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On Learning of a Corporate Client's Crime or Fraud—the Lawyer's Dilemma

By JUNIUS HOFFMAN*

ON A TYPICAL weekday morning—take Thursday, February 3, 1972, for example—the fictive but archetypal corporate lawyer[1] was relatively certain to be occupationally well-occupied with any one of the host of matters that usually occupies the genus. He was also relatively certain not to be immediately concerned with the focus of this piece: his obligations to the atypical corporate client that had engaged, was engaging, or proposed to engage, in a "crime" or "fraud" in a non-litigation setting and his other professional responsibilities in connection therewith. More often a counselor or advisor than courtroom litigator,[2] he could reasonably believe the secur-

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Professor Hoffman feels that his own lawyer's full disclosure obligation requires acknowledgment of the debt he owes to his colleagues, Professors Charles E. Ares and Charles M. Smith for their suggestions and criticisms and to Ms. Nikki Chayet, a third-year student at the University of Arizona College of Law, for her valuable research help. None of them, however, should be held liable as an aider or abettor for any crime or fraud that appears within.

1. For the sake of brevity and readability hereinafter referred to as the "lawyer" or "counsel." As used herein, the term also includes partners, associates and other employees.

2. Even this threshold question of whether one can separate the adversarial from the counseling-advisory role of a lawyer has been subject to debate.

For example, Dean Monroe H. Freedman has stated:

> [O]ur legal system is basically an adversarial one, and every lawyer—whether drafting a contract, counselling in a business venture . . . or performing any other service on behalf of a client—acts in such a way as to protect the client from being at a disadvantage in potential future litigation.

Freedman, *Professional Responsibility in Securities Regulation,* N.Y.L.J., April 24, 1974, at 4, col. 3.

On the other hand, Professor E. Wayne Thode has written:

> The lawyer as counselor does not represent his client in an adversary proceeding. Thus, the ethical problems presented to him need not be, and probably should not be, the same as that applied to the lawyer in an adversary proceeding.

Thode, *The Ethical Standard for the Advocate,* 39 Tex. L. Rev. 574, 578 (1961).

Ethical Consideration 7-3 of the ABA Code of Professional Responsibility (1975) also distinguishes between the two roles:

> Where the bounds of law are uncertain, the action of a lawyer may depend on whether he is serving as advocate or adviser. A lawyer may serve simultaneously as both advocate and adviser, but the two roles are essentially different. In asserting a position on behalf of his client, an advocate for the most part deals with past conduct and must take the facts as he finds them. By contrast, a lawyer serving as adviser primarily assists his client in determining the course of future conduct and relationships.

ity blanket of the attorney-client privilege and the related obligation to protect a client's secrets, combined with his own sense of the meet, provided a secure vade mecum for resolving possible conflicts between duty to client and responsibility to other segments of society.

That very day, however, the Securities and Exchange Commission (the "SEC") filed its Complaint in the *National Student Marketing Corporation* case[3] and a new epoch had commenced, one in which a hundred commentaries and questions—if not flowers—have blossomed and the old verities have been challenged.

Upon learning of the suit, the lawyer's first reaction was probably shock and disbelief.[4] His first action might well have been to consult the Code of Professional Responsibility that had become effective for American Bar Association members on January 1, 1970[5] ("ABA CPR") and was applicable through state adoptions to most practising lawyers. Like Gaul, the ABA CPR is divided into three parts: Canons ("statements of axiomatic norms, expressing in general terms the standards of professional conduct expected of lawyers in their relationships with the public, with the legal system, and with the legal profession"), Ethical Considerations ("ECs") ("aspirational in character and represent[ing] the objectives toward which

3. SEC v. National Student Marketing Corp., No. 225-72, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,360 (D.D.C. Feb. 3, 1972). To recite the complicated facts of this case, now all too well-known to the lawyer, would be to pile Pelion atop Ossa. For the purposes of this piece, its importance centers about the SEC's contention that lawyers may have the duty to cease representing corporate clients who refuse to disclose or correct allegedly misleading financial statements, and under certain circumstances may also have the duty to disclose the misleading nature of such statements to the SEC.

For a factual statement of the National Student Marketing Complaint, see Karmel, *Attorneys' Securities Law Liabilities*, 27 Bus. Law. 1153, 1153-55 (1972).

For settlement of the SEC's case against the law firm of White & Case and its partner, Marion J. Epply, III, *see* [Current] Fed. Sec. L. Rep. (CCH) § 96,027 (D.D.C. May 2, 1977).

4. Lawyers are scrambling for copies of an SEC complaint charging National Student Marketing Corp. and numerous other defendants with violations of federal securities law. They are keenly interested—and deeply shaken—by the fact that two of the defendants are prestigious law firms. . . . The attack on these law firms is believed to be unprecedented.

"Every firm on Wall Street is very, very concerned about this case," says a New York securities lawyer. "It's going to change the way of doing business." Adds a prominent Washington attorney: "I'd state conservatively that securities lawyers are shaking in their boots."

Along Wall Street, almost every firm with a sizable securities-law practice has called a meeting to discuss the implications of the case. Wall St. J., Feb. 15, 1972, at 1, col. 1.

5. The ABA Code of Professional Responsibility was adopted by the House of Delegates of the American Bar Association on August 12, 1969 and became effective for ABA members on January 1, 1970. Amendments thereto were adopted by the ABA House of Delegates in February 1970, February 1974 and February 1975. Preface to ABA Code of Professional Responsibility at ii (1975). For a history of the prior Canons of Professional Ethics and the considerations leading to adoption of the Code of Professional Responsibility, *see id.* at i.

every member should strive . . ."), and the Disciplinary Rules ("DRs") ("mandatory in character . . . [and] stat[ing] the minimum level of conduct below which no lawyer can fall without being subject to disciplinary action.").[6]

A review of that formidable document would probably have focused on the following Canons, DRs and ECs as being the most relevant both for determining his obligations to a client having engaged, engaging, or proposing to engage, in a crime or fraud in the non-litigation setting and for prescribing his other professional responsibilities:

(1) Lawyer's Obligations to Client

CANON 4—*A Lawyer Should Preserve the Confidences and Secrets of a Client*

EC 4-1 Both the fiduciary relationship existing between lawyer and client and the proper functioning of the legal system require the preservation by the lawyer of confidences and secrets of one who has employed or sought to employ him. A client must feel free to discuss whatever he wishes with his lawyer and a lawyer must be equally free to obtain information beyond that volunteered by his client. A lawyer should be fully informed of all the facts of the matter he is handling in order for his client to obtain the full advantage of our legal system. It is for the lawyer in the exercise of his independent professional judgment to separate the relevant and important from the irrelevant and unimportant. The observance of the ethical obligation of a lawyer to hold inviolate the confidences and secrets of his client not only facilitates the full development of facts essential to proper representation of the client but also encourages laymen to seek early legal assistance (footnotes omitted).

EC 4-4 The attorney-client privilege is more limited than the ethical obligation of a lawyer to guard the confidences and secrets of his client. This ethical precept, unlike the evidentiary privilege, exists without regard to the nature or source of information or the fact that others share the knowledge. A lawyer should endeavor to act in a manner which preserves the evidentiary privilege; . . . A lawyer owes an obligation to advise the client of the attorney-client privilege and timely to assert the privilege unless it is waived by the client.

DR 4-101 Preservation of Confidences and Secrets of a Client (footnote omitted).

(A) "Confidence" refers to information protected by the attorney-client privilege under applicable law, and "secret" refers to other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.

6. *Id.* at 1C.

(B) Except when permitted under DR 4-101(C), a lawyer shall not knowingly:

(1) Reveal a confidence or secret of his client (footnote omitted).

. . .

(3) Use a confidence or secret of his client for the advantage of himself or of a third person, unless the client consents after full disclosure (footnotes omitted).

(C) A lawyer may reveal:

. . .

(2) Confidences or secrets when permitted under Disciplinary Rules or required by law or court order (footnote omitted).

(3) The intention of his client to commit a crime and the information necessary to prevent the crime (footnotes omitted).

(4) Confidences or secrets necessary to . . . defend himself or his employees or associates against an accusation of wrongful conduct (footnote omitted).

(2) Lawyer's Obligations to Other Parties:

CANON 1—*A Lawyer Should Assist in Maintaining the Integrity and Competence of the Legal Profession*

DR 1-102 Misconduct.

(A) A lawyer shall not:

(1) Violate a Disciplinary Rule.

(2) Circumvent a Disciplinary Rule through actions of another (footnote omitted).

. . .

(4) Engage in conduct involving dishonesty, fraud, deceit, or misrepresentation.

(5) Engage in conduct that is prejudicial to the administration of justice.

. . . .

DR 1-103 Disclosure of Information to Authorities.

(A) A lawyer possessing unprivileged knowledge of a violation of DR 1-102 shall report such knowledge to a tribunal or other authority empowered to investigate or act upon such violation (footnote omitted).

. . .

EC 1-5 A lawyer should maintain high standards of professional conduct and should encourage fellow lawyers to do likewise. He . . . should refrain from all illegal and morally reprehensible conduct. Because of his position in society, even minor violations of law by a lawyer may tend to lessen public confidence in the legal profession. Obedience to law exemplifies respect for law. To lawyers especially, respect for the law should be more than a platitude (footnote omitted).

CANON 7—*A Lawyer Should Represent a Client Zealously Within the Bounds of the Law*

EC 7-1 The duty of a lawyer, both to his client and to the legal system, is to represent his client zealously within the bounds of the law which includes Disciplinary Rules and enforceable professional regulations. The professional responsibility of a lawyer derives from his membership in a profession which has the duty of assisting members of the public to secure and protect available legal rights and benefits. In our government of laws and not of men, each member of our society is entitled to have his conduct judged and regulated in accordance with the law, to seek any lawful objective through legally permissible means; and to present for adjudication any lawful claim, issue, or defense (footnotes omitted).

EC 7-10 The duty of a lawyer to represent his client with zeal does not militate against his concurrent obligation to treat with consideration all persons involved in the legal process and to avoid the infliction of needless harm.

DR 7-102 Representing a Client Within the Bounds of the Law.

(A) In his representation of a client, a lawyer shall not:

. . .

(3) Conceal or knowingly fail to disclose that which he is required by law to reveal.

. . .

(7) Counsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent.

(8) Knowingly engage in other illegal conduct or conduct contrary to a Disciplinary Rule.

(B) 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 (footnote omitted).

(2) A person other than his client has perpetrated a fraud upon a tribunal shall promptly reveal the fraud to the tribunal (footnote omitted).

EC 7-15 providing in part: Where the applicable rules of the agency impose specific obligations upon a lawyer, it is his duty to comply therewith, unless the lawyer has a legitimate basis for challenging the validity thereof. . . .

(3) Lawyer's Rights and Obligations Relating to Continuation or Withdrawal of Representation

EC 7-8 providing in part: In the event that the client in a non-adjudicatory matter insists upon a course of conduct that is contrary to the

judgment and advice of the lawyer but not prohibited by Disciplinary Rules, the lawyer may withdraw from the employment (footnote omitted).

DR 2-110 Withdrawal from Employment (footnote omitted).

(A) In general.

. . .

(2) In any event, a lawyer shall not withdraw from employment until he has taken reasonable steps to avoid foreseeable prejudice to the rights of his client, including giving due notice to his client, allowing time for employment of other counsel, delivering to the client all papers and property to which the client is entitled, and complying with applicable laws and rules.

. . .

(B) Mandatory withdrawal.

A lawyer representing a client before a tribunal with its permission if required by its rules, shall withdraw from employment, and a lawyer representing a client in other matters shall withdraw from employment, if:

. . .

(2) He knows or it is obvious that his continued employment will result in violation of a Disciplinary Rule (footnote omitted).

. . .

(C) Permissive withdrawal (footnote omitted).

If DR 2-110(B) is not applicable, a lawyer may not request permission to withdraw in matters pending before a tribunal, and may not withdraw in other matters, unless such request or such withdrawal is because:

(1) His client:

. . .

(b) Personally seeks to pursue an illegal course of conduct.

(c) Insists that the lawyer pursue a course of conduct that is illegal or that is prohibited under the Disciplinary Rules.

. . .

(e) Insists, in a matter not pending before a tribunal, that the lawyer engage in conduct that is contrary to the judgment and advice of the lawyer but not prohibited under the Disciplinary Rules.

. . .

(2) His continued employment is likely to result in a violation of a Disciplinary Rule.

. . .

Since the three general but discrete categories I have arbitrarily created deal with interrelated problems, it should not be surprising to find that a Canon, EC or DR placed in one category has a relationship to another; nor, given the nature of the problems these Canons, ECs and DRs attempt to deal with, should it be surprising to find conflicts among some of them.

Even within the construct of the particular Canons, ECs and DRs purporting to deal primarily with one of the three problems, internal conflicts and ambiguities immediately leap up to greet one.

For example, withdrawal is mandated pursuant to DR 2-110(B)(2) if the lawyer "knows or it is obvious that his continued employment will result in violation of a Disciplinary Rule" whereas it is permissive under DR 2-110(C)(1)(c) if the client "[i]nsists that the lawyer pursue a course of conduct that is illegal or that is prohibited under the Disciplinary Rules." Doubtless, casuists can and will reconcile the two; however, it would seem difficult for the lawyer to do so with any assurance.

What is the practical significance between the language in DR 7-102(B)(1) that the client's "fraud" must be perpetrated "in the course of the representation" against either a "tribunal" or "person" and the requirements in DR 7-102(B)(2) that for "fraud" perpetrated by someone other than a client it must be against a "tribunal" only but without regard to whether it is "in the course of the representation"?

Can a lawyer disregard the command of DR 2-110(A)(2) not to "withdraw from employment until he has taken reasonable steps to avoid forseeable prejudice to the rights of his client" given his right of withdrawal under DR 2-110(C)(1)(e) where the client "[i]nsists, in a matter not pending before a tribunal, that the lawyer engage in conduct that is contrary to the judgment and advice of the lawyer but not prohibited under the Disciplinary Rules" where the very act of withdrawal prejudices the rights of his client?

Is there a meaningful distinction between the use of the term "crime" in DR 4-101(C)(3) permitting the lawyer to disclose prospective conduct and use of the term "fraud" mandating disclosure of past conduct under certain circumstances in DR 7-102(B)(1)?

Viewed only from the perspective of a need to resolve a particular factual situation, the conflicts between those Canons, ECs and DRs primarily concerned with protection of the client's interest and those concerned with the lawyer's responsibility to other segments of society can indeed be real.

I think it fair to say the great majority of the bar has believed in good faith that given an adversary system, the goals of society are best served by postulating that the lawyer's primary duty is to his client.[7] A logical way to insure that such primary duty will be done is to constitute the lawyer a safe house of nondisclosure for confidential information received from his client.

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7. Expressive of such majority view are such statements as these: The attorney's obligation of entire devotion to the interests of the client . . . would seem to be beyond serious controversy. M. Freedman, Lawyers' Ethics in an Adversary System 9 (1975).

[The] loyalty [of a lawyer in private practice] runs to his client. He has no other master. . . . The lawyer's official duty, required of him indeed by the court, is to devote himself to the client. The court comes second by the court's, that is the law's, own command! Curtis, *The Ethics of Advocacy*, 6 Stan. L. Rev. 3 (1951).

And of course the particular foundation upon which such safe house has been built is the attorney-client privilege.

Curiously enough though, such privilege was not created primarily for benefit of the client, but apparently found its beginnings as a lawyer's protective device. In the words of Professor John Noonan:

> Since bankers, accountants, psychiatrists, and confessors are not entitled at common law to confidentiality in their relationships with those with whom they deal, one may well inquire why lawyers possess such an extraordinary privilege. In the early English case which established the lawyer-client privilege, counsel offered several justifications: (1) A "gentlemen of character" does not disclose his client's secrets. (2) An attorney identifies himself with his client, and it would be "contrary to the rules of natural justice and equity" for an individual to betray himself. (3) Attorneys are necessary for the conduct of business, and business would be destroyed if attorneys were to disclose their communications with their clients.[8]

But by the middle of the 18th century, the justification for the privilege had shifted to a basis still seen as the reason for its retention today, to wit:

> In order to promote freedom of consultation of legal advisers by clients, the apprehension of compelled disclosure by the legal advisers must be removed; hence the law must prohibit such disclosure except on the client's consent.[9]

Such privilege is of course integrally related both to the right of counsel and the privilege against self-incrimination.[10] Also implicit is the notion that if a client can discuss matters freely with its counsel without fear of involuntary disclosure, it will do so where it otherwise would not. From which it follows, optimally, that because of such consultation the lawyer may be apprised of, and able to dissuade the client from pursuing, an unlawful course of conduct that might otherwise be undertaken.

8. Noonan, *The Purposes of Advocacy and the Limits of Advocacy*, 64 Mich. L. Rev. 1485 (1966) (citing Annesley v. Anglesey, 17 How. St. Tr. 1140, 1223-26, 1241 (Ex. 1743)). *See also* C. McCormick's Handbook of the Law of Evidence § 87 (2d ed. 1972); 8 J. Wigmore, Evidence in Trials at Common Law § 2290 (J. McNaughton rev. 1961).

9. 8 J. Wigmore, *supra* n. 8, at 545. *See also Statement of Policy Adopted by ABA Regarding Responsibilities and Liabilities of Lawyers in Advising with Respect to the Compliance by Clients with Laws Administered by the Securities and Exchange Commission*, 31 Bus. Law. 543 (1975).

10. Of course, the privilege against self-incrimination is not available to a corporation. George Campbell Painting Corp. v. Reid, 392 U.S. 286 (1968), Hale v. Henkel, 201 U.S. 43 (1906).

Yet, from its inception, the privilege has been recognized as a barrier to justice[11] and attempts have been made to limit it.

Recent commentators have suggested "that in an important sense, the Code of Professional Responsibility is an attempt to accommodate at least five interests . . . those of (1) lawyers as individuals, (2) lawyers in their relationships with each other, (3) clients, (4) the public, and (5) the legal system"[12] and question whether "the client's interest [is] always to be furthered above all others."[13]

Moreover, the accountant, a fellow laborer in the corporate vineyard, has no privilege for information received from a client except where created by statute.[14]

Further, the rationale of the recent decisions of the California Supreme Court in *Tarasoff v. Regents of University of California*[15] involving the doctor-patient privilege may also serve as a warning that the attorney-client privilege can be trimmed where the public's interest requires it. In *Tarasoff*, the court held that

11. Nevertheless, the privilege remains an exception to the general duty to disclose. Its benefits are all indirect and speculative; its obstruction is plain and concrete. 8 J. Wigmore, *supra* n. 8, § 2291, at 554. Probably, the most coruscating jeremiad attacking the privilege is to be found in Jeremy Bentham's Rationale of Judicial Evidence (1827) abstracted in 8 J. Wigmore, *supra*, at 549.

12. T. Morgan & R. Rotunda, Problems and Materials on Professional Responsibility 4 (1976). Professor Charles Fried has suggested a sixth relationship, that of friend. Fried, *The Lawyer as Friend: The Moral Foundations of the Lawyer-Client Relationship*, 85 Yale L.J. 1060 (1976). However, the end product of the Fried analysis is emphasis of the lawyer's primary duty to his client-friend at the possible expense of other interests.

13. Morgan & Rotunda, *supra* n. 12. *See also*, Morgan, Book Review, 89 Harv. L. Rev. 622 (1976) (review of M. Freedman, *supra* n. 7).

14. Eleven states have statutes granting privilege for communications to both attorneys and accountants. An additional three states have a statutory privilege for accountants, whereas 26 other states have statutes only providing an attorney-client privilege. 8 J. Wigmore, *supra* n. 8, § 2286, at 533 n. 22, § 2292, at 555 n. 2.

For a chronological picture of the interplay between the accountant's need for information to discharge his obligations and the lawyer's need to protect the confidentiality of lawyer-client communications, *see* Deer, *Lawyers' Responses to Auditors' Requests for Information*, 28 Bus. Law. 947 (1973); Financial Accounting Standards Bd., Statement of Financial Accounting Standards No. 5 (Accounting for Contingencies) (1975); *ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, 31 Bus. Law. 561 (1975); Am. Institute of Certified Public Accountants, Auditing Standards Executive Comm., Statement on Auditing Standards No. 12 (Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments) (1976); ABA Comm. on Audit Inquiry Responses, *Introductory Analysis and Guides to Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, 31 Bus. Law. 1737 (1976); *Second Report of ABA Committee on Audit Inquiry Responses Regarding Initial Implementation*, 32 Bus. Law. 177 (1976); Am. Institute of Public Accountants, Auditing Standards Executive Comm., Statement on Auditing Standards No. 17 (Illegal Acts by Clients) (1977).

15. 17 Cal. 3d 425, 551 P.2d 334, 131 Cal. Rptr. 14 (1976), *vacating* 13 Cal. 3d 177, 529 P.2d 553, 118 Cal. Rptr. 129 (1974).

> once a therapist does in fact determine, or under applicable professional standards reasonably should have determined, that a patient poses a serious danger of violence to others, *he bears a duty to exercise reasonable care to protect the foreseeable victim of that danger* (emphasis added).[16]

Of course, *Tarasoff* can be limited to cases involving crimes of violence to persons; on the other hand, its reasoning can logically be extended to require a lawyer learning of a client's intention willfully to violate the securities or antitrust laws to disclose such intention to the "foreseeable victims", presumably the trading public in the first instance, and suppliers, customers and competitors of the putative violator in the second.[17]

Nor have the results that are thought to follow from zealous representation of clients under the shield of the attorney-client privilege escaped criticism from corporate lawyers themselves. As early as 1934, William O. Douglas saw fit to write:

> All of these [regulatory] measures, of course, merely check or control rather than cure a fundamental condition which underlies the whole problem. That condition has been reflected by the amazing absence of social consciousness on the part of directors and business executives and by their lack of any awareness of the implications and results of many practices which flourished in recent years. It has not been so much a matter of depravity and of evil intent as the consequence of cutting as close to the mythical legal line as possible. This lack of social mindedness has not been wholly or largely that of business. It has been equally shared by lawyers. It has been evidenced by the almost perverted singleness of purpose with which they have championed the cause of their clients, whether it be in the drafting of a deposit agreement, the handling of a merger, the conduct of a reorganization, or the marketing of securities. It resulted in getting accomplished what clients wanted but without regard for the long-term consequences of those accomplishments. That singleness of purpose has been wholly incompatible with the use of these aggregations of capital for either the welfare of the investors or the good of the public.[18]

16. *Id.* at 429, 551 P.2d at 345, 131 Cal. Rptr. at 25. The possible ramifications of this decision threaten to draw as much commentary as National Student Marketing has drawn. Two of the most thoughtful articles, although sharply in conflict, are Fleming & Makimov, *The Patient or His Victim: The Therapist's Dilemma,* 62 Calif. L. Rev. 1025 (1974), and Stone, *The Tarasoff Decision: Suing Psychotherapists to Safeguard Society,* 90 Harv. L. Rev. 358 (1976).

17. This would change the "may" of DR 4-101(C)(3) to "must," a result not inconsistent with ABA Comm. on Professional Ethics, Opinions, No. 314 (1965). *See* discussion, n. 58 *infra.*

18. Douglas, *Directors Who Do Not Direct,* 47 Harv. L. Rev. 1305, 1328-29 (1934). The same strains were echoed almost simultaneously in Mr. Justice Stone's famous address delivered at the dedication of the Law Quadrangle, University of Michigan, memorialized in Stone, *The Public Influence of the Bar,* 48 Harv. L. Rev. 1, 6-7 (1934).

Or as Dean Norman Redlich has put it recently:

> The only effective answer which the legal profession can give to the position which appears to have been asserted by the SEC, and others, is that society's interest in effective law enforcement will be harmed by requiring lawyers to divulge information acquired during the course of representation, concerning the continuing commission of a crime by the client.
>
> I am not certain that even this answer will suffice. But I am certain that unless the public, the regulatory bodies and the courts are convinced that communication between lawyers and clients is in fact having a positive effect on compliance with the law, the legal profession has little hope in persuading the courts that imposing on lawyers a limited duty to divulge is harmful, even if such compulsory disclosure does result in some restrictions on the willingness of clients to consult with lawyers.
>
> If all or even most, practicing lawyers could come home every night and say truthfully that they did everything in their power, including the threat of withdrawing from representation, to make their clients comply with the law, the effect on law enforcement in this country would be beyond calculation. The failure of lawyers to do this, and the public's full appreciation of this failure, is why lawyers now find themselves on the defensive in dealing with the issues that confront this Institute [on Responsibilities and Liabilities of Lawyers and Accountants].
>
> The legal profession is now engaged in a dialogue with the American people in which the lawyers are saying, "We want to retain our privileged position in the American system of law enforcement because it is in your best interests that we do so," and the American people are replying, "Unless we are convinced that the legal profession carries on its day-to-day practice in such a way as to promote compliance with the law, even among the rich and the powerful, we will seriously consider restructuring the privileged sanctuary which we have created for you." As we lawyers work in the market place, and claim to have the ethics of the temple, we would delude ourselves if we failed to realize that the outcome of that dialogue is very much in doubt.[19]

It is true the SEC itself had, in *American Finance Company,*[20] inferentially recognized the lawyer's role in securities matters as being primarily that of advocate by contrasting it with the role of the independent accountant:

> Though owing a public responsibility, an attorney in acting as the client's advisor, defender, advocate and confidant enters into a personal

19. Redlich, *Lawyers, the Temple, and the Market Place,* 30 Bus. Law. 65, 72 (Special Issue, March 1975). Those of the *plus ça change, plus c'est la même chose* persuasion will perhaps be reminded of Juvenal's "Quis custodiet ipsos custodes?"

20. 40 S.E.C. 1043 (1962).

relationship in which his principal concern is with the interests and rights of his client. The requirement of the Securities Act of 1933 of certification by an independent accountant, on the other hand, is intended to secure for the benefit of public investors the detached objectivity of a disinterested person. The certifying accountant must be one who is in no way connected with the business or its management and who does not have any relationship that might affect the independence which at times may require him to voice public criticisms of his client's accounting practices.[21]

However, public statements of individual Commissioners following the filing of the *National Student Marketing* Complaint, as well as the filing itself, appeared to leave little remaining of the *American Finance Company* dictum respecting the role of lawyers in securities matters.

For example, Commissioner A. A. Sommer, Jr., in a widely noted speech declared:

> Consequently, I would suggest that all the old verities and truisms about attorneys and their roles are in question and in jeopardy—and, unless you are ineradicably dedicated to the preservation of the past, that is not all bad. I would suggest that in securities matters (other than those where advocacy is clearly proper) the attorney will have to function in a manner more akin to that of the auditor than to that of the advocate. This means several things. It means he will have to exercise a measure of independence that is perhaps uncomfortable if he is also the close counselor of management in other matters, often including business decisions. It means he will have to be acutely cognizant of his responsibility to the public who engage in securities transactions that would never have come about were it not for his professional presence. It means he will have to adopt the healthy skepticism toward the representations of management which a good auditor must adopt. It means he will have to do the same thing the auditor does when confronted with an intransigent client—resign.
>
> This may seem shocking to many ears, but I would suggest that these conclusions are already implicit in what the courts and the Commission have already said; more important, their foundations lie deep in the past.[22]

Only shortly before, the then SEC Chairman Ray Garrett, Jr. had noted:

> [Although] the lawyers' position in corporate and financial matters is subtler and less obvious [than that of accountants] . . . when it comes to matters affecting public stockholders and investors, we are not prepared to agree that the corporate lawyer's duty is solely, or even primarily, to protect the interests of the individuals constituting corporate management, when he is retained to serve the corporation.[23]

21. *Id.* at 1044.

22. Sommer, *The Emerging Responsibilities of the Securities Lawyer* [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,631, at 83,689-90.

A clear theme emerging from the Douglas, Sommer and Garrett statements is this: there may be times in the non-litigation representation of corporate clients when a lawyer's duty to his client must be subordinated to his responsibility to protect a particular segment of the public. A coda to this theme is paragraph 48(i) of the SEC Complaint in *National Student Marketing* alleging that lawyers for acquiring and merged corporations had

> [a]s part of the fraudulent scheme . . . failed to refuse to issue their opinions . . . and failed to insist that financial statements be revised and shareholders be resolicited, and failing that, to cease representing their respective clients and, under the circumstances, notify the plaintiff Commission concerning the misleading nature of the nine month financial statements.[24]

One can imagine and understand the genuine concern and dismay with which this theme and coda were heard by lawyers convinced that the public interest was best served in the end by their adherence to the principle of primary loyalty to the client.

Not encouraging either was the Second Circuit's apparent tacit approval in *Meyerhofer v. Empire Fire & Marine Co.*[25] of the actions of a lawyer who voluntarily delivered an affidavit to the SEC in which he alleged that a law firm from which he had resigned had failed to disclose excessive legal and possible finder's fees in a client's registration statement.[26]

Moreover, there was the specific language problem of ABA CPR DR 7-102(B)(1). Until its amendment in 1974,[27] it *required* a lawyer who

23. Garrett, Sec. Reg. & L. Rep. (BNA), No. 223, A-16 (Oct. 17, 1973). *See also* additional statements of the SEC and other Commissioners quoted in Lowenfels, *Emerging Public Responsibilities of Securities Lawyers: An Analysis of the New Trend in Standard of Care and Priorities of Duties,* 74 Colum. L. Rev. 412, 424-426 (1974).

24. [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,360, at 91,913-17.

25. 497 F.2d 1190 (2d Cir.), *cert. denied,* 419 U.S. 998 (1974).

26. It should be noted that the lawyer's act of voluntary disclosure to the SEC was not at issue in *Meyerhofer.* For the suit related to the lawyer's subsequent action in turning over the SEC affidavit to plaintiffs (who had independently discovered the alleged nondisclosure) suing the lawyer's former client in a securities fraud suit when such plaintiffs included the lawyer as a defendant in such suit. The trial court had granted an injunction against the lawyer from disclosing confidential information received from his former client and had also dismissed the plaintiffs' complaint because the lawyer "had obtained confidential information from his client Empire which, in breach of relevant ethical canons, he revealed to plaintiffs' attorneys in their suit against Empire." *Id.* at 1194. The Second Circuit reversed, holding that DR 4-101(C)(4) permitted the lawyer to make such disclosure to "defend himself against an 'accusation of wrongful conduct' " *Id.* at 1194-95. Although the earlier disclosure to the SEC was not at issue, there would seem to be an implicit assumption that such conduct was not wrongful in view of the court's approval of the subsequent turning over of the SEC affidavit to plaintiffs.

27. ABA, Summary of Action and Reports to the House of Delegates, 1974 Midyear Meeting, Summary of Action 3 (Feb. 4-5, 1974). *See* text accompanying n. 40 *infra.*

received information "clearly establishing" that his client had perpetrated a "fraud" on a "person or tribunal"[28] "in the course of the representation" of the client to disclose promptly such "fraud" to the "affected person or tribunal" if the client refused or was unable to do so even if the information had been received as a privileged communication.

More fundamentally, *National Student Marketing* spotlighted the fact that representation of a corporate client involved in a crime or fraud often raises complex questions for the lawyer not encountered in his representation of an individual in a non-business context. Reflection reveals at least three reasons why this is true.

First, in the usual case involving an individual, the distinction between an intention to commit a future crime and a crime already committed is easily made and the lawyer's responsibilities are clear. If a client informs his lawyer he intends to commit murder, the lawyer can—and I am certain in the view of most lawyers, must—disclose such intention to the proper authorities. On the other hand, if during the course of representation, the lawyer learns that the client has committed murder in the past, such information is clearly privileged and cannot be disclosed.[29] In the corporate setting, failure to disclose a past crime or fraud may often constitute an intention to commit a further crime and raise the possibility of conflict between DR 4-101(C)(3) and DR 7-102(B)(1). For example, as will be discussed more fully later,[30] the willful failure to disclose a previous crime or fraud in a forthcoming registration statement may constitute an intention to commit a future crime. Indeed in certain cases where the previous criminal conduct has ceased and there is no crime now being actively committed as in the case of an abandoned price-fixing arrangement, the ripple effect of such past illegal activity may continue into the future as reflected by a retailer's sales to consumers at artificially high prices in an attempt to recoup the artificially high prices earlier charged such retailer while the supplier's price-fixing arrangement was in operation.

Second, the typical representational simplicity of the criminal case involving a single individual client is often missing in the corporate setting. Despite the view expressed in ABA CPR EC 5-18 that a lawyer hired by a corporation "owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity," *Garner v. Wolfinbarger*,[31] the landmark Fifth Circuit 1970 case, established the proposition that a corporation could not assert the attorney-client privilege in a class and derivative action by its shareholders alleging violation of the securities laws in sale of securities to them. And as indicated earlier, the rationale of *Garner* may be used to expand the clientele to whom the lawyer's duties are deemed to extend and confront the lawyer with directly conflicting responsibilities to different clients.[32]

Third, in the representation of a corporate client, the lawyer may be faced with the necessity of complying with a myriad of different sets of rules, some of them in conflict with each other. If these rules are in conflict, as they may well be on occasion, the lawyer's dilemma could rival that of Shaw's Doctor.

28. The ABA Code of Professional Responsibility defines these terms as follows:

> (3) "Person" includes a corporation, an association, a trust, a partnership, and any other organization or legal entity.
>
> (6) "Tribunal" includes all courts and all other adjudicatory bodies.

Definitions, ABA Code of Professional Responsibility, *supra* n. 5, at 48.

It at least seems clear human beings are included in the definition of "person." The definition of "tribunal" appears to relate to entities involved in the process of adversary decision making and thus can reasonably be deemed to exclude an agency such as the SEC when it is not acting in a traditionally adjudicatory manner.

29. *But see* People v. Belge, 50 App. Div. 2d 1088, 376 N.Y.S.2d 771 (1975), *aff'd*, 41 N.Y.2d 60 (1976). The court did uphold invocation of the attorney-client privilege by two lawyers who had not disclosed the location of the bodies of two murder victims revealed to them by a client and were later indicted for violating a "decent burial" statute and another requiring report of a death occurring without medical attendance. However, it then went on to declare:

> In view of the fact that the claim of absolute privilege was proffered, we note that the privilege is not all-encompassing and that in a given case there may be conflicting considerations. We believe that an attorney must protect his client's interests, but also must observe basic human standards of decency, having due regard to the need that the legal system accord justice to the interests of society and its individual members.
>
> We write to emphasize our serious concern regarding the consequences which emanate from a claim of an absolute attorney-client privilege. Because the only question presented, briefed and argued on this appeal was a legal one with respect to the sufficiency of the indictments, we limit our determination to that issue and do not reach the ethical questions underlying this case.

50 App. Div. at 1088, 376 N.Y.S.2d at 772.

When faced with the problem of the lawyer's obligation to disclose a "continuing crime," the position of the former ABA Committee on Professional Ethics and its sucessor, the present ABA Committee on Ethics and Professional Responsibility, has hardly been consistent.

ABA Comm. on Professional Ethics, Opinions, No. 23 (1930), held a fugitive client's whereabouts should not be disclosed by the lawyer even if the information comes from relatives of the client. The same Committee in Opinion No. 155 (1936) held a lawyer must disclose the whereabouts of a client who jumped bail after indictment and failed to reappear for trial to proper authorities, and its Opinion No. 156 (1936) held a lawyer must disclose to proper authorities information received from client that he had violated conditions of a previous probation order.

However, its Opinion No. 287 (1953) involving the disclosure obligations of a lawyer who is told by his client that he has committed perjury in a previous divorce suit held the lawyer does not have the duty to disclose and explicitly stated that any inconsistency between Opinion 23 and Opinions 155 and 156 should be resolved in favor of Opinion 23.

The waters are muddied still further by a footnote to DR 4-101(C)(2) promulgated by the present ABA Committee on Ethics and Professional Responsibility quoting only from Opinions 155 and 156 and by its delphic Informal Opinion 1141 (1971) relating to the duty of a lawyer to disclose the whereabouts of a deserter from the armed forces when the deserter has previously consulted him. For a full discussion of this problem, *see* A. Kaufman, Problems in Professional Responsibility, 116-18 (1976).

30. *See* text accompanying nn. 60, 61 & 79 *infra*.

31. 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971).

32. *See* text accompanying nn. 77 & 78 *infra*.

For example, in a securities matter, if the SEC view as evidenced in *National Student Marketing* prevails, the lawyer may be subject to criminal prosecution,[33] discipline under SEC rule 2(e),[34] an injunctive action by the SEC,[35] even a suit for damages as an aider and abettor under the federal securities laws[36] if he does not disclose certain information. Yet the very disclosure of such information may require him to violate the applicable state attorney-client privilege and related DR, subjecting him to the threat of disciplinary action by his state bar association and a suit for damages by his client.[37]

With the surfacing of the conflict between the lawyer's duty to client and his responsibility to others in *National Student Marketing*, there also came not unnaturally a flood of symposia and articles subjecting such conflict to the microscope and macroscope of academic and practitioner analysis.[38]

33. United States v. Benjamin, 328 F.2d 854 (2d Cir.), *cert. denied*, 377 U.S. 953 (1964).

34. Such rule provides in part:

> The Commission may deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice of and opportunity to for hearing in the matter . . . (ii) to be lacking in character or integrity or to have engaged in an unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the federal securities laws . . . or the rules and regulations thereunder.

17 C.F.R. § 201.2(e) (1976). Rule 201.2(g) defines "practice" to include "transacting any business with the Commission" giving the SEC a potent weapon that can be wielded against the lawyer. *Id.* § 201.2(g). *See, e.g.*, Johnson, *The Expanding Responsibilities of Attorneys in Practice Before the SEC: Disciplinary Proceedings Under Rule 2(e) of the Commission's Rules of Practice*, 25 Mercer L. Rev. 637 (1974).

35. SEC v. Universal Major Indust. Corp., 546 F.2d 1044 (2d Cir. 1976); SEC v. Spectrum, Ltd., 489 F.2d 535 (2d Cir. 1973). The *Spectrum* holding that negligence is sufficient to support an injunction is cited in *Universal Major* even though the United States Supreme Court in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) had, after the *Spectrum* decision but before *Universal Major* was decided, held in a private damage action against accountants that *scienter* was required. However, in *Universal Major*, the court also found that defendant had "acted 'with knowledge or reckless disregard of the truth'," 546 F.2d at 1047 n.1 (*quoting* the unreported District Court decision), thus rendering reliance on the negligence ground unnecessary. Such footnote also contains language that can be read as casting doubt on the future viability of the *Spectrum* holding.

36. However, for damages to be awarded against an attorney for violation of the securities laws, there must be *scienter*. SEC v. Bausch & Lomb, 420 F. Supp. 1226 (S.D.N.Y. 1976), *citing* Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). The Proposed Federal Securities Code places liability on knowing aiders and abettors. Federal Securities Code § 1418 (ALI Tent. Draft No. 2, March, 1973).

37. Zeiden v. Oliphant, 54 N.Y.S.2d 27 (Sup. Ct. 1945).

38. A representative but by no means complete list would include ABA Section of Corporation, Banking and Business Law National Institute, *Advisors to Management—Responsibilities and Liabilities of Lawyers and Accountants* Oct. 3-5, 1974, 30 Bus. Law. Special Issue (March 1975); Expanding Responsibilities Under the Securities Laws, (S. Goldberg, ed., N.Y.L.J. Special Conference, June 5-6, 1972); Bergadano, *Developments and Perspectives in Attorneys' Professional Liability*, 26 Fed'n Ins. Counsel Q. 65 (1975); Cheek, *Counsel Named in a Prospectus*, 6 Rev. Sec. Reg. 939 (1973); Cheek, *Professional Responsibility and Self-Regulation of the Securities Lawyer*, 32 Wash. & Lee L. Rev. 597 (1975); Cohen, Wheat & Henderson, *Professional Responsibility—The Corporate Bar*, in Practising Law Institute, Fourth Annual Institute on Securities Regulation 181 (1973); Cooney, *The Implications of the Revolution in Securities Regulation for Lawyers*, 29 Bus. Law. 129 (Special Issue 1974); Daley & Karmel, *Attorneys' Responsibilities: Adversaries at the Bar of the SEC*, 24 Emory L.J. 747 (1975); Evans, *Disclosure Obligations of Lawyers Advising in the SEC Area*, 31 Bus. Law. 468 (1975); Fraidin, *Developments in Federal Securities Regulation*, 30 Bus. Law. 313, 352-356 (1975); Freedman, *A Civil Libertarian Looks at Securities Regulation*, 35 Ohio St. L.J. 280 (1974); Freeman, *Opinion Letters and Professionalism*, 1973 Duke L.J. 371; Fuld, *Legal Opinions in Business Transactions—An Attempt to Bring Some Order Out of Some Chaos*, 28 Bus. Law. 915 (1973); Garrett, *New Directions in Professional Responsibility*, 29 Bus. Law. 7 (Special Issue 1974); Goldberg, Ethical Dilemma: Attorney-Client Privilege v. The National Student Marketing Doctrine, 1 Sec. Reg. L.J. 297 (1974); Goldberg, *Policing Responsibilities of the Securities Bar: The Attorney-Client Relationship and The Code of Professional Responsibility—Considerations for Expertizing Securities Attorneys*, 19 N.Y.L. Forum 221 (1973); Johnson, *supra* n. 34; Karmel, *supra* n. 3; Koch, *Attorney's Liability: The Securities Bar and the Impact of National Student Marketing*, 14 Wm. & Mary L. Rev. 883 (1973); Landau, *Problems of Professional Responsibility*, in Practising Law Institute, Sixth Annual Institute on Securities Regulation 191 (1975); *Lawyers' Responsibilities and Liabilities Under the Securities Laws*, 121 Colum. J.L. & Soc. Prob. 99 (1974); Leiman, *Responsibility to Report Securities Law Violation*, in Practising Law Institute, Sixth Annual Institute on Securities Regulation 265 (1975); Lipman, *The SEC's Reluctant Police Force: A New Role for Lawyers*, 49 N.Y.U.L. Rev. 437 (1974); Lowenfels, *supra* note 23; Messer, *Roles and Reasonable Expectations of the Underwriter, Lawyer and Independent Securities Auditor in the Efficient Provision of Verified Information: Truth in Securities'* [sic] *Reinforced*, 52 Neb. L. Rev. 429 (1973); Myers, *The Attorney-Client Relationship and the Code of Professional Responsibility: Suggested Attorney Liability for Breach of Duty to Disclose Fraud to the Securities and Exchange Commission*, 44 Fordham L. Rev. 1113 (1976); Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution*, 120 U. Pa. L. Rev. 597 (1972); Shipman, *The Need for SEC Rules to Govern the Duties and Civil Liabilities of Attorneys Under the Federal Securities Statutes*, 34 Ohio St. L.J. 231 (1973); Small, *An Attorney's Responsibilities Under Federal and State Securities Laws: Private Counselor or Public Servant?*, 61 Calif. L. Rev. 1189 (1973); Sommer, *The Commission and the Bar: Forty Good Years*, 30 Bus. Law. 5 (1974); Sonde, *Professional Responsibility—A New Religion, or the Old Gospel?*, 24 Emory L.J. 827 (1975); Sonde, *The Responsibility of Professionals Under the Federal Securities Laws—Some Observations*, 68 Nw. U.L. Rev. 1 (1973); Wozencraft, *Policies and Procedures for Law Firms*, in Practising Law Institute, Sixth Annual Institute on Securities Regulation 221 (1975).

Comment, David v. Goliath Revisited: Will 10b-5 Become the Security and Exchange Commission's Sling Shot Against Securities Lawyers?, 23 DePaul L. Rev. 737 (1974); Comment, *SEC Disciplinary Rules and the Federal Securities Laws: The Regulation, Role and Responsibilities of the Attorney*, 1972 Duke L.J. 969; Comment, SEC v. National Student Marketing Corporation: The Extent of Attorney Liability, 46 Temp. L.Q. 571 (1973); Note, *A New Ethic of Disclosure—National Student Marketing and the Attorney-Client Privilege*, 48 Notre Dame Law. 661 (1973); Note, *Client Confidentiality and Securities Practice: A Demurrer from the Current Controversy*, 8 Ind. L. Rev. 549 (1975); Note, *The Duties and Obligations of the Securities Lawyer: The Beginning of a New Standard for the Legal Profession?*, 1975 Duke L.J. 121.

Attempts were made to resolve directly some of the problems raised by such conflict. Perhaps previsioning *National Student Marketing*, the District of Columbia had fashioned a solution easy for the lawyer to apply by adopting, on October 1, 1971, its own version of DR 7-102(B)(1) to be effective April 1, 1972, that provided:

(B) 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.

(2) A person other than his client has perpetrated a fraud upon a tribunal shall promptly reveal the fraud to the tribunal.[39]

The House of Delegates of the American Bar Association sought to deal with the language problem of DR 7-102(B)(1) in February 1974, by an amendment adding the italicized phrase below:

(B) 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.*[40]

Although the pre-adoption history of such amendment available is elliptical,[41] the House of Delegates of the American Bar Association on August 12, 1975, adopted a statement of policy regarding the ethical duties of securities lawyers that emphasized the overriding necessity for "[t]he confidentiality of lawyer-client consultations and advice and the fiduciary loyalty of the lawyer to the client."[42]

In November 1976, the New York State Bar Association narrowed the disclosure requirements of the amended version of the ABA DR 7-102(B)(1) still further. For in substituting the phrase *"except when the information is protected as a confidence or secret"* for the phrase *"except when the information is protected as a privileged communication,"*[43] the New York amendment protects "secrets" as well as the "confidences" protected by the ABA

39. D.C. Code Encycl. app. A (West Supp. 1976-77).

40. Such amendment was first proposed at the 1973 Annual Meeting of the American Bar Association but was not adopted at such meeting. ABA Summary of Action and Reports to the House of Delegates, 1973 Annual Meeting, Report of the Standing Committee on Ethics and Professional Responsibility 7 (Aug. 6-8, 1973).

41. The Report of the ABA's Standing Committee on Ethics and Professional Responsibility concerning this amendment which was its proposal 3 to "Other Proposed Code Revisions" states simply that proposal "3 . . . result[s] from problems we found with the . . . Code [of Professional Responsibility] in the course of our normal work." ABA, *supra* n. 27, Report of the Standing Committee on Ethics and Professional Responsibility 11.

42. *Federal Criminal Code, Amnesty, Gun Control, Bank Secrecy are Debated by the House of Delegates,* Lawyers, Clients and Securities Laws, 61 A.B.A. J. 1079, 1086 (1975). *See also* Report by ABA Comm. on Counsel Responsibility and Liability, *The Code of Professional Responsibility and the Responsibility of Lawyers Engaged in Securities Law Practice,* 30 Bus. Law. 1289 (1975).

43. Memorandum from Frederick C. Stimmel, Counsel, New York State Bar Association, (Nov. 18, 1976).

CPR attorney-client privilege.[44] At the same time, it also codified the interpretation of the term "fraud" rendered in ABA Opinion No. 341[45] by adding the following definition:

(9) "Fraud" means conduct which involves an element of scienter, deceit, intent to mislead, or knowing failure to correct misrepresentations which can be reasonably expected to induce detrimental reliance by another person, but does not include conduct lacking these elements, although characterized as fraudulent by statute or administrative rule.[46]

Of course, the very existence of the District of Columbia variant, and the

44. *See* ABA Code of Professional Responsibility DR 4-101(A) (1975), in text accompanying nn. 5 & 6 *supra.*

45. Also, we believe that it is inconsistent with the lawyer's confidential relationship with his client to impose at the same time a duty to evaluate the client's confidences to determine whether the level of evidence of "fraud" has ben reached that would require disclosure of such confidences. The lawyer's problem is not lessened, in this respect, by interpreting fraud in DR 7-102(B), as we do, as being used in the sense of active fraud, with a requirement of scienter or intent to deceive.
ABA Comm. on Professional Ethics, Opinions, No. 341, at 5 (1975).

46. Memorandum from Frederick C. Stimmel, *supra* n. 43.
An initial report of the Special Committee to Review the Code of Professional Responsibility of the New York State Bar Association had recommended that DR 7-102(B)(1) be amended to read:

A lawyer who receives information clearly establishing that:

(1) His client, in the course of the representation has perpetrated, is perpetrating or intends to perpetrate a fraud related to the subject matter of the representation upon any person or tribunal, shall promptly call upon his client to rectify the same if the fraud has been perpetrated, or to refrain from the same if the fraud is in progress or is intended. If his client refuses or is unable to do so, the lawyer shall in a matter pending before a tribunal, with its permission if required by its rules, withdraw from the representation and in other matters shall withdraw from the representation.

N.Y. State Bar Ass'n., Special Comm. to Review the Code of Professional Responsibility, *Provisions Relating to Confidences, Secrets and the Duty of Diligence to the Client* 9 (April 8, 1975).
In personal correspondence, Professor Gray Thoron, Chairman of Special Committee to Review the Code of Professional Responsibility of the New York Bar Association has suggested amending DR 7-102(B)(1) and adding a new DR 7-102(C) as follows:

(B) A lawyer who receives information clearly establishing that:

(1) His client has, in the course of representation, perpetrated, or is perpetrating or intends to perpetrate a fraud related to the subject matter of the representation upon any person or tribunal, shall promptly call upon his client to rectify the same if the fraud has been perpetrated, or to refrain from the same if the fraud is in progress or is intended.

(C) Where the client refuses or is unable to rectify a past fraud or to refrain from a continuing or future fraud after being called upon to do so under DR 7-102(B)(1), the lawyer may reveal the fraud to the affected person or tribunal, or take such other action as is necessary to rectify a past fraud or to prevent a continuing or future fraud.

The effect of such amendment and addition would be to meld the District of Columbia variant of DR 7-102(B) with a discretionary authority in the lawyer to reveal the past fraud should the client be unable or unwilling to rectify it.

ABA and New York State Bar Association amendments, of the original version of ABA CPR DR 7-102(B)(1) may support the argument that lawyers subject to the Disciplinary Rules of the majority of jurisdictions that still retain the original ABA version[47] are *required* to disclose a *past fraud* where a client is unable or refuses to do so. This in turn would raise the apparent anomaly that a past "fraud" must be revealed whereas the lawyer may have some discretion in not revealing the intention to commit a future "crime." It is even conceivable that in a multi-state corporate transaction involving a lawyer admitted to the bars of two states with conflicting versions of DR 7-102(B)(1), compliance with the rule of one state might submit him to the threat of discipline for breach of the conflicting rule in the other!

Cast adrift in this sea of general propositions, some conflicting, some abstruse, some ambiguous, the lawyer still must chart the proper course in a variety of concrete cases.

Fortunately from the lawyer's viewpoint—and correspondingly unfortunate from that of the client—we are dealing here only with those cases where the client's conduct admittedly involves a "crime" or "fraud." This eliminates the difficult judgmental process of determining whether the client action or inaction in question constitutes a "crime" or "fraud." On the other hand, it does require the lawyer to face up squarely to the disclosure problem he might otherwise avoid on the assumption such action or inaction was not of a certainty a "crime" or "fraud."

From this point on, I shall use "crime" and "fraud" as synonyms even while realizing that in DR 4-101(C)(3) and DR 7-102(B)(1) and for certain other purposes they may be distinguishable from each other. I do so because it seems to me that in the corporate and securities areas, something actionable as a "fraud" will almost always constitute a "crime" as well. Especially is this so since the interpretations given to the term "fraud" in ABA Opinion No. 341,[48] its definition in the New York State Bar Association's amendment of DR 7-102(B)(1)[49] and the *Hochfelder* decision[50] all require an intent to deceive, manipulate, or defraud. And if such intent is present, some crime will also almost surely be involved.

But even assuming the past, present or future existence of crime or fraud and the exclusive applicability of the amended ABA version and interpretation of DR 7-102(B)(1), the lawyer's proper course of conduct still cannot be set on automatic pilot. For surely his duty to disclose ought to bear some relationship to the seriousness and the effect of the offense.

47. The records of the American Bar Association indicate that only Arkansas, Colorado, Connecticut, Maine, Nebraska, New Jersey, South Dakota, Tennessee and Vermont had adopted the ABA version as of March 21, 1977. Telephone interview with C. Russell Twist, Director of Department of Professional Standards, American Bar Association (March 21, 1977).

48. *See* n. 45 *supra.*

49. *See* n. 46 *supra.*

50. *See* discussion nn. 35 & 36 *supra.*

For example, a corporation that knowingly intends to include potential carcinogens in a widely-used drug without warning and a corporation that intentionally proposes to disregard an applicable state "blue sky" law in selling 50 shares of stock to a resident of that state are both probably committing a "crime." Yet good sense tells us that the "may" of DR 4-101(C)(3) cries out to be read as "must" in the drug case and that the discretion provided in the word "may" should permit the responsible lawyer not to disclose the "blue sky" law violation. Thus, the "crime is a crime is a crime" rationale aids the lawyer little in deciding whether he should disclose in a particular case.

However, any attempt to provide fast rules for the types of crimes that must be disclosed will very likely go the way of most fast rules—that is, they will include some that good judgment would exclude and vice versa.

One could attempt to distinguish between crimes *mala in se* and crimes *mala prohibita.* But without guidelines for distinguishing between the two, this is still not likely to provide a sure answer. Yet the distinctions usually made are not of much practical use. For example, one distinction commonly made between the two is that a crime *malum in se* is wrong in itself or inherently evil whereas a crime *malum prohibitum* is wrong only because of prohibitory legislation.[51] And yet some statutory crimes have been held to be *mala in se*[52]—and most would agree others ought to be. To say that "generally a crime involving 'moral turpitude' is *malum in se,* but otherwise is *malum prohibitum*"[53] affords the lawyer no sure polestar; to say that "crimes which are dangerous to life or limb are likely to be classified as *mala in se,* while other crimes are more likely to be considered *mala prohibita*"[54] simply shifts the debate to what is "dangerous to life or limb." In sum, as a criminal punster might have it, one *malum's se* is another *malum's prohibitum.*[55]

Since we cannot prepare a checklist of intended crimes that should be disclosed, it seems fair to suggest that the lawyer's obligation to disclose will turn not only on the nature of the crime, but also on the balancing of other factors: the effect its disclosure would have on the well-being of the corporate client, the effect its commission or disclosure would have on third parties and whether third parties are reasonably relying on the lawyer to protect their expectations.

For purposes of the following discussion, I am assuming the past crime or fraud has been committed or perpetrated by the lawyer's client during the course of the lawyer's representation of the client,[56] that its commission

51. W. LaFave & A. Scott, Jr., Handbook on Criminal Law 29 (1972).

52. *Id.*

53. *Id.*

54. *Id.*

55. For a thought-provoking series of life-like hypotheticals illustrating the possible gradations of crimes, *see* Kaufman, *supra* n. 29, at 113-15.

56. The ABA Code of Professional Responsibility seems to be silent concerning the responsibility of the underwriters' lawyer who discovers the perpetration or commis-

or perpetration would subject the client to significant liability to third parties if disclosed, that its disclosure would have significant impact on third parties and that compliance with the ABA CPR would not only protect the lawyer against legal liability but discharge his other responsibilities as a professional person.[57] Even after making these assumptions that narrow the area of consideration considerably further, problems in the disclosure area still exist. Since they illumine those problems the lawyer is most likely to face, I shall for the most part use securities area examples although the same dilemmas will undoubtedly arise in other corporate areas.

A. INTENTION TO COMMIT FUTURE CRIME

Let us commence with the easiest—if most unlikely—case first, one unrelated to the securities field. A client informs its counsel of an intention to bribe United States government officials to obtain an important contract. Despite counsel's attempts to dissuade management and the board of directors from so doing, a firm decision to proceed is made. At that point, I would read the "may" of DR 4-101(C)(3) to mean "must," requiring counsel to disclose the information to the proper government authority and ABA Opinion 314 would seem to support this position.[58] Whether resignation of any

sion of a past fraud or crime by an issuer from whom the underwriters propose to buy or have bought securities for subsequent resale to the public. He would undoubtedly reveal that information to his client, the underwriters, and nothing would appear to prevent that. If the discovery were made before the transaction was consummated, it seems certain the underwriters would insist on disclosure as the price for consummation. If the issuer refused to disclose and the underwriters withdraw, to be replaced by another group ignorant of the past crime or fraud, the first underwriters' lawyer would seem to have no duty to make the disclosure himself. DR 7-102(B)(1), requiring disclosure, is inapplicable since the lawyer's client, the first underwriters, had perpetrated no fraud. DR 7-102(B)(2) is also inapplicable since the mandatory disclosure provision for frauds perpetrated by persons other than one's client applies only to those perpetrated upon a tribunal. Moreover, the first underwriters' withdrawal from the proposed transaction would seem to end their involvement. Hence, even if a successor group of underwriters proceeded with the sale without the required disclosure, the first group would not seem to have any intention to commit a future crime; thus, DR 4-101(C)(3) permitting disclosure of the intention of a client to commit a crime would not apply.

If the underwriters' lawyer discovered the past crime or fraud while sales of securities were still being made in reliance on the fraudulently misleading registration statement, he would doubtless urge his client to disclose in order to limit his client's liability. If the underwriters refused to do so, then it would appear the problems of the underwriters' lawyer would be the same as those of counsel for the issuer, discussed in the text accompanying nn. 74-75 *infra*. For duties of underwriters' counsel generally, *see* Henkel, *Liability of Counsel for Underwriter*, 24 Bus. Law. 641 (1969).

57. Of course, U.S. v. Simon, 425 F.2d 796 (2d Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970) is a warning that compliance with applicable professional standards may not insulate a party even from criminal prosecution if a court finds such standards too low. In which event, a fortiori, civil liability might be imposed even though such standards were met.

58. This Opinion dealing with a lawyer's duties in his practice before the Internal Revenue Service states:

> Nor does the absolute duty not to make false assertions of fact require the disclosure of weaknesses in the client's case and in no event does it require the disclosure of his confidences, *unless the facts in the attorney's possession indicate beyond reasonable doubt that a crime will be committed.*

ABA Comm. on Professional Ethics, Opinions, No. 314, at 691 (1965) (emphasis added). It could logically be read to require the disclosure of the intention to commit a crime, no matter what the countervailing reasons for nondisclosure, at which point I would invoke the Emersonian apothegm about "foolish consistency" and "hobgoblin of little minds" as a rebuttal when faced with an appropriately different set of circumstances.

59. Of course, resignation, usually unpleasant at worst for outside counsel, rises to the level of crucial life choice for inside corporate counsel. To sacrifice the fruits (both present and future) of a career devoted singlemindedly to the affairs of a single client has perhaps even the slight flavor of Greek tragedy. But given the same circumstances I see no way one can avoid the same decision, individually heartrending though it may be. *See* Leiman, *supra* n. 38, at 289.

60. § 24 of the Securities Act of 1933 provides:

> Any person who willfully violates any of the provisions of this subchapter, or the rules and regulations promulgated by the Commission under authority thereof, or any person who willfully, in a registration statement filed under this subchapter makes any untrue statement of a material fact or omits to state any

further representation should also occur is probably academic. That would probably be forced by corporate action with laser-like speed.[59]

B. TERMINATED PAST CRIME OR FRAUD SIMPLE

Next, suppose that in the course of his general representation of a corporate client, a lawyer discovers or is informed of a past but now terminated corporate crime or fraud that the client refuses to disclose. Disclosure by him would not be warranted at that time. DR 4-101(C)(3) permits disclosure only of the intention to commit a future crime and DR 7-102(B)(1) would regard the past fraud as a privileged communication. Of course, such crime or fraud should be revealed to the appropriate management officials; if management refuses to make disclosure itself or disclose it to the board of directors, the lawyer should lay it before the board. At which point, his duty ends.

C. TERMINATED PAST CRIME OR FRAUD WITH FUTURE SECURITIES LAWS CRIME IMPLICATIONS

(i) *Period before filing of registration statement*

Assume that having knowledge of such terminated past crime or fraud by virtue of his representation of a client, the lawyer is later asked to help prepare a Securities Act of 1933 registration statement so that such client can sell additional common stock. Let us also assume the crime or fraud is one requiring disclosure under the Securities Act of 1933 or the Securities Exchange Act of 1934 and that management and the board of directors refuse to make disclosure for fear the corporation would be subjected to liabilities that might otherwise not arise. On the one hand, the information is privileged; on the other, the intention to violate willfully either of such Acts evidences an intention to commit a future crime[60] that the lawyer is

permitted to disclose under DR 4-101(C)(3). One thing would seem clear: the lawyer should not work on the registration statement. But is there also an obligation to resign from general representation of the client or to disclose? And if there is a duty to disclose, to whom is it owed?

After all, it is a past, non-recurring crime or fraud and the corporation's reason for refusal to disclose it is premised to be protection of its present and future shareholders, a not unreasonable position. DR 4-101(C)(3) appears to give the lawyer discretion whether to disclose the intention to commit a future crime.[61] Since the corporation's reasons for nondisclosure are rational if not correct and assuming general representation does not require entanglement with the past crime or fraud, I think the lawyer should neither be required to resign the general representation nor to make disclosure to the SEC or the trading public since he has assumed no public role in respect of the proposed registration statement on which the investing public could reasonably have relied.

A nettlesome problem is raised if the corporation decides to proceed with different counsel representing the client in the preparation of the registration statement. As an experienced practitioner has put it, if the registration statement as distributed either in preliminary or final form contains no disclosure:

> The first lawyer cannot tell from the document whether the new lawyer has been smarter than he and figured out some way to get around the problem, or whether he simply does not know about it. My conclusion . . . is that the first lawyer does nothing although I have . . . trouble with this conclusion. . . .[62]

Apart from the instinctive feeling that this somehow violates the philosophy of the "game as it's played" toward another member of the bar, this

material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than $10,000 or imprisoned not more than five years, or both.

Securities Acts Amendments of 1975, Pub. L. No. 94-29, § 27(a), 89 Stat. 163 (*amending* 15 U.S.C. § 77X (1970)).

§ 32(a) of the Securities Exchange Act of 1934 provides in pertinent part:

> Any person who willfully violates any provision of this chapter, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this title, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this title or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of [§] 78 O of this title . . . which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than five years, or both, . . .

Id. §§ 23,27(b), 89 Stat. 162-63 (*amending* 15 U.S.C. § 78ff(a) (1970)).

61. *But see* ABA Comm. on Professional Ethics, Opinions, No. 314 (1965), discussion n. 58 *supra*.

62. Leiman, *supra* n. 38, at 278. Such conclusion is supported by ABA Comm. on Professional Ethics, Opinions, No. 268 (1945).

conclusion seems sound. Although the shareholder who purchases stock in reliance on the registration statement would presumably have paid less had the past crime or fraud and attendant liabilities been disclosed, if such crime or fraud is subsequently discovered, such purchasing shareholder may at least have remedies under the sections 11, 12 and 17(a) of the Securities Act of 1933[63] and section 10(b) and rule 10b-5 of the Securities Exchange Act of 1934.[64]

Certainly, if successor counsel inquires as to the reason for the first lawyer's resignation, the latter should at least indicate that privilege prevents him from speaking. That may well trigger the successor's ferreting out of the past crime or fraud himself. In which case, the information would not be privileged under DR 7-102(B)(1) since the fraud would not have been perpetrated "in the course of the [successor's] representation" but failure to disclose would constitute an intention to commit a crime that the successor could reveal pursuant to DR 4-101(C)(3).

In this example, the original lawyer would seem to have no relationship with the trading public that later buys the securities in reliance on the misleading registration statement. Hence, the discretion of DR 4-101(C)(3) points toward nondisclosure.[65]

(ii) *Period between filing and effective date of registration statement*

Even though it is unpalatable, if counsel insists on disclosure of the past crime or fraud before the preliminary registration is filed, the corporation at least has a choice, Hobsonesque though it may be. If it believes consequences of the disclosure will be sufficiently harmful, it can refrain from filing the registration statement.[66] However, if a past crime or fraud is discovered between the time of filing and the effective date and the corporation wishes to withdraw the registration statement, it may have difficulty doing

63. 15 U.S.C. §§ 77k, l, & q(a) (1970) respectively.

64. 15 U.S.C. § 78j(b) (1970), and 17 C.F.R. § 240.10b-5 (1976) respectively.

65. Even under the exceedingly far reach of the rationale of Black & Co. v. Nova-Tech, Inc., 333 F. Supp. 468 (D. Ore. 1971), this conclusion should still stand. In that case involving the allegedly illegal sale of unregistered securities under the Oregon Blue Sky Law, the court held the law firm, a partner of which had prepared the legal documents necessary to complete the sale, subject to service since it had authorized the issuer to include the law firm's name in its annual reports used in connection with the sale. In our example, there would be presumably no reference to the original lawyer in any of the registration statement materials. In any event, the vitality of the *Black* holding is in some doubt in view of Adams v. American-Western Securities, Inc., 265 Or. 514, 510 P.2d 838 (1973), a subsequent case decided by the Oregon Supreme Court.

66. As pointed out by Small, *supra* n. 38, at 1224-25 nn. 113-14, even this option may not be available where because of outstanding convertible securities or an agreement with selling shareholders, it is necessary to keep an S-16 registration statement current or where filings under the Securities Exchange Act of 1934 must be made. Of course, since the S-16 is an abbreviated form, disclosure of the past crime or fraud might not be required there even though disclosure would be required if an S-1 registration statement were used.

so for SEC rule 477 permits such withdrawal only "if the Commission, finding such withdrawal consistent with the public interest and protection of investors, consents thereto" and requires that the request for withdrawal "state fully the grounds upon which made."[67]

If the client refuses to disclose, should the lawyer resign his registration statement representation? It is true DR 2-110(A)(2) provides that a lawyer "shall not withdraw from employment until he has taken reasonable steps to avoid foreseeable prejudice to the rights of his client"; it is also true such withdrawal after distribution of the preliminary registration statement material indicating the lawyer's participation will probably be prejudicial to the client. But the combined force of DR 7-102(A)(7) forbidding a lawyer from assisting "his client in conduct that the lawyer knows to be illegal or fraudulent," DR 7-102(A)(8) also forbidding him from "knowingly engag[ing] in . . . conduct contrary to a Disciplinary Rule" and EC 7-8 permitting withdrawal in a non-adjudicatory matter where the client insists on a course of conduct contrary to the lawyer's advice even where no DR is involved, should outweigh DR 2-110(A)(2) and dictate resignation.[68]

As a practical matter, if knowledge of the first lawyer's resignation is bruited about, the client may be hoist by its own petard. If, for example, an investment analyst should ask why the first lawyer has resigned his representation, the client can either (a) disclose (unlikely, since the original resignation was caused by unwillingness to do so), (b) simply not respond (in which event suspicions—if not hackles—may be raised), or (c) respond in a partially or totally misleading manner. If the client's response is misleading, it seems reasonable that the first lawyer be permitted to disclose the true reason for resignation on one of several grounds. First, that by its misleading statement, the client has inferentially discussed the subject of the privileged material, thus waiving the privilege;[69] second, that to allow the false statement to gain public currency might make the lawyer an aider and abettor of

67. 17 C.F.R. § 430.477 (1976).

It is true that in Jones v. SEC, 298 U.S. 1 (1936), the United States Supreme Court (Justices Cardozo, Brandeis, and Stone dissenting) upheld a registrant's right to withdraw a preliminary registration statement despite SEC objections. However, later lower court cases upholding the validity of Rule 477 cast considerable doubt on the Jones decision. *See* R. Jennings & H. Marsh, Securities Regulation 216-17 (4th ed. 1977).

68. Actually, DR 2-110(A)(2) taken as a whole can be read as merely requiring that the resignation be effected in a manner that will give the client time to get adequate substitute representation. So read, it would not give rise to any conflict with DR 7-102(A)(7) and (8) or EC 7-8. I cannot conceive that a lawyer would continue to give an opinion as to the legality of the securities being issued while allowing another lawyer to give a misleading opinion about the registration statement, an opinion required by the underwriters as a condition of closing. *See* text accompanying nn. 72-74 *infra*.

69. *Cf.* H. Drinker, Legal Ethics (1953), briefly discusses an analogous situation:

> When a lawyer-client testifies in a disciplinary proceeding as to the advice given him by another lawyer, the latter is free to testify as to what advice he actually gave.

Id. at 134.

the corporation;[70] or third, if the reason assigned for the resignation casts reflection on the first lawyer's competence or integrity, he has the right to disclose the true reason to protect himself.[71]

(iii) *Post-effective period when trading in reliance on misleading registration statement continues*

More difficult is the case where counsel, publicly identified in the registration statement as having rendered an opinion in connection with the sale of securities, later discovers either a past undisclosed crime or fraud or that the client had an intention to commit a future crime at the time the registration statement became effective where there is still trading in reliance on the registration statement. Usually, there is a statement in the Prospectus to the effect that "[t]he legality of the [securities] offered by this Prospectus will be passed upon for the Company by Messrs. . . ." Such opinion, addressed to the corporate client and filed as Exhibit 6 to the S-1 registration statement typically states that based upon examination of certain materials, the issuer is duly organized and existing under the laws of a particular jurisdiction with a specified authorized capital and that "the securities outstanding are, and those to be sold pursuant to the registration statement will be, validly issued and outstanding, fully paid and nonassessable."[72] Unless the past crime or fraud related to the issuance of the shares itself, such opinion could properly be given even if there were material misstatements or omissions in the registration statement.[73]

However, the typical underwriting agreement usually requires, as a condition precedent to the underwriters' purchase of and payment for the securities, that counsel for the issuer deliver an opinion to them stating such counsel

> does not believe that the Registration Statement or the Prospectus, on [the] effective date [of such Registration Statement or Prospectus] contained any untrue statement of a material fact or omitted to state any material fact required to be stated therein or necessary to make the statements therein not misleading.

Several states have statutes providing that voluntary testimony on the part of a client regarding a particular communication or subject will result in a waiver of the privilege on that matter so that the attorney may, or may be compelled, to testify. *See generally* C. McCormick, *supra* n. 8, at § 93; 8 J. Wigmore, *supra* n. 8, at § 2327.

70. *See* nn. 33-36 *supra*.

71. Disclosure on this basis may be supported by the analogy of DR 4-101(C)(4) permitting the lawyer to reveal "[c]onfidences or secrets necessary . . . to defend himself or his employees or associates against an accusation of wrongful conduct." ABA Code of Professional Responsibility DR 4-101(C)(4) (1975).

72. Except in a jurisdiction like New York where under certain circumstances shareholders may be liable for specified corporate debts such as unpaid wages, in which case an appropriate exception is included. N.Y. Bus. Corp. Law § 630 (McKinney 1963 & Supp. 1976).

73. Babb, Barnes, Gordon & Kjellenberg, *Legal Opinions to Third Parties in Corporate Transactions*, 32 Bus. Law. 553, 569 (1977).

Such closing opinion usually also includes a statement to the effect that "This opinion is furnished by us, as counsel for the Company, to you as Representatives of the several Underwriters and is solely for the benefit of the several Underwriters."

In these circumstances, does the lawyer have any obligations to the underwriters or the purchasing shareholders when he later discovers the existence of a past crime or fraud, the issuer's nondisclosure of which in the registration statement can be viewed as an intention to commit a future crime?

Before trying to answer this question, two facts must be noted. First, the opinion itself is still correct; for at the time of its delivery, the lawyer did not know—and we posit he could not reasonably have known—there was a material omission in the registration statement. Second, he could not—and would not—have delivered the opinion, a condition precedent for selling of the securities, had he known of such material omission.

One's response to the above question depends largely on whom the lawyer is regarded as representing. Although the underwriters are clearly not clients of the issuer's counsel in any traditional sense, they certainly relied on the opinion of issuer's counsel in purchasing the issuer's securities and for that reason issuer's counsel may owe a duty of disclosure to the underwriters.[74] Since the issuer can be charged with knowledge that his counsel would never have delivered the opinion had he known of the material omission, it seems unreasonable for such issuer to prevent its lawyer from notifying the underwriters of such omission after the client has refused to do so. The lawyer's disclosure would also seem to be permitted by DR 4-101(C)(3), since there is an intention to commit a crime under the securities laws. As a practical matter, if such material omission is revealed to the underwriters, they will probably wish to disclose it publicly in order to eliminate any possibility of liability they might otherwise have.

But if for some reason the underwriters do refuse to disclose, then the lawyer must decide whether he has the obligation to notify the SEC, public purchasers of such securities or the trading public.

The traditional view is that the lawyer is an advisor or advocate for the issuer and owes no duty to persons who have purchased or may purchase securities in reliance on the misleading registration statement.[75] And certainly the intendment of the closing opinion, stating it to be "solely for the benefit of the several Underwriters," is to eliminate privity between issuer's counsel and public purchasers or the trading public.

74. The very purpose of having the opinion of issuer's counsel addressed to the purchaser is to cut the privity knot. Commonly, the purchasers also have their own counsel, and in negotiation of terms I doubt that many persons would think that issuer's counsel is representing anyone other than the issuer. On the matters covered by the opinion, however, the relationship between issuer's counsel and the purchasers may be one of attorney and client. Shipman, *supra* n. 38, at 241 (footnote omitted); *see also id.* at 241 n. 30. For a discussion of the interplay of the *Restatement of Torts* and possible securities laws liabilities, *see* Small, *supra* n. 38, at 1233-34 n. 136.

75. *See, e.g.,* Karmel, *supra* n. 3, and Lipman, *supra* n. 38.

On the other hand, the requirement that issuer's counsel deliver the closing opinion containing the above-quoted comfort language about the registration statement is also found in the typical underwriting agreement. And that *is* a public document, being filed, for example, as Exhibit 1 in a Form S-1 filing under the Securities Act of 1933. From this, one can reasonably argue that public purchasers and the trading public did in fact rely on the existence and truth of the opinion at the time they purchased the securities even though the clean closing opinion delivered to the underwriters included the limiting language quoted above. If that is so, should not they be entitled to be informed of this, having purchased or traded in reliance on the misleading registration statement?

It would seem that *Fischer v. Kletz,*[76] although dealing with accountants' duty of disclosure, supports this view. There, accountants who had certified a year-end balance sheet and related income statement subsequently discovered that figures contained therein were substantially misleading, but failed to make disclosure of this. The court held that plaintiffs, suing for damages because of reliance on the erroneous financial statements, had stated a cause of action under both the common law and rule 10b-5.

Even though the lawyer's initial duty of investigation of factual matters is different from that of an accountant, I think Professor Morgan Shipman is correct when he argues:

> [O]nce there is knowledge of a material defect in the portion of the disclosure document passed upon by the [lawyer], it seems artificial and decidedly contrary to the purposes of the securities laws to treat the attorney differently from the accountant. Conceiving of the lawyer as counsel to shareholders and prospective shareholders for purposes of determining his duties to the trading markets is, therefore, a distinct possibility.[77]

If the public purchasers and the trading public are limited purpose clients of issuer's counsel, discovery of a fraud perpetrated upon them should not,

76. 266 F. Supp. 180 (S.D.N.Y. 1967). It should be noted that Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 441, (N.Y. 1931), although denying a third party relief for an accountant's negligence in preparation of financial statements, stated that such holding "does not emancipate accountants from the consequences of fraud." *Id.* at 189, 174 N.E. at 448. *See also* Rusch Factors, Inc. v. Levin, 284 F. Supp. 85 (D.R.I. 1968) where the court in dictum indicated it might not follow *Ultramares* even in respect of an action alleging only negligence.

77. Shipman, *supra* n. 38, at 262.

Such cases as Gold v. DCL Inc., 399 F. Supp. 1123 (S.D.N.Y. 1973) and Wessel v. Buhler, 437 F.2d 279 (9th Cir. 1971), holding that accountants are not subject to rule 10b-5 liability for mere possession and nondisclosure of material facts in respect of financial statements in which the accountant has not issued an opinion or publicly certified, indicate there would be a duty to disclose had there been public reliance on the offending statements.

under the rationale of *Garner v. Wolfinbarger,* be privileged.[78] Hence, under DR 7-102(B)(1) the lawyer's duty would require him promptly to "reveal the fraud to the affected person"—here, the public purchasers and the trading public. Certainly, disclosure to the SEC, as agent for them, should satisfy the requirement that the disclosure be made to the "affected person" and would be far more effective than any personal attempt to disseminate it publicly the lawyer could likely make, be it at 2 a.m. from a front stoop in Georgetown or by more conventional means.

(iv) *Lawyer's responsibility to disclose terminated crime or fraud if nondisclosure constitutes intention to commit future crime where no opinion is involved*

Perhaps the most difficult case facing the lawyer occurs when, in his general counseling of a corporate client (as contrasted with the instance in which the public may be reasonably thought to be relying on his specific opinion), the crime or fraud has occurred in the past and there is assurance it will not recur but the failure to disclose constitutes a continuing crime. For example, he helps in the preparation of a Form 10-K, knowing that if the corporation willfully fails to disclose a particular past crime or fraud, such failure to disclose constitutes a separate crime under Section 32(a) of the Securities Exchange Act of 1934.[79] Here the corporation does not even have a Hobson's choice: it must file the 10-K. But there also exist difficult if not impossible cost-benefit trade-offs to weigh. For example, revelation of a prior antitrust violation might permit tens of thousands of customers to recover a few dollars apiece while jeopardizing the corporation's capacity to continue in business to the far more direct detriment of employees, suppliers, shareholders, and perhaps even present customers. Again, where disclosure of a crime or fraud permits certain security holders to receive payment from the corporate treasury, it will be at the expense of other security holders who may be fully as innocent as those recovering. The weighing of such conflicting considerations may be fit grist for the maw of a computerized Solomon; but it is not within the proper decisional province of the lawyer, Nestor-like (to switch epochs) though he may be in other respects.

From which I conclude that where the crime or fraud is past and nonrecurring, management and the board of directors has made a good faith decision not to disclose to protect the corporation and the lawyer's opinion is not being relied on by the public, then the lawyer should neither be required to disclose nor to resign his representation. It should also follow that he ought not to be liable as an aider or abettor if the corporation is later found guilty for not having disclosed.[80]

78. Such a result has already been forecast by Professor Shipman. Shipman, *supra* n. 38, at 256-57 & n. 99.

79. *See* n. 60 *supra.*

80. Inclusion of the lawyer's name as counsel for the corporation in its annual report or the fact that he is generally known to be its counsel should not alter this result.

D. COMMISSION AND DISCOVERY OF CRIME OR FRAUD AFTER EFFECTIVE DATE OF REGISTRATION STATEMENT WHEN TRADING IN RELIANCE THEREON CONTINUES

If a crime or fraud should both occur and be discovered after a registration statement has become effective but while the public is still trading in reliance thereon, the rationale of *SEC v. Manor Nursing Centers, Inc.*[81] dictates that supplementary material or an up-dated sticker be delivered with the prospectus in order to prevent liability under section 17(a) of the Securities Act of 1933 and rule 10b-5 under the Securities Exchange Act of 1934.[82]

The lawyer, whose clean closing opinion was accurate when delivered, will have no difficulty in persuading the issuer to prepare and deliver such material as soon as possible in order to limit its liability to those persons who have purchased its securities in reliance on the original registration statement after the subsequent crime or fraud should have been discovered and disclosed unless the disclosure of the crime or fraud would expose the issuer to greater liability than it would incur for violation of the securities laws. Since the original registration statement was accurate at the time it became effective, those persons purchasing before the subsequent crime or fraud was committed would have no cause of action for registration statement nondisclosure.

In the event the issuer is unwilling to disclose, the lawyer's obligation should be the same as those set forth in the "Post-effective period" discussion in C(iii) above.

CONCLUSION

From the previous discussion, it seems apparent that the lawyer's duty to disclose—or not disclose—his corporate client's crime or fraud will often require a nice weighing of a number of competing considerations; that even after such weighing, the decision may still be exquisitely difficult to make and fraught with risks whichever way the decision goes.

However, one general principle and an exception to it do suggest themselves. In the great majority of instances, the lawyer's obligation to preserve his client's secrets and confidences will be paramount. However, there will be exceptional occasions where the lawyer's transactional presence is so

Even assuming that Black & Co. v. Nova Tech, Inc., 333 F. Supp. 468 (D. Ore. 1971), is good law (a Greek contrary-to-fact conditional in my view), it is still distinguishable from our example. For in *Black,* delivery of the annual report in which counsel's names appeared was a *sine qua non* for sale of the securities whereas it is not in the ordinary trading situation.

81. 458 F.2d 1082 (2d Cir. 1972).

82. *See* Shipman, *supra* n. 38, at 260 for the proposition that the court erred in also holding it to be a violation of Section 5 of the Securities Act of 1933 not to provide such supplementary material.

public and crucial that third parties can reasonably be thought to rely on such presence as evidence that reasonable third party expectations are not being jeopardized by the client's concealment of crime or fraud. In such instances, statistically few in number I suspect, the duty to disclose should control, disclosure of the client's confidence of secret notwithstanding.

Supplemental Remarks by Professor Hoffman:

SINCE TIME is passing quickly, let me be brief. In one sense, I have an easy assignment since I can shortcut a good part of today's discussion by assuming that a corporate crime or fraud has been or will be committed, thus eliminating the usually protracted factual debate on that issue. Moreover, Loeber Landau has made the task still easier by limiting my discussion to the non-litigation context, thus reducing the scope of the problem further.

However, there is a trade-off. For given the existence of past or future corporate crime or fraud, responsible corporate counsel cannot avoid facing up to the issue by concluding that management's resolution of the problem can be accepted since reasonable persons could disagree as to its existence and counsel is not an expert.

Moreover, consideration of crime or fraud in the non-litigation setting raises at least three problems the lawyer does not ordinarily face in dealing with the discharge of his responsibilities under the ABA Code of Professional Responsibility.

First, as Frank Wheat mentioned this morning, the Code deals primarily with the lawyer as advocate and with the adversary relationship; but in the non-litigation, corporate context, the corporate lawyer is more often a counselor than advocate and there may be no adversary in the usual sense of the term. Moreover, the corporate lawyer typically has a continuing relationship with the client, often extending over a long period of time, rather than the one-shot advocate representation that the Code primarily concerns itself with. All these factors give raise to problems not found in the usual lawyer-as-advocate representing his client in an adversary relationship.

Second, the representational simplicity presented where the lawyer owes his loyalty to a single client may disappear in certain corporate situations where obligations may be owed to others as I will mention in a minute.

Third, in the corporate, non-litigation setting, the failure to disclose a past crime or fraud may involve the commission of an additional crime in contrast with the usual criminal case where the lawyer simply represents a client who has already committed a crime that involves no future crime aspects. This duality gives rise to potential conflict between the lawyer's duty to disclose and his obligation to maintain the confidentiality of information relating to his client.

The ABA Code of Professional Responsibility itself sets different standards for disclosure of past frauds and the intention to commit a future crime, DR 4-101(C)(3) giving the lawyer discretion to disclose the intention to commit a crime and DR 7-102(B)(1) requiring disclosure of past fraud committed during the course of representation except where the information is protected as a privileged communication.

In deciding whether to disclose the intention to commit a future crime,

obviously the seriousness of the intended offense, the harm and benefits flowing from disclosure and management's reasons for non-disclosure all require the exercise of considerable lawyer judgment.

Where the failure to disclose a past crime or fraud constitutes the commission of a future crime or fraud, another congeries of factors must be considered. Here, one's duty to disclose may depend on such factors as these: whether the lawyer is simply acting as a general counsellor or is expected to give a legal opinion, and if an opinion is to be given, whether it is reasonably to be relied on by parties other than those to whom it is addressed; whether the terminated crime or fraud involves the chance of future replication; whether the revelation of the past crime or fraud would harm the client more than it would benefit other parties; whether there are justifiable reasons for not disclosing.

Despite the general primacy of the lawyer's obligation to preserve the confidentiality of information received from his client as limned in the attorney-client privilege, I do believe there are limited instances in which the nature of the transaction and the role of the lawyer are such that third parties will be relying on counsel to disclose past crimes or frauds that might significantly influence their course of action. For example, where a client's past violation of the antitrust laws has significantly increased its past profits, a prospective purchaser of the client's securities might well alter his decision to buy had the doubtful quality of the past profits been disclosed. And a failure to disclose the relationship between past profits and past antitrust violations would constitute omission of a material fact in the registration statement used to sell such securities, a crime under the Securities Act, giving the lawyer discretion to disclose under DR 4-101(C)(3).

In stating that counsel does not believe there to be any material omission, an opinion required by the typical Underwriting Agreement, a public document, it seems to me counsel owes an obligation to inform purchasers of securities covered by, and others relying on, the registration statement of such omission when he subsequently discovers that, through no fault of his own, his opinion was wrong if the client will not make the necessary disclosure. And this even though the original opinion attempted to disclaim any responsibility to third parties. In such a case as this, statistically few in number I suspect, it seems to me the corporate lawyer's duty of disclosure to third parties should outweigh his duty of confidentiality to client.

Commentary by Marshall L. Small*:

IT WOULD be useful at the outset of my comments to note the development of certain trends which we as business lawyers may have to consider in weighing our responsibility to respond to fraudulent or criminal conduct. First is the trend toward elimination of the doctrine of caveat emptor outside the securities area—where we have tended to focus our attention of late—when considering the problem of professional responsibility. There are other types of business transactions—sales of real property, for example,[1] where the client may have an affirmative duty of disclosing problems even where there is a clearly understood "as is" sale without warranties. Our client's duty of disclosure will inevitably have some impact on our own conduct when we become aware of material facts which have not been disclosed.

A second possible trend is suggested by the balance struck by the California Supreme Court in the *Tarasoff* case[2] cited in Junius Hoffman's paper, which required a therapist with information that a patient might cause physical harm to a third person to warn the potential victim. The court considered carefully the potential adverse effect on the confidential professional relationship between patient and therapist of requiring disclosure, but nevertheless struck the balance in favor of requiring disclosure to avoid harm to others. The *Tarasoff* case may be distinguishable on the ground that it involved potential physical rather than financial harm[3] and that no general publication of the confidential information was required since the intended victim was known and could be individually warned. By way of contrast to the result in *Tarasoff*, the courts to date have declined to impose a general duty on accountants—who have no legally recognized privilege of confidentiality in most states—to warn of defects in their clients' financial statements for which they do not assume responsibility.[4] Furthermore, disclosure required in *Tarasoff*—the intention to commit a future crime—would not in

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* Member, California Bar.

1. *See* Orlando v. Berkeley, 220 Cal. App. 2d 224, 32 Cal. Rptr. 860 (1963) (failure of vendor to disclose termite and damp rot damage on sale of residence in "as is" condition); Massei v. Lettunich, 248 Cal. App. 2d 68, 56 Cal. Rptr. 232 (1967) (failure of subdivider to disclose that lots were on filled land and engineering report as to depth of foundations). Cal. Civil Code § 1668 precludes use of a sale "as is" clause to bar liability in the event of fraud. *See, generally,* 3 Restatement of Torts, Scope Note to Chapter 22; 1 Harper & James, The Law of Torts (1956), pp. xxxiv-xxxvi, § 7.1.

2. Tarasoff v. Regents of the University of California, 17 Cal. 3d 425, 131 Cal. Rptr. 14, 551 P.2d 334 (1976).

3. In the past courts have been more willing in some circumstances to extend relief for tortious acts resulting in physical harm than in cases of financial harm. *Compare, e.g.,* Restatement of Torts 2d, § 311, *with* Restatement of Torts, § 552.

4. *See* Wessel v. Buhler, 437 F.2d 279 (9th Cir. 1971); Fischer v. Kletz, 266 F. Supp. 180, 195-96 (S.D.N.Y. 1967); Gold v. DCL, Inc. Fed. Sec. L. Rep. (CCH) ¶ 94,036 (S.D.N.Y. 1973); Grimm v. Whitney, Fidalgo Seafoods, Inc., Fed. Sec. L. Rep. (CCH) ¶ 96,029 (S.D.N.Y. 1973). *Compare* Restatement of Torts 2d, §§ 314, 315.

any event have been protected by the attorney-client privilege. Nevertheless, the *Tarasoff* case suggests that in the future we as a professional may not be completely free to shape our obligations under the Code of Professional Responsibility without regard to how the larger community may view the relative social costs and benefits of preserving the attorney-client privilege when dealing with fraudulent or criminal conduct which may cause harm to others.

A third trend which may be developing is an increased emphasis by governmental agencies on the use of criminal sanctions to deter socially objectionable business conduct, coupled with an increased responsibility for the consequences of corporate decision-making being placed on senior management and potentially the board of directors, as illustrated by the decision of the U.S. Supreme Court in *United States v. Park*.[5] Increasingly, we as business lawyers may therefore be called upon not only to consider the criminal implications of corporate conduct as it affects our corporate clients and their executives, but also our own professional responsibility in dealing with these matters.

Having noted these general trends by way of background, I will now turn to some of the specific issues which seem to me to be posed in attempting a definition of the lawyer's obligation to respond to fraudulent or criminal conduct.

In dealing with the lawyer's responsibility to respond to fraudulent conduct, we have at the outset a serious definitional problem which must first be resolved as to what constitutes "fraud." Before we are able to fashion workable rules which govern the lawyer's duty to deal with fraudulent conduct, we must have a common understanding as to what will be viewed as fraud. The law in this area has been changing and will no doubt continue to evolve over a period of years which will require us to proceed slowly and with care in attempting to articulate our own rules of professional responsibility. A few examples will serve to illustrate the definitional problems we face. First, we have for some time been engaged in an on-going debate in the securities area as to whether we need scienter in order to conclude that conduct is fraudulent. Only recently has the matter begun to be resolved with the decision of the U.S. Supreme Court in the *Hochfelder* case,[6] in a private damage action, but we are left with many unanswered questions. Conduct may still be viewed as "fraudulent" for purposes of injunctive proceedings even in the absence of scienter,[7] although some courts do not agree on this point.[8] Furthermore, it is not clear what level of conduct falling short of intent to deceive may be viewed as sufficiently reprehensible to warrant the same consequences as intentional deception under section 10(b) of the Securities Exchange Act of 1934.[9] If a professional expresses an opinion based on facts when he knows that he does not have the facts to support the opinion, it was long ago recognized that such conduct may be fraudulent.[10] On the other hand, if reckless failure to investigate troublesome facts may be viewed as tantamount to fraud, then hard questions will be presented—as to which reasonable individuals might conceivably differ—as to whether a particular set of facts is sufficiently troublesome to make it reckless not to inquire further.[11] Under such circumstances, the lawyer's study to respond may be far different where the "fraudulent" conduct under consideration is reckless failure to investigate rather than an intentional attempt to deceive.

A second example of the definitional problem we have is the application of the evolving of materiality to the characterization of conduct as fraudulent. Although not expressly recognized as such in the Code of Professional Responsibility[12] materiality should be considered as an essential element in testing whether a "fraudulent" statement or omission may be relied upon and therefore is actionable.[13] The concept of materiality in the securities law context alone is still being evolved by the courts, and it cannot yet be concluded that the test only recently annouced by the U.S. Supreme Court in *TSC Industries, Inc. v. Northway*[14] in a proxy statement setting under section 14(a) of the Securities Exchange Act of 1934 will be equally applicable in all settings.[15] Furthermore, the views of the Securities and Ex-

5. United States v. Park, 421 U.S. 658 (1975).
6. Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).
7. *See* S.E.C. v. Universal Major Industries Corp., 546 F.2d 1044 (2d Cir. 1976).
8. S.E.C. v. Bausch & Lomb, 420 F. Supp. 1226 (S.D.N.Y. 1976), and S.E.C. v. American Realty Trust, Fed. Sec. L. Rep. (CCH) ¶ 95,913 (E.D. Va. 1977).

9. The question was left open in the Hochfelder case. *See supra* n. 6, at 193-4, fn. 12. The lower courts are now beginning to explore the extent to which conduct not involving intentional deception may nevertheless be subject to sanction under rule 10b-5. *See* Sundstrand Corporation v. Sun Chemical Corp., Fed. Sec. L. Rep. (CCH) ¶ 95,887 (7th Cir. 1977); Sanders v. John Nuveen & Co., Inc., Fed. Sec. L. Rep. (CCH) ¶ 96,030 (7th Cir. 1977).
10. "Fraud involves the pretense of knowledge when knowledge there is none." Ultramares Corporation v. Touche, 255 N.Y. 170, 174 N.E. 441, 444 (1931).
11. *Compare,* the majority opinion in Lanza v. Drexel & Co., 479 F.2d 1277 (2d Cir. 1973), *with* the dissenting opinion of Judge Timbers, 479 F.2d 1321 (when has one in fact seen "seagulls on the water").
12. DR 7-102(B)(1) of the New York State Bar Association was amended in 1976 to add the following definition of "fraud" to that Association's Code of Professional Responsibility:

> "Fraud" does not include conduct, although characterized as fraudulent by statute or administrative rule, which lacks an element of scienter, deceit, intent to mislead, or knowing failure to correct misrepresentations which can be reasonably expected to induce detrimental reliance by another.

However, the definition does not contain any limitation as to materiality.
13. Restatement of Torts, §§ 537, 538. If reliance on fraudulent conduct is not justifiable due to lack of materiality, it is questionable whether its disclosure should be mandated by the CPR.
14. TSC Industries, Inc. v. Northway, 426 U.S. 438 (1976).
15. It has also been recognized that the SEC has the power to require disclosure of "non material" information that has economic significance. The consequences of failure to disclose such information may still subject the issuer to SEC enforcement action even though civil damages may not be available. *See* National Resources Defense Council v. S.E.C., Fed. Sec. L. Rep. (CCH) ¶ 96,057 (D.C.D.C. 1977), at 91,766, n. 26 & 91,769, n. 56.

change Commission and its staff have changed over the years and will no doubt continue to evolve as to the types of disclosures which are deemed material. The questionable business practices area with its emphasis on misrecording of transactions and management involvement[16] affords a current example of an area which many securities law practitioners may not until recently have considered as one which warranted specific disclosure absent economic materiality to the corporation. Changing economic conditions have in the past produced and will in the future produce added rules by the SEC for disclosure.[17] Furthermore, the SEC may through judicial and enforcement proceedings seek to establish requirements for disclosure which are in good faith resisted by lawyers representing their clients vigorously as contemplated by the Code of Professional Responsibility. The securities bar may not always agree with the SEC as to the need for such disclosures.[18]

The fact that the SEC or members of its staff announce their own views as to the concept of materiality should not thereby trigger an obligation on the part of the securities bar to agree unquestionably under pain of being charged either by a governmental agency or a bar disciplinary committee or in a private damage suit with aiding and abetting the commission of a "fraud." I would not assume that the SEC believes otherwise.

The uncertainties reflected in the recent debates over framing an appropriate response to auditors as to existence of contingent liabilities of a client is a further example of how the concept of materality has continued to evolve and also illustrates the problem of defining what constitutes a continuing "fraud." The ABA Statement of Policy on Responses to Auditors[19] offers a reasonably balanced approach to disclosure to auditors of contingent liabilities, and permits the lawyer to withhold disclosure to auditors of unasserted claims when the client has a reasonable basis for concluding that the likelihood of such assertion is not probable. The statement therefore provides a practical basis for testing whether the existence of an unasserted claim is of such materiality as to warrant its disclosure to auditors. The comparable principles set forth in Statement No. 5 of the Financial Accounting Standards Board affords a similar test as to materiality for disclosure in financial statements. It is assumed that the same test would govern disclosure in the narrative portion of disclosure documents, such as registration statements and periodic reports under the Securities Act of 1933 and Securities Exchange Act of 1934. While it is not certain that this result is as yet fully accepted by the SEC and its staff,[20] it may be concluded that under some circumstances all would agree that some cases of wrongful conduct by a client giving rise to unasserted claims need not be disclosed and are therefore not "material". In this connection, it becomes important to distinguish between wrongful conduct which is continuing and wrongful conduct which has ceased. Continued wrongful conduct poses for the lawyer the problem of avoiding assistance in or seeking termination of the conduct as well as the problem of disclosing the conduct. Where the wrongful conduct has ceased, the problem may be more simply posed as one of disclosure, and if under the ABA Statement of Policy and FAS 5 nondisclosure would be justified on grounds of lack of materiality then failure to make a public disclosure should not constitute engaging in a continuing "fraud"[21] absent other facts such as senior management or director involvement.

The definitional problems noted above with respect to what constitutes "fraud" should not lead one to the conclusion that nothing can or should be done to deal with the lawyer's responsibilities when he discovers that a client has misstated or omitted to state a fact. Rather, it is intended only to suggest that the subject is a complex one and that DR 7-102(B)(1) of the CPR should not be read to mandate disclosure of fraud in any event unless the intent to deceive is clear and the fraud is in fact ongoing so as not to be protected by the attorney-client privilege.[22]

As noted above, if it is determined that a fraud has in fact been committed by a client, DR 7-102(B)(1) of the Code of Professional Responsibility appears to mandate disclosure absent a privileged communication. By contrast, in most instances the CPR leaves it in the *discretion* of the lawyer as to whether to report the commission of a crime.[23] Although the CPR is not

16. *See* Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices Submitted to the Senate Banking, Housing and Urban Affairs Committee, May 12, 1976.

17. See SEC Accounting Services Release No. 133, Fed. Sec. L. Rep. (CCH) ¶ 72,155 (disclosure of price control violations); Sec. Act Rel. No. 5704, '75-'76, Fed. Sec. L. Rep. (CCH) ¶ 80,495 (1976) (disclosure of material capital expenditures for environmental purposes); Sec. Act Form S-1, Item 9, Instruction 5, Item 12, Instruction 4, Sec. Exchange Act Form 10, Item 1, Instruction 6, Item 10, Instruction 4, Sec. Exchange Act Form 10-K, Item 1(a)(7), Item 5, Instruction 4 (disclosure of matters concerning environment).

18. *See, e.g.,* comments of former SEC Commissioner A. A. Sommer, Jr., as reported in N.Y. Times, April 5, 1976, p. 51.

19. *ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information,* 31 Bus. Law. 561 (1975).

20. For example, a member of the SEC staff, speaking only for himself during a recent panel discussion, suggested that this test as to propriety of non-disclosure of contingent liabilities might only be applicable to financial and not to narrative portions of disclosure documents, and that disclosure would in any event be required even if assertion of a contingent liability is unlikely if the consequences of assertion would be materially adverse to the issuer.

21. There may be a different result if the person engaging in the conduct was a member of senior management. *See, e.g.,* S.E.C. v. Kalvex, Inc. '75-'76 Fed. Sec. L. Rep. (CCH) ¶ 95,276 (S.D.N.Y. 1975); *cf.* Heit v. Weitzen, 402 F.2d 909 (2d Cir. 1968). In any event, the lawyer may have an obligation to inform an employee's superiors of deceptive conduct which has ceased even if there is no duty to make a public disclosure.

22. In the case of an intent to commit a fraud or an ongoing fraud, the attorney-client privilege would not be available. *See* 8 J. Wigmore, Evidence §§ 2298-99 (2d ed. 1961). However, as noted above, failure to disclose a matter which need not be disclosed should not turn the nondisclosure into a continuing fraud.

23. CPR DR 4-101(C)(3). A fraud would normally also constitute a crime, but the CPR does not seem to recognize this contradiction between DR 4-101(C)(3) and DR 7-102(B)(1). The CPR does impose a duty on the lawyer to report unprivileged knowledge of attorney misconduct. *See* DR 1-103.

explicit on the point, the lawyer's discretion should extend only to situations such as intended or continuing criminal acts, which do not fall within the attorney-client privilege. On reflection, the discretion thus vested by the CPR in the lawyer is probably a necessary one. As Junius Hoffman points out in his paper, crimes may be classified in a number of ways—for example, felonies vs. misdemeanors, crimes *malum in se vs. malum prohibitum,* crimes involving moral turpitude, and those which do not. The reasons for the classifications vary, and include matters of substantive criminal law (*e.g.,* whether a death has been caused in the course of committing a felony), procedural classifications (for example, the court in which a case may be tried), and the basis for administrative action (such as grounds for disbarment or deportation).[24]

The lawyer's appropriate response to commission of a crime by a client will of necessity vary from case to case depending upon the particular facts. Take the simple case of the lawyer who is traveling with a client to an important closing. The client wants to exceed the speed limit to make certain that they will be on time for the closing. Does the lawyer have an obligation to take action to prevent that client from speeding or to report the client if the client ignores the lawyer's admonition to obey the law? I would think not. Would it make any difference if the client were under the influence of alcohol and driving in congested traffic? While the examples used may seem facetious[25] they do serve to emphasize that the lawyer's response to criminal conduct by the client must of necessity vary with the facts of the particular case, so that the CPR properly leaves a necessary discretion with the lawyer as to how to respond.

The lawyer's response may well involve counselling the client not to engage in the conduct in question. This may require the lawyer to discuss the matter with senior management or, if necessary, with outside members of the board of directors in order to secure cessation of the conduct. In so doing, the lawyer must keep clearly in mind whom he is representing. While the employee engaging in the wrongful conduct may for some purposes share a common interest with the corporate client in avoiding prosecution, the corporation itself is usually the lawyer's client,[26] and its interest must be considered in determining what actions—including public disclosure—may be necessary or desirable on behalf of its shareholders taken as a whole.

What should the lawyer do if the client is unwilling to cease the wrongful conduct. In many cases—as in the simple speeding case noted above—the lawyer may not feel compelled to take any action. But depending upon the

24. *See* W. LaFave & A. Scott, Jr. Handbook on Criminal Law 26-33 (1972).

25. These examples appear in A. Kaufman, Problems in Professional Responsibility 113-15 (1976).

26. EC 5-18 of the CPR provides that a lawyer employed by a corporation or other entity owes his allegiance to the entity and not a stockholder, director, officer, employee, representative or other person connected with the entity.

seriousness of the conduct, the lawyer may be obliged to do more. The seriousness of the crime and its potential consequences to third parties may well be deemed to affect the lawyer's actions and escalate the extent of the response—that is, it may not be sufficient for the lawyer to refrain from counselling or assisting in a violation of law, as mandated by the CPR.[27]

The lawyer may be justified—if not obliged—to withdraw from the representation or even to report an intended or continuing violation to authorities or to an actual or potential victim. The CPR properly leaves the matter to be decided on a case by case basis in the lawyer's discretion as a matter of professional responsibility. However, it must be remembered that at some point the courts may impose a legal duty on the lawyer to act.

To what extent does the responsibility undertaken by the lawyer affect the action the lawyer is obligated or permitted to take? The following examples serve to illustrate the varying situations in which the lawyer may be required to act:

(1) The lawyer may discover wrongful conduct by one who is not a client and while not engaged in the course of representing a client. In this setting, the lawyer should normally be in no different position than any other citizen and have no duty to act simply because he or she is a lawyer. An exception is mandated by the CPR when the wrongdoer is another lawyer or when the wrongdoer has perpetuated a fraud upon a tribunal.[28]

(2) The lawyer may discover wrongful conduct by one who is not a client while in the course of representation of a client as, for example, wrongful conduct by the other party to a business transaction. So long as the lawyer does not assist the client in a conspiracy or other joint effort to violate the law, the lawyer may not be obligated to report the violation by the other party except under the circumstances noted in (1) above. On the other hand, if the wrongful conduct is by a business which is being acquired by the lawyer's client, the lawyer will have to consider not only effecting cessation of the conduct but the client's duty to disclose past misconduct affecting the business once it has been acquired, and even possibly a suit for any harm caused to the acquired corporation.

(3) The lawyer may discover wrongful conduct by an employee or agent of a client which does not involve a matter on which the lawyer is representing the client. Whether or not the lawyer has a legal duty to do so, consideration must be given to reporting the conduct to superiors to insure that the conduct will cease and not be repealed, and that appropriate attention will be given to any public disclosure responsibilities which the conduct may require. Furthermore, unlike (1) above, the

27. DR 7-102(A)(7).

28. DR 1-103; DR 7-102(B)(2). Contrast the potentially broader duty imposed by DR 7-102(B)(1) upon the lawyer to disclose fraud by a client.

CPR seems to expand the lawyer's duty to report fraud committed by a client on another person as well as on a tribunal unless the information is within the attorney-client privilege.[29]

(4) The lawyer may discover wrongful conduct by an employee or agent of a client involving a matter on which the lawyer is representing the client. Here the nature of the lawyer's response may well depend upon whether or not the lawyer's representation is manifested to third parties, such as by delivery of an opinion, and on whether the wrongful conduct is discovered before or after the transaction is consummated and any opinion is delivered. However, suppose the lawyer's opinion is being delivered on a subject which is not really germane to the particular conduct in question. If, for example, a lawyer were asked to pass on the due issuance of stock of a company which was going to make a public offering, I would assume that the lawyer would want to make certain that there was some competent review of other aspects of the issuer's business before the lawyer would make himself or herself a party to the transaction. Perhaps we will not need or want to spell out all of these matters in detail in the CPR. Nevertheless it may be useful to articulate as a general principle that there are steps that should responsibly be taken by some qualified person in a transaction before a lawyer's professional reputation is lent to helping carry out the transaction.

In conclusion, I would suggest that there are several actions we might want to take in the area under discussion.

First, there are certain inconsistencies in the CPR itself which we may wish to clarify. Consider, for example, the duty of a lawyer not to engage in illegal conduct involving moral turpitude (DR 1-102(A)(3)), or in conduct involving dishonesty, fraud, deceit or misrepresentation (DR 1-102(A)(4)). DR 1-102(A)(3) and DR 1-102(A)(4) of the CPR should not of course be construed to authorize the lawyer to engage in illegal conduct which does *not* involve moral turpitude or dishonesty, fraud, deceit or misrepresentation, but it might be desirable to make those provisions consistent with the broader prohibition contained in DR 7-102(A)(7) setting forth the lawyer's duty not to counsel or assist a client in conduct the lawyer knows to be illegal or fraudulent. It might also be desirable to consider further the distinctions drawn between the *duty* to report unprivileged knowledge of attorney misconduct in DR 1-103 and the *duty* to report unprivileged fraud in DR 7-102(B)(1) with the *permission* granted in DR 4-101(C)(3) to disclose the intention of a client to commit a crime—insofar as distinctions are drawn between attorneys, clients and others and between fraudulent conduct and crimes, since fraudulent conduct may itself be a crime.

29. DR 7-102(B)(1).

Second, we should consider preparing commentaries on specific problems arising under the CPR to assist us as business lawyers in using the CPR as a practical guide to professional conduct in a business law setting.

Third, we should consider articulating for the public the basic social goals sought to be advanced by the law in general and by the CPR in particular which cause lawyers to act as they do in specific situations. For example, we should explain to the general public the following objectives of the CPR: (1) to encourage compliance with applicable law (including the admonition to lawyers to vigorously represent their clients but not counsel violation of law unless there is a non-frivolous basis for challenge), (2) to encourage the seeking of legal counsel to minimize prospective violations of law, with the resulting trade-off of protecting past violations of law against disclosure under the attorney-client privilege, (3) to afford adequate and effective counsel to persons who have violated the law (including placing the burden of proof of violation on the government), (4) to discourage the promotion and encourage the settlement of legal disputes (including the policy implicit in statutes of limitations which eventually bar suits on unasserted claims), and (5) to insure the integrity of the judicial process (including disclosure of fraud on an affected tribunal).

Finally, I think it will be important for us to encourage institutional safeguards within the corporation to assist the lawyer in dealing with corporate misconduct once it is discovered. For example, the presence of outside members of the board of directors offers a disinterested forum for review in cases where members of management may have an interest in the decision. Furthermore, it may be desirable to give corporate lawyers who serve as employees of the corporation a more direct relationship to the board itself by providing that the senior or general counsel (however he or she is denominated) is to be appointed and removed by the board of directors.[30]

30. For example, the By-Laws of General Motors Corporation provide for a General Counsel as a corporate officer who is subject to appointment and removal by the Board of Directors.