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Harvey Frank

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ARTICLES

A HIGHER DUTY: A NEW LOOK AT THE ETHICS OF THE CORPORATE LAWYER

HARVEY FRANK*

THE CORPORATE LAWYER WORKS IN a complex world of finance and convoluted business transactions involving intricate, ambiguous, and constantly evolving law. It is a world in which few significant transactions can be concluded without his active participation; he is an indispensable link in the chain. It is a world of "other people's money."¹

The effects of corporate action by public and large private corporations are often so substantial that they reach beyond the confines of the business world and into the general community. Thus the lawyer performing a vital role in the corporate world can no longer disclaim responsibility for the results of his actions on the pretext that he is merely executing the desires of his client. And one would hope that while he executes his legal function in the best interests of his client, he does so without offending the mores of the public.

Although it has not always been clear to the legal profession that the conduct of its most powerful clients affects ethical responsibilities, the resulting problems have become more evident in recent years to the courts, the Securities Exchange Commission (SEC), and members of the bar. Moreover, there is what might be termed the evolving "Watergate principle" — that there are matters of significant public concern in which a lawyer may have an even greater duty to the citizenry than to his client. Recent developments have been diffuse, and include a changing legal conceptualization of corporations as well as numerous considerations involved in corporate legal representation. Viewed together and placed into focus, these developments shed considerable light on the sometimes conflicting duties of the corporate lawyer to clients and to the public. While some of these ethical questions are of interest to all attorneys, the current ethical dilemmas of the lawyer representing public corporations and the corporate specialist dealing in matters relating to the federal securities acts² can be especially acute.

The legal establishment has resisted any changes in the duty of a law-

* A.B., New York University; J.D., Harvard; LL.M., New York University; Member, New York and Virginia Bars; Professor of Law, College of William and Mary, Marshall-Wythe School of Law.

¹ See L. BRANDEIS, *OTHER PEOPLE'S MONEY* (1933).

² Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1970 & Supp. V 1975); Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1970 & Supp. V 1975); Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79-79z-6 (1970 & Supp. V 1975); Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to -52 (1970 & Supp. V 1975); Investment Advisors Act of 1940, 15 U.S.C. §§ 80b-1 to -21 (1970 & Supp. V 1975).

yer as articulated in the Code of Professional Responsibility,³ producing potential conflicts with evolving developments in the courts and the SEC, as well as rising public expectations. However, as former Commissioner Sommers suggested, "the security bar's *conception* of its role too sharply contrasts with the *reality* of its role in the securities process . . . and in such situations the reality eventually prevails. . . . I would suggest that the bar will make a serious error if it seeks to defend itself against the emerging trends by reliance upon old shibboleths and axioms. Society will not stand for it."⁴ This article will analyze recent developments and endeavor to offer some solutions to the ethical conflict by proposed changes in the Code of Professional Responsibility.

I. THE CORPORATE LAWYER

The lawyer's traditional role as an adversary representing a clearly identifiable client with undivided loyalty is reflected in the Code of Professional Responsibility,⁵ with the underlying presumption that by such service the lawyer best serves society.⁶ This description and the underlying presumption are not consistent with the modern practice of a corporate lawyer, economic reality, or recent legal developments.

The practice of the lawyer representing public corporations is unique. He represents corporations whose shares are held by members of the public, either directly as shareholders or indirectly as participants in mutual funds, retirement plans, or the like⁷ and whose activities affect both large numbers of employees and the national economy.⁸ In his representation a corporate lawyer rarely functions in an adversary position, particularly where legal opinions or disclosure problems involving the securities acts are concerned. Although attorneys for an issuer⁹ and underwriter¹⁰ in a public offering may have honest differences concerning the contents of a registration statement, they have a common interest in consummating the

³ See text accompanying note 121 and Part IV B of the text *infra*.

⁴ Speech of A. A. Sommer, Jr., *The Emerging Responsibilities of the Securities Lawyer*, [1973-1974] FED. SEC. L. REP. (CCH) ¶ 79,631, at 83,689, 83,691.

⁵ ABA Code of Professional Responsibility and Canons of Judicial Ethics [hereinafter ABA Code] EC 5-18 states in part that "a lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not to the stockholder, director, officer, employee, representative, or other person connected with the entity."

⁶ ABA Code Preamble.

⁷ See New York Stock Exchange, Shareownership - 1970, Census of Shareowners (undated pamphlet).

⁸ Two examples will illustrate the significance of public corporations. In 1976 American Telephone & Telegraph Co. had consolidated sales and revenues of \$33 billion, 927,000 employees, and 3,500,000 shareholders. MOODY'S PUBLIC UTILITY MANUAL 117, 121 (1977). General Motors Corp. had consolidated sales and revenues of \$47 billion, 748,000 employees, and 1,300,000 shareholders. 1 MOODY'S INDUSTRIAL MANUAL 725, 727 (1976).

⁹ An issuer is defined in section 2(4) of the 1933 Act to include every person (including a corporation) "who issues or proposes to issue any security." 15 U.S.C. § 77b-4 (1970 & Supp. V 1975).

¹⁰ An underwriter is defined in section 2(11) of the 1933 Act to include "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection, with the distribution of a security." 15 U.S.C. § 77b-11 (1970 & Supp. V 1975).

offering and avoiding a common liability under section II of the 1933 Act.¹¹ Similarly, in a merger the proxy statement¹² is prepared jointly by counsel and is almost identical for both corporate parties, since both corporations must meet essentially the same legal requirements under the securities acts.¹³ Again there is a mutual interest in effectuating the transaction and avoiding liabilities since the merged corporation will be liable for all obligations of both corporations. In these common examples, the interests of the clients are parallel; they succeed or fail together, and their attorneys are in effect attorneys for the situation. When an attorney prepares or reviews a proxy statement, a press release, an annual report to shareholders,¹⁴ or an annual report to the SEC on form 10K,¹⁵ there is no second party at all. Moreover, these legal problems are largely ones of disclosure to the public, requiring an act which the lawyer could undertake himself, in lieu of and independently of his client, if he possessed the information and it were proper to do so either by advising the SEC or otherwise.¹⁶

The corporate lawyer is often indispensable to the consummation of a transaction, particularly when a legal opinion is a customary condition of closing¹⁷ as in a merger,¹⁸ public offering¹⁹ or sale of restricted se-

¹¹ Section 11(a) provides in part:

In case any part of the registration statement when such becomes effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such a security . . . may, either at law or in equity, in any court of competent jurisdiction sue —

(1) every person who signed the registration statement;
(2) every person who was a director of . . . the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(4) every accountant . . . or an appraiser whose profession gives authority to a statement made by him who has with his consent been named as having prepared or certified any part of the registration statement or as having prepared or certified any report . . . which is used in connection with the registration statement, with respect to the statement in such registration statement, report . . . , which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

15 U.S.C. § 77k(a) (1970 & Supp. V 1975).

¹² The requirements of a proxy statement are codified in Schedule 14A, 17 C.F.R. § 240.14a-101 (1977), passed pursuant to section 14(d) of the 1934 Act, 15 U.S.C. § 78n(d) (1970 & Supp. V 1975) with respect to securities registered under section 12 of the 1934 Act. 15 U.S.C. § 781 (1970 & Supp. V 1975).

¹³ Schedule 14 A, Item 14, 17 C.F.R. § 240.14a-101 (1977).

¹⁴ Under rules passed pursuant to the 1934 Act, an annual report to shareholders must be sent to all shareholders in connection with an annual meeting of shareholders at which directors are to be elected. 17 C.F.R. §§ 240.14a-3(b), C-2(a) (1977).

¹⁵ 17 C.F.R. § 249.310 (1977).

¹⁶ See *In re Emanuel Fields, Securities Act Release No. 5404* (June 18, 1973), [1973] FED. SEC. L. REP. (CCH) ¶ 79,407; Speech of A. A. Sommer, Jr., *The Commission and the Bar: Forty Good Years, quoted in Matthews, Liabilities of Lawyers Under the Federal Securities Laws*, 30 BUS. LAW. 105, 119-21 (1975).

¹⁷ See *United States v. Benjamin*, 328 F.2d 854, 863 (2d Cir. 1964).

¹⁸ See note 106 *infra*.

¹⁹ See Schneider and Manko, *Going Public — Practice, Procedure and Consequences*, 15 VIL. L. REV. 283, 295 (1970).

curities.²⁰ Moreover, the importance of the lawyer's role in the preparation of SEC registration statements is emphasized in the following reflections of A. A. Sommer:

[The registration statement] has always been a lawyer's document and with very, very rare exceptions the attorney has been the field marshal who coordinated the activities of others engaged in the registration process, wrote (or at least rewrote) most of the statement, made the judgments with regard to the inclusion or exclusion of information on the grounds of materiality, compliance with registration form requirements, necessities of avoiding omission of disclosure necessary to make those matters stated not misleading. . . . With the exception of the financial statements, virtually everything else in the registration statement bears the imprint of counsel.²¹

The central role of the corporate lawyer is further emphasized by the philosophy of self-regulation as "the mainspring of the federal securities laws."²² The SEC exercises no supervisory function in such important areas as private offerings, sales of securities pursuant to Rule 144,²³ annual reports to shareholders, and press releases. Even when it does assume an active role, as in the processing of registration statements or proxy material, the SEC does not make an independent examination of the facts but basically relies upon the information contained in the documents furnished to it,²⁴ which are primarily the work of lawyers and accountants. The resources of the SEC are too meager for it to be otherwise.²⁵ This situation has made the "courts alert to provide such remedies as are necessary to make effective the congressional purpose,"²⁶ so that the Supreme Court has allowed private remedies for violation of the proxy rules²⁷ and Rule 10b-5,²⁸ despite the absence of an express statutory right to bring a private civil action.²⁹ This system of self-regulation will not function without the cooperation of the bar, and, therefore, "the task of enforcing the securities law rests in overwhelming measure on the bar's shoulders,"³⁰ and places upon the securities bar a rigorous standard of professional honor.

Finally, the SEC has consciously adopted a program to improve pro-

²⁰ See *SEC v. Spectrum, Ltd.*, 489 F.2d 535 (2d Cir. 1973).

²¹ See Speech of A. A. Sommer, Jr., *supra* note 4, at 83,688.

²² *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 370 (2d Cir. 1973).

²³ 17 C.F.R. § 230-144 (1977).

²⁴ *J. I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964).

²⁵ See *In re Emanuel Fields, Securities Act Release No. 5404*, (June 18, 1973), [1973] FED. SEC. L. REP. (CCH) ¶ 79,407, at 83,175.

²⁶ *J. I. Case Co. v. Borak*, 377 U.S. 426, 433 (1964).

²⁷ *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964).

²⁸ *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971).

²⁹ *Id.* See also *J. I. Case Co. v. Borak*, 377 U.S. 426, 431 (1964); *Kardon v. Nat'l. Gypsum Co.*, 69 F. Supp. 512 (E. D. Pa. 1946).

³⁰ *In re Emanuel Fields, Securities Act Release No. 5404* (June 18, 1973) [1973] FED. SEC. L. REP. (CCH) ¶ 79,407, at 83,175.

fessional performance in the belief that "[e]ven if certain businessmen are not moved to full compliance by ethical considerations or the fear of punishment, they will do far less damage if their lawyer and accountants won't play"³¹ the game of business without regard for the law.

II. THE CORPORATE ATTORNEY'S DUTY

A. *Identification of the Client*

The starting point for an analysis of the ethical duties of a corporate lawyer must be the identification of his client. For most lawyers this is obvious, but for the corporate lawyer the matter may not be so simple, the difficulty being in the unique structure and nature of a corporation. A corporation is an artificial entity created by law, operated by officers and employees, and under the management of a board of directors for the benefit of the shareholders. The shareholders elect the directors who select the president³² who in turn customarily retains and discharges counsel. Who then is the lawyer's client? Is it the corporate entity in whose name the lawyer acts, the directors who manage the corporation, the shareholders who own the corporation, or the president who has hired and can fire the attorney?³³ Client identification appears to be the key to much of the difficulty encountered by the SEC in dealing with the professional conduct of securities lawyers.³⁴

Normally, numerous interests of the parties comprising the corporation are intertwined, and the lawyer is said to represent the "corporate entity."³⁵ This is an overly simplified fiction which does not stand analysis. For example, when the lawyer of a solvent, profitable corporation assists in a dissolution, or a merger in which the corporation will not be the survivor, he is not acting in the best interests of the corporate entity, but presumably that of its shareholders.

B. *Changing Legal Conceptualizations of the Corporation*

As long as the entity theory persisted undiminished, the question whether a corporate lawyer owed any duty to the shareholders of his corporate client could not be asked. The recognition of shareholders as a separate legal component not always subsumed within the corporate entity came first in civil litigation under section 10b of the Securities Exchange Act of 1934³⁶ and Rule 10b-5.³⁷ For example, in *Pappas v.*

³¹ See Speech of R. Garrett, Jr., *Professional Responsibility and the Securities Laws*, quoted in 30 BUS. LAW. 118, 119 (Special Issue, March, 1975).

³² See, e.g., DEL. CODE tit. 8, §§ 104, 141, 142, 211 (1974). It is the practice of some corporations for the board of directors to approve the retention of counsel who is nevertheless chosen by the chief executive officer.

³³ See Freeman, *Opinion Letters and Professionalism*, 1973 DUKE L. J. 371, 374.

³⁴ See Speech of R. Garrett, Jr., *supra* note 31.

³⁵ See note 5 *supra*.

³⁶ It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

Moss³⁸ the board of directors of a listed company, all but one of whom were officers, and who in the aggregate owned more than fifty percent of the outstanding stock, issued a large block of the shares of the company's common stock to themselves at a fraudulently low price. Plaintiff, a minority shareholder, alleged in a derivative action on behalf of the corporation³⁹ that they were guilty of fraud and misrepresentation in the sale, a direct violation of Rule 10b-5.⁴⁰ The defendants argued that the corporation could only act through its agents, and that all of its agents, the directors, were aware of the facts so that the corporation was not deceived.⁴¹ The Third Circuit found the required deception by viewing the fraud "as though the 'independent' stockholders were standing in place of the defrauded corporate entity at the time the original resolution authorizing the stock sale was passed."⁴² Certainly, it was pointed out,

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78(j) (1970 & Supp. V 1975).

³⁷ It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1977).

Promulgated under section 10 of the 1934 Act, *see* note 35 *supra*, Rule 10b-5 has become the basic provision of the 1934 Act to prevent fraud in the purchase and sale of securities and has been broadly construed to effect its remedial purpose. *See* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971). The SEC is given a right to bring actions under section 21 of the 1934 Act, 15 U.S.C. § 78u (1970), and a private right of action has been inferred from the rule. *See* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971); Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946). The core of the rule is that all investors should have equal access to the rewards of participation in securities transactions, be subject to equal market risk, and have equal access to material information available to insiders. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 851 (2d Cir. 1968).

³⁸ 393 F.2d 865 (3rd Cir. 1968); *See also* Bailes v. Colonial Press, Inc., 444 F.2d 1241 (5th Cir. 1971).

³⁹ *See* FED. R. Civ. P. 23.1, which sets forth the conditions for bringing a derivative action in the federal courts:

In a derivative action brought by one or more shareholders . . . to enforce a right of a corporation . . . , the corporation . . . having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder . . . at the time of the transaction of which he complains. . . . The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders . . . similarly situated in enforcing the right of the corporation.

⁴⁰ Pappas v. Moss, 393 F.2d 865, 868 (3rd Cir. 1968).

⁴¹ *Id.* at 869.

⁴² *Id.*

"the deception of the independent stockholders is no less real because 'formalistically' the corporate entity was the victim of the fraud."⁴³

A similar fracturing of the corporate entity was reached by the Second Circuit in *Schoenbaum v. Firstbrook*,⁴⁴ in which the complaint in the derivative action alleged that defendants, the directors of Banff Oil, Ltd., knowing of oil discoveries by Banff, conspired to sell to its controlling corporate shareholder, Aquitaine Company of Canada, Ltd., the other defendant, shares of stock of Banff at vastly inadequate prices.⁴⁵ The Second Circuit, sitting *en banc*, overruled a panel decision and held that the complaint stated a triable claim under Rule 10b-5, even though all of the directors were aware of the facts.⁴⁶ In his dissenting panel opinion, Judge Hays, who wrote the majority *en banc* opinion, dealt with the corporate entity question and stated that "[e]ndowing a corporation with a fictitious 'personality,' so that for example it has 'knowledge' is a useful device for the analysis of many problems. But it can also constitute a trap for the unwary when they ascribe reality to the fictions. . . . There is, of course, no justification for interposing the corporate fiction between the directors and the minority stockholders who were the victims of the directors' fraudulent actions."⁴⁷

With a similar disregard for the unitary corporate entity, the Supreme Court in *J.I. Case v. Borak*⁴⁸ combined the rights of a group of shareholder of J.I. Case Company brought an action alleging that a consummated merger with American Tractor Corporation was effected through the use of a false and misleading proxy statement in violation of Section 14a of the 1934 Act.⁴⁹ The Supreme Court held that section 27 of the 1934 Act authorized a derivative and a direct private federal cause of action for violation of section 14(a) of the 1934 Act by the complaining stockholder, stating that "[t]he injury which a stockholder suffers from corporate action pursuant to a deceptive proxy solicitation ordinarily flows from the damage done the corporation, rather than the damage inflicted directly upon the stockholder. The damage suffered results not from the deceit practiced on him alone but rather from the deceit practiced on the stockholders as a group. To hold that derivative actions are not within the sweep of the section would be tantamount to a denial of private relief."⁵¹ The Court held that the statute granted such a derivative

⁴³ *Id.*

⁴⁴ 405 F.2d 215 (2d Cir.) (rehearing *en banc*), *rev'g in part* 405 F.2d 200 (2d Cir. 1968). See *Rekant v. Desser*, 425 F.2d 872 (5th Cir. 1970). See also *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 475 n. 15 (1977) (citing the foregoing cases and *Pappas v. Moss*, 393 F.2d 865 (3d Cir. 1968) with apparent approval).

⁴⁵ *Schoenbaum v. Firstbrook*, 405 F.2d 215, 218 (2d Cir. 1968).

⁴⁶ *Id.* at 219.

⁴⁷ 405 F.2d 200, 215.

⁴⁸ 377 U.S. 426 (1964).

⁴⁹ *Id.* at 432.

⁵⁰ *Id.* at 427.

⁵¹ *Id.* at 432.

right despite the absence of a specific reference to a private right of action in section 14(a).⁵²

C. Duty to Shareholders

The trend in the federal courts to disregard the corporate entity in favor of treating the rights of shareholders independently when the circumstances require has application to the relationship of a corporate attorney to his client, although the Code of Professional Responsibility of the American Bar Association has and continues to postulate that the corporate entity alone is always the lawyer's client.⁵³ The ABA position was specifically rejected by the Fifth Circuit in *Garner v. Wolfnbarger*,⁵⁴ in which access to communications between the attorney for the corporation and its officers was sought in a derivative suit charging the corporation and its officers with acts injurious to the interest of the plaintiffs as stockholders.⁵⁵ The defendant objected to the disclosure on the grounds of attorney-client privilege.⁵⁶

Taking note of the ABA brief presented as amicus the court could not accept that "prospective decision of the client on whether to abide by advice or disregard it, or the guarantee of a veil of secrecy, either establishes or narrows the attorney's obligation in giving advice. And to grant to corporate management plenary assurance of secrecy for opinions received is to encourage it to disregard with impunity the advice sought."⁵⁷ Nor did the Fifth Circuit find "[c]onceptualistic phrases describing the corporation as an entity separate from its stockholders" a useful tool of analysis, for it served only "to obscure the fact that management has duties which run to the benefit ultimately of the stockholders."⁵⁸ Therefore, if all the shareholders wished to inquire into a communication between the corporation's representatives and the company's attorney they would clearly have a right to do so.⁵⁹ When a minority shareholder seeks access to the communication, then discretion must be exercised by the court in granting such access to protect the interests of the other shareholders.⁶⁰

The court was also persuaded that two traditional exceptions to the attorney-client privilege were pertinent: communications in contempla-

⁵² *Id.* at 431.

⁵³ See note 5 *supra*.

⁵⁴ 430 F.2d 1093, 1101 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971). See also *Bailey v. Meister Brau*, 55 F.R.D. 211 (N.D. Ill. 1972). Cf. *Valente v. Pepsico, Inc.*, 68 F.R.D. 361 (D. Del. 1975), where the court held that the attorney for defendant-majority shareholders, who was also a member of the Board of Directors of the same corporation, could not protect defendant by claiming privileged communications at the expense of his corporate clients, the plaintiff-minority shareholders.

⁵⁵ *Garner v. Wolfnbarger*, 430 F.2d at 1095.

⁵⁶ *Id.* at 1096.

⁵⁷ *Id.* at 1102.

⁵⁸ *Id.* at 1101.

⁵⁹ *Id.*

⁶⁰ *Id.* at 1101 n. 17.

tion of a crime or fraud,⁶¹ and communications to a joint attorney.⁶² The latter exception was found to apply on the theory that counsel was acting on behalf of or at least for the benefit of the shareholders as well as the corporate entity.⁶³

The logic of the Fifth Circuit has a broader implication for the corporate attorney-client relationship than the question of privilege, particularly with respect to the voluntary disclosure of pertinent matters to the shareholders by counsel under appropriate circumstances. A public corporation is not an end or an entity unto itself, but a means to an end through the organization of capital for a large number of shareholders who are the sole owners of the corporation.⁶⁴ If this position is correct and the shareholders are therefore the ultimate client of counsel to a public corporation, then it is reasonable to propose that the SEC and the courts adopt as a public policy the assumption that shareholders expect their company to be run in a lawful manner. If the corporation acting through its board of directors or management does not meet that expectation, it is a breach of the shareholders' trust. A corporate attorney should have a duty to fulfill the expectation of integrity of his ultimate client, the shareholders. When that expectation fails because of corporate misconduct as to a material matter, the attorney should have a duty to disclose these facts to the shareholders. When there are a large number of shareholders, direct communication may not be possible, and in any event such widely disseminated information would quickly become public. In view of the impracticality of direct disclosure, the attorney should be obliged instead to make appropriate disclosures to the SEC or other authorities, at least as to matters that are breaches of law or would be breaches of law if not disclosed, and if it is clear the corporation through its directors or officers will not make the required disclosure. Under this theory, the attorney-client privilege would not be applicable to such disclosure situations.⁶⁵ Moreover, the attorney's duty to the corporation's shareholders and his duty to the public are likely to be congruous.⁶⁶

D. Duty to Public

For the past decade a doctrine has been developing cautiously in the securities law that a corporate lawyer may have a duty not only to his client, whomever that may be, but to the general public, or at least the investing public, as well.⁶⁷

⁶¹ *Id.* at 1102.

⁶² *Id.*

⁶³ *Id.* at 1103.

⁶⁴ *Id.* at 1101. Shareholders elect directors, must approve any charter amendments, mergers, dissolutions, etc., and alone are entitled to all of the net profits and net assets of the corporation. See, e.g., ABA-ALI Model Bus. Corp. Act §§ 34, 54, 67, 77, 80.

⁶⁵ See text accompanying notes 61-63 *supra*.

⁶⁶ See part III D of the text *infra*.

⁶⁷ For a discussion of the traditional viewpoint of the duty of a securities lawyer, see

The first significant assertion of the attorney's duty to others beside his corporate client occurred in *Escott v. BarChris Construction Corp.*⁶⁸ This was an action for damages under section 11 of the Securities Act of 1933 (1933 Act)⁶⁹ against the BarChris Corporation and its officers, directors, accountants, and attorneys. The suit was brought by purchasers of BarChris debentures in a public offering, who alleged and proved that the company's registration statement contained materially false and misleading statements.⁷⁰ The court first noted the long-standing position of the bar, accepted by the SEC, that the lawyer preparing a registration statement is not liable under section 11(a)(4) of the 1933 Act⁷¹ for the material prepared by him, although the accountant was liable as an expert with respect to his audit.⁷² The court then considered the liability of Grant, an outside director, signer of the BarChris registration statement, and partner of the law firm responsible for its preparation. Grant had asserted a due diligence defense⁷³ under section 11(b)(3).⁷⁴ In disallowing the defense, the court found that more was required of Grant in the way of reasonable investigation than could be fairly expected of an outside director who had no connection with the preparation of the registration statement.⁷⁵ Such an outside director, one who was not an officer of BarChris, would at a minimum have had to read the prospectus with care, and to make some investigation of its accuracy with the diligence a prudent man would employ in the management of his own property.⁷⁶ Grant, who as counsel for BarChris prepared the registration statement, should not have relied solely upon the officers of the corporation, but should have at least checked those matters easily verifiable and tested oral information against the original written record including minutes and material contracts.⁷⁷ Had he made such a reason-

Lowenfels, *Expanding Public Responsibilities of Securities Lawyers*, 74 COLUM. L. REV. 412, 413 (1974).

⁶⁸ 283 F. Supp. 643 (S.D.N.Y. 1968).

⁶⁹ See note 11 *supra*. See also Lowenfels, *supra* note 66, at 428.

⁷⁰ 283 F. Supp. at 652.

⁷¹ See note 11 *supra*.

⁷² 283 F. Supp. at 683.

⁷³ *Id.* at 682, 683.

⁷⁴ 15 U.S.C. § 77 K(b)(3) (1970 & Supp. V 1975) sets forth the due diligence which expulps directors, but not the issuer, from section 11(a) of the 1933 Act for false and misleading statements contained in a registration statement:

(b) Notwithstanding the provisions of subsection (a) no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof—

... (3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or . . . of an expert, . . . he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading;

⁷⁵ 283 F. Supp. at 690.

⁷⁶ *Id.* at 688.

⁷⁷ *Id.* at 690-92.

able independent investigation of the non-expertised portion of the prospectus, he would have uncovered many of the false and misleading statements or omissions.⁷⁸ The fact that Grant honestly believed the registration statement to be true and that no material facts had been omitted was insufficient.⁷⁹ While this is technically a decision relating to Grant's due diligence defense as a director, his duty as a director to members of the purchasing public was broadened because of his function in preparing the registration statement as an attorney for the registrant.⁸⁰ As Judge McLean pointed out, this was not a malpractice suit. Grant's obligation did not necessarily run only to the client corporation, but also to those members of the public at large who as purchasers of the debentures had a cause of action against Grant as a director.⁸¹

The court in *BarChris* treated Grant as an outside director with special responsibilities. In *Feit v. Leasco Data Processing Equipment Corp.*⁸² which strongly relied on *BarChris*, however, the court considered a due diligence defense asserted by a lawyer in an action under section 11 of the 1933 Act⁸³ for false and misleading statements in a registration statement used in connection with an acquisition. The court treated the lawyer as an inside director because of his close involvement as counsel with his client's affairs.⁸⁴ The standard of due diligence for an inside director is so high that as a practical matter his liability approaches that of a guarantor of the accuracy of the registration statement.⁸⁵ Counsel in this case was involved in all aspects of the acquisition from the preliminary stages to the conclusion of the transaction, and was directly responsible for the preparation of the registration statement.⁸⁶ Thus again, a lawyer's legal role altered his obligations not to his clients, but to the plaintiff purchasers under section 11 of the 1933 Act.⁸⁷ Lawyers have generally accepted the application of the *BarChris* standards of diligence even when they are not directors.

In the same year that *BarChris* was decided, the Second Circuit in *SEC v. Frank*⁸⁸ reviewed what appears to be the first instance in which

⁷⁸ *Id.*

⁷⁹ *Id.* at 690.

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² 332 F. Supp. 544 (E.D.N.Y. 1971).

⁸³ 15 U.S.C. § 77 K(b)(3)(A) (1970 & Supp. V 1975).

⁸⁴ 332 F. Supp. at 576.

⁸⁵ *Id.* at 579.

⁸⁶ *Id.* at 576.

⁸⁷ The court did not speak of the lawyer's liability *qua* lawyer. However, the difference in the standard of care expected of an outsider director and an outside director who is also counsel for the company is an indication of the care owed by the attorney to the public who relied on the prospectus he prepared, and to the corporate issuer which may have relied on the attorney to perform his functions in such a way as to avoid liability for his client. See STAFF REPORT OF THE SEC TO THE SPECIAL SUBCOMMITTEE ON INVESTIGATIONS OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE, THE FINANCIAL COLLAPSE OF THE PENN CENTRAL COMPANY 113 (Subcomm. Reprint 1972), which discusses one company's policy of nondisclosure of financial liabilities.

⁸⁸ 388 F.2d 486 (2d Cir. 1968). See also *United States v. Sarantos*, 455 F.2d 877

the SEC obtained an injunction against an attorney for alleged violations of the fraud provisions of the securities law based upon his "participation in the preparation of an allegedly misleading offering circular or prospectus"⁸⁹ in connection with a public offering of securities. The defendant contended that the alleged misrepresentations had been furnished to him by the officers of his client, and that he had been no more than a scrivener placing the ideas in proper form. The court rejected this argument.⁹⁰ A lawyer may not properly assist in the preparation of an offering circular or prospectus which he knows to be false simply because the misinformation was furnished to him by his client.⁹¹ At the other extreme, the court found it unreasonable to hold a lawyer responsible for reasonable technical errors in the explanation of a chemical process he was describing.⁹² What the attorney should have known was a more difficult question.⁹³ If the information is of a kind that even a non-expert should recognize as false, then the lawyer must refrain from using it.⁹⁴ The court did not establish guidelines as to how far such a lawyer should go when preparing an offering circular or registration statement to run down possible infirmities in his client's story of which he has been put on notice.⁹⁵

Obviously, the grounds for the injunction in *Frank* were not a breach of duty by the lawyer to his client, whose wishes he carried out too well, but a breach of duty to the offerees and purchasers of his client's securities.⁹⁶

In 1973 the Second Circuit again examined the duty of a securities lawyer in *SEC v. Spectrum Ltd.*⁹⁷ As a result of a merger pursuant to Rule 133 under the 1933 Act,⁹⁸ one of the shareholders of the acquired company received a substantial block of unregistered stock of Spectrum. The shareholder retained Schiffman, an attorney who was not familiar

(2d Cir. 1972), in which an attorney prepared false visa petitions on behalf of aliens who had entered into sham marriages in order to gain entry into the United States. He was convicted of aiding and abetting others to make false statements, because the petitions were prepared with a reckless disregard of whether the statements in the petition were true, and with a conscious effort to avoid learning the truth, despite a contention that such a rule alters the lawyer-client relation.

⁸⁹ 388 F.2d at 488. The Second Circuit reversed on procedural grounds and returned the case to the district court for further findings of fact. *Id.* at 493.

⁹⁰ *Id.* at 488-89.

⁹¹ *Id.* at 489 (citing *United States v. Benjamin*, 328 F.2d 854, 863 (2d Cir. 1964)).

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.* at 488.

⁹⁷ 489 F.2d 535 (2d Cir. 1973).

⁹⁸ 17 C.F.R. § 230.133 (1976). Rule 133 provided that for purposes of section 5 of the 1933 Act only, certain mergers would not be deemed to involve a sale or offer to sell securities of the surviving corporation to the security holders of the disappearing corporation. The rule provided that controlling persons of the constituent corporations could not, except for certain limited amounts, publicly sell their securities in the surviving corporation (whether previously owned or received on the merger) without registration under the 1933 Act. The defendant counsel's opinion in *Spectrum* incorrectly opined that a shareholder (who in fact was a controlling shareholder in a constituent corporation) could publicly sell his share without registration.

with the merger, to write an opinion letter on the legality of the sale of the proposed stock. After making some preliminary inquiries Schiffman wrote an opinion letter addressed to *his client*, which was subsequently furnished by the client to a broker to facilitate the illegal sale of his unregistered securities — a violation of section 5 of the 1933 Act.⁹⁹ The SEC alleged that Schiffman was therefore an aider and abettor of the illicit sale and that it was not necessary to show actual knowledge plus an intent to further the improper scheme.¹⁰⁰ On appeal the Second Circuit held that the imposition of a mere negligence standard was appropriate, at least in an injunction proceeding, because “[t]he legal profession plays a unique and pivotal role in the implementation of the securities law . . . and the smooth functioning of the securities markets will be seriously disturbed if the *public* cannot rely on the expertise proffered by an attorney when he renders an opinion on such matters.”¹⁰¹ Here again, the alleged violation of the lawyer’s duty was not to the attorney’s client but to the public.

These ideas were even more broadly stated in *SEC v. National Student Marketing Corp.* (NSMC),¹⁰² where the SEC sought an injunction against attorney Robert Katz for aiding and abetting the violation of the anti-fraud and reporting sections of the 1933 and 1934 Acts.¹⁰³ Katz had rendered an opinion letter which stated that title to, and risk of loss of, a subsidiary of NSMC which was losing money had passed to the purchasers on August 29, 1969, although the agreement for the sale of stock of the subsidiary was not executed until that November.¹⁰⁴ The opinion was written by Katz as attorney for the purchasers, but addressed to NSMC, the

⁹⁹ 15 U.S.C. § 77(e) (1970). See 489 F.2d at 538-40.

¹⁰⁰ 489 F.2d at 540-41. Cf. *United States v. Benjamin*, 328 F.2d 854 (2d Cir. 1964) (in which the defendant attorney’s role was sometimes more than that of an attorney and he was aware his legal opinions would be used to perpetrate a fraud).

¹⁰¹ 489 F.2d at 541. But cf. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (in which the Supreme Court held that a professional is not civilly liable under Rule 10b-5 of the Securities Exchange Act for negligence, but left open the questions of civil liability for reckless conduct, and injunctive relief for negligence under the rule). In *SEC v. World Radio Mission, Inc.*, 554 F.2d 535 (1st Cir. 1976), decided after *Ernst & Ernst*, the court held that scienter is not required for injunctive relief for violations of Rule 10b-5. However, of the cases cited in part III of the text, only *SEC v. National Student Mktg. Corp.*, 360 F. Supp. 284 (D.D.C. 1973) relies at all on Rule 10b-5.

¹⁰² 402 F. Supp. 641 (D.D.C. 1975).

¹⁰³ *Id.* at 642-43. Katz allegedly violated section 17(a) of the 1933 Act, which reads:

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

- (1) to employ any device, scheme, or artifice to defraud, or
- (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

- (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77q(a) (1970). Katz was also accused of aiding and abetting a violation of Rule 10b-5 (see note 37 *supra* for the text of the rule) and of the corporate reporting requirements of section 13(a) of the 1934 Act, 15 U.S.C. § 78m(a) (1970 & Supp. V 1975).

¹⁰⁴ 402 F. Supp. at 644-45.

selling corporation. Its purpose was, as Katz allegedly knew, to allow NSMC's accountants to exclude the losses of the subsidiary from NSMC financials for the three-month period between August, 1969, and the date of the NSMC financial statements. In denying a motion by Katz for summary judgment, the court said that even if Katz's legal opinion was technically correct, as it appears it may have been, "[l]awyers are not free to ignore the commercial substance of a transaction which could obviously be misleading to *stockholders* and the investing *public*. . . . Katz's focus on the narrow legal questions on which he opined is unrealistic in view of his participation in the total transaction which obviously had the possibility for [sic] misleading *outsiders*."¹⁰⁵

Thus it appears from the above that the courts, sometimes prodded by the SEC, have begun to recognize that the duty of a lawyer runs not only to the corporate entity but to its shareholders¹⁰⁶ and at least in certain circumstances to the public, that such duty includes a standard of due care, and that this duty sometimes supercedes the privilege protecting confidential communications between a client and his attorney.

E. Conflicts between the Duties to the Client and the Public

The duty of care to exercise due diligence and proper ethical conduct which runs from a corporate lawyer to the public may be an expansion of his obligations inconsistent with the duty owed to his corporate client.¹⁰⁷ Conflict may arise, for example, when there are purportedly privileged communications,¹⁰⁸ or where the public good and the good of the corporation as an entity do not coincide. The SEC maintained that the public good must come first in another aspect of their proceedings against NSMC.¹⁰⁹ The agency alleged violations of the anti-fraud,¹¹⁰ proxy,¹¹¹

¹⁰⁵ *Id.* at 647 (emphasis added).

¹⁰⁶ See Parts III A-D of the text for a survey of the trend toward establishing a duty of care owed by the corporate attorney to both the stockholders and the public at large.

¹⁰⁷ An attorney normally advises his client how to conform to the law, including the securities acts, advice completely consistent with his obligations to the public. See AMERICAN BAR ASSOCIATION, STATEMENT OF POLICY REGARDING RESPONSIBILITIES AND LIABILITIES OF LAWYERS IN ADVISING WITH RESPECT TO THE COMPLIANCE BY CLIENTS WITH LAWS ADMINISTERED BY THE SEC (adopted Aug. 12, 1975), reprinted in 31 BUS. LAW. 543, 545 (1975) [hereinafter cited as ABA STATEMENT OF POLICY REGARDING SEC COMPLIANCE]. The difficulty arises only if the attorney is in error through negligence or otherwise, or the client refuses to follow his advice. The lawyer's concern about his personal exposure for negligence has been ameliorated somewhat by *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). See note 101 *supra*.

¹⁰⁸ See Part IV of the text *infra*.

¹⁰⁹ *SEC v. National Student Mktg. Corp.*, 360 F. Supp. 284 (D.D.C. 1973), and *SEC v. National Student Mktg. Corp.*, 402 F. Supp. 641 (D.D.C. 1975), both derive from the same Commission complaint but relate to different transactions of NSMC. A settlement of the Commission's action was entered into between the Commission and White & Case, one of the attorney defendants, which by its terms did not constitute an admission by White & Case and pursuant to which they have agreed to undertake certain remedial internal procedures with respect to their practice of securities law in general, and representation of National Student Marketing Corporation in particular. As part of the stipulation, White & Case agreed in connection with any transaction involving the issuance of securities to the public: (1) not to deliver with respect thereto an opinion if it has knowl-

and reporting¹¹² sections of the securities laws in a merger context. The defendants were both public companies which were subject to the proxy rules of the Exchange Act.¹¹³ The merger agreement contained the customary clause that, as a condition of the closing, an opinion letter would be supplied to Interstate, the acquired corporation, stating that NSMC had taken all steps necessary to consummate the merger, and that to the knowledge of counsel there was no violation of any federal or state statute or regulation.¹¹⁴ The merger was approved as required by the shareholders of both corporations on the basis of proxy material furnished to them by their respective corporations and prepared by counsel.¹¹⁵ At the closing, a proposed closing letter from the accountant required by the agreement contained certain reservations, indicating that instead of the nine-month profit of approximately \$700,000 reflected in the NSMC financial statements in the proxy materials, adjustments would have to be made which would show a net loss of approximately \$80,000 for the period.¹¹⁶ Despite this information, which allegedly neither counsel passed on to its client, counsel delivered their required opinions and the merger was consummated.¹¹⁷

The SEC alleged that the lawyers should not have permitted the closing to occur, and should have insisted that the financial statements be revised and the shareholders resolicited. If their clients still wished to proceed without such disclosure to the shareholders, counsel should have abandoned their representation and advised the SEC.¹¹⁸ It should be noted that in each instance the opinion of counsel was not delivered to

edge that any material representation made by a client is not true and correct in material respects; (2) that if the firm becomes aware of any false or misleading misrepresentation or warranty by the client, it will advise the client of the clients' disclosure obligations under the Federal Securities Laws; and (3) if the client does not take appropriate action to comply with such obligation, to consider the need to withdraw from employment or take other appropriate action. SEC v. National Student Mktg. Corp. (1977) FED. SEC. L. REP. (CCH) ¶96,027.

¹¹⁰ Securities Act of 1933 § 17(a), 15 U.S.C. § 77q(a) (1970 & Supp. V 1975). See note 103 *supra*.

¹¹¹ Securities Exchange Act of 1934 § 14(a), 15 U.S.C. § 78n(a) (1970 & Supp. V 1975). This section prohibits solicitation of proxies for any security registered under section 12 of the 1934 Act, 15 U.S.C. § 781 (1970 & Supp. V 1975), in contravention of the rules of the Commission. See note 12 *supra*.

¹¹² Securities Exchange Act of 1934 § 13(a), 15 U.S.C. § 78n(a) (1970 & Supp. V 1975).

¹¹³ 15 U.S.C. § 78n(a) (1970 & Supp. V 1975).

¹¹⁴ SEC v. National Student Mktg. Corp., 360 F. Supp. 284, 289 (D.D.C. 1973).

¹¹⁵ *Id.*

¹¹⁶ *Id.* at 289-90.

¹¹⁷ *Id.* at 290. However, the materiality of the adverse financial statements in the accountant's letter to the stockholders of NSMC is open to some question, since the financials tended to make the terms of the merger more attractive, if anything, to the shareholders of NSMC. It is questionable, moreover, whether a reasonable shareholder of NSMC who had approved the merger would consider the omitted facts important in deciding how to vote, while the shareholders of Interstate clearly should have been resolicited. See TSC Industries v. Northway, Inc., 426 U.S. 438 (1976), where an omitted fact from a proxy statement was found to be material if there was a substantial likelihood that a reasonable shareholder would consider the fact important in deciding how to vote.

¹¹⁸ SEC v. National Student Mktg. Corp., 360 F. Supp. 284, 297 (D.D.C. 1973).

its own client but to the other party to the merger. The above charges arose out of the performance of counsel as lawyers in the exercise of their professional judgment,¹¹⁹ and were characterized in a memorandum by defendant's counsel as a "breach of the most fundamental ethical and professional obligation of counsel."¹²⁰ Certainly, this appears to have been the first time that such an allegation had been asserted by the government in an action against counsel,¹²¹ and may be inconsistent with an attorney's responsibilities as set forth in the Code of Professional Responsibility.¹²² Nevertheless, the court denied motions to dismiss for failure to state a claim and for summary judgment on the grounds that the acts with which they were charged, if performed with an awareness that the financial statements were false and misleading, could have been a knowing and willful violation of the securities laws.¹²³ This would seem to be a sound decision, and while neither the complaints nor the court's opinion is clear on this point, they seem to assert a duty on the part of Interstate's counsel both to the shareholders of their client Interstate and to NSMC, and a comparable duty by NSMC's counsel to shareholders of both corporations, not to permit either party to the merger to violate the securities laws to the detriment of the shareholders of either corporation.¹²⁴ This is a logical extension of the thesis that the true client of a corporate lawyer is not the entity but its shareholders, and perhaps members of the public as well.¹²⁵

III. PRIVILEGED COMMUNICATIONS

Since the legal problems of corporate lawyers are so often disclosure problems, the principal ethical questions for lawyers that have surfaced recently and are likely to surface in the near future will also involve disclosure, and hence the issue of the attorney-client privilege. The American Bar Association opposes the legal development discussed in this Article, maintaining that a lawyer's responsibility is exclusively to the corporate entity which is his client, and that this important relationship can be maintained properly only by asserting the doctrine that communications between a client and his attorney are privileged.¹²⁶

¹¹⁹ See Memorandum filed by Arnold & Porter as Counsel for certain defendants in *SEC v. National Student Mktg. Corp.*, 360 F. Supp. 284 (D.D.C. 1973).

¹²⁰ *Id.*

¹²¹ A search of the literature has failed to disclose any comparable prior charge. *But see SEC v. National Student Mktg. Corp.*, 360 F. Supp. 284 (D.D.C. 1973).

¹²² See note 5 *supra*.

¹²³ Cf. *SEC v. Century Investment Transfer Corp.*, [1971-72 TRANSFER BINDER] FED. SEC. L. REP. (CCH) ¶ 93,232 (S.D.N.Y. 1971) (an attorney's opinion letters were inconsistent with a statute on its face and were used to facilitate the illegal distribution of unregistered securities. The court found his conduct "enough beyond a mere mistake in legal judgment to constitute a probable violation of the anti-fraud provisions of the securities Acts laws" and approved issue of a preliminary injunction).

¹²⁴ *SEC v. National Student Mktg. Corp.*, 360 F. Supp. 284, 296-99 (D.D.C. 1973).

¹²⁵ See Part II A-D of the text *supra*.

¹²⁶ See ABA STATEMENT OF POLICY REGARDING SEC COMPLIANCE, *supra* note 107, 31 BUS. LAW. at 543-48.

The attorney-client privilege was discussed briefly in connection with *Wolfenbarger* but deserves further attention.¹²⁷

The policy behind the privilege is founded upon the subjective determination made in the eighteenth century that, to promote the freedom of legal consultations, apprehension of compelled disclosure must be removed.¹²⁸ Two hundred years later it may be appropriate to reexamine that subjective determination as applied to the modern public corporation.¹²⁹

"The beginning point," as the Fifth Circuit, citing *Wigmore*, stated in *Wolfenbarger*, "is the fundamental principle that the public has the right to every man's evidence, and that exemptions from the general duty to give testimony that one is capable of giving are distinctly exceptional."¹³⁰ Such exceptions are to be determined by "a balancing of interests between injury resulting from disclosure and the benefit gained in the correct disposal of litigation."¹³¹

Wigmore sets forth four fundamental conditions recognized as necessary to the establishment of a privilege not to disclose confidential communications.¹³² All of these four conditions must be present for a privilege to be recognized,¹³³ and two are pertinent here:

1. The element of *confidentiality must be essential* to the full and satisfactory maintenance of the relation between the parties.
2. The *injury* that would inure to the relationship by the disclosure of the communication must be *greater than the benefit* thereby gained for the correct disposal of litigation.¹³⁴

However, the ethical disclosure problems of corporate lawyers rarely involve litigation, except for stockholder derivative suits, so that a broadening reformulation of Wigmore's second condition in a manner consistent with the thesis presented in this Article will be useful for analysis.¹³⁵ Wigmore's modified second condition would read as follows:

¹²⁷ See the discussion of *Garner v. Wolfenbarger*, 430 F.2d 1093 (5th Cir. 1970) in the text accompanying notes 54-66 *supra*.

¹²⁸ 8 J. WIGMORE, EVIDENCE § 2291 (rev. ed., J. McNaughton 1961).

¹²⁹ See *Garner v. Wolfenbarger*, 430 F.2d 1093 (5th Cir. 1970), in which the court made a similar analysis but on the more limited question of the rights of shareholder plaintiff in a derivative suit to access to privileged communications.

¹³⁰ *Garner v. Wolfenbarger*, 430 F.2d 1093, 1100 (5th Cir. 1970) (citing 8 J. WIGMORE, *supra* note 128, at § 2192).

¹³¹ *Garner v. Wolfenbarger*, 430 F.2d 1093, 1101 (5th Cir. 1970).

¹³² 8 J. WIGMORE, *supra* note 128, at § 2285. The two conditions not discussed in the text are that the communication must originate in a confidence that it will not be disclosed and the relation must be one which in the opinion of the community ought to be sedulously fostered.

¹³³ *Id.*

¹³⁴ *Id.* (Emphasis in original).

¹³⁵ Compare the discussion in Part III of this article with ABA Code EC 7-3, 7-4, 7-5.

2. The injury that would inure to the *corporate attorney-client* relationship by the disclosure of the communication must be greater than the benefit gained thereby for the *protection of significant interests of the shareholders of the corporation or the public*.¹³⁶

Determining the "public interest" may not always be easy. For purposes of this discussion the "protection of the public interest" will be defined as the prevention or uncovering of a crime or fraud which may have a materially adverse effect on a significant interest of the shareholders of a corporation or the general public.

A. *The Code of Professional Responsibility*

The American Bar Association has continued to resist any expansion of lawyers' professional responsibilities by maintaining that a lawyer's sole responsibility is to his own client, which in the case of a corporation is the corporate entity, and by asserting the doctrine of attorney-client privilege.¹³⁷ The corporate entity theory has been discussed above. In the ABA Code of Professional Responsibility, the attorney-client privilege is interposed between what might without the Code be termed a lawyer's ethical duty to disclose wrongdoing, and his ability to fulfill that duty without violating the Code's provisions. This is accomplished primarily through two Disciplinary Rules in the Code of Professional Responsibility. Disciplinary Rule 4-101 states in part:

- (B) Except when permitted under DR4-101(C), a lawyer shall not knowingly:
 - (1) Reveal a confidence or secret of his client.
 - (2) Use a confidence or secret of his client to the disadvantage of the client.
 - (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.
- (C) A lawyer may reveal:
 - (1) Confidences or secrets with the consent of the client or clients affected, but only after a full disclosure to them.
 - (2) Confidences or secrets when permitted under Disciplinary Rules or required by law or court order.
 - (3) The intention of his client to commit a crime and the information necessary to prevent the crime.
 - (4) Confidences or secrets necessary to establish or collect his fee or to defend himself or his employees or associates against an accusation of wrongful conduct.¹³⁸

¹³⁶ See the discussion of the possible duty of the corporate lawyer to the public, and the conflict between that duty and his duty to his principle client in parts III, D, E of the text *supra*.

¹³⁷ See ABA STATEMENT OF POLICY REGARDING SEC COMPLIANCE, *supra* note 107.

¹³⁸ ABA Code DR 4-101(B), (C).

Disciplinary Rule 7-102 states in part:

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*.¹³⁹

Moreover, while an attorney may not violate the attorney-client privilege in order to disclose corporate wrongdoing affecting the shareholders or the public, he may disregard the privilege in order to establish or collect his fee.¹⁴⁰ This reflects a strange ordering of values, and yields an inconsistent result under Wigmore's modified second condition.

B. Lawyers' Responses to Auditors' Requests for Information

The conflict that can arise between the need for public disclosure by counsel and the inhibitions imposed on that disclosure by attorney-client privilege as expressed in the Code of Professional Responsibility¹⁴¹ is illustrated by a policy recently formulated by the ABA regarding lawyers' responses to auditors' requests for information. A preliminary report, drafted by the ABA in 1974, observed that the American "legal, political and economic systems depend to an important extent on public confidence in published financial statements."¹⁴² These statements are accompanied by the opinion of an independent certified public accountant that he has examined the statements and found them to "fairly present the financial condition of the company and the results of its operations for the period included in the financial statements in accordance with generally accepted accounting principles."¹⁴³

To meet professional auditing standards in this examination, the accountant is required to obtain sufficient competent evidence to afford a reasonable basis for his opinion,¹⁴⁴ and evidence obtained from sources outside the company provide greater assurance of reliability.¹⁴⁵ The corporate lawyer is one of those independent sources.¹⁴⁶ If the accountant is unable to complete these procedures satisfactorily, he must

¹³⁹ *Id.* at DR 7-102 B(1). The italicized phrase was added in 1974. See ABA, MIDYEAR MEETING, SUMMARY AND REPORTS 3 (1974).

¹⁴⁰ ABA Code DR 4-101(C)(4).

¹⁴¹ See text accompanying note 138 *supra*.

¹⁴² ABA SECTION OF CORPORATE, BANKING AND BUSINESS LAW, SCOPE OF LAWYERS' RESPONSES TO AUDITORS' REQUESTS FOR INFORMATION (rev. exposure draft Aug. 1974), reprinted in 30 BUS. LAW. 513, 515 (1975) [hereinafter cited as ABA REPORT ON AUDITORS' REQUESTS].

¹⁴³ *Id.*, 30 BUS. LAW. at 520.

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

qualify his opinion or issue a disclaimer of opinion.¹⁴⁷ Such an opinion will not be acceptable to the SEC in connection with the public offering of securities.¹⁴⁸ Therefore, the failure of a lawyer to respond properly to an auditor's request for information could have serious consequences for the corporation. In recent years, accountants have broadened their request for information from attorneys to include not only a description and evaluation of present litigation, impending litigation, and asserted claims, but also of unasserted contingent claims of which the attorney has knowledge.¹⁴⁹ This development has concerned the American Bar Association because complete compliance with such an auditor's request could impinge on the attorney-client privilege.¹⁵⁰ As a result of discussions between representatives of the two professions, a mutually acceptable procedure was adopted,¹⁵¹ purportedly recognizing both the importance of public confidence in published financial statements and the need to maintain the confidentiality of the lawyer-client relationship.¹⁵²

The accountant does not request information directly from the attorney. Rather, the client at the auditor's direction asks his counsel to furnish the company's accountants with certain information. This request could constitute a waiver of the attorney-client privilege,¹⁵³ though given somewhat under duress because of pressure from the accountant, provided counsel assures himself that the client understands the consequences of the disclosure in providing an informed consent.¹⁵⁴

Furnishing responses with respect to asserted claims and pending litigation created no problem in this regard.¹⁵⁵ The principle area of conflict involved contingent liabilities for unasserted claims. In the ABA's view, the disclosure of such matters might stimulate claims or lawsuits and cut off the free flow of information from clients which is necessary for good legal advice.¹⁵⁶ The conflict was generally resolved in favor of nondisclosure.¹⁵⁷

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*, 30 BUS. LAW. at 521.

¹⁴⁹ *Id.*, 30 BUS. LAW. at 524.

¹⁵⁰ *Id.*, 30 BUS. LAW. at 521.

¹⁵¹ AMERICAN BAR ASSOCIATION, STATEMENT OF POLICY REGARDING LAWYERS' RESPONSES TO AUDITORS' REQUESTS FOR INFORMATION (approved Dec. 8, 1975), *reprinted in* 31 BUS. LAW. 1709 (1976) [hereinafter cited as ABA POLICY REGARDING AUDITORS' REQUESTS]. Guidelines for auditors and accountants are set forth in AICPA AUDITING STANDARDS EXECUTIVE COMMITTEE, INQUIRY OF A CLIENT'S LAWYER CONCERNING LITIGATION, CLAIMS, AND ASSESSMENTS (issued Jan. 1976), 1 AICPA PROF. STANDS. REP. (CCH) AU § 337; and FINANCIAL ACCOUNTING STANDARDS BOARD, STATEMENT OF FINANCIAL ACCOUNTING STANDARDS No. 5: ACCOUNTING FOR CONTINGENCIES, 3 AICPA PROF. STANDS. REP. (CCH) AC § 4311.

¹⁵² See ABA POLICY REGARDING AUDITORS' REQUESTS, *supra* note 151, 31 BUS. LAW. at 1709-10.

¹⁵³ *Id.*, 31 BUS. LAW. at 1716.

¹⁵⁴ *Id.*, 31 BUS. LAW. at 1711, 1716.

¹⁵⁵ *Id.*, 31 BUS. LAW. at 1712.

¹⁵⁶ See ABA REPORT ON AUDITORS' REQUESTS, *supra* note 142, 30 BUS. LAW. at 524.

¹⁵⁷ See ABA POLICY REGARDING AUDITORS' REQUESTS, *supra* note 151.

One type of unasserted claim is of special interest. This is a potential claim arising from the failure of the corporation to make an obligatory public disclosure, which if discovered would clearly subject the corporation to material liability, despite the advice of counsel that such disclosure was obligatory.¹⁵⁸ Under guidelines proposed in the 1974 ABA report,¹⁵⁹ an attorney who had given such advice could make an appropriate disclosure in response to an auditor's request for information, provided that the obligatory public disclosure was not merely the advisable or preferred course, but was "*of such importance and seriousness that rejection by the client of such advice would in all probability require the lawyer's withdrawal from employment in accordance with the Code of Professional Responsibility.*"¹⁶⁰ This guideline represented a change in the positions traditionally held by lawyers,¹⁶¹ but unfortunately this enlightened view did not prevail in the final Statement of Policy.¹⁶² Instead, the approved Statement of Policy notes that the lawyer should not knowingly participate in any violation by the client of the disclosure requirements of the Securities Acts, and that he may be required to resign in appropriate circumstances if his advice concerning disclosures is disregarded by the client.¹⁶³ This appears to do no more than apply the present ABA Code of Professional Responsibility¹⁶⁴ to securities lawyers.

There is admittedly a genuine corporate interest in refraining from advertising claims which have not been asserted and which, unless brought to light by the client, may never be asserted. On the other hand, facts leading to potential claims by shareholders or the public seem an appropriate matter for disclosure, and in keeping with the previously discussed¹⁶⁵ duty of the corporate lawyer to both groups. The client's request on behalf of the auditors contains a consent to disclosure, albeit a pressured consent. But without such pressures many corporations would reveal little, either to the auditors or to the public. Why then must the bar reach so far to protect a knowledgeable and consenting client from itself? The suspicion remains that the bar may be protecting lawyers as well as their clients.¹⁶⁶

C. Disclosure or Privilege

To examine the validity of the ABA position that disclosures of privi-

¹⁵⁸ See ABA REPORT ON AUDITORS' REQUESTS, *supra* note 142, 30 BUS. LAW. at 517.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* (emphasis in original).

¹⁶¹ *Id.*, 30 BUS. LAW. at 513. Part IV of the Report summarizes comments expressing concern over the proposed policy, submitted by members of the ABA Section of Corporation, Banking and Business Law. *Id.*, 30 BUS. LAW. at 529-30.

¹⁶² See ABA POLICY REGARDING AUDITORS' REQUESTS, *supra* note 151.

¹⁶³ Compare *id.*, 31 BUS. LAW. at 1714, with ABA REPORT ON AUDITORS' REQUESTS, *supra* note 142, 30 BUS. LAW. at 517.

¹⁶⁴ See ABA Code DR 7-102 (A)(3), (7) and (8); DR 2-110(B)(2).

¹⁶⁵ See Part III C, D and E of the text.

¹⁶⁶ See ABA REPORT ON AUDITORS' REQUESTS, *supra* note 143, 30 BUS. LAW. at 524.

leged information by an attorney, even as to matters of significant shareholder or public interest, is never justified except as permitted by the Code of Professional Responsibility, it will be useful to test it against Wigmore's two conditions.¹⁶⁷

The first condition requires that confidentiality must be essential to the relationship between the parties. Confidentiality between a corporation and its counsel is useful, but no more essential than among directors, officers, and key employees who are involved in the corporate decision-making process and whose communications are not privileged.¹⁶⁸ Information must be furnished to selected individuals in the corporate structure or else decisions could not be made. It appears unlikely that management will refuse to communicate confidential information to a more trusted, if unprivileged, advisor when his advice is considered important, and when such conferral may be an essential part of a due diligence defense to a civil or criminal action.¹⁶⁹ An affirmative duty of disclosure by counsel should not seriously inhibit client communication, since counsel may at present reveal confidences to prevent present or future crimes,¹⁷⁰ and willful violations of the securities acts are crimes.¹⁷¹ Nor should a corporate officer conferring with his advisors assume that only a lawyer would feel obliged to disclose significant corporate improprieties. In the absence of empirical data, it is possible only to speculate on the importance of confidentiality to the attorney-corporate client relationship, but perhaps the burden of proof should be on those who would assert the privilege.¹⁷²

Wigmore's modified second condition¹⁷³ balances the benefits of disclosure to the shareholders and the public against the damaging effects of such disclosure upon the attorney-client relationship and the property rights of a large amorphous entity. Perhaps of even greater benefit to the public interest would be the restoration of confidence in the integrity of the bar as guardians of freedom, rather than as corporate servants whose morality is measured by the actions of their clients. Moreover, it has been postulated herein¹⁷⁴ that one of the interests of shareholders is, as a matter of public policy, to have their corporation behave in a lawful manner. Nor is there any public or shareholder interest in allowing a corporation and its management to

¹⁶⁷ See text accompanying note 134 *supra*.

¹⁶⁸ See the discussion of privilege in 8 J. WIGMORE, *supra* note 128, at §§ 2191, 2286.

¹⁶⁹ Failure to use due diligence has included aiding and abetting a violation for false statements on securities registration. See *In Re Equity Funding Corp. of America Securities Litigation*, 416 F. Supp. 161 (C.D. Cal. 1976); *In Re Caesars Palace Securities Litigation*, 360 F. Supp. 366 (S.D.N.Y. 1973). See also note 74 *supra*.

¹⁷⁰ ABA Code DR 4-101(C)(3), quoted in the text at note 138 *supra*.

¹⁷¹ 15 U.S.C. §§ 77(x) 78f(b) (1970 & Supp. V 1975).

¹⁷² A carefully drawn empirical study of the need for the privilege in corporate lawyer-client relations might prove most useful.

¹⁷³ See text accompanying notes 135-36 *supra*.

¹⁷⁴ See text following note 64 *supra*.

consult an attorney, and then to ignore with impunity his advice that a present policy or proposed action of the corporation is improper.¹⁷⁵

This restoration of confidence in the bar requires among other things a change in the Code of Professional Responsibility with respect to matters of corporate disclosure. To take an extreme example, what *must* a lawyer do when his client tells him in confidence that he is going to plant a time bomb aboard TWA's flight 703 leaving New York for Paris next Sunday afternoon at 6:00 p.m.? Nothing, according to the Code of Professional Responsibility, which permits but does not require a lawyer to reveal his client's confidence in order to prevent a crime.¹⁷⁶ Presumably, all lawyers would contact the appropriate authorities. It is less clear that a corporate lawyer will voluntarily inform the authorities upon learning in confidence that his client plans to file a criminally false report with the Civil Aeronautics Board, which the lawyer will not prepare or file, that a commercial passenger plane it is manufacturing meets the required safety standards. Still less likely is the possibility that a corporate lawyer would advise the Commission that in a corporate annual report on SEC Form 10K,¹⁷⁷ which he neither prepared nor will file, his client will falsely state against his advice that the plane meets all federal safety standards. These are differences of degree and not principle. Disclosure should be mandatory in each instance. The attorney clearly may not knowingly assist in the preparing or filing of a false report,¹⁷⁸ and given the previously postulated duty to the shareholders and to the public, he should not silently tolerate such conduct even where he has not personally prepared the report.

Assume further that the attorney learned of the false statements after the documents have been filed and processed, but before there has been an accident or any securities have been sold. As before, assume that the lawyer was not responsible for the preparation of the documents. The client no longer intends to commit a crime; the crime has already been committed, though it will have a future effect. Under the Disciplinary Rules, the attorney would not be permitted to make disclosure of the privileged information,¹⁷⁹ yet the public interest would seem to require disclosure. Even in the more difficult situation in which the attorney learns of the false statements after the first plane has crashed or securities have been sold in reliance upon the false financial statements, should not the lawyer speak before the second plane crashes or additional securities are sold? The Disciplinary Rules say "no."¹⁸⁰ If the defective planes have been grounded or the securities offering has been completed, then there is no future harm to be pre-

¹⁷⁵ See *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1973).

¹⁷⁶ ABA Code DR 4-101(C).

¹⁷⁷ 17 C.F.R. § 249.310 (1976).

¹⁷⁸ ABA Code EC 7-5. It would also constitute aiding and abetting.

¹⁷⁹ ABA Code DR 4-101.

¹⁸⁰ *Id.*

vented, and disclosure would primarily affect prospective litigation and should not be made. However, if the attorney unknowingly assisted in the preparation of the false documents, then, since the fraud was committed "in the course of the [attorney's] representation" and "upon a person or tribunal," the attorney must with one significant exception reveal the fraud if his client refuses to do so.¹⁸¹ The exception is that counsel may not reveal the fraud when the information is protected as a privileged communication,¹⁸² even as planes crash and investors are defrauded.

This discussion of the shortcomings of the present Code of Professional Responsibility is not to say that the attorney-client relationship is not important in the corporate setting, but rather that the attorney-client privilege should not have continued viability in those areas in which there are prevailing and conflicting shareholder or public interests.¹⁸³

IV. A PROPOSAL FOR REFORM

The present ethical mode of the corporate bar, as this Article has demonstrated, is under increasing challenge by the SEC and the courts. The lawyer-corporate client relationship, important as it may be, cannot continue to defeat public expectations of responsible professional conduct. As the Fifth Circuit remarked about the ABA brief in *Wolfenbarger*, it "does not always distinguish clearly between the separate interests of the corporate client and the attorney in freedom from disclosure, nor is it always possible to do so."¹⁸⁴ However, any concern of the bar that stricter standards might result in increased exposure of its members to civil liabilities for negligence under Rule 10b-5 was removed by the Supreme Court in *Ernst & Ernst v. Hochfelder*.¹⁸⁵ Perhaps a lessening of the bar's resistance to reform may follow.

If the bar is brought to reform by the courts and the SEC, there will be a long period of uncertainty due to the conflict between the Code of Professional Responsibility, with its reliance on the corporate entity theory and the privileged attorney-corporate client relationship, and the developments in the courts and the SEC. Nor will the bar's image

¹⁸¹ ABA Code DR 7-102(B)(1). See note 138 *supra*. It is not clear whether "tribunal" would include an administrative agency acting in its administrative rather than judicial capacity.

¹⁸² *Id.*

¹⁸³ Compare ABA STATEMENT OF POLICY REGARDING SEC COMPLIANCE, *supra* note 107, with *Garner v. Wolfenbarger*, 430 F.2d 1093, 1103 (5th Cir. 1970).

¹⁸⁴ 430 F.2d at 1102. The ABA's position was that the privilege is most necessary where a lawyer furnishes a corporation his opinion that a prospective transaction is not lawful but the corporation disregards his advice. Counsel, urged the ABA, must be free to state his opinion without fear of later disclosure and without the privilege counsel might in the words of the brief, be "required by the threat of future discovery to hedge or soften their opinions." This is still very much the ABA's position. See ABA STATEMENT OF POLICY REGARDING SEC COMPLIANCE, *supra* note 107.

¹⁸⁵ *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). See note 101 *supra*.

be enhanced by a prolonged resistance to reform evidenced by reluctance to amend the Code.

Several proposed changes in the Code of Professional Responsibility, designed to meet some of the needs for higher standards foreseen by this Article with a minimum of disruption of traditional values, are set forth below, followed by brief commentary.

Proposed Disciplinary Rule 4-101(E), (F), (G), and (H)

DR 4-101¹⁸⁶ (E) A lawyer for a public corporation shall reveal the intention of the corporation or any of its officers or directors (individually or on behalf of the corporation) by an act or omission to act:

(1) to commit a crime and the information necessary to prevent the crime.

(2) to commit a fraud, tort, or act of questionable legality materially and adversely affecting the shareholders of the corporation.

(F) A lawyer for a public corporation shall reveal a crime which has already been committed by the corporation or any of its officers or directors (individually or on behalf of the corporation) if the failure to disclose the crime may have a material adverse effect in the future on a significant interest of the public or of the shareholders of the corporation.

(G) The provisions of DR 4-101 (E) (2) and (F) shall not apply to confidential communications made with respect to overtly threatened or pending litigation.¹⁸⁷

(H)¹⁸⁸ A lawyer shall not make the revelations required by DR 4-101 (E) and (F) until he has advised the appropriate officers and the board of directors of his advice concerning the proposed or continuing course of action or refusal to act, which advice in his opinion reflects the required and not merely the advisable or preferred course, and that the matter is of such importance and seriousness that rejection by the client of the advice would in all probability require the lawyer's withdrawal from employment and his advising of the appropriate authorities in accordance with the Code of Professional Responsibility, and the officers or board of directors have failed to take appropriate corrective action after a reasonable opportunity to do so.

First and foremost, these sections make the lawyer's obligation to disclose a client's intended crime mandatory rather than permissive.¹⁸⁹

¹⁸⁶ These are new sections to replace ABA Code DR 4-101(C)(3) with respect to public corporate clients.

¹⁸⁷ Under the original theory of the attorney-client privilege only communications received after the beginning of litigation were considered confidential. 8 J. WIGMORE, *supra* note 128, § 2290 at 544.

¹⁸⁸ This is a new section.

¹⁸⁹ See Part IV C of the text.

Subsection (E)(1) extends the lawyer's obligation to disclose intended crimes of officers and directors of the corporation, to avoid such questions as whether the officer or director was acting within the scope of his authority. The provision is not intended to change the lawyer's obligation as to completely unrelated crimes, such as the vice president's intention to beat up his wife when he gets home. Subsection (E)(2) carries out the thesis expressed in Part III of this Article by requiring counsel to disclose to shareholders frauds, torts, or acts of questionable legality—acts which might give rise to stockholder derivative suits or shareholder doubts about the integrity of management, such as participation in corporate bribery. Disclosure is also required of past crimes when the failure to disclose could work a significant future harm to the shareholders or to the public.¹⁹⁰ For example, if a corporate lawyer learns in confidence that his client has filed a materially false annual report on form 10K with the SEC, which the lawyer did not prepare, but upon which shareholders and members of the investing public will continue to rely for some time to come, he would be under an obligation to disclose the false filing. However, subparagraph (H) has been added to make it clear that the matter must be of considerable importance, and that in the lawyer's opinion the recommended remedial action must clearly be required. His opinion must be brought home directly to the appropriate officers and the board before he makes any disclosure. Except in rare instances, a corporation is not likely to disregard such advice and thereby force a disclosure, so the threat must be used with caution by attorneys and with confidence that they are right. Economic self-interest in a continuing retainer with the client should adequately restrain counsel, except in circumstances in which the facts of the situation and the reluctance of the client to follow professional advice make conflict inevitable. These changes would not apply to privileged communications in pending or overtly threatened litigation.

Proposed Ethical Consideration 5-18

EC 5-18¹⁹¹ A lawyer employed or retained by a public corporation owes his allegiance to all of the shareholders as a group, *qua* shareholders, and not to the corporate entity nor to any director, officer, employee, representative, or other person connected with the corporation; but in his representation the lawyer shall take his instructions solely from the board of directors as the elected representatives of the shareholders, and from the officers of the corporation chosen by such board. In the normal course of business the interests of the shareholders *qua* shareholders will be co-extensive, provided however that when there may be differing interests among the shareholders a lawyer may follow the instructions of the board of directors so long as it does not require him to assist the corporation in

¹⁹⁰ *Id.*

¹⁹¹ This replaces the first two sentences of ABA Code EC 5-18. See note 5 *supra*.

performing an act described in subsections (1) or (2) of DR 4-101(E).

This Ethical Consideration is an outgrowth of the point of view expressed in Part III of this Article, and provides a rationale for the disclosure obligations imposed on lawyers by proposed sections DR 4-101(E) and (F). A shareholder-director who proposes to enter into an agreement with the corporation does so as an individual and not *qua* shareholder. Occasions may arise where the economic interest of the controlling shareholders of the corporation is different than other stockholders, and this dilemma is resolved by allowing the attorney to follow the instructions of the board, subject to his disclosure obligations under these proposed rules.

Proposed Disciplinary Rule 7-101(C)

DR 7-101(C)¹⁹² In his representation of a public corporation a lawyer shall refuse to aid or participate in conduct that he believes to be unlawful even though there is some support for an argument that the conduct is legal.

The word "may" in present DR 7-101(B)(2) has been changed to "shall" so that a lawyer cannot be put in the anomalous position of being required under proposed DR 4-101(E) to disclose corporate conduct in which he assisted despite his personal belief that such conduct was unlawful.

Proposed Disciplinary Rule 7-102(C)

DR 7-102(C)¹⁹³ A lawyer for a public corporation who receives information clearly establishing that the corporation in the course of the representation committed a fraud upon a person, tribunal, or administrative agency shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall promptly reveal the fraud to the affected person, tribunal, or agency.

(1)¹⁹⁴ If disclosure to the affected persons is not practical, then disclosure to an appropriate governmental authority may be made instead.

The purpose of the change is to make the section applicable to administrative agencies, not sitting as a tribunal, and to provide a viable

¹⁹² This is a new section to replace ABA Code EC 7-101(B)(2) with respect to public corporate clients.

¹⁹³ This is a new section to replace ABA Code DR 7-102(B)(1) with respect to public corporate clients, and would remove the privilege exception added to that subsection in 1974 as to such clients. For the present version of this rule, *see* the text accompanying note 139 *supra*. *See also* ABA Code, EC 7-26, 7-27.

¹⁹⁴ This is a new section.

mechanism for disclosure when a fraud is perpetrated on all of the shareholders of a corporation or the public at large.

V. CONCLUSION

The revisions of the Code of Professional Responsibility suggested in this Article reflect trends in the regulation of corporate lawyers by the SEC and the courts. These changes will not in practice turn a corporation's counsel into a tattler, but will give him an effective veto over certain improper corporate acts. What the bar will not do for itself others will eventually do for it. Strong and mature counsel, by the nature of their relationships with their clients, have long had a practical veto over their clients' acts if they have chosen to exercise it, and observation would indicate that they usually have. However, the weaker or less scrupulous lawyers must be given firm guidelines. The standards of all must be raised to what hopefully are already the standards of the many, and the lawyer-client privilege should not stand as an obstacle to lawyers in their quest for a higher ethic.