Filed August 14, 2002

Bar No. 8652

SUPREME COURT

OF THE STATE OF WASHINGTON

In the Matter of the Disciplinary Proceeding Against

DOUGLAS A. SCHAFER,

an Attorney at Law.

RESPONDENT LAWYER'S FOURTH STATEMENT OF ADDITIONAL AUTHORITIES

Attorneys for Respondent:

Douglas A. Schafer, Attorney
Schafer Law Firm
P.O. Box 1134
950 Pacific Ave., Suite 1050
Tacoma, WA 98401-1134
(253) 383-2167

Donald H. Mullins, Attorney
Badgley~Mullins Law Group
Washington Mutual Tower
1201 Third Avenue, 51st Floor
Seattle, WA 98101
(206) 621-6566

Shawn T. Newman, Attorney
2507 Crestline Dr. NW
Olympia, WA 98502
(360) 866-2322

RESPONDENT LAWYER'S FOURTH STATEMENT OF ADDITIONAL AUTHORITIES

Pursuant to RAP 10.7, the following additional authorities are submitted without argument:

The Sarbanes-Oxley Act of 2002 (Public Law 107-204, effective July 30, 2002. An Act to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.)

> "**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."

Fred C. Zacharias, "Federalizing Legal Ethics," 73 Tex. L. Rev. 335 (1994). Professor Zacharias begins his article with, "Scholars increasingly have referred to the prospect of uniform federal rules that would govern the professional conduct of lawyers. Some commentators assume the inevitability of such rules ...."

<-- Link to Mr. Pitt's 1981 article in PDF

Harvey L. Pitt, "The Georgetown Proposals," 36 Business Lawyer 1931 (1981). Private practice corporate lawyer Pitt (now SEC Chairman) describes the 1978 proposals by the Institute for Public Interest Representation (affiliated with Georgetown University Law Center) that the SEC, by rule, should require that lawyers representing public companies *report evidence of fraud or lawlessness* (essentially as Section 307 of the Sarbanes-Oxley Act of 2002 now provides). The ABA Business, Banking, and Corporations Section vigorously opposed that 1978 proposal and dissuaded the SEC from adopting it by offering to address the matter by a provision in the new ABA Model Rules[1], which ultimately became Rule 1.13 (*that the Washington Supreme Court rejected when it adopted the Model Rules in 1985*). Mr. Pitt said in his 1981 article, "I really prefer not to disturb what is lying in the grave. The Georgetown Proposals have been denied and it is unlikely in my view that they will be resurrected ...." But Enron, Worldcom, and other corporate scandals resurrected the Georgetown Proposals — during Harvey Pitt's watch as SEC Chairman — and have renewed public cries to *federalize* the lawyer ethics rules.

Stephanie Francis Cahill, "Corporate-Fraud Law Forces Lawyers to be Whistle-Blowers," ABA Journal e-Report, Aug. 2, 2002. This article about Section 307 of the Sarbanes-Oxley Act quotes an ABA Litigation Section leader as condemning the new law and quotes a past chair of the American Corporate Counsel Association as being quite comfortable with the new law — characteristic of their fraternities' very different views concerning the roles of lawyers and their duties to society. A copy is attached as Exhibit A. <-Link to Exhibit A on the Internet

Preliminary Report of the American Bar Association Task Force on Corporate Responsibility, July 16, 2002. (Posted on the ABA Section of Business Law's website at http://www.abanet.org/buslaw/corporateresponsibility/) The Task Force, Chaired by James H. Cheek (recent Chair of the ABA Business Law Section), published a 51-page report that strongly recommends adoption of *all* the ABA Ethics 2000 Commission's recommended changes to Model Rule 1.6 and further recommends ***mandatory*** lawyer reporting of information to prevent

[1] This well-orchestrated and successful campaign by the ABA Business, Banking, and Corporations Section is described in Ted Schneyer, "Professionalism as Bar Politics: The Making of the Model Rules of Professional Conduct," 14 Law & Social Policy 677, 698-99, 705-07 (1989).

<--Link to journal articles. (10 seconds to load.)

conduct involving crime that *has been furthered* [past tense] by the lawyer's services. The Task Force Report's sage words (absent footnotes, with emphasis added), at pages 30-33 are:

> The ABA Commission on Evaluation of the Rules of Professional Conduct ("Ethics 2000") proposed in February of this year, consistent with the Restatement (Third) of the Law Governing Lawyers, that three exceptions be added to Model Rule 1.6 to permit the lawyer to disclose client confidences to third parties. The ABA House of Delegates approved one of those exceptions, permitting disclosure when necessary to prevent reasonably certain death or substantial bodily harm. It rejected the other two Ethics 2000 proposals to expand permissive disclosure under Rule 1.6. *Those proposals would have permitted disclosure to prevent or rectify the consequences of a crime or fraud in which the client had used or was using the lawyer's services and that was reasonably certain to result, or had resulted, in substantial injury to the financial interests or property of another.*
>
> The Task Force recommends that the House of Delegates reconsider and adopt these Ethics 2000 proposals. We endorse the following articulation in the Ethics 2000 report of the rationale for those proposals:
>
> > The Commission recommends that a lawyer be permitted to reveal information relating to the representation to the extent necessary to prevent the client from committing a crime or fraud reasonably certain to result in substantial economic loss, but only when the lawyer's services have been or are being used in furtherance of the crime or fraud. Use of the lawyer's services for such improper ends constitutes a serious abuse of the client-lawyer relationship. The client's entitlement to the protection of the Rule must be balanced against the prevention of the injury that would otherwise be suffered and the interest of the lawyer in being able to prevent the misuse of the lawyer's services.
> >
> > Moreover, with respect to future conduct, the client can easily prevent the harm of disclosure by refraining from the wrongful conduct. …
> >
> > The rationale for [permitting disclosure to prevent,

mitigate or rectify substantial economic loss resulting from client crime or fraud in which client has used lawyer's services] is the same …, the only difference being that the client no longer can prevent disclosure by refraining from the crime or fraud. See also Comment [8]. The Commission believes that *the interests of the affected persons in mitigating or recouping their substantial losses and the interest of the lawyer in undoing a wrong in which the lawyer's services were unwittingly used outweigh the interests of a client who has so abused the client-lawyer relationship.*

The Task Force further recommends amendment of Rule 1.6 to make disclosure ***mandatory****, rather than permissive, in order to prevent client conduct known to the lawyer to involve a* ***crime****, including violations of federal securities laws and regulations, in furtherance of which the* ***client has used*** *or is using the lawyer's services, and which is reasonably certain to result in substantial injury to the financial interests or property of another.*

Forty-one states either permit or require disclosure to prevent a client from perpetrating a fraud that constitutes a crime, and *eighteen states permit or require disclosure to rectify substantial loss resulting from client crime or fraud in which the client used the lawyer's services*. If existing Rule 1.6 was "out of step with public policy" a year ago, as Ethics 2000 concluded, it is even more out of step today, when public demand that lawyers play a greater role in promoting corporate responsibility is almost certainly much stronger. The Ethics 2000 proposals are an important part of an effective response to the problems that have provoked public criticism of the bar.

Speech by SEC Chairman Harvey L. Pitt to the ABA Business Law Section on August 12, 2002. (Posted on the Securities and Exchange Commission website at: http://www.sec.gov/news/speech/spch579.htm. Chairman Pitt discusses his agency's Congressional mandate to develop responsible, public-interest Rules of Professional Conduct for lawyers representing public companies. While much of his talk dealt with corporation-as-client (*not* corporate-executive-as-client) issues addressed in ABA Model Rule 1.13 (that the Washington State Supreme Court even rejected in 1985), he also discussed the broader lawyer ethics and public

policy issues. Particularly noteworthy were the following passages:

> Sarbanes-Oxley reflects some skepticism about the degree to which the legal profession can police itself, by making explicit the Commission's ability, *and our obligation*, to regulate how lawyers appear and practice before us, including minimum standards of professional conduct for corporate lawyers.
>
> [T]here are risks inherent in giving an agency that sometimes faces corporate lawyers as adversaries the ability to regulate whether and how they satisfy our notions of appropriate professional behavior. It's in the profession's interest to work with us to remedy deficiencies in the present system.
>
> ***The profession should examine itself*** and provide guidance about how ***its members should behave*** that is broader than technical legality, and ***truly in the public interest***. The Report produced by Jim Cheek's Task Force is in the best tradition of this kind of private sector self-examination.
>
> [C]onsider Dante's "counselors of fraud." We're told that they "used their high mental gifts for guile, and because of their higher endowment their sin is reckoned greater and their place is lower than that of thieves." There is an analogy to modern times. Lawyers cannot escape their role in giving assistance to corporate wrongdoers by hiding behind their ability to craft a clever phrase to circumvent what they know to be the right answer. In fact, according to Dante it's that very gift that makes lawyers even more complicit!
>
> The Task Force's Report makes other sensible suggestions, including broadening the circumstances under which lawyers may disclose conduct that might result in injury to the financial assets or property of another.

Susan B. Koniak, "Who Gave Lawyers a Pass?" Forbes Magazine, August 12, 2002, page 58. (Available at http://www.forbes.com/forbes/2002/0812/058_print.html and copy attached as Exhibit B.) Boston University Law Professor Koniak, condemning lawyer complicity in or enablement of corporate client fraud, writes (in selected excerpts):

<-- Link to Exhibit B on the Internet

> The dirty secret of the mess is that without lawyers few scandals

would exist, and fewer still would last long enough to cause any real harm. Lawyers need to be regulated. No other legal reform enacted will do any good as long as there are no consequences to lawyers who bless anything a manager wants to do.

Is it good that a profession so prone to harming clients and shareholders remain virtually unpoliced? Three avenues of regulation exist: state disciplinary authorities, the Securities & Exchange Commission and private lawsuits against lawyers. None of them now works.

Disciplinary authorities are charged with enforcing state ethics rules, which are law. In all my research, I have come across no state disciplinary authority that has initiated charges against a big law firm for aiding securities fraud. The disciplinary authority would be absurdly outgunned.

Every state's ethics rules prohibit assisting client fraud and demand that a lawyer resign when he "knows" his services are being used for fraud. Lawyers never "know," and thus never have to resign. Other ethics rules allow lawyers to do certain things, like alert the chief executive or board to corporate fraud; some allow lawyers to tell the SEC. But none of that is required.

The law that prohibits aiding and abetting fraud applies to everyone, including lawyers. But prosecutors rarely enforce it against lawyers.

Because lawyers are necessary to commit almost any fraud of more than a moment's duration, their firms' survival should be on the line. What's needed is to restore aiding-and-abetting liability, joint-and-several liability and the recklessness standard, at least for lawyers.

The lawyer problem is systemic: no "few bad apples" here. ... This is a disgrace.

Professor Koniak wrote a scholarly and insightful journal article in 1992 documenting the extent to which highly organized bars dominate the judiciary (that lacks leadership and commitment, and lacks independence from the organized bars) in determining and enforcing lawyers' professional norms of behavior. Susan P. Koniak, "The Law Between the Bar and the State," 70 N.C.L. Rev. 1389 (1992). *<--Link to journal articles. (10 seconds to load)*

Recognizing the different attitudes between courts and organized bars on the issue of reporting client fraud, Professor Koniak, with Professors Geoffrey Hazard Jr. and Roger Cramton, wrote in their law student case book, “In general, rules adopted by state courts provide for disclosure of client fraud while bar interpretations call for nondisclosure.” Geoffrey C. Hazard, Jr., Susan P. Koniak, and Roger C. Cramton, “The Law and Ethics of Lawyering,” pg. 282 (Foundation Press, Third Edition, 1999).

Peter Aronson, “Law Firms Pay $109M to Settle Investment Fraud Suits,” The National Law Journal, May 23, 2002. (Available at http://www.law.com/jsp/article.jsp?id=1022761087674 and a copy attached as Exhibit C.) The article describes a $500 million fraud by a Portland investment management firm, perpetrated mostly against pension and health benefit trusts, and the recovery of $109 million from allegedly complicitous lawyers. The list includes law firms prominent in Washington state, including Lane Powell Spears Lubersky ($25 million) and Stoel Rives ($12.5 million).

<-- Link to Exhibit C on the Internet

Of particular note in the article is its closing line stating that the law firm that blew the whistle—“immediately notifying authorities once it realized fraud was being committed”—was from **New Jersey**, McCarter & English ($2.5 million). That is not surprising, since the New Jersey Supreme Court demonstrated true leadership in 1982 by adopting a public-interest version of Rules of Professional Conduct Rule 1.6 that *requires* lawyers to report ongoing client criminal, illegal or fraudulent acts and *permits* such reporting to rectify the consequences of such acts in which the lawyer had been used. A copy of that Rule is attached as Exhibit D (Available at http://njlawnet.com/nj-rpc/rpc1-6.html)

<--Link to Exhibit D on the Internet

Leslie C. Levin, “Testing the Radical Experiment: a Study of Lawyer Response to Clients Who Intend to Harm Others,” 47 Rutgers L. Rev. 81 (1994). Law Professor Levin surveyed New Jersey lawyers eleven years after the state’s confidentiality rule was adopted in 1982 to *mandate* lawyer reporting to prevent client’s *criminal, illegal or fraudulent act* and to *permit* lawyer reporting to rectify consequences of a client’s *criminal, illegal or fraudulent act*. She found that clients continued to employ and confide in New Jersey lawyers—that nothing had significantly changed in clients’ reliance on their lawyers.

<--Link to Prof. Levin's article in PDF format.

Respectfully submitted this 14th day of August, 2002.

____
Douglas A. Schafer, WSBA No. 8652