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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 EIGHTH STATEMENT OF ADDITIONAL AUTHORITIES

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RESPONDENT LAWYER'S EIGHTH
STATEMENT OF ADDITIONAL AUTHORITIES

These additional authorities are submitted pursuant to RAP 10.8:

Final Rule of U.S. Securities and Exchange Commission ("SEC" or "Commission") codified as 17 C.F.R. Part 205, titled "Standards of Professional Conduct for Attorneys," explained in Release No. 33-8185 (January 29, 2003); 68 Fed. Reg. 6296 (February 6, 2003). On January 23, 2003, the SEC adopted final rules as directed by Section 307 of the Sarbanes-Oxley Act to set "standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers." Its News Release 2003-13 <http://www.sec.gov/news/press/2003-13.htm> summarizes the new rules, including their *prevent fraud* and *rectify fraud* provisions and their *preemption of conflicting state ethics rules*, saying that the new rules:

Link to Final Rule

Fed. Register edition

Link to News Release

- "**allow an attorney**, without the consent of an issuer client, **to reveal confidential information** related to his or her representation to the extent the attorney reasonably believes necessary (1) **to prevent** the issuer from committing **a material violation** likely to cause substantial financial injury to the financial interests or property of the issuer or investors; (2) to prevent the issuer from committing an illegal act; **or** (3) **to rectify the consequences of a material violation or illegal act in which the attorney's services have been used**; (emphasis added)
- "state that the rules govern in the event the rules conflict with state law, but will not preempt the ability of a state to impose more rigorous obligations on attorneys that are not inconsistent with the rules."

In Release No. 33-8185, at 68 Fed. Reg. (FR) 6310-12, the Commission explained its rationale for permitting lawyers to reveal confidential client information to prevent fraud or to rectify fraud furthered by the lawyer's services, saying about the new paragraph 205.3(d)(2):

> "It corresponds to the ABA's Model Rule 1.6 as proposed by the ABA's Kutak Commission in 1981-1982 and by the ABA's Commission of Evaluation of the Rules of Professional Conduct ("Ethics 2000 Commission") in 2000, and as adopted in the vast majority of states.

....
"Although commenters raised a concern that permitting attorneys to disclose information to the Commission without a client's consent would undermine the issuers' trust in their attorneys, the vast majority of states already permit (and some even require) disclosure of information in the limited situations covered by this paragraph, and the Commission has seen no evidence that those already-existing disclosure obligations have undermined the attorney-client relationship. In addition, the existing state law ethics rules support the proposition that **generalized concerns about impacting the attorney-client relationship must yield to the public interest where an issuer seeks to commit a material violation** that will materially damage investors, seeks to perpetrate a fraud upon the Commission in enforcement proceedings, **or has used the attorney's services to commit a material violation.**" (emphasis added)

And responding to the comment letter by the Conference of Chief Justices <http://www.sec.gov/rules/proposed/s74502/jskaye1.htm> asking the SEC to delay action on the prevent/rectify fraud ethics rule so that state supreme courts might *take a leadership role* in enacting it, since the Conference on August 1, 2002, had formally endorsed it (a mere 20 years after the Kutak Commission first wrote it in 1982), the Commission explained at FR 6312:

Link to CCJ Letter

"[D]elay pending further developments does not promise to be fruitful: most state supreme courts already have rules in place that are consistent with this paragraph, and there is no evidence when, if ever, state supreme courts (or legislative bodies) will revisit these issues, and the public interest in allowing lawyers appearing and practicing before the Commission to disclose the acts covered by this paragraph counsels against waiting indefinitely for further refinement of state ethics rules."

The Commission noted, at FR 6311, that a number of commenters had supported the prevent/rectify fraud provision "and stated that the Commission should not delay action on this provision," citing in its fn.108 to that passage several public comment letters including "Comments of Douglas A. Schafer" <http://www.sec.gov/rules/proposed/s74502/daschafer121602.htm> a copy of which is attached as Exhibit A.

Link to Exhibit A

SEC Historical Society, ***Roundtable on Enforcement: A Brief History of the SEC's Enforcement Program 1934-1981 (September 25, 2002).*** At <http://www.sechistorical.org/museum/museum_Oral_Histories.shtml>. This historical narrative describes, at pages 24-28, the SEC's extraordinary and unprecedented enforcement initiative in the 1970s that was precipitated by the "rampant corruption among some of the country's largest corporations," including "corporate bribery, slush-funds, kickbacks, illegal campaign contributions and other fraudulent acts." To maximize the effectiveness of limited SEC resources, and recognizing that large corrupt corporations were supported by the "pillars" of the legal and accounting professions who were also their "keys" to the financial markets, the SEC aggressively began the "access theory" of enforcement – "bringing enforcement actions against [major law firms and accounting firms and their partners] for their conduct in connection with securities law violations by their clients." The narrative, at page 27, quotes from a *1976* speech by Stanley Sporkin, Director of the SEC's Division of Enforcement that was created in 1972:

To List of Histories

> "We all recognize that a major securities fraud cannot be perpetrated by a corporation, its officers and directors without access to our financial markets. Such access can only be provided through the activities of broker-dealers, banks, insurance companies, et al. In addition, systematized frauds frequently depend on the cooperation, intentional or otherwise, of professionals such as lawyers and public accountants. Many of the most egregious frauds of the past few years – frauds resulting in losses to investors of hundreds of millions of dollars – have involved the full panoply of professional participation." (*Has anything changed?–millions became billions!*)

The narrative, at page 28, understates the Bar's outrage over the SEC's fraud lawsuit against White & Case, the sixth largest U.S. law firm (*Wall Street Journal*, Feb. 15, 1972, p.1, col.1), and other elite *pillars* of the Bar:

> "The Commission also brought **numerous actions against lawyers and their law firms in the 1970s**. Among the most notable of these enforcement proceedings were actions against the law firm of White & Case in connection with the National Student Marketing Corp. matter and against lawyers at the firm of Brown, Wood, Ivey, Mitchell & Petty in connection with the National Telephone Company matter. **These actions were particularly controversial and generated heated debate** over whether the Commission had the authority to discipline lawyers and law firms under Rule 2(e) of its Rules of Practice." (emphasis added; footnotes omitted)

SEC Chairman Harvey L. Pitt's Speech on January 29, 2003, to the Securities Regulation Institute at San Diego, California, condemning the ABA's 1970s defensive-ethics strategy. The full speech transcript is at <http://www.sec.gov/news/speech/spch012903hlp.htm>. Chairman Harvey Pitt lectured the Bar last month, echoing assertions that I made at page 8 of Schafer's Reply Brief and in my SEC comment letter attached as Exhibit A, that the ABA's irresponsible and self-serving defensive reaction to the SEC's 1972 anti-fraud enforcement initiative was simply to reverse its long-standing ethics rule that traditionally had required lawyers to report client fraud perpetrated during the course of representation. Mr. Pitt lectured:

Speech Transcript

> [T]he conduct of securities professionals was a subject of discussion and debate at this Institute thirty years ago, due to the SEC's decision to sue two large law firms and one large accounting firm for their roles in the *National Student Marketing* securities fraud. ... Consonant with the ABA Model Code of Professional Responsibility then in effect, [n.4] the Commission claimed lawyers and accountants were obligated not only to stop fraudulent conduct in conjunction with a merger but also to report to shareholders or the SEC if their clients failed to rectify their course. [n.5]
>
> **The legal profession reacted negatively to *National Student Marketing*; in fact, the ABA amended its Model Code to cloak corporate communications about fraud in privilege.**[n.6] Now, three decades later, Congress focused on lawyers who sit by while corporate frauds are perpetrated on their watch. The resulting legislation reflects a Congressional belief that lawyers who failed to speak up facilitated the recent spate of corporate collapses. Some suggest the Bar "provided its members with many confusing notions and no guidance on how to act."[n.7] ... I have no doubt **the Bar must assume greater responsibilities if public trust is to be restored**. The Bar has a chance to assess its responsibilities and establish clear guidelines for the professional conduct of attorneys who represent public corporations. I encourage the Bar to do so ...." (emphasis added)

[n.4] The ABA Model Code of Professional Responsibility provided:
A lawyer who receives information clearly establishing that
(1) His client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal.

[n.5] *SEC v. National Student Marketing Corp.*, 412 Federal Securities Law Reports ¶93,360 (CCH).

[n.6] ABA Code of Professional Responsibility [Disciplinary Rule] 7-102(B)(1) (amended in 1974 to add "except when the information is protected as a privileged communication").

[n.7] Theodore Sonde and F. Ryan Keith, *"'Up the Ladder' and Over: Regulating Securities Lawyers - Past, Present & Future"* (2002) (available at http://www.crowell.com/pdf/Ladder.pdf ; a finalized version will appear in a forthcoming issue of the Washington and Lee Law Review).

"Up the Ladder" article

Theodore Sonde and F. Ryan Keith, *"Up the Ladder" and Over: Regulating Securities Lawyers – Past, Present & Future*, (Nov. 2002) <http://www.crowell.com/pdf/Ladder.pdf>. Theodore Sonde was the SEC's lead trial counsel in its *National Student Marketing Corp.* case from 1972 through 1978. With his recent comment letter on the SEC's proposed lawyer ethics rules <http://www.sec.gov/rules/proposed/s74502/tsonde1.htm>, Mr. Sonde submitted his pre-publication edition of this forthcoming Washington and Lee Law Review article to describe with historical accuracy the SEC's 1972 enforcement initiative and the Organized Bar's irresponsible, if not outright corrupt, defensive response to it of changing to its own model ethics rule that had always required lawyers to report their discoveries of client fraud. At page 5, Mr. Sonde and his co-author, Mr. Keith, wrote:

> [T]he SEC in 1972 did something nevertheless unheard of in the history of securities regulation: it sued two large law firms for securities fraud. Further, the SEC claimed, as it had never done before, that both of those law firms had a professional obligation to not only stop the consummation of a fraudulent merger, but, when their clients failed to heed what would have been sound legal advice under the circumstances, the firms had an additional obligation to report to the shareholders of the two companies or to the SEC the fraudulent nature of the transaction. Although unprecedented, the complaint in that case, *SEC v. National Student Marketing*, at least on its face, did not seem so remarkable.
>
> Indeed, the Bar's existing ethical rule on point precluded the conduct at the heart of the *National Student Marketing* case. At the time, the ABA Model Code of Professional Responsibility [DR 7-102(B)(1)] provided thus:
>
> A lawyer who receives information clearly establishing that

> (1) His client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal.
>
> (2) A person other than his client has perpetrated a fraud upon a tribunal shall promptly reveal the fraud to the tribunal.

> The Commission's theory in the case was consistent with this duty, as well as with the historical exemption of crime or fraud from attorney-client communications that enjoyed a privilege in the first place. [fn.7]

[fn.7] This had been the rule in American law for at least 100 years, though, as a practical matter, was never enforced against large law firms, as in *National Student Marketing*. *See* 1928 ABA Canon of Professional Ethics 37 ("announced intentions of a client to commit a crime is not within the confidences which [the attorney] is bound to respect"); 1908 ABA Canon of Professional Ethics 41 (lawyer "should endeavor to rectify" fraud or deception, independent of client confidentiality); *see also Nix v. Whiteside*, 475 U.S. 157, 167-68 (1986) (these rules "articulate centuries of accepted standards of conduct"); *Queen v. Cox*, 14 Q.B.D. 153, 168 (1884) (quoted with approval in *Clark v. United States*, 289 U.S. 1, 15 (1932)). In fact, in 1969, when the conduct at issue in *National Student Marketing* occurred, the somewhat stricter Canon of Professional Ethics 37 remained the law in most states. *See generally* [Theodore] Sonde, [*Professional Responsibility – A New Religion, or the Old Gospel?*, 24 Emory L.J. 827 (1975)], at 830-32.

At page 6, Messrs. Sonde and Keith noted the Bar's defensive response – it added an exception for "privileged" information to DR 7-102(B)(1) in February 1974 and 19 months later interpreted (ABA Formal Ethics Opinion 341) that new exception to cover *both* privileged and unprivileged information, reversing the historical rule on reporting client fraud:

> [T]he Bar's "comment" and "assessment" culminated in – to major surprise – the functional evisceration of the ethical rule on its books. By the decade's end, information "protected as a privileged communication," even if that information was perpetrating an

unrectified fraud, purportedly no longer needed to be disclosed. This move turned *National Student Marketing*, and, of course, the historical rule, on their heads.

With this change, the legal profession was reacting to *National Student Marketing* with unabashed denial. Rather than accept any form of public responsibility, the organized Bar proceeded to weaken its ethical rules, and provided its members with many confusing notions and no guidance on how to act. In fact, the Bar actually provided so much misdirection that it may have actually caused many members of the profession to lose sight of their professional obligations.

G. Richard Shell, *It's About Time: Corporate Responsibility Law Finally Makes Lawyers More Accountable*, Wharton Business Ethics (Aug. 14, 2002), an e-newsletter of Wharton Business School, U. of Pennsylvania.
http://knowledge.wharton.upenn.edu/articles.cfm?catid=11&articleid=604

To Shell's article

Legal Studies Professor G. Richard Shell applauds Congress for finally *federalizing* the sorely needed regulation of amoral "*legal enablers*," saying:

> Why is the legal profession so worried? Because the new law pricks at the heart of a system under which lawyers have always escaped accountability in business cases.
>
> There are, essentially, **two models of the lawyer's role** in business, the Trusted Counselor model and the Legal Enabler model. The former is what law school deans talk about at graduation and retired lawyers write about in their memoirs. **Trusted Counselors act as officers of the court** whose job is to **prevent clients from falling into crime**. When their advice goes unheeded, they withdraw in protest. On rare occasions, **they even blow the whistle.**
>
> **The Legal Enabler model, by contrast, is what the average corporate lawyer follows** to make a living at the law. **Legal Enablers pass no judgments** on corporate acts and take no positions on the wisdom of business decisions. Instead, **they provide morally neutral risk analysis**. Their stock in trade is not legal judgment; it is **legal rationalization**. **They provide legal spin** to justify both questionable as well as sound transactions. (emphasis added)

Mark L. Tuft, *For Your Eyes Only: California's duty of confidentiality is both more inclusive and more protective than the attorney-client privilege*, Los Angeles Lawyer, Vol.25, No.9 (Dec. 2002), P.26. Available in picture-perfect PDF at: <http://www.lacba.org/showpage.cfm?pageid=2700> and in unpaginated HTML at:<http://www.lacba.org/showpage.cfm?pageid=2687> Mr. Tuft, active in multiple California Bar *ethics* committees, wrote a comprehensive article in which he observed, frankly, at page 32:

Tuft article in PDF

Tuft article in HTML

> The ABA has not been a model of consistency on the issue of disclosing client crime or fraud as an exception to the duty of confidentiality. Early versions of the ABA rules permitted discretion to disclose confidential information to protect third parties from being victims of a crime. **The ABA Model Code obligated a lawyer to rectify client fraud by, if necessary, revealing the fraud to third parties. However, after the SEC's reliance on ABA Model Code DR 7-102(B)(1) in a highly publicized investigation that led to *SEC v. National Student Marketing Corporation*, the ABA amended its rule to preclude disclosure of client fraud "when the information is protected as a privileged communication." The next year the ABA changed its rule to define "privileged communication" as including all "confidences and secrets" learned during the attorney-client relationship.**
>
> The controversy over the application of the crime-fraud exception to the duty of confidentiality was played out again in 1983 with the adoption of the ABA Model Rules and the rejection of the Kutak Commission proposal that Model Rule 1.6 permit disclosures to prevent or rectify client crime or fraud. Another proposal to restore much of the Kutak recommendation was again rejected in 1991.

Mr. Tuft discussed the Bar's obsessive fears of ***Tarasoff* liability** (see Schafer's Reply Brief at 6-7) for failing to warn the victims of their clients' lawlessness, should their shielding *ethics* rules ever change to permit them to sound such humane warnings. (The San Diego County Bar has now web-posted its ethics opinion 1990-1 that a lawyer *ethically* must let a witness be murdered rather than warn him or the police that a client is heading his way to kill him. <http://www.sdcba.org/ethics/ethicsopinion90-1.html>) Mr. Tuft discussed the ***Tarasoff* liability** exposure that purportedly arises from 1993 legislation that added a crime-fraud exception to California's Evidence Code, and from the 2001 ABA-approved (over the Calif. Bar's strong objections)

SDCBar Op.1990-1

Ethics 2000 Commission change to Model Rule 1.6(b)(1)(slightly expanding the "prevent death and substantial bodily injury exception"), at page 30:

> Although the application of *Tarasoff* to lawyers has been heavily debated, in the 25 years since the case was decided, no court has held a lawyer to a similar duty of disclosure, particularly to a person who is not the lawyer's client. However, new ABA Model Rule 1.6(b)(1) and Evidence Code Section 956.5 could lead to an analogous liability for lawyers.

Mr. Tuft's statements at page 32 illustrate the California Bar's self-serving refusal to acknowledge that their own state courts already have declared their duty of confidentiality is subject to *all* the exceptions to privilege (even the crime-fraud exception) that are codified in their statutory Evidence Code (as reported in Schafer's Opening Brief at page 47 and its n.64):

> There is uncertainty in California whether the exceptions to the attorney-client privilege apply equally to the duty of confidentiality. In *General Dynamics v. Superior Court*, the California Supreme Court suggested in dicta that Evidence Code Section 956.5 represents a situation in which the legislature decided that "the principle of professional confidentiality does not apply." More recently, the court of appeal in *Fox Searchlight Pictures, Inc. v. Paladino* found that Business and Professions Code Section 6068(e) must be read in conjunction with other statutes and ethics rules that permit the attorney to depart from strict confidentiality requirements, including Evidence Code Section 958, which applies to communications that are relevant to an issue of breach, by the lawyer or client, of a duty arising out of the attorney-client relationship. Relying on *In the Matter of Lilly*, the *Fox Searchlight* court found that the State Bar Court has determined that the duty of confidentiality under Section 6068(e) is modified by the exceptions to the attorney-client privilege contained in the Evidence Code. This assertion was repeated in *People v. Dang*. However, the *In the Matter of Lilly* opinion does not support the conclusion that Section 6068(e) is modified by the Evidence Code. (footnotes omitted)

James M. McCauley, *Corporate Responsibility and the Regulation of Corporate Lawyers*, Virginia Lawyer Register, Vol. 51, No. 4 (Nov. 2002) (11 pages).
<http://www.vsb.org/publications/valawyer/nov02/legal_ethics.pdf>
Virginia State Bar Ethics Counsel Jim McCauley examines the rich history of lawyer complicity in lucrative corporate corruption, saying at page 3:

McCauley's article

> The media's hyperventilation over these recent corporate scandals [*e.g.,* Enron, Adelphia, WorldCom, Global Crossing, Tyco, etc.] creates the impression that these corporate scandals are unprecedented. Regrettably, this simply is not so. Over the past 50 years, this country has witnessed a series of newsworthy corporate frauds. All of these scandals raise questions about a lawyer's responsibilities when a lawyer discovers, or has reason to know, that officers or other agents of the lawyer's corporate client are engaged in conduct that violates the law or breaches their fiduciary duty to the corporation and is likely to result in harm to the corporation, shareholders or other third persons. Examples include the National Student Marketing scandal in the late 1960s, O.P.M. in the early 1970s, Lincoln Savings & Loan during the S & L crisis of the 1980s and the more recent BCCI bank failure and fraud of the 1990s, which involved Washington insiders Clark M. Clifford and Robert Altman. In each of these situations, without admitting liability, outside law firms paid massive sums of money to settle liability claims in which injured parties asserted that the lawyers assisted their corporate clients in conduct that was fraudulent or illegal. (footnotes omitted)

Mr. McCauley notes, at page 3, that Virginia is a leader among the states by already *requiring* lawyer disclosures to prevent crime and permitting lawyer disclosures to rectify past client fraud, consistent with the recent Congressional mandate in the Sarbanes-Oxley Act. He concludes, at page 8 under the heading, "**Are Reforms Needed?**," by saying:

> The confidentiality rules in all states should provide an exception to at least permit, if not require, disclosure of client information necessary 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. The ABA House of Delegates in August 2001 rejected

> such a proposal made by the Ethics 2000 Commission. The ABA should **be a leader** for reform of the pertinent ethics rules instead of opposing the federal government's authority to require securities lawyers to **do the right thing**. (emphasis added)

Restoring the traditional public-interest fraud reporting ethics rules that were abandoned in the 1970s and 1980s due to self-serving Bar financial interests, is not truly "reform" but is simply re-establishing the profession's central moral traditions of placing respect for the law and service for the good of society ahead of serving the interests of one's self and one's lawless clients.

* * *

Respectfully submitted this 17th day of February, 2003.

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Exhibit A

December 16, 2002

Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File No. 33-8150.wp
Proposed Rule: Standards of Professional Conduct for Attorneys

Dear SEC Officials:

This comment letter about Release 33-8150 ("Release"), 67 Fed. Reg. 71670, is intended principally to support the concept inherent in the rules proposed as 17 CFR Part 205 that lawyers are not merely *hired guns*, but they, "as guardians of the law, play a vital role in the preservation of society." (Preamble to ABA's 1969 Code of Professional Responsibility, "CPR.") I specifically support Section 205.3(d) and (e) -- the proposed *mandatory* "noisy withdrawal" to signal future or past but ongoing illegality, the proposed *permissive* "noisy withdrawal" to signal past but not ongoing illegality, and the *permissive* disclosure of confidential client information to prevent illegality or to rectify the consequences of illegality that was furthered by the lawyer's services. I assume that those proposed provisions will produce considerable opposition from lawyers who will claim, mistakenly, that those provisions violate traditional core values of the legal profession and sacrosanct attorney-client confidentiality doctrines. I intend here to refute such claims.

My observation, based on considerable research, is that the present *hired gun* culture of American lawyers was born shortly before, and was codified in, the ABA's 1983 Model Rules of Professional Conduct ("Model Rules"). Prior to that time, American lawyers had recognized their duty in the *public interest* to prevent client crime and fraud and to rectify such if committed during their engagement, as exceptions to their general duty of confidentiality.

The Release, in the text linked to footnote 73, quotes passages from the ABA's 1908 Canons of Professional Ethics, Canons 37 and 41, reflecting the *public interest* exceptions to confidentiality. And those *public interest* exceptions were continued in the CPR, at Disciplinary Rule ("DR") 4-101(C)(3) ("A lawyer may reveal: (3) The intention of his client to commit a crime and the information necessary to prevent the crime.") and in DR 7-102(B)(1), quoted below, requiring disclosures to rectify client fraud committed during the lawyer's engagement. By mid-1973, 46 states had adopted the CPR, mostly without alterations.

In the early 1970's, the SEC took some highly visible enforcement actions against prominent law firms and lawyers for failing to act consistent with applicable law and the *public interest*

Fred Lipman's Letter

exceptions to confidentiality under the CPR. For background, see the penultimate paragraph of Frederick D. Lipman's November 27, 2002, comment letter on the Release. In the interests of its members, the ABA's Corporation, Banking and Business Law Section then assumed a leading role in analyzing, interpreting, and revising the profession's ethics rules on client confidentiality. In 1973, that Section's chairman, Donald J. Evans, formed a 35-member Committee on Counsel Responsibility and Liability ("Don Evans Committee"), which he himself chaired until 1981 when W. Loeber Landau became its chairman. During that time, committee rosters were published in the prefatory pages of the November issues of *The Business Lawyer*.

Mr. Don Evans was a partner in Goodwin, Procter & Hoar, one of Boston's largest firms.

Mr. Loeber Landau was a partner in Sullivan & Cromwell, one of the largest firms New York City.

One of the first projects of the Don Evans Committee was obtaining the adoption by the ABA House of Delegates of a formal Statement of Policy regarding responsibilities and liabilities of lawyers in advising with respect to the compliance by clients with laws administered by the SEC. The House of Delegates did so on August 12, 1975. The recommended and adopted Statement of Policy included the following passage that *still recognized the lawyer's traditional duty to disclose future as well as past client crime and fraud committed during the representation:*

> "4. Lawyers have an obligation under the CPR to advise clients, to the best of their ability, concerning the need for or advisability of public disclosure of a broad range of events and circumstances, including the obligation of the client to make appropriate disclosures as required by various laws and regulations administered by the SEC. In appropriate circumstances, **a lawyer may be permitted or required** by the Disciplinary Rules under the CPR **to resign his engagement if his advice concerning disclosures is disregarded by the client and, if the conduct of a client clearly established his prospective commission of a crime or the past or prospective perpetration of a fraud in the course of he lawyer's representation, even to make the disclosures himself**." (emphasis added)

The brief Report of the Don Evans Committee and the Council of the Corporation Section to the ABA House of Delegates supporting their recommended Statement of Policy included the following passage that recognized the lawyer's duty, under certain circumstances, to report client illegality to third parties:

> "This [attorney-client] relationship is undermined to the extent that client communications with lawyers are made with the risk that the lawyer will, if not satisfied with the client's response to his advice or if concerned over his own potential personal liabilities, **report possible deficiencies to third parties**. Accordingly, **it has long been recognized** by the Code of Professional Responsibility ("CPR") and its predecessor Canons of Ethics **that only in the clearest cases of illegal or fraudulent activities by a client in the course of the lawyer's representation should the lawyer be called upon or permitted to take such action**." (emphasis added)

The Statement of Policy and the supporting Report are reprinted both at 31 Bus. Law. 543

(November 1975) and at 100 ABA Annual Reports 999 (1975).

When that Statement of Policy was presented in the 1975 Annual Meeting of the ABA House of Delegates by the Corporation, Banking and Business Law Section, a motion was made on behalf of the Board of Governors to defer action on it until the 1976 Midyear Meeting, but that motion was defeated, after which the Statement was adopted as the Corporation Section had recommended it. The proceedings of that meeting, demonstrating the widespread support of the Statement, were recorded as follows:

> "Donald J. Evans of Massachusetts, a former Chairman of the Section, informed the House that he had created a Section committee when he was Chairman to consider the matter and that the Committee had the benefit of advice of liaison representatives of other interested ABA sections, including the Sections of Local Government Law, Insurance, Negligence and Compensation Law, Public Contract Law, Antitrust Law, Public Utility Law, Administrative Law, Probate and Trust Law, and Taxation. In addition, the Standing Committee on Ethics and Professional Responsibility had maintained a liaison relationship with the Section committee. Copies of the recommendation had been sent to nearly every other section and committee of the Association. Mr. Evans indicated that the only replies which had been received were favorable. Therefore, he opposed the Board's recommendation for deferral. Mr. Evans' remarks were supported by former President Robert W. Meserve of Massachusetts [who later served on the Kutak Commission and became its Chair upon Robert Kutak's death in January 1983], who spoke in opposition to deferral and in favor of adoption of the recommendation.
>
> "*The Chairman of the Standing Committee on Ethics and Professional Responsibility, Lewis H. Van Dusen, Jr., of Pennsylvania, indicated that his Committee was in favor of the recommendation and that it was consistent with the formal opinion which the Committee planned to issue in the near future*." (emphasis added)

100 ABA Annual Reports 665-68 (1975). The chair of the ABA Ethics Committee, Lewis H. Van Dusen, Jr., served on the Don Evans Committee from its formation in 1973 until at least 1982. He served on the eight-member ABA Ethics Committee from August 1969 through July 1978 and as its chair from August 1974 through July 1978. See *ABA Annual Reports* for those years, listing committee members.

Forty-nine days after the Statement of Policy was approved, the ABA Ethics Committee issued its highly controversial (as discussed below) Formal Opinion 341 (September 30, 1975), interpreting the "except clause" amendment to DR 7-102(B)(1) that the House of Delegates had approved 18 months earlier, at the February 1974 Midyear Meeting. That 1974 amendment had been recommended by the ABA Ethics Committee as one of eight "housekeeping" amendments presented without explanation and approved without debate. 99 ABA Annual Reports 166 (1974). As so amended in February 1974, DR 7-102(B)(1) read:

> "A lawyer who receives information clearly establishing that: (1) His client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal, *except when the information is protected as a privileged communication*." (the "except clause" emphasis is added)

The Don Evans Committee's full Report in the July 1975 issue of *The Business Lawyer* (Vol. 30, Pg. 1289, 1296) specifically analyzed the amended DR 7-102(B)(1) in the context of clients' past or future violations of the securities law, stating:

> "[A] clear violation of the securities laws, if known to the lawyer, would probably invoke the application of DR 7-102(B)(1), unless protected by the last clause thereof, which protects confidential communications. This clause was added in 1974, apparently to avoid conflicts with the applicable state law concerning the attorney-client privilege. . . . Thus, **if the attorney-client privilege under state law does not prevent a lawyer from disclosing his client's prospective crime or fraud or crime or fraud perpetrated during the course of representation, the addition of the 1974 exception clause would not have any effect in reducing the required disclosures** because such information would not be protected by the attorney-client privilege.
>
> "Applying this to the role of a lawyer in various SEC contexts, **if the crime has already been committed** and no future or ongoing offense is predicated on the client's act, **the lawyer may not disclose the confidential communication unless the crime was committed during the course of the lawyer's representation. However, if the client is about to engage in illegal conduct**, for example, publish a prospectus which he knows and the lawyer knows to be fraudulent, **the lawyer's duty would clearly be to take steps to reveal the fraud**." (footnotes omitted and emphasis added)

The Don Evans Committee's 1975 interpretation of the 1974 "except clause" amendment to DR 7-102(B)(1) reflected input from Lewis Van Dusen, its liaison to the ABA Ethics Committee that had drafted that amendment and had caused its adoption by the ABA House of Delegates. On October 3, 1974, Mr. Van Dusen had participated in a panel discussion titled *Responsibilities of Lawyers Advising Management* moderated by Mr. Evans at the ABA National Institute titled *Advisors to Management–Responsibilities and Liabilities of Lawyers and Accountants*, the proceedings of which were published in 30 Bus. Law. *Special Issue* 13 (March 1975). During the panel discussion, in response to Mr. Evans' request for background on the 1974 "except clause" amendment, Mr. Van Dusen stated (*Special Issue* at 20):

> "MR. VAN DUSEN: The Committee on Ethics and Professional Responsibility suggested this change, which has been very controversial. The SEC people are unhappy about it, and perhaps it was suggested without full consideration. But the thought was that the privilege with respect to confidential communications and

secrets was so fundamental that we ought not to put a lawyer in the position of being required by the Code to divulge confidential communications if the state law provided that he couldn't do so.

"Some governmental authorities have taken the position that in no state is there such a protection with respect to communications related to fraudulent activities. I do not know what the law is of the fifty states. That may or may not be the fact. The thought is that if any state says that a given communication is privileged, then its disclosure should not be required by the Canons, and there is considerable discussion going on as to whether this is an appropriate amendment for the reason I have given."

Of more significance in explaining future actions of the ABA Ethics Committee were Mr. Van Dusen's remarks from the panel discussion on the interpretative approach to be followed by the ABA Ethics Committee under his then commencing chairmanship (*Special Issue* at 29):

Mr. Van Dusen was a partner in Drinker, Biddle & Reath, one of the largest firms in Philadelphia.

"MR. VAN DUSEN: It seems to me that it is very important for the Bar as a whole, for the Corporation Section as a group, to make known their views, if they have got a view that they can express as a unit, to the Bar Association as a whole, because it will assist the Committee on Ethics in interpreting the Canons. *We don't wish to go interpreting the Canons in a fashion that is totally different from that put forth by the experts -- and you are the experts!*" (emphasis added)

Reprinted in 61 J. ABA 1543 (Dec. 1975).

To the astonishment of many, and contrary to Mr. Van Dusen's prior statements, on September 30, 1975, the ABA Ethics Committee issued its Formal Opinion 341 interpreting the *except clause* of DR 7-102(B)(1) as barring disclosure of not only *confidences* protected by a state's law of attorney-client privilege, but also as barring disclosure of *secrets* – information unprotected by a state's law but likely detrimental to a client if disclosed. DR 4-101(A). The effect of Formal Opinion 341, according to commentators, was to render DR 7-102(B)(1) a nullity, to effectively repeal it. *E.g.*, Charles W. Wolfram, *Client Perjury*, 50 S. Cal. L. Rev. 809, 820 (1977). ABA Formal Opinion 341 may have marked the first instance of what scholars commenting critically on the Model Rules later called "defensive ethics," meaning "ethics" rules interpreted or written by the organized bar principally for the purposed of shielding its members from liability to governmental agencies and to third parties.

"Bar Politics" article

In the Release, you invite interested persons to comment on whether the SEC should leave certain matters of *public interest* to the ABA and state bar associations to address. Any public official contemplating such deference should first read law professor Ted Schneyer's extensively researched article titled, *Professionalism as Bar Politics: The Making of the Model Rules of Professional Conduct*, 14 Law & Social Inquiry (formerly Journal of the Am. Bar Found.) 677 (1989)(hereafter "*Bar Politics*"). In researching and writing the article, Professor Schneyer indicated, at 679:

"One of my aims is to advance an ongoing policy debate on the extent to which courts and administrative agencies should defer to the ABA when they adopt rules

> to govern the lawyers practicing in their jurisdictions."

Bar Politics details the overwhelming extent to which special interests and self-interests -- as opposed to *public interests* -- shape the product, like the Model Rules, when there is a *de facto* delegation of public lawmaking to private groups such as the organized bar groups. Illustrative of the disregard for *public interests*, the president of the American Trial Lawyers Association, one of the private groups that actively and successfully opposed the Kutak Commission's proposed confidentiality provisions wrote, "We have rejected one concept that the Kutak Commission apparently espouses, that lawyers have a general duty to do good for society that often overrides their specific duty to serve their clients." Theodore I. Koskoff, Preface to *The American Lawyer's Code of Conduct* (1982).

Reprinted in TRIAL, Vol. 18, No. 7 (July 1982), pg. 55.

Several attempts since 1983 have been made to restore the traditional *public interest* exceptions to a lawyer's duty of confidentiality (including the Ethics 2000 Commission's attempt noted in footnote 68 of the Release), but at the ABA House of Delegates those attempts have been defeated based upon organized campaigns asserting that lawyers owe no duty to the public and that lawyers would face increased liability exposure to victims if their ethics rules restored the *public interest* exceptions to confidentiality.

While the ABA's Cheek Task Force on Corporate Responsibility's July 2002 Preliminary Report (noted in the Release linked to footnotes 7, 40, and 72) affords some hope for the full restoration of the *public interest* exceptions to lawyer confidentiality, a possibly more promising sign came from the Conference of Chief Justices adopting, on August 1, 2002, *Resolution 35 In Support of Rule 1.6(b)(2) and 1.6(b)(3) of Ethics 2000*. It reads as follows:

> WHEREAS, there is national concern for the need to incorporate integrity, public trust and responsibility in the conduct of agents and advisors of corporations and other organizations in the light of the unexpected and traumatic failures in recent months of several large American corporations; and
>
> WHEREAS, the adoption by state courts and by the American Bar Association (ABA) of clear and firm ethical principles and Model Rules of Professional Conduct governing the role of lawyers as advisors to corporations will strengthen the public's confidence in corporate integrity;
>
> NOW, THEREFORE, BE IT RESOLVED that the Conference of Chief Justices expresses its support of the recommendation of the ABA Commission on Evaluation of the Model Rules of Professional Conduct (Ethics 2000) in its Report 401 submitted to the ABA House of Delegates with respect to Rule 1.6(b)(2) rejected by the ABA House in August 2001, that would permit the lawyer to reveal "information relating to the representation of a client to the extent the lawyer reasonably believes necessary 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 lawyers services;" and
>
> BE IT FURTHER RESOLVED that the Conference likewise supports the recommendation of Ethics 2000 in its proposed Rule 1.6(b)(3) that would similarly permit the lawyer to "reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary . . . 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."

We can hope that the respective Chief Justices of the highest court of each state and other U.S. jurisdiction, with their judicial colleagues, will adopt for their own jurisdiction's lawyers confidentiality rules implementing the Ethics 2000 recommended *public interest* exceptions without awaiting prior adoption (which may never happen) by the ABA and their own jurisdiction's organized bar, but such leadership cannot be assured. In 1985, the supreme court of my own state of Washington adopted a version of the Model Rules that, as modified and recommended by my state's bar association, did *not* include any of the Model Rule's official comments (such as those supporting a "noisy withdrawal" as noted in footnote 62 of the Release), did *not* include Model Rule 1.13 (Organization as client), and *did* include the American College of Trial Counsel's version of Model Rule 3.3 (elevating duty of confidentiality over duty to rectify fraud on a tribunal) that the ABA House of Delegates even had *rejected* (*Bar Politics* at 722).

I note that the Release is proposing conduct standards for lawyers that resemble those proposed in 1978 by the Institute for Public Interest Representation, then affiliated with Georgetown University Law Center, as described in Harvey L. Pitt, *The Georgetown Proposals*, 36 Bus. Law. 1831 (1981) ("*Georgetown*"). In 1979 and 1980, the SEC rejected those two proposals due in part to deference to the ABA's then pending Model Rules project. *Georgetown* at 1835 and 1837; *Bar Politics* at 699 and 706.

"Georgetown" article

I also note that the ABA House of Delegates' rejection in February 1983 of the Kutak Commission's *public interest* confidentiality exceptions and adoption of nearly absolute confidentiality rules led former prosecutor Senator Arlen Specter, fearing the new Model Rules would create "a haven for white-collar criminals," to introduce in Congress a bill that would have turned the Kutak Commission's disclosure provisions into lawyers' duties under federal criminal law. *Bar Politics* at 713. *Lawyer's Duty of Disclosure Act*. S.485, 98th Cong., 1st Session (1983). History has shown Senator Specter's concerns to have been well-founded.

Given the history of the last 25 years, I believe it would be irresponsible for the SEC (and Congress) to defer to the ABA and the state bars and supreme courts on important standards of professional conduct for attorneys, such as the prevention and rectification of illegality that is likely to substantially harm investors, including pension plan beneficiaries. That history shows lawyers as having too great a willingness to serve as *hired guns* rather than as guardians of the law and protectors of society. *See, e.g.*, William H. Simon, *The Kaye Scholer Affair: The*

"Kaye Scholer Affair" article

Lawyer's Duty of Candor and the Bar's Temptations of Evasion and Apology, 23 Law & Soc. Inquiry 243 (Spring, 1998).

Thank you for considering these comments.

Sincerely yours,

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