead to confusion as to who is subject to the obligations of the rules, and to its sanctions in the event of non-compliance.” This concern was partly self-motivated, as the ABA worried “that subjecting foreign attorneys to regulation by the SEC could result in foreign agencies seeking to regulate the conduct of U.S. attorneys representing U.S. companies abroad or foreign companies.”

Others were uncompromising in supporting the proposal’s extra-territorial reach. The submission to the SEC by three leading law school professors, endorsed by at least 53 others, unapologetically applauded the rule, reflecting a “U.S.-first” mood not limited to Section 307 alone: “No foreign country, lawyer or corporation has a “right” to participate in our securities markets on their own terms. They have a choice: to play by our rules or not” [emphases added]. The professors argued that exempting foreign lawyers would simply open a loophole for many large corporations to skirt the SEC’s rules, resulting in “violence to the legislative scheme, harm to investors, and harm to the domestic securities bar who would be placed at a competitive disadvantage vis-à-vis their foreign counterparts.” They concluded:
The arguments made by foreign bars are virtually indistinguishable from those made by the ABA to ward off SEC regulation of domestic lawyers. What we know of foreign enforcement efforts against securities lawyers suggests that their arguments are as illusory as those advanced by domestic lawyers in the effort to ward off effective federal regulation. The Commission should maintain its principled, wise and legislatively justified stance to regulate foreign and domestic lawyers equally.

The particularly vexing part of the proposed rule (and the legislation) for both domestic and foreign lawyers was a proposal that would have required “noisy withdrawal.” In addition to requiring a lawyer to report potential violations “up the ladder” within a company to its chief legal officer or CEO and then to the audit committee, an independent committee, or the board of directors, the original proposal for Part 205 mandated that a lawyer take further steps if the company failed to act to rectify the situation. Where a lawyer believed the company had not adequately responded to reported “evidence of a material violation” of the securities laws, “a material breach of fiduciary duty, or a similar material violation,” the lawyer would then be required to 1) withdraw from representation; 2) notify the SEC of the withdrawal, indicating that it was based on professional considerations, and 3) disaffirm any filing with the SEC that the attorney has prepared or assisted in preparing that the attorney believes is or may be materially false or misleading. Noted as going “to the heart of the attorney-client relationship,” this part was criticized as “almost deputiz[ing] attorneys to become quasi-governmental inspectors,” and for turning all “lawyers into junior regulators, surveillance operatives, whistleblowers.” The ABA said the rule contradicted legislative intent, relying on comments by Senator John Edwards (one of the principal architects of Section 307) that in Sarbanes-Oxley there “is no obligation to report anything outside the client — the corporation.” The President of the American Corporate Counsel Association noted, “There’s a very real fear that the rules will change the relationship [with the client].”

These comments overlooked the fact that even in the absence of the “noisy withdrawal” requirement, lawyers in forty-one states were, at the time, permitted (but not obliged) to report evidence of a continuing crime or fraud by a client. The ABA had, prior to this point, twice rejected proposals by its own Ethics 2000 Commission to tighten this requirement. The SEC proposal stepped into that breach and would have made this conduct mandatory; a more rigorous SEC standard would in effect pre-empt state rules.

Other provisions in the Rule further exacerbated these concerns about the attorney-client relationship. Section 205.3(e)(2) allows an attorney to disclose confidential information to the Commission without the issuer’s consent:

i) to prevent the issuer from committing an illegal act that the attorney reasonably believes is likely to result in substantial injury to the financial interest or property of the issuer or investors;


ii) to prevent the issuer from committing an illegal act that the attorney reasonably believes is likely to perpetrate a fraud upon the Commission; or

iii) to rectify the consequences of the issuer’s illegal act in the furtherance of which the attorney’s services had been used.

Section 205.3(e)(1) allows an attorney to use any report under this section in self-defence. Section 205.3(e)(3) provides that sharing of information with the Commission by an issuer through its attorney does not constitute a waiver of any privilege or protection as to other persons. Nonetheless, the ramifications of this part in respect of the lawyer-client relationship, as well as the relationship of lawyers to the SEC, are significant and fundamental: the traditional conception of loyalty and fealty to the client or organization may be infringed upon for the greater public good.

The final Rules implementing Section 307 provisions of Sarbanes-Oxley on attorney conduct took a considerably different turn from the original proposals and constituted a major retreat by the SEC. The Final Rule maintained the “up the ladder” reporting requirement for evidence of material violations of securities laws, but changed the test for “evidence of a material violation” from a relatively straightforward determination to a standard which is considerably more difficult to enforce because the definition of what constitutes “evidence of a material violation” is now far more complex than in the proposed rule. Further, even if a lawyer finds such evidence under the new standard, he or she can back down from pressing the company to change the behavior if another lawyer opines that there is a “colorable defence” for the company’s actions.

The Commissioners also backed down on the “noisy withdrawal” requirement so strongly advocated by the group of law professors and strongly resisted by the practicing bar. The SEC extended the comment period on this issue for a further 60 days, and suggested a possible alternative rule requiring a lawyer to withdraw from representation but requiring the client, rather than the lawyer, to publicly disclose the withdrawal or written notice that the lawyer did not receive an appropriate response to a report of a material violation. While formally never concluded, for the time being it appears this fight is over. The CBA called the changes a positive step, but insisted that they did not go far enough to preserve lawyer-client relationships. More importantly, the CBA press release signalled again a more fundamental debate: “The CBA continues to stress that it is unacceptable for any government agency to dictate ethical standards for Canadian lawyers.”

NOTES AND QUESTIONS

1. In the SEC Regulations implementing Sarbanes-Oxley, a lawyer is required to report evidence of a “material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law” subject to certain exceptions and qualifications. What should
a lawyer’s obligation be when he or she has reservations about the morality or legality of a company’s conduct, even though that conduct might not constitute “material violations” of securities laws? Does your answer change if the lawyer is acting as in-house counsel rather than as an attorney from an outside law firm?

2. Is “noisy withdrawal” by lawyers ever appropriate or necessary? If auditor resignations serve to protect the public by signalling to the market that corporate conduct is awry, why should lawyers be exempted from similar requirements?

3. Are the American Bar Association’s objections to SEC regulation of lawyer conduct warranted? Who should regulate lawyers? Who should be able to decide? Is the Canadian Bar Association right when it says that it is “unacceptable for any government agency to dictate ethical standards for Canadian lawyers”, or just that it is inappropriate for American authorities to do so? Consider these questions in light of the arguments for and against self-regulation discussed in Chapters 2 and 13.

In the eyes of many key U.S. lawmakers, the American Bar Association and all bar regulators had failed to take appropriate steps to ensure that lawyers representing corporate clients were upholding the highest standards of conduct. The introduction of section 307 and the granting of authority to the SEC for the regulation of lawyer conduct reflected this concern. The American Bar Association eventually responded with changes to the Model Rules of Professional Conduct to address concerns about lawyers in organizational settings, prompted in particular by the March 2003 report of the ABA Task Force on Corporate Responsibility on the role of lawyers for public corporations. As you review these Rules, consider whether they are sufficient to ensure that lawyers representing corporate clients will uphold the standard of ethical conduct. The Canadian approach, considered further below, leaves out key components of these Rules, notably the “crime-fraud exception” to confidentiality in Rule 1.6. Consider why the Canadian regulators might have done so, and which approach has greater merit.

**AMERICAN BAR ASSOCIATION**

*Model Rules of Professional Conduct*

**Rule 1.13 Organization as Client**

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

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

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

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

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

(d) Paragraph (c) shall not apply with respect to information relating to a lawyer’s representation of an organization to investigate an alleged violation of law, or to defend the organization or an officer, employee or other constituent associated with the organization against a claim arising out of an alleged violation of law.

(e) A lawyer who reasonably believes that he or she has been discharged because of the lawyer’s actions taken pursuant to paragraphs (b) or (c), or who withdraws under circumstances that require or permit the lawyer to take action under either of those paragraphs, shall proceed as the lawyer reasonably believes necessary to assure that the organization’s highest authority is informed of the lawyer’s discharge or withdrawal.

(f) In dealing with an organization’s directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization’s interests are adverse to those of the constituents with whom the lawyer is dealing.

(g) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7 [Conflicts of Interest]. If the organization’s consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

*Rule 1.6 Confidentiality of Information*

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

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

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

(4) to secure legal advice about the lawyer’s compliance with these Rules;

(5) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer’s representation of the client; or

(6) to comply with other law or a court order.

4. The Canadian Response

Though the focus on changes to the rules and regulation of lawyer conduct has been developed most publicly in the United States, the same issues and concerns about the ethics of lawyers advising corporations has been important in Canada. The Law Society of Upper Canada, the self-regulatory body responsible in Ontario for lawyer discipline and conduct, introduced amendments to the Rules of Professional Conduct in 2004 without public deliberation or debate. The Federation of Law Societies of Canada’s Model Code of Professional Conduct, new in 2010–2011, adopted the same language first introduced in Ontario, omitting an ABA-style “crime-fraud” exception to the professional conduct rules on confidentiality. As you review these changes, consider why Canadian legal regulators might have taken a different approach.

As in the United States, there has been some debate in Canada about what role, if any, securities regulators should be playing in the regulation of lawyer conduct. Does such regulation contradict or complement the acts of the law societies? Under provincial Securities Acts, provincial securities regulators (rather than a national regulator like the SEC) exercise responsibilities comparable to those of the SEC for oversight of participants in the Canadian capital markets. Section 1 of the Ontario Securities Act,\(^2\) for example, provides that the purposes of the Act are “to provide protection to investors from unfair, improper or fraudulent practices” and “to foster fair and efficient capital markets and confidence in capital markets”. The Ontario Securities Com-

mission (OSC) is given the mandate and responsibility for administering the Act and for enforcement of its provisions. While the OSC exercises jurisdiction over the practices of lawyers in relation to the Commission’s statute and regulations accordingly — and did so prior to the Enron scandal — the extent of its commitment to this oversight, and the merits of having the OSC responsible for disciplining lawyers at all has been questioned. As you read Wilder v. Ontario (Securities Commission) excerpted in this chapter, consider whether the approach the court adopts will be sufficient to ensure ethical practice by those lawyers appearing before the OSC. Are Law Society concerns about regulatory encroachment by securities regulators warranted?

(a) Law Society Rules

FEDERATION OF LAW SOCIETIES OF CANADA

Model Code of Professional Conduct

When the Client is an Organization

2.02 (3) Although a lawyer may receive instructions from an officer, employee, agent or representative, when a lawyer is employed or retained by an organization, including a corporation, the lawyer must act for the organization in exercising his or her duties and in providing professional services.

Dishonesty, Fraud, when Client an Organization

2.02 (8) A lawyer who is employed or retained by an organization to act in a matter in which the lawyer knows that the organization has acted, is acting, or intends to act dishonestly, fraudulently, criminally, or illegally, must do the following, in addition to his or her obligations under subrule (7):

(a) advise the person from whom the lawyer takes instructions and the chief legal officer, or both the chief legal officer and the chief executive officer, that the proposed conduct is, was or would be dishonest, fraudulent, criminal, or illegal and should be stopped;

(b) if necessary because the person from whom the lawyer takes instructions, the chief legal officer or the chief executive officer refuses to cause the proposed conduct to be stopped, advise progressively the next highest persons or groups, including ultimately, the board of directors, the board of trustees, or the appropriate committee of the board, that the proposed conduct was, is or would be dishonest, fraudulent, criminal or illegal and should be stopped; and

(c) if the organization, despite the lawyer’s advice, continues with or intends to pursue the proposed wrongful conduct, withdraw from acting in the matter in accordance with Rule 2.07.

Commentary

The past, present, or proposed misconduct of an organization may have harmful and serious consequences, not only for the organization and its constituency, but also for the public who rely on organizations to provide a variety of goods and services. In particular, the misconduct of publicly traded commercial and financial corporations may have serious consequences to the public at large. This rule addresses some of the professional responsibilities of a lawyer acting for an organization, including a corporation, when he or she learns that the organization has acted, is acting, or proposes to act in a way that is dishonest, fraudulent, criminal or illegal. In addition to these rules, the lawyer may need to consider, for example, the rules and commentary about confidentiality (Rule 2.03).

This subrule speaks of conduct that is dishonest, fraudulent, criminal or illegal. Such conduct includes acts of omission. Indeed, often it is the omissions of an organization, such as failing to make required disclosure or to correct inaccurate disclosures that constitute the wrongful conduct to which these rules relate. Conduct likely to result in substantial harm to the organization, as opposed to genuinely trivial misconduct by an organization, invokes these rules.

In considering his or her responsibilities under this section, a lawyer should consider whether it is feasible and appropriate to give any advice in writing.

A lawyer acting for an organization who learns that the organization has acted, is acting, or intends to act in a wrongful manner, may advise the chief executive officer and must advise the chief legal officer of the misconduct. If the wrongful conduct is not abandoned or stopped, then the lawyer must report the matter “up the ladder” of responsibility within the organization until the matter is dealt with appropriately. If the organization, despite the lawyer’s advice, continues with the wrongful conduct, then the lawyer must withdraw from acting in the particular matter in accordance with Rule 2.07. In some but not all cases, withdrawal means resigning from his or her position or relationship with the organization and not simply withdrawing from acting in the particular matter.

This rule recognizes that lawyers as the legal advisers to organizations are in a central position to encourage organizations to comply with the law and to advise that it is in the organization’s and the public’s interest that organizations do not violate the law. Lawyers acting for organizations are often in a position to advise the executive officers of the organization, not only about the technicalities of the law, but about the public relations and public policy concerns that motivated the government or regulator to enact the law. Moreover, lawyers for organizations, particularly in-house counsel, may guide organizations to act in ways that are legal, ethical, reputable, and consistent with the organization’s responsibilities to its constituents and to the public.
Recall the discussion of the lawyer’s duty of confidentiality in Chapter 4, and the future harm/public safety exception to confidentiality. The Federation of Law Societies of Canada’s Model Code provision on this exception provides:

**Future Harm/Public Safety Exception**

2.03 (3) A lawyer may disclose confidential information, but must not disclose more information than is required, when the lawyer believes on reasonable grounds that there is an imminent risk of death or serious bodily harm, and disclosure is necessary to prevent the death or harm.

**NOTES AND QUESTIONS**

1. What would it mean for a lawyer to “withdraw from acting” as required by Rule 2.02(8)(c) if the lawyer is employed by the corporation? Rule 2.07 which governs withdrawal provides no guidance in this respect, concentrating exclusively on directing lawyers in private practice as to when and in what manner they should withdraw. Is it reasonable to require a lawyer to quit his or her employment as an ethical duty? Should a lawyer who followed the chain of upward reporting but did not withdraw be subject to professional discipline?

2. Compare ABA Model Rule 1.6(b)(1)-(4) and the FLSC Model Code Rule 2.03(3). The U.S. approach contains provisions that permit (but do not require) disclosure in the event of fraud as well as for incidents involving imminent death or serious bodily harm. Does it matter that the U.S. approach is permissive, not mandatory? Given the impact of corporate fraud on the investing public, should the provision be added to the Canadian rules?

3. The rules refer to the organization acting “dishonestly, fraudulently, criminally, or illegally”. How does a lawyer know an organization’s conduct is illegal? Is illegality simply a matter of the lawyer’s own judgment, such that if the lawyer suspects that the conduct might be found to be illegal that triggers the obligation, or does the lawyer need some tangible basis — arising from legislation or judicial decision — to justify the assertion of illegality? Consider the following scenario.

**Scenario Two**

Jack works as in-house counsel for an automotive manufacturer. The manufacturer has discovered that its construction of a recent vehicle has a design flaw which in a certain number of cases will cause the vehicle to explode in even minor rear-end collisions. The manufacturer does an actuarial calculation which shows that the cost of civil tort claims arising from such explosions will be lower than the cost of a vehicle recall to repair the design flaw. Jack is asked to provide a legal opinion about the likelihood of a plaintiff obtaining a judgment against the manufacturer in tort and as to the likely quantum of damages that would result. Based on the actuarial calculation, and on Jack’s opinion, the manufacturer decides not to recall the vehicles. Does Jack have any obligations under the FLSC Model Code as a result of his knowledge of the manufacturer’s decision?

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4 This example is adapted from David Luban’s discussion of the infamous Pinto case in Lawyers and Justice (Princeton: Princeton University Press, 1988) at 206-10.
(b) The Role of the Securities Regulators

The question of whether securities regulators in Canada should have authority or responsibility for regulating lawyer conduct was addressed in a case that pre-dated the Enron scandal. The Law Society of Upper Canada vehemently objected to an effort by the Ontario Securities Commission to reprimand a law firm lawyer representing a corporate client for his alleged misconduct in filing misleading materials with the Commission.

WILDER v. ONTARIO (SECURITIES COMMISSION)

(Ont. C.A., Abella, Goudge and Sharpe J.J.A.)

SHARPE J.A.:— This appeal calls into question the authority of the Ontario Securities Commission (the “OSC”) to reprimand the appellant, Lawrence D. Wilder (“Wilder”), a solicitor, for alleged misconduct in connection with his representation of a client before the OSC. The appellants, Wilder and Cassels Brock and Blackwell (“Cassels”), supported by the intervenor, The Law Society of Upper Canada (“The Law Society”), submit that the OSC lacks a statutory mandate to reprimand Wilder for his conduct. They argue that the allegations against Wilder must be dealt with either by way of quasi-criminal proceedings before the Ontario Court of Justice or by The Law Society. They appeal, with leave of this Court, the order of the Divisional Court dismissing their application for judicial review, asking for an order that the OSC be prohibited from continuing proceedings against the appellants and quashing a Notice of Hearing.

FACTS

Wilder is a solicitor and a partner in the Cassels firm. At all relevant times, YBM Magnex International Inc. (“YBM”) was a client of Cassels and Wilder in connection with the filing of a preliminary prospectus with the OSC. Wilder is not and never has been an officer, director, shareholder or promoter of YBM. In all of his dealings with the OSC on behalf of YBM, Wilder acted exclusively as YBM counsel.

The proceedings at issue before the OSC were commenced by a Notice of Hearing, dated November 1, 1999, naming Wilder, YBM, the directors of YBM, its CEO and CFO, and the co-lead underwriters for a YBM financing. The Notice advises the named parties of a hearing to determine whether various orders should be made against them pursuant to ss. 127 and 128 of the Securities Act, R.S.O. 1990, c. S.5. With respect to Wilder, the Notice of Hearing states that at the hearing the OSC will consider:

1. whether in its opinion it is in the public interest to make an order pursuant to s. 127(1), para. 6 of the Act to reprimand Wilder; and

2. whether, if the OSC determines that Wilder has not complied with Ontario securities law, application should be made to the Superior Court of Justice for a declaration that Wilder has not complied with
Ontario securities law, pursuant to s. 128(1) of the Act, and/or a remedial order against Wilder, pursuant to s. 128(3) of the Act.

The Statement of Allegations of the Staff of the OSC, served in support of the Notice of Hearing, provides details of the specific allegations. The Staff alleges that a letter to the OSC written by Wilder on behalf of YBM contained misleading or untrue statements of fact:

Wilder made statements in a letter dated July 4, 1997 to Staff of the Commission that in a material respect, and at the time and in the light of the circumstances under which the statements were made, were misleading or untrue or did not state a fact that was required to be stated or that was necessary to make the statements not misleading; specifically, statements concerning the result of due diligence conducted in respect of YBM. In doing so, Wilder acted in a manner contrary to the public interest.

The allegations against the other named parties relate to alleged non-disclosure by YBM in prospectuses filed with the OSC and to YBM’s alleged failure to comply with its continuous disclosure obligations. The allegations against these parties concern contraventions of duties and obligations imposed by Ontario securities law.

LEGISLATION

The Securities Act, Part XXII provides for three methods of enforcement that are available to the OSC in carrying out its mandate to regulate the securities industry. …

[The court reviewed the availability of: i) quasi-criminal proceedings in provincial court leading to conviction and fines or imprisonment for false or misleading statements made in materials filed with the OSC; ii) the power of the OSC to apply for a declaration from superior court that a person or company is not complying with securities laws; and iii) the power of the OSC to hold its own administrative proceedings and make an “order in the public interest”. This “public interest” power, in s. 127(1) of the Act, provides for a broad range of possible sanctions, including restrictions from participating in the market for securities.]

JUDGMENT OF THE DIVISIONAL COURT …

Before the Divisional Court, the focus of the appellants’ attack on the OSC proceedings was the submission that s. 127(1) should be interpreted so as not to apply to lawyers acting in their professional capacity. It was further submitted that if the provision does apply to lawyers acting in their professional capacity, it is to that extent unconstitutional and should be read down.

Swinton J., writing for the Court, rejected the appellants’ submission. She observed that there was nothing in the language of s. 127(1) nor in its legislative history to suggest that it should not apply to lawyers. Indeed, she noted … adoption of the provision indicated a legislative intention “to broaden the powers of the [OSC] to make orders in the public interest” and that the legislature “chose words which do not preclude their application to lawyers.” The
Divisional Court rejected the contentions that The Law Society has exclusive jurisdiction to regulate the professional conduct of lawyers, and that to allow the OSC to involve itself in the professional conduct of lawyers would have a chilling effect upon the ability of members of the public to obtain independent legal representation.

The Divisional Court found that the OSC’s proposed exercise of jurisdiction over Wilder was not inconsistent with the important role of The Law Society in regulating the legal profession. Both The Law Society and the OSC exercise public interest functions, but “the public interests which they seek to protect are not the same.” The Law Society’s role is “to govern the legal profession in the public interest, and to ensure that members of the profession do not engage in professional misconduct or conduct unbecoming a barrister and solicitor.” The role of the OSC, on the other hand, was described as “that of protecting investors and the proper functioning of Ontario’s capital markets. Ensuring proper disclosure and maintaining the integrity of its processes are an important part of this role.” The Divisional Court concluded that there was no basis for holding lawyers immune from the regulatory powers of the OSC:

In proceedings such as these, the [OSC] is not usurping the role of the Law Society, as its objective is not to discipline the lawyer for professional misconduct; rather its concern is to remedy a breach of its own Act which violates the public interest in fair and efficient capital markets, and to control its own processes.

Finally, the Divisional Court rejected the contention that by exercising jurisdiction over Wilder, the OSC would infringe the rule of law by interfering with the independence of the bar. The Divisional Court observed that all the OSC was seeking to do was “to ensure that lawyers, among others, do not mislead” it and that the exercise of that jurisdiction “will not interfere with the ability of lawyers who practice securities law to continue to provide excellent and vigorous representation to their clients.”

ISSUES

1. Does the OSC have jurisdiction, as a matter of statutory interpretation, to reprimand Wilder for the alleged misconduct?

2. Does the OSC have jurisdiction to reprimand lawyers for their conduct as solicitors before the OSC?

ANALYSIS

Issue 1: Does the OSC have jurisdiction, as a matter of statutory interpretation, to reprimand Wilder for the alleged misconduct?

[The court held that the OSC has the requisite jurisdiction as a matter of statutory construction and interpretation, noting that the arguments raised on this issue had “nothing to do with Wilder’s status as a solicitor or member of The Law Society. They are based entirely upon the wording of the relevant provi-
sions of the Act and would apply to any person or corporation alleged to have provided misleading or untrue information to the OSC”.

Issue 2: Does the OSC have jurisdiction to reprimand lawyers for their conduct as solicitors before the OSC?

The appellants submit that s. 127(1) should be interpreted so as not to apply to lawyers acting in their professional capacity and that the attempt by the OSC to assert jurisdiction with respect to Wilder’s conduct collides with the authority of The Law Society to discipline lawyers. The appellants further submit that the assertion of jurisdiction by the OSC infringes the constitutional principle of the rule of law.

In my view, these arguments were fully and correctly dealt with in the reasons for judgment of Swinton J., writing for the Divisional Court. I cannot improve upon her analysis of these issues and for the reasons she gave, I would dismiss this aspect of the appeal.

I would, however, add this caveat with respect to the importance of ensuring that solicitor-client privilege is maintained and protected.

Solicitor-client privilege was described by Dickson J. in Canada v. Solosky as a “fundamental civil and legal right and more recently by Major J. in R. v. McClure ... as “fundamental to the justice system in Canada.” It is an important substantive right, long recognized as essential to ensuring that citizens have access to full and candid advice about their legal rights. The rationale for the privilege was explained in Anderson v. Bank of British Columbia in terms that have been quoted by the Supreme Court of Canada ...

The object and meaning of the rule is this: that is, by reason of the complexity and difficulty of our law, litigation can only be properly conducted by professional men, it is absolutely necessary that a man, in order to prosecute his rights or to defend himself from an improper claim, should have recourse to the assistance of professional lawyers, and it being so absolutely necessary, it is equally necessary, to use a vulgar phrase, that he should be able to make a clean breast of it to the gentleman whom he consults with a view to the prosecution of his claim, or substantiating his defence against the claim of others; that he should be able to place unrestricted and unbounded confidence in the professional agent, and that the communications he so makes to him should be kept secret, unless with his consent (for it is his privilege, and not the privilege of the confidential agent), that he should be enabled properly to conduct his litigation. That is the meaning of the rule.

Members of the public engaged in activities in the capital markets and subject to the authority of the OSC need to be able “to place unrestricted and unbounded confidence” in their legal advisors.

However, I do not accept the contention of the appellants and The Law Society that the need to respect solicitor-client privilege requires a blanket preclusion, preventing the OSC from reprimanding lawyers in all cases, provided the OSC pays adequate heed to the importance of solicitor-client privilege.
Where a lawyer is threatened with a reprimand by the OSC, there are two important interests at stake. On the one hand, the lawyer is entitled to be dealt with fairly and to be permitted to answer the allegations that have been made. On the other hand, where the lawyer’s answer involves revealing the confidence of the client, the client’s interest in confidentiality is invoked. In this regard, the lawyer’s promise of confidentiality is not absolute. It is recognized by The Law Society’s Rules of Professional Conduct, Rule 2.03(4), there are situations in which a lawyer may be entitled to reveal the confidence of a client to defend against allegations of criminal misconduct, claims of civil liability or allegations that the lawyer is “guilty of malpractice or misconduct”. It seems to me that a lawyer facing a reprimand for making an untrue or misleading statement is facing an allegation of “misconduct”. The Law Society’s Rules of Professional Conduct define the terms upon which a lawyer’s promise of confidentiality is made. They contain a general provision allowing for disclosure of confidential information where necessary to defend the lawyer’s legal interests, and there is no reason that provision should not apply to an allegation of misconduct by the OSC.

However, this exemption for the lawyer does not, in my view, allow the OSC to ignore the importance of solicitor-client privilege in the exercise of its enforcement powers. The OSC, like any other public body exercising statutory authority, must ensure on a case-by-case basis that the substantive legal right to solicitor-client privilege is respected. In my view, the OSC must exercise particular caution where it decides to proceed against both the lawyer and the lawyer’s client. Such a situation creates an inherent danger that the lawyer will have to reveal the client’s confidence in order to mount a full defence. The OSC should avoid creating a dynamic where the lawyer is placed in the dilemma of either forgoing the right to defend his or her own interests or harming the interests of the client by disclosing privileged information. In such a case, it may well be that the OSC will have to decide to forgo proceeding against the lawyer or, at a minimum, ensure that adequate steps are taken to ensure that the proceedings are conducted in a fashion that fully respects the procedural rights of the lawyer and the substantive legal rights of the client. Failure to do so could well result in a situation where it would not be in the public interest to continue the proceedings against both the lawyer and the client.

I hasten to add that as the application for judicial review amounted to a pre-emptive strike against the OSC’s intended hearing, there is nothing in the record as it now stands to indicate either that Wilder will argue the need to reveal privileged information in his own defence or, if that be the case, how the OSC will protect the client’s interest.

CONCLUSION

For these reasons, I would dismiss the appeal with costs.
NOTES AND QUESTIONS

1. Should Canadian lawyers be concerned with regulation by both Canadian and U.S. authorities? For which lawyers is this most likely to be a concern?

2. In *Wilder*, the Divisional Court notes that both the Law Society and the OSC exercise public interest functions, but that “the public interests which they seek to protect are not the same”. Do you agree? Should Wilder be subject to discipline by both the OSC and the Law Society for the same act(s)?

3. What are the goals of lawyer regulation in the corporate context? What remedies or sanctions will be effective in achieving them? Who should impose discipline where more than one regulator might govern? Consider the OSC investigation and proceedings against Sally Daub, Vice President and General Counsel for ATI Technologies Inc., a publicly traded Canadian technology company. During the OSC investigation of a company press release about lower than expected financial performance, Daub provided a letter to the OSC setting out a chronology of material events. In preparing the letter she relied upon information from members of senior management and a member of the company’s board. Daub did not take sufficient steps to confirm that information for herself, and the letter to the OSC was misleading. The Settlement Agreement noted that Daub “did not intend to mislead” OSC staff in the letter, cooperated with the investigation, and “no longer works at ATI”. Daub was reprimanded under s. 127(1) of the *Securities Act* and ordered to pay $5,000 in respect of the cost of the investigation and hearing. Should the case have been prosecuted? Should the Law Society have taken action as well?

(c) Privilege for Corporate Counsel and the European Approach

Because in-house counsel are not just lawyers — they are also employees and sometimes hold non-legal management or officer positions or have non-legal duties in addition to their legal ones — one of the challenges for in-house lawyers working for organizations is to carefully manage divergent roles and responsibilities both as legal advisors and as members of the management team. Often these lawyers are relied upon and expected to provide both business and legal advice; lawyers working for law firms may be asked to do the same by their corporate clients, but the intertwining of the advice is especially pronounced when a lawyer is working in an in-house capacity. While all lawyers need to be careful to ensure that privilege and confidentiality are protected, this is especially important for corporate counsel.

In *Pritchard v. Ontario (Human Rights Commission)*, the Supreme Court of Canada wrote:

> Owing to the nature of the work of in-house counsel, often having both legal and non-legal responsibilities, each situation must be assessed on a case-by-case basis to determine if the circumstances were such that privilege arose. Whether or not the privilege will attach depends on the nature of the relationship, the subject matter of the advice, and the circumstances in which it is sought and rendered.3

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The Saskatchewan Court of Queen’s Bench had considered this issue in *Potash Corp. of Saskatchewan v. Barton* and held that:

\[\ldots\] when corporate counsel works in some other capacity, such as an executive or board secretary, information is not acquired in the course of the solicitor/client relationship and no privilege attaches.\(^6\)

So, where in-house counsel is playing an executive role that is not necessarily a legal role, the safest course is to assume that privilege will not apply. But subject to the kinds of cautions noted in these two cases, Canadian jurisprudence still affords privilege for the legal advice and communications between corporate counsel and their organizational clients. This is not the case in Europe, where at least in the context of regulatory investigations conducted by the European Commission, communications between European in-house lawyers and their corporate clients are not considered privileged as those lawyers have been held to lack the requisite independence that the European Court of Justice found to be necessary as a prerequisite for recognizing privilege between lawyer and client.

**PAUL D. PATON**

“The Future of Privilege”

*The Lawyers Weekly In-House Counsel* (2011) at 8

Should in-house counsel be treated the same as their law firm counterparts, especially when it comes to solicitor-client privilege? A recent European case and Canadian Bar Association (CBA) report have reignited the debate.

The European Court of Justice decision [in September 2010] in *Akzo Nobel Chemicals, Ltd. and Akcros Chemicals Ltd. v. Commission* offered a rare opportunity for the European Court of Justice (ECJ) to revisit two previous landmark decisions from 1982 and 1984 that privilege was not available to prevent disclosure of communications involving in-house lawyers in competition law investigations. In addition to reaffirming that principle, *Akzo* set back perceptions of the role of in-house lawyers in Europe by 30 years or more, and put into question the protections available for any communications between North American in-house counsel and their European counterparts or company executives.

In *AM&S*, a 1982 decision, the European Commission (EC) seized documents emanating from in-house counsel during surprise raids on the company and used them as evidence of infringement of European Union (EU) competition law even though the documents contained only legal advice to company management. The ECJ established that a “legal professional privilege” exists in the EU where i) the communication was made for the purpose of and in the interest of a client’s defense, and, ii) where the communication involves an

\[\ldots\]

“independent lawyer, that is to say one who is not bound to his client by a relationship of employment.”

In John Deere, a 1984 case, the document seized during a similar raid was a memorandum from Deere and Co.’s American general counsel to company managers in Europe in which he expressed the view that company policies may have been violating EU law. The EC rejected the company’s privilege claim and used the memo as evidence that the company was engaging in competition law violations willingly and knowingly.

Akzo Nobel was the latest round in this battle. The case arose out of raids by the EC in 2003 on the premises of Akzo and its subsidiary Akcros during an investigation of suspicions that the companies were participating in a cartel. The documents seized included two emails between a company executive and Akzo’s in-house counsel for competition law, who was admitted to the Netherlands Bar. The in-house lawyer had signed an agreement with Akcros specifically acknowledging his independence, which would have permitted the company to assert privilege under Dutch law.

In its September 14, 2010 decision, the ECJ reconfirmed AM&S and held that legal professional privilege did not apply to communications with in-house lawyers in competition law investigations conducted by the EC under EU law, despite the independence agreement the Dutch lawyer had signed with the company. The language the ECJ adopted in coming to this conclusion had both practical and symbolic implications. In particular, the court focused on the in-house lawyer’s “economic dependence” and “close ties” with his employer to find that he “does not enjoy a level of professional independence comparable to that of an external lawyer.” Despite the fact that an in-house lawyer is enrolled with a Bar or law society and has professional ethical obligations which flow as a result, he “occupies the position of an employee which, by its very nature, does not allow him to ignore the commercial strategies pursued by his employer, and thereby affects his ability to exercise professional independence.”

While the [U.S.] Association of Corporate Counsel (ACC) attempted to diminish the impact of the decision in a September 2010 member briefing by noting that in “concrete terms … the overwhelming majority of potential legal privilege cases or incidents will not be affected by the Akzo ruling at all,” and that the decision “has limited legal effect outside EU competition law investigations conducted by the EC,” an ACC press release suggested much more grave consequences.

The ACC quoted J. Daniel Fitz, former ACC board chair in London, as saying that the ruling “has serious ramifications as it denies in-house attorneys and multinational businesses in Europe and elsewhere the critical legal counsel on competition law matters that companies working in today’s global legal marketplace require. The Court has locked into place the notion that in-house lawyers are not capable of independent judgment under EU professional standards.” The ACC’s General Counsel was even stronger in her condemnation.
Susan Hackett said the court ignored “the realities of modern in-house practice. In-house counsel are top legal practitioners who are just as capable as their outside counsel counterparts; the idea that professional independence stems from the type of office a lawyer works in, rather than from their moral and professional compass, evidences a deep misunderstanding of legal professionalism and lawyers.”

And while *Akzo Nobel* started as a competition investigation, language in the judgment signals that the same result may be applied beyond the narrow confines of competition law and perhaps to other European Union (EU) regulations and institutions. The decision creates a direct conflict with privilege that might otherwise be accorded at a national level to in-house counsel (in England, for example). Further, the European Advocate General’s opinion in the case, though not binding, took the position that privilege does not extend to external counsel who are not admitted to the Bar of an EU member state.

For practical purposes, then, all communications between North American corporate counsel and the offices and subsidiaries in Europe are potentially at risk. The decision could drive company management to ensure that any communications with in-house lawyers about EU competition law are oral, not written; North American corporate counsel will need to remember that their conversations with European counterparts may not be privileged for certain purposes in Europe; and the possibility exists that challenges might arise in Canadian and U.S. courts to privilege claims over inter-company communications: can a communication with in-house lawyers arise with a “reasonable expectation of confidentiality” when such communications are subject to seizure by the European Commission?

A February 2011 discussion paper prepared for the Canadian Bar Association entitled “Solicitor-Client Privilege: Challenges for the 21st Century” raises curious questions about privilege in corporate contexts within its broad sweep. The paper’s author, … Professor Adam Dodek, notes that Canadian law has “only begun to address the multiplicity of issues that can arise in the corporate context” and that the Supreme Court of Canada “has only determined the most fundamental question,” that privilege applies to advice given in the corporate context. Yet in a previous 2010 article upon which much of the CBA paper is based, Dodek concluded that “[w]hen the client is an organization, the privilege should not apply” and argued for reduced protection for privilege in organizational contexts. Such a radical recommendation both misunderstands the importance of privilege within corporations and — like *Akzo* — could consequently cast corporate counsel into a lesser status within the profession. In contrast, a 2010 CBA report [the CBA’s Ethics Committee’s November 2010 “FAQs on Solicitor-Client Privilege and Confidentiality”] offers both practical tools for corporate counsel and reaffirms the importance of privilege to the lawyer-client relationship in all practice environments.

*Akzo Nobel* shows there is a need for a better understanding of the rationale for privilege and of the professional ethics and role of in-house counsel. Be-
coming more aware of both the domestic and international challenges, substantive and symbolic, is only the first step.

NOTES AND QUESTIONS

1. What practical steps might in-house counsel in Canada take to ensure that privilege is protected?

2. The European Court of Justice found that because an in-house lawyer has “economic dependence” upon and “close ties” with his employer, he “does not enjoy a level of professional independence comparable to that of an external lawyer”. Do you agree? How does the role of the corporate counsel differ from that of the external lawyer? How might an in-house counsel ensure that his or her independence is protected and maintained?

C. CONCLUSION

In providing an introduction to the important roles lawyers play in organizations, together with the ethical challenges they encounter, this chapter has sought both to raise questions about how lawyers practise law in such settings and about the rules that guide them in doing so. The Enron scandal and responses to it by legislators and regulators in the United States set the stage for fundamental changes not only to those rules, but also to the assignment of responsibility for creating and enforcing them. The broader debate over whether lawyers are “gatekeepers” continues, and is especially important for lawyers in corporate or organizational settings. Differences in Canadian and U.S. approaches to regulating lawyer conduct in this area remain, for the time being, though for Canadian lawyers working in organizational settings the influence of globalization and cross-border practice means that knowing about U.S. rules and approaches is especially important. And as Wilder and Daub indicate, Canadian lawyers are not immune from scrutiny and discipline by regulators other than their own law societies.

Knowing the general rules concerning client relationships, privilege and confidentiality, and the distinction between legal and business advice are also of particular importance for lawyers in organizational settings, even though the general guidance provided in Rules of Professional Conduct may not specifically address in-house settings. Who is the client? When does privilege apply? Where is the line drawn between legal and business advice? How might the answers change because of the corporate context?

With these challenges come opportunities. Lawyers in organizational settings can serve as the “corporate conscience”, aiding their organizational clients to situate and assess the daily business challenges and economic imperatives with broader and longer-term concerns, and to establish an organizational culture of compliance and integrity. In order to do so, however, these lawyers need to be aware of the pressures to compromise their own independence and integrity. Understanding and appreciating the underlying personal and professional pressures is the necessary prerequisite to informing thoughtful rule development.
Rules alone are not enough, however. Recognizing the unique ethical challenges corporate counsel in Canada face, acknowledging the increasing importance of corporate counsel in Canada, and taking constructive steps to support them as they face their personal and organizational tests, are all part of the solution. In the end, lawyers, corporations and the public will all be better served by corporate counsel who have the broader bar’s understanding of — and empathy for — the social and professional reality they occupy within the complex set of fiduciary and professional responsibilities to their clients and to the public in the post-Enron era.

D. FURTHER READING


