University of Virginia Law School
Public Law and Legal Theory Working Paper Series

Year 2006 *Paper* 46

Lawyer for the Organization: An Essay on Legal Ethics

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George Rutherglen

Abstract

The Model Rules of Professional Responsibility speak to the issue of a lawyer's duty to an organizational client in Rule 1.13(a), in language now adopted in virtually every state: "A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents." The greatest virtue and the clearest signal sent by this rule are negative. It tells the lawyer that the individuals within the organization are not the client, only the organization is. The rule does not pierce, but instead respects, the organizational veil. It does not purport to add to or subtract from the authority conferred by the law of corporations, partnership, or other entity, but to take it as given in the analysis of organizational representation.

If Rule 1.13 has these virtues, it also has the corresponding vices. It does not tell the lawyer who exactly does speak for the organization, since the organization, unlike an individual client cannot speak for itself. If the lawyer does not represent the directors, officers, or partners as individuals, how does the lawyer represent them as "duly authorized constituents" of the organization? At a more fundamental level, the pervasive dependence of the Model Rules on external law raises the question whether legal ethics can make any distinctive contribution to the analysis of ethical problems.

Part I of this essay begins by addressing this general question, distinguishing the several different senses in which legal ethics involves ethics properly so called. This part distills a prohibition against complicity in client wrongdoing as a core principle animating the ethical rules on organizational representation, both for the profession as a whole and for individual lawyers. Part II then brings this general analysis to bear on the representation of organizations under Model Rule 1.13,

using it to explain the dependence of the rule on other sources of law to define the duties owed by counsel to different constituents of the organization. Part III then considers two well-known cases of corporate representation, one involving securities violations by a publicly traded corporation and the other the breach of fiduciary obligations in a closely held corporation.

Lawyer for the Organization:
An Essay on Legal Ethics

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> When an ethical law of the form, "Thou shalt ..." is laid down, one's first thought is, "And what if I do not do it?" It is clear, however, that ethics has nothing to do with punishment and reward in the usual sense of the terms."
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> –Ludwig Wittgenstein[1]

These concerns might be applied, with no little irony, to the rules of legal ethics. More often than not, these rules are addressed to those who are tempted to violate them, but without the prospect of effective sanctions to counteract such temptations. Nowhere is this more true than in Model Rule 1.13, the central provision of the Model Rules of Professional Responsibility on organizational representation. Model Rule 1.13(a) speaks to the issue of a lawyer's duty to an organizational client with delphic simplicity, in language now adopted in virtually every state: "A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents."[2] This language does not contain a command, create a duty, or establish an obligation of any kind, yet it invites us to consider what happens when a lawyer fails to represent an organization "acting through its duly authorized constituents." In offering only a partial answer to this question, Rule 1.13 reveals much about the fundamental issues affecting organizational representation.

The greatest virtue and the clearest signal sent by Rule 1.13 is negative: It tells the lawyer that the individuals within the organization are not the client, only the organization is. The rule does not pierce, but instead respects, the organizational veil. This respect extends beyond corporations to all organizations, whether incorporated or not, and more generally, the rules respect the law governing the organization in other ways as well, by making the ability of individuals to speak for the organization dependent on their status as "duly authorized constituents." The rule does not purport to add to or subtract from the authority conferred by the law of corporations, partnership, or other entity, but to take it as given in the analysis of organizational representation. The rule aspires to be part of the proverbial "seamless web" of the law.

If Rule 1.13 has these virtues, it also has the corresponding vices. It does not tell the lawyer who exactly does speak for the organization, since the organization, unlike an individual client cannot speak for itself. If the lawyer does not represent the directors, officers, or partners as individuals, how does the lawyer represent them as "duly authorized constituents" of the organization? The rule leaves the lawyer with a research project instead of a definite answer to this question. In this respect, it is hardly better than the rule on protecting client confidences, which

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[1] Tractatus Logico-Philosophicus § 6.422 (D.F. Pears & B.F. McGuinness trans. 1963).

[2] ABA Model Rules of Professional Responsibility (as amended 2003) (hereafter Model Rules) Rule 1.13(a).

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contains a catch-all exception allowing disclosure of client confidence "to comply with other law or court order."[3] The need to reconcile the rules of legal ethics with other sources of law perhaps is obvious, but a cross-reference falls far short of effective ethical guidance. The rules seem to leave all the crucial question to be resolved elsewhere.

At a more fundamental level, the pervasive dependence of the Model Rules on external law raises the question whether legal ethics can make any distinctive contribution to the analysis of ethical problems. Part I of this essay begins by addressing this general question, distinguishing the several different senses in which legal ethics involves ethics properly so called. This part distills a prohibition against complicity in client wrongdoing as a core principle animating the ethical rules on organizational representation, both for the profession as a whole and for individual lawyers. Part II then brings this general analysis to bear on the representation of organizations under Model Rule 1.13, using it to explain the dependence of the rule on other sources of law to define the duties owed by counsel to different constituents of the organization. Part III then considers two well- known cases of corporate representation, one involving securities violations by a publicly traded corporation and the other the breach of fiduciary obligations in a closely held corporation.

I. The Ethics in Legal Ethics

The relationship between professional ethics and ethics generally, or morality as it is more usually called, has been much discussed. The two kinds of norms are plainly related, and just as plainly, they are also distinct. They share the common features of norms of all kinds, as standards of conduct whose violation justifies criticism and formal or informal sanctions. They also share further features, signaled by the use of "ethics" to refer to both: in setting both minimum standards and aspirational ideals, in depending upon practices that resist codification in a set of definite rules, and in offering a critical perspective on other legal norms.

The first of these features was most apparent in the structure of the Model Code of Professional Responsibility,[4] which divided its provisions among general canons, mandatory disciplinary rules, and advisory ethical considerations. Only violation of the disciplinary rules could result in sanctions under the Model Code. The same division of norms appears in the Model Rules, although mostly in the implicit form of permitting lawyers to do the right thing, such as disclose client confidences in order to prevent death or substantial bodily harm.[5]

These permissive provisions invite lawyers to look to the uncodified norms of professional practice, the second respect in which legal ethics resembles ethics generally. From mundane issues of custom and routine in the local courthouse to intense disputes over legal liability, lawyers rely on

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[3] Model Rule 1.6(b)(6).

[4] ABA Model Code of Professional Responsibility (as amended 1981).

[5] Model Rule 1.6(b)(1).

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what other lawyers do to determine the standards of acceptable conduct. This reliance is most evident in the standards for legal malpractice, dependent as they are on what the prevailing practice is among lawyers in the same community or area of expertise. Even when lawyers look to codes or authoritative opinions for guidance, these sources of professional standards are themselves based on an appeal to previously uncodified practices. Moreover, these practices themselves are complex, embodying not just conventional uniformity of conduct but criticism, evaluation, and revision of current practices, no matter how pervasive. The same is true of morality, where elaborate codes of conduct can only be found within religious traditions, and even there, do not purport to cover the entire range of situations that generate moral questions. These are, instead, addressed through an open-ended process of reasoning from general principles, particular cases, and specific rules.

The variable and uncertain pedigree of such norms allows them to be invoked to criticize existing law, the third common feature of legal ethics and ethics generally. Ethics in both senses can be used as a vantage point from which the deficiencies of existing law can be identified and proposals for reform advanced. The independence of ethical judgment comes at the cost, however, of acknowledging that its demands are not backed by the force of law: that what the law ought to be departs from what the law is. Thus one of the few explicitly aspirational provisions of the Model Rules concerns pro bono legal services, including the responsibility of lawyers to engage in law reform efforts.[6] This obligation is explicitly exempt from the usual sanctions for professional misconduct.[7] Even for the profession as a whole, advocacy of law reform appears to be less an obligation than a necessity. Yet this obligation, too, is enforced only the sanction of public opinion. The legal profession cannot passively acquiesce in legal regimes widely perceived to be inefficient or unfair without losing whatever esteem it has in society at large.

The similarities between ethics and legal ethics do not, of course, dissolve the differences between them. As legal ethics is distilled into specific rules that establish the minimum standards for acceptable professional conduct, they also become open to general moral criticism. The rules, for instance, on protecting client confidences, often are criticized as preserving the prerogatives of the legal profession,[8] as are many of the positions that the organized bar takes on questions of law reform. To the extent that the rules of legal ethics are legally enforced, it is always possible to hold them up to the same forms of moral criticism as the law generally. It is only an apparent paradox to assert that rules of legal ethics are themselves unethical. Regardless of what the law or legal ethics requires, a lawyer can still ask the question whether, all things considered, it is right to conform to those requirements. As applied specifically to Model Rule 1.13, no purely moral principle requires a lawyer always to act as instructed by "its duly authorized constituents." Ethics in this sense requires lawyers to look beyond the law governing the organization and beyond legal ethics itself.

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[6] Model Rule 6.1.

[7] Comment to Model Rule 6.1 ¶ 12.

[8] Susan Koniak, The Law Between the Bar and the State, 70 N.C. L. Rev. 1389 (1992).

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Equivocation over the sense of "ethics" in legal ethics often leaves debates over the subject in the uneasy middle ground between regulation of the profession through law and criticism of the profession through morality. To the extent that ethical rules create legal obligations, they become subject to moral criticism like any other source of law. But if they impose no such obligations, or those obligations prove to be unenforceable, they compromise their status as law. They are "legal" only in the sense that they are addrerssed to the legal profession. The equivocal status of legal ethics seems to leave it without any independent significance and force, making it either an inferior form of morality or an inferior form of law. Like the Holy Roman Empire–which was said to be neither holy nor Roman nor an empire–legal ethics might be thought to be neither law nor ethics.

Nowhere is this more evident than in the legal ethics of organizational representation, where the latest corporate or government scandal provides the template for each new wave of regulation. Each decade seems to have its paradigmatic scandals, from the "go-go" market of the 1960s, the Watergate scandal of the 1970s, the savings and loan crises of the 1980s, and Clinton scandals of the 1990s and Enron, HealthSouth, and Worldcom bankruptcies of the current decade. Instead of firmly closing the gate after the horses have left the stable, it might have been better to anticipate how similar problems could arise in the future. After one form of misconduct has been found out and prohibited, it is not likely to be repeated again, but instead, to be replaced by innovative forms of misconduct. In a seemingly unending cycle, moralistic reform based on direct translation of ethics into law is followed by laissez-faire advocacy insisting that legal regulation must be kept separate from ethical aspirations.

The failure of such continual equivocation is in using the ethical dimension of legal ethics alternatively as a lever for or as an excuse to avoid legal reform. The only way to avoid the resulting stalemate is to return to the core principles of the subject, one of which is the prohibition against complicity in client wrongdoing. This prohibition is both legal and ethical: legal, because it draws on well-developed principles of accomplice liability and independent standards of client conduct; and ethical, because it requires the attorney to be at fault in assisting in the client's wrongdoing. It reflects the minimum content of legal ethics: the attorney's duty to the client is in keeping him or her (or it, in the case of an organization) out of legal trouble, not in getting them further into it. This duty is not at all aspirational, but embodies minimum standards for the profession, enforceable through a range of legal sanctions, from professional discipline to civil and criminal liability.

This duty is also minimal in another sense as well. It leaves the attorney with the latitude to advise the client (whether an individual or an organization) to take any course of conduct that can reasonably be construed to be in compliance with the law. Avoiding complicity in the wrongful acts of another is a principle so widely accepted that its role in legal ethics might appear to be altogether unexceptional. The Model Rules themselves codify this prohibition and repeat it in various forms at different points.[9] It is also embodied in different forms of accomplice liability in criminal and

[9] Model Rule 1.2(d) ("A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent . . . ."). See Model Rule 1.16(a)(1) (duty to withdraw if "the represenatation will result in violation of the rules of professional conduct or other

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civil law.[10] Yet it constitutes a significant restraint on legal representation because lawyers are expected to aid their clients in avoiding legal liability, based on past acts for which lawyers provide an adversary defense or on future acts for which lawyers provide advice about their legality. It is in the latter respect that the actions of corporate counsel most commonly are called into question and the prohibition against complicity acts as a restraint on the advice that can be given by corporate counsel.

This restraint takes the form, again pervasive in legal ethics, that the attorney offer advice with a reasonable basis in law and fact.[11] Referring to what is reasonable appeals to the prevailing standards of the profession, with all the indefiniteness that that implies. Yet any workable standard must leave attorneys with the latitude to exercise discretion and judgment in offering advice to their clients, while recognizing that the range of such advice must be limited. The lawfulness of a client's action cannot be assessed ex post--after a court or jury has evaluated it--when the client has asked for an assessment of that action ex ante--before it has even been done. But if the prohibition against complicity in client wrongdoing is to be effective at all, it must be supported by the corollary that attorneys cannot offer unreasonable advice categorizing an action as permissible when it is in fact illegal.

As applied to organizational representation, this corollary has more complicated implications than with respect to representation of an individual client. For an individual, the attorney need only take a reasonable position in that individual's interests. For an organization, which acts only through its officers, directors, shareholders, or other constituents, the attorney must take a position that is reasonable with respect to all of their interests, as defined by the law governing the organization. The dependence of an organization on its constituents explains the dependence of Rule 1.13 on other sources of law and its explicit appeal to external sources of law. The interests of each of its constituents depends upon the law defining and governing their conduct within the organization and identifying the "duly authorized constituents" through which the organization acts. Lawyers represent organizations only through the laws that constitute the organizations themselves.

It follows that a program of organizational reform cannot be accomplished through the rules of legal ethics alone. Instead, it must recognize the intimate connection between narrower issues of professional ethics and broader issues of business and institutional law. To take the most recent

law"); 3.3(a)(3) (duty to correct to false material testimony by witness called by attorney); 4.1(b) (duty to disclose material fact when necessary to avoid assisting client in criminal or fradulaent conduct); 8.4(a) (misconduct to "knowingly assit or induce another" to violate the rules "or do to so through the acts of another); 8.4(d) (knowingly assist a judge in violation of rules of judicial conduct or other law).

[10] E.g., 18 U.S.C. § 2; Restatement (Second) of Torts § 876 (1977).

[11] Model Rule 3.1; Fed. R. Civ. P. 11.

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example, the Sarbanes-Oxley Act[12] has coupled a program of corporate reform with enhanced legal obligations of corporate counsel. Whatever the merits of these reforms, they do not simply equate personal standards of morality with professional norms. To do so is to perpetuate the cycle of retrospectively imposed blame and liability, followed by periods of unrestrained advocacy. A learned profession cannot act effectively if it places itself under the shadow of ethical violations, alternating with the command to do whatever serves the interests of the client, in the case of an organization, as narrowly defined by its management. The lawyer must instead to determine what the interests of the organization and its constituents legitimately are and how they legitimately may be pursued. It is the judgment on these issues, as much legal as it is ethical, that is the true subject of professional regulation: how to instill and, where necessary, to constrain professional judgment that lawyers exercise on behalf of their clients. Rule 1.13 provides the framework for properly exercising such judgment on behalf of organizational clients.

II. Legal Ethics and Fiduciary Obligations

Strictly speaking, Rule 1.13 governs only questions of professional discipline: reprimand, suspension, or disbarment.[13] Like the rest of the Model Rules of Professional Responsibility, its focus is upon professional self-regulation, not on civil or criminal liability or procedural issues, such as disqualification. Some states still limit their rules of professional conduct only to disciplinary proceedings, but a growing trend, evident in the current version of the Model Rules, is to make violation of the rules (and presumably compliance also) relevant to the issue of breach of standards of conduct that result in other forms of liability.[14] Thus Model Rule 1.13 influences other sources of law at the same time as it is dependent upon them.

This mutual dependence of the rule and the law governing the organization makes good theoretical sense, for all the reasons given in Part I, but it diminishes the practical guidance that either source of law can provide to lawyers who face actual ethical problems. Rule 1.13(a) thus does not tell the practicing lawyer who are the “duly authorized constituents” of the organization who can speak on its behalf and what the extent of their authority is. By the same token, the law governing the organization does not directly address the obligations that its attorney owes to it, leaving those to be address by the Model Rules or perhaps the law of malpractice. The cross-references between each of these sources of law leaves both of them with a troubling indeterminacy. Neither one appears to be the fixed point from which the other’s content can be filled out.

So, for instance, in disputes over control of a corporation, the very issue in dispute among the competing factions is who are the “duly authorized constituents” of the corporation. Yet

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[12] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (to be codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

[13] Model Rules Note on Scope ¶ 19.

[14] Id. ¶ 20.

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corporate counsel, if he or she is to abide by the dictates of Rule 1.13(a), must know who those constituents are. This apparent paradox can only be resolved through rules derived from a kind of equilibrium achieved between the corporate law on the appropriate role of incumbent management and ethical restrictions on the role of corporate counsel. What management can do puts limits on the advice that corporate counsel can give, and conversely, the advice of corporate counsel determines the range of actions that management can take.

The mutual dependence of the Model Rules and principles of fiduciary obligation extend even deeper, however. Since the rules apply of their own force only to issues of professional discipline, their effect on the civil liability of attorneys and their clients depends upon how they are translated into fiduciary obligations. At this point, any definite guidance that the rules appear to offer gets lost in the abstract terms in which fiduciary obligations are defined. Thus the general rule on the duties of an agent to a principal is framed even more abstractly than Model Rule 1.13, defining these duties by reference to "the terms of the agreement between the parties, interpreted in light of the circumstances under which it is made," except to the extent that the agreement is overridden by "fraud, duress, illegality, or the incapacity of one or both parties to the agreement."[15] So, too, the agent's duty to obey the principal is framed in similarly general terms: "Unless otherwise agreed, an agent is subject to a duty to obey all reasonable directions in regard to the manner of performing a service that he has contracted to perform."[16] The range of agents subject to these principles, and the range circumstances under which they act, no doubt account for the abstract terms in which these duties are defined. Yet this degree of abstraction leaves open the task of making these duties applicable to attorneys, and in particular, in forging a synthesis between the rules of professional discipline and the standards of civil liability.

The principal obstacles to achieving this synthesis revolve around the remedies peculiar to each form of regulation. The remedies under the disciplinary rules are limited almost entirely to deterrence and prevention, through restrictions on an attorney's ability to practice law. Moreover, because disciplinary actions are brought only in the clearest or most egregious cases, seldom do they deter marginally unethical conduct in controversial cases. Civil actions by private parties, or procedural motions for sanctions or disqualification, depend far more heavily on the stakes in the underlying litigation. The larger the claim, the more likely an adversely affected party is to allege that an attorney representing an opposing party engaged in unethical behavior. Everything else being equal, a party has more to gain and therefore greater reason to take the trouble in making such allegations.

This tendency has resulted in persistent fears on the part of the legal profession that civil liability for violating standards of professional conduct will result in overdeterrence of otherwise proper professional conduct. In the terms used by torts theorists, increased civil liability would result in "activity level" effects, deterring aggressive, but appropriate, representation in circumstances

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[15] American Law Institute, Restatement (Second) of Agency § 376 (1958).

[16] Id. § 385(1).

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where it might be mistaken for unethical conduct. Concerns along these lines led, for instance, to the most recent amendments to Federal Rule of Civil Procedure 11, drastically restricting the frequency and severity of sanctions under this rule. In this round of amendments, the standards for proper conduct went unchanged, leaving them almost entirely dependent upon external sources of law. So long as an attorney takes reasonable positions on behalf of her client, reached after reasonable investigation, no violation of the rule occurs.

As suggested in Part I, exactly the same model should apply outside of litigation. In an adversary system, where attorneys are expected to assert the interests of their clients, it is hard to condemn an action as unethical simply because it proved to be unsuccessful: simply because the attorney's argument for protecting the client's interest proved to be unpersuasive. The judgment that attorneys must exercise on behalf of their clients requires some latitude for reasonable advice, even if, with the benefit of hindsight, it was found to be erroneous. Hence the prevalence of the word "reasonable" and similar terms throughout the provisions in Rule 1.13 on reporting wrongdoing by corporate officials.[17] Even if a standard of reasonable action provides little definite guidance to attorneys, it does indicate where they should look for a baseline for permissible action for themselves and their clients. This is not to general ethical principles, but to the law governing the organization.

Left at that level of abstraction, however, almost all doubts about the propriety of actions by organizational officers and directors will be resolved in their favor. In giving advice to management, a lawyer would only be bound by the same ethical constraints as a lawyer defending a corporate officer from a claim of wrongdoing. Attorneys for an organization would defend the interests of management, so long as these can be construed to be reasonably in accord with the law. The complication in organizational representation is that the attorney also has duties to other constituents in the organizations, perhaps subordinate to the duties to management in most cases, but independent of those duties when the interests of different constituents conflict. An action that reasonably protects the interests of corporate officer and directors might be detrimental to the interests of shareholders. Hence the attorney for the organization has a duty also to act reasonably on behalf of constituents other than management. Again, the reference point to determine the extent of those duties is the law governing the organization itself. The constraints on lawyers for the organization arise from duties to subordinate constituents of the organization, like shareholders, who do not usually direct the attorney's actions.

The task of making these duties more definite thus depends, as does much else in legal ethics, on working out a standardized response to recurring problems. Two of these, reporting wrongdoing by corporate officers and resolving disputes between partners, will be discussed in the next part of this essay. Although these model responses must retain a degree of flexibility to accommodate different situations, they share a few common structural features. These are, first, a triggering event that requires the attorney to act outside the course of ordinary representation; second, a duty to have the matter resolved within the organization; and third, if that cannot be achieved, a duty to withdraw, partially or wholly, from representation of the conflicting interests within the organization. It is this

[17] Model Rule 1.13(b), (c), (e).

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last step that is most controversial because it requires the organization to duplicate the work of the attorney who is now disqualified and because the attorney loses the representation, either partly or wholly depending upon whether the client is alienated by the attorney's actions.

Note that none of these features involve disclosure of client confidences outside the organization. This issue, which has dominated arguments about attorneys as whistleblowers, cannot serve as a plausible focus of regulation. Apart from disclosure of fraud on the court,[18] exceptions to the duty to maintain client confidences are almost all permissive, rather than mandatory. A permissive rule does not, by definition, limit what attorneys can do in response to perceived wrongdoing. Whatever might be said for or against such rules, they do not require members of the profession who might acquiesce in a client's wrongdoing to do anything to stop it. Only mandatory disclosure would accomplish this result, but that step has been taken only where necessary to protect the integrity of the judicial process. Even "noisy withdrawal," a close substitute for disclosure, has not been proposed as a mandatory response to client fraud. Withdrawal by this means, which signals an attorney's ethical problems with continued representation by a client, has been left as a permissive option, making withdrawal itself the only mandatory step necessary to avoid participation in client wrongdoing.

As several commentators have pointed out,[19] the real focus of dispute should be on the first of the common features identified earlier: the standard that triggers a transition from ordinary representation of an organization to the extraordinary circumstances created by actual or probable wrongdoing by those who normally run the organization. The problem at this point is avoiding the extremes of too little regulation or too much. Model Rule 1.13(b) adopts a standard of knowledge, both that someone within the organization has engaged in wrongdoing and that it is likely to harm the organization. Critics of this standard have argued that it allows the attorney to resolve all doubts in favor of incumbent management which does, after all, make the decisions about retaining or terminating the attorney. At the opposite extreme, a standard that required only evidence available to the attorney that wrongdoing had occurred and was detrimental organization would transform every close question about behavior within the organization into an ethical problem.

Both extremes have in common a fundamental distrust of the judgment that attorneys bring to bear on the question whether any "duly authorized constituents" of the organization have engaged in wrongdoing. Requiring knowledge of wrongdoing relieves the attorney of any need to act except in the clearest cases of upon the clearest cases of guilt. Requiring only evidence of wrongdoing forces the attorney to act except in the clearest cases of innocence. To paraphrase Justice Jackson, a learned profession cannot be expected to perform its functions without wits or with wits borrowed

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[18] Model Rule 3.3(b).

[19] Susan Koniak, When the Hurlyburly's Done: The Bar's Struggle With the SEC, 103 Colum. L. Rev. 1236 (2003); Geoffrey C. Hazard, Jr., Triangular Lawyer Relationships: An Exploratory Analysis, Geo. J. Leg. Ethics 15 (1987).

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only from the rules.[20] Even the most explicit ethical rules require judgment in determining when they apply. And those governing representation of an organization, dependent as they are on the interrelated fiduciary obligations of directors, officers, and agents, are more complicated that most ethical rules. Instead of denying the judgment necessary to take account of such complexity, it would be better to use it to frame the analysis of the attorney's obligations.

Invoking a standard of reasonable representation, the attorney for the organization should act reasonably with respect to the legal rights of all constituents of the organization, not just management. Despite the social and economic pressure that leads attorneys to follow the interests of those from whom they usually take orders in the organization–the managers who hire and fire them and who pay their bills–they must also act reasonably to protect the interests of others in the organization.[21] The fiduciary obligations of managers impose constraints on the legal position that the attorney for the organization can reasonably take on their behalf. The attorney must act reasonably to protect the interests of shareholders or other constituents of the organization to whom management owes fiduciary obligations. A standard of reasonable action does not allow the attorney to take an adversary position on behalf of management as if it were in litigation with shareholders. Instead, by recognizing the interests of others within the organization, it imposes constraints on the range of positions that the attorney can take.

The extent and nature of those constraints depend ultimately upon the law governing the organization, not upon ethical values in some general sense that constitute a brooding omnipresence over the legal profession. If, for instance, corporate law places shareholders at a disadvantage with respect to management, the ethical obligations of corporate counsel cannot improve their position. As Rule 1.13 makes clear, the attorney's ethical obligations derive from corporate law, which determines both the authority of those who speak for the organization and whether they have engaged in wrongdoing that requires special action by the attorney. It follows that perceived deficiencies in the ethical rules governing of corporate counsel cannot be remedied through reform of the rules alone, but must extend deep into the structure of the corporation. What holds true of corporations, by the general terms of Rule 1.13, applies to any organization. The law governing the organization largely determines the ethical obligations of the attorney who represents the organization. Promoting ethical behavior within the organization requires more than changing legal ethics in the narrow. It also requires a change in the other sources of law on which legal ethics necessarily depends.

The extent of this dependence also reaches the remedial issues necessary to transform disciplinary rules into effective incentives for ethical behavior. The network of contracts that constitute an organization also result in a network of fiduciary obligations among the constituents of the organization. This network must include the attorney for the organization also, making her

[20] Hickman v. Taylor, 329 U.S. 495, 516 (1947) (Jackson, J., concurring).

[21] William Simon, Whom (Or What) Does the Organization's Lawyer Represent?: An Anatomy of Intraclient Conflict, 91 Calif. L. Rev. 57 (2003).

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obligations enforceable by private actions for recovery of damages in addition to any disciplinary proceedings of the state bar. The transition from ethical rules as a matter of professional discipline to sources of civil liability is a vexed issue, addressed with studied ambiguity in the preamble addressing the scope of the Model Rules. In its current version, the preamble allows that "a lawyer's violation of a Rule may be evidence of breach of the applicable standard of conduct."[22] The previous version of this provision disclaimed such an inference altogether, a position that a number of states still adhere to.[23] Whatever the outcome of this particular debate, the reference to other law in Rule 1.13, as it does elsewhere in the Model Rules, brings their requirements into closer conformity with the fiduciary obligations of attorneys enforced through malpractice claims and other forms of civil liability. Under the current version of the rules, it facilities an inference from violation of the rules to violation of fiduciary obligations. And even under the previous version, it increases the overlap between the obligations imposed by the rules and those imposed for ostensibly independent reasons based on other sources of law. The professional obligations of attorneys cannot stray too far from their fiduciary obligations.

As a matter of enforcement, liability as a fiduciary creates the only real deterrent to unethical conduct, since professional discipline is rarely imposed upon attorneys in major law firms, let alone in the complicated situations typically involved in organizational representation. Even in the absence of a money judgment, sanctions imposed by way of disqualification can be costly to attorneys dependent upon a retainer or regular business from an organizational client. Purely as a conceptual matter, sanctions in these forms can be imposed only for breach of fiduciary obligations, but as a practical matter, effective deterrence depends upon expanding the range of sanctions, and therefore the nature of the obligation, imposed upon attorneys. Rule 1.13(a) facilitates that transition by grounding the attorney's ethical obligations in the other sources of law that actually determine behavior within the organization. How that transition is borne out in the context of reporting wrongdoing by corporate officers and in resolving conflicts within a partnership are discussed in the next part of this essay.

III. Two Concrete Cases

As William Simon has recently observed, everyone knows that Rule 1.13(a) requires corporate counsel to represent the organization, but not the individuals within it. Yet no one knows precisely what that requires corporate counsel to do.[24] Only the negative command against individual representation is clear. The question of how to represent the organization through the

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[22] Model Rules Note on Scope ¶ 20.

[23] American Bar Association, Model Rules of Professional Responsibility Note on Scope ¶ 18 (1983).

[24] William H. Simon, Whom (Or What) Does the Organization's Lawyer Represent?: An Anatomy of Intraclient Conflict, 91 Calif. L. Rev. 57, 61-65 (2003).

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same individuals, however, remains mysterious. The approach developed in this essay attempts to resolve these problems by looking to the law governing the organization to determine who acts as "its duly authorized constituents" in different circumstances. This approach, however, runs the risk of circularity of all the difficult problems of organizational representation are referred to the law of the organization and then all the difficult problems in that body of law are referred to professional ethics. The division of intellectual labor cannot become an excuse for gerrrymandering the problems at the intersection of both fields into one field or the other. An integrated approach that draws on the insights of both fields is necessary, recognizing the heterogeneous sources of law and different situations that arise in the course of organizational representation. At this point, an analysis based on general proposition must yield to one focused on concrete cases.

The two cases discussed in this part are *In re Carter and Johnson*[25] and *Fassihi v. Sommers, Schwartz, Silver, Schwartz & Tyler, P.C.*[26]: the first a well-known example of an attempt to impose a duty of disclosure on corporate counsel who is aware of wrongdoing by management in a publicly held company; the second a dispute over the role of corporate counsel in a struggle for control of a closely held corporation. These cases arise in contrasting settings which, although fairly common, hardly exhaust the circumstances in which the actions of corporate counsel raise ethical issues, let alone the actions of counsel for some other kind of organization. In several respects, these cases no longer are as controversial as they once were. Under the current version of Rule 1.13, they could be decided more easily today and certainly with better notice to the attorneys whose actions were in dispute. The point of analyzing these cases under the current rule is not to invoke the benefits of hindsight, but to examine the scope and limits of the principle that an attorney acts through the "duly authorized constituents" of the organization.

A. *In re Carter and Johnson*

This case arose from the financial difficulties of a publicly traded corporation, the National Telephone Co., that was in the business of leasing telephone equipment to business clients. Because of the way in which the leases were structured, the corporation faced large up-front costs in entering into a lease which were only gradually reimbursed through payments over the course of the lease. The corporation therefore had to turn to outside financing in order to expand its business, leading in turn to increasingly severe cash-flow problems. Even if this business was profitable over the long term, it turned out to have a fatal weakness over the short term. In order to preserve the value of its shares, and therefore its access to new financing, the corporation had to keep increasing the number and value of its leases, but these leases, in turn, increased its need for immediate financing. The banks which had financed the corporation's current portfolio of leases became concerned at this pattern of lending and provided new financing only on the condition that the corporation operate under a "Lease Maintenance Plan" (LMP) if its liquidity fell below a specified level. Once the LMP

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[25] Exchange Act Release No. 17, 597 [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) & 82,847 (Feb. 28, 1981).

[26] 107 Mich. App. 509, 309 N.W.2d 645 (1981).

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came into effect, the corporation had to concentrate its resources on existing leases, essentially winding down its operations by foregoing any new business.

Faced with this potential endgame situation, the president of the company adopted an endgame strategy that rapidly evolved into nondisclosure and fraud, deceiving the corporation's outside counsel among others. Two of these outside lawyers, Carter and Johnson, were charged with misconduct by the Securities and Exchange Commission, despite the fact that they had repeatedly advised the president of the corporation to make full disclosure. Nevertheless, in the last quarter of 1974, the attorneys acquiesced in nondisclosure of the LMP, advising that it need not be disclosed in a press release announcing the new credit agreement and in the quarterly filing of a Form 8-K. The lawyers' rationale was that disclosure was required only if the LMP was incorporated as an exhibit to the loan, but not if it was simply referred to. The SEC's opinion, ultimately exonerating the lawyers, found both the press release and the Form 8-K to be misleading. The SEC exonerated the lawyers on the ground that they had insufficient knowledge of the materiality of the LMP. In any event, the lawyers' role in drafting or approving these public statements were as close as they came to active participation in fraudulent conduct.

All the other misstatements by management–and they increased in number and severity as the financial condition of the corporation deteriorated–were made without the knowledge or over the active opposition of outside counsel. These all involved the LMP and diverging statements about its implementation. To shareholders and independent directors, management issued statements assuring them that the company was proceeding with business as usual, without any disclosure that the conditions triggering the LMP had occurred. To the corporation's creditors, management made statements assuring them that the LMP was being implemented when, in fact, it was not. The outside lawyers learned of these discrepancies only when they were informed by counsel for the creditors.

Largely because management had deceived the outside lawyers, the SEC refused to impose any sanctions upon them, making its ruling prospective only and initiating a rulemaking process that, in the end, resulted in no change in the regulation governing lawyers engaged in practice before the SEC. To the extent that the Commission recognized any new duties upon the part of corporate counsel, it did so in the most tentative and open-ended terms:

> [A] lawyer must, in order to discharge his professional responsibilities make all efforts within reason to persuade his client to avoid or terminate proposed illegal action. Such efforts could include, where appropriate, notification to the board of directors of a corporate client.[27]

Substantially the same obligations, stated in more definitely and in greater detail, now appear in the provisions for reporting "up the ladder" of an organization in Rule 1.13(b). At the time, however,

[27] *Carter & Johnson* at 84, 170 (footnote omitted).

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the opinion in *Carter and Johnson* caused an uproar among the corporate bar and attempts to amend the rules on practice before the SEC came to nothing.

The bar's immediate concern arose directly from the facts of the case: What more could the outside attorneys have reasonably been expected to do? As much as the shareholders and independent directors, they were the victims of management's fraudulent statements and nondisclosures. With the benefit of hindsight, we can confidently say today that they should have disclosed what they knew to the board of directors as soon as they realized that management was engaged in a campaign of misinformation. As it happened on the facts of that case, the board had its own concerns about mismanagement of the corporation, so that disclosure to the board would not have been an empty gesture, resulting only in endorsement of management's wrongdoing.[28] This feature of the case should be encouraging to supporters of "up the ladder" reporting as a remedy for corporate misbehavior. Yet it also raises the further question of what an attorney should do in the absence of a sympathetic decisionmaker within the organization. What should Carter and Johnson have done in the board wanted to go along with the misstatements of management?

In this essay, it is impossible to offer a definitive answer to these questions, which have prompted an extended debate over the responsibilities of corporate counsel ever since *Carter and Johnson* was decided 25 years ago. Instead, it is necessary to focus on how the general principle of representation of an organization through "its duly authorized constituents" constrains the answers to these questions. It gives very little room either to absolve corporate counsel entirely of any duty to seek direction from a disinterested source within the organization or to impose a duty of disclosure outside the organization. If a conclusion at either of these extremes is adopted, it must be for reasons apart from and to some degree inconsistent with the general principle of Rule 1.13(a).

Consider, first, the alternative of not reporting "up the ladder." It requires corporate counsel either to do nothing or to withdraw. On the facts of *Carter and Johnson*, both courses of action were or would have been detrimental to the corporation. Doing nothing, after having exhausted attempts to get the president of the corporation to comply with his obligations, allowed his fraudulent statements to continue, harming shareholders who relied upon his statements and delaying attempts by the board of directors to oust current management and to save what was left of the corporation. Both conditions are prerequisites to reporting "up the ladder" as that duty is now codified in Rule 1.13(b). Withdrawing from representation would have had the same consequences for the corporation, unless it served as an ambiguous signal, like "noisy withdrawal," that induced someone, most likely the board of directors, to take effective remedial action. If it did serve as a signal, it would have been just a less effective version of reporting to the board. If it did not, it would have resulted in continuing fraud. Withdrawal in the face of continuing fraud is permitted–and sometimes required–by Model Rule 1.16, but only if counsel cannot stop the fraud by other means. It is an option of last resort, with harmful effects on the corporation, which presupposes that alternative courses of action are not available. Reporting "up the ladder" is the most obvious of such alternatives.

[28] Id. at 84, 164.

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Relieving corporate counsel of any duty to report "up the ladder" can be justified only on the assumption that incumbent management, despite continuing wrongdoing, still acts as the duly authorized constituent of the corporation. Only on this assumption can the adverse consequences to the corporation be justified. Like an individual who acts contrary to the advice of counsel and violates the law, the corporation must suffer the consequences of its wrongdoing. When it comes to the rights of third parties who deal with the corporation, the law often adopts this view, holding the corporation liable for the wrongful acts of management. But when it comes to authority to direct the actions of counsel, this is not the view adopted in legal ethics which, on the contrary, requires counsel not to follow the instructions of a client, whether an individual or an organization, to assist in its wrongful activity. Managers who engage in wrongful conduct forfeit their authority to direct the actions of corporate counsel, and in so doing, allow recourse to disinterested sources of authority within the corporation.

Conceivably another justification could be offered for blocking the access of corporate counsel to others within the organization, but it is difficult to formulate one that does not depend upon the continuing authority of management. This permission becomes a duty because corporate counsel must be directed by someone within the organization. We have not, as Judge Henry Friendly observed in the context of settlement, entered a "brave new world" in which corporate counsel are presumed to have plenary authority to act on behalf of the corporation.[29] In this respect, lawyers for an organization are no different from lawyers for an individual client. They must abide by the client's decisions about what goals to seek and consult with the client over how to achieve them. In a crisis over wrongdoing within the organization, counsel cannot act without the guidance of those authorized to speak on the organization's behalf.

The same considerations, rooted in the principle of representation through the organization's duly authorized constituents, also bears upon the analysis of proposals at the opposite extreme from doing nothing: those involving disclosure outside the organization, or what amounts to the same thing, disclosure to shareholders in a publicly traded corporation. The current version of Rule 1.13(c) allows disclosure, but does not require it, if other means are inadequate to protect the organization from harm. Similar, but narrower, provisions in the general rule on client confidences also allow an attorney to disclose criminal or fraudulent action by any client, whether an organization or an individual.[30] These provisions stop short of a duty to disclose partly because of the controversy that attends any erosion of client confidentiality. It was only the corporate scandals that precipitated the passage of the Sarbanes-Oxley Act that resulted in the bar approving these provisions in the rules.

But another reason supports the limitation of these provisions to permissive disclosure. Without client control, the attorney must act as a completely independent agent, under the provisions

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[29] International Telemeter Corp. v. Teleprompter Corp., 592 F.2d 49, 58 (2d Cir. 1979) (Friendly, J., concurring).

[30] Model Rule 1.6(b).

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in Rule 1.13(c), assessing whether disclosure is "necessary to prevent substantial injury to the organization." It may be, as some have contended, that lawyers should assume the role of whistleblower or gatekeeper, acting in the interest of shareholders or the public generally.[31] Even in the case of shareholders, however, these roles take the attorney far from the traditional one of acting with consultation and control of the client. In any publicly held corporation, consultation with the shareholders is equivalent to public disclosure and the possibility that they will exercise any realistic degree of control over corporate counsel is nonexistent. So, too, the content, timing, and extent of disclosure make the decision necessarily discretionary in large part, even if some duty to disclose is actually imposed. Exactly how much should the attorneys in *Carter and Johnson* have disclosed outside the confines of corporate managers and directors? Permissive disclosure under the current provisions of the rules at least recognizes the considerable scope that judgment must necessarily play in any such decision.

Some ethical rules, of course, do require disclosure in some circumstances, notably those on client perjury in judicial proceedings.[32] Even these, however, stop short of dictating precisely what the attorney should do and require the attorney only to "take reasonable remedial measures, including, if necessary, disclosure to the tribunal." Whatever might be said in favor of a duty to disclose in other circumstances, it depends on considerations entirely independent of client control over the attorney, and in the organizational context, independent of the principle of Rule 1.13(a) that the attorney acts through the agents of the organization. Disclosure within the organization need not resort to any such independent argument. To the extent that the board of directors control the officers in the corporation, they are entitled to full information on which to base their decisions.

Indeed, on the facts of *Carter and Johnson*, the board of directors independently questioned the actions of the president and could have, with earlier disclosure from the attorneys, acted more effectively to limit damage to the corporation. If, on the other hand, the board had gone along with the president's fraudulent course of action, the attorneys would have been placed in the dilemma now addressed by Rule 1.13(c), whether to disclose publicly, or under Rule 1.16(a)(1), to withdraw to avoid complicity in the fraud. Either or both of these actions may be necessary to protect shareholders from the losses resulting from continuing exposure of the corporation to liability for fraudulent misstatements. Any resulting damages awarded against the corporation will depend upon how long the fraud went undetected and its cost will ultimately be borne by the shareholders. Perhaps disclosure would prevent such losses, or perhaps it would only prevent corporate counsel from getting the necessary information in the first place. Whatever the answer to this question, it is independent of the principle of Rule 1.13(a).

B. *Fassihi v. Sommers, Schwartz, Silver, Schwartz & Tyler, P.C.*

[31] E.g., John C. Coffee, Jr., Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms, 84 Colum. L. Rev. 301, 353-63 (2004).

[32] Model Rule 3.3.

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When the context of representation moves from large organizations to small ones, the scope and extent of the attorney's obligations change as well. When the change is from large, publicly held corporations to small, closely held ones, the contrast is quite striking, so much so that it leads some courts "pierce the corporate veil" and treat all the shareholders in a closely held corporation as individual clients. Whether justified or not, this step represents a departure from the principle of Rule 1.13(a), by treating the attorney as if he represented the individual constituents of the organization rather than the organization itself. In *Fassihi v. Sommers*, the court took a different approach, one that preserved the organizational nature of the representation yet recognized fiduciary obligations that the attorney owed to individuals within the organization.[33]

Like *Carter and Johnson*, the facts of *Fassihi v. Sommers* admit of a direct and simple solution under the current version of the Model Rules. It was not available, either to the court or to the parties and their attorneys, at the time. Dr. Fassihi owned half the shares in a closely held corporation with another doctor, Dr. Lopez. Both practiced radiology. Both were also directors and officers of the corporation, Fassihi was the secretary-treasurer and Lopez was the president. There was some dispute over whether another individual was a third director of the corporation. The work of both doctors depended upon access to the facilities at a local hospital, a privilege that, unknown to Fassihi, was controlled entirely by Lopez in his individual capacity.[34]

After practicing medicine together for a year and a half, Lopez decided to terminate his relationship with Fassihi. To do so, he contacted his individual attorney, Epstein, who was also the attorney for the corporation. At a meeting of the board of directors, as alleged by Lopez, he and the third director voted to terminate Fassihi's interest in the corporation. Fassihi alleged that he received no prior notice of this meeting. After his staff privileges at the hospital were terminated, he eventually sued Epstein for malpractice, breach of fiduciary and ethical obligations, and fraud. On an interlocutory appeal, the court held that Epstein's motion for summary judgment was properly denied, as were his objections to questions about his communications with Lopez about the ouster of Fassihi from the corporation.[35]

Both holdings today would follow directly from Rule 1.13(g), which requires any joint representation of a corporation and an individual officer or director to be subject to the general rule on joint representation and where necessary, to require the consent of other constituents within the organization. Under the this provision, Epstein joint representation of the corporation and Lopez constituted a conflict of interest, either from the beginning or as soon as a conflict over control of the corporation developed. Epstein could not fulfill both his duties to the corporation, acting through Fassihi as a director, and to Lopez individually in trying to terminate Fassihi's interests in the corporation, including his power as director. The corporation could make an informed decision

[33] *Fassihi v. Sommers*, 107 Mich. App. at 514, 309 N.W.2d at 648.

[34] Id. at 514, 309 N.W.2d at 647-48.

[35] Id. at 518-19, 309 N.W.2d at 650.

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about Fassihi's status within it only if the entire of board of directors, including Fassihi himself, were fully informed on this issue. Likewise, in order to obtain Fassihi's consent to joint representation, Epstein would have had to fully inform him of the nature of his representation of Lopez individually, including communications with Lopez about his attempt to terminate Fassihi's interests in the corporation.

As noted in Part II, the Model Rules themselves do not determine questions of fiduciary obligations or evidentiary privileges. Yet they are plainly relevant to such questions, and at a minimum, must be interpreted consistently with the other sources of law that actually govern these questions. It is only a small step from the conclusion that joint representation violated the attorney's ethical obligations to the conclusion that it also violated his fiduciary obligations and deprived him of any claim of privilege as against Fassihi. The same arguments that support the first conclusion also support the second. No attorney today would undertake joint representation in violation of Rule 1.13(g) and expect to be free of any claim of breach of fiduciary obligations to the corporation or its duly authorized constituents.

The analysis in *Fassihi v. Sommers* would be more complicated, but not very different in outcome, if corporate counsel had represented only the corporation and had avoided individual representation of a director and officer. In those circumstances, whatever Epstein learned about Lopez's attempt to oust Fassihi from the corporation would have had to be disclosed to Fassihi, and for the same reason as discussed earlier. The corporation could decide whether to keep Fassihi as director, officer, and shareholder only through the fully informed decision of its board of directors, which includes Fassihi himself.

A more complicated variation on the facts of this case involves Fassihi's status only as a shareholder. If he were not a director and officer of the corporation, he could not plausibly argue that fiduciary obligations ordinarily directly to him from corporate counsel. The usual control of the business, including control over corporate counsel, rests with management, not with shareholders, even in a closely held corporation. Yet if management violates its fiduciary obligations to shareholders, the ordinary rules of corporate representation no longer apply. Corporate counsel in this situation can take steps to protect the interests of shareholders. Unlike the situation discussed earlier, involving a publicly held corporation in *Carter and Johnson*, disclosure to the shareholders of closely held corporation is not tantamount to public disclosure and it does not foreclose the possibility of an attorney obtaining direction and information from the shareholders as a group. On the assumption that Lopez would have been acting in breach of his fiduciary obligations to Fassihi as a shareholder, Epstein would have been obligated to take whatever steps were necessary to protect Fassihi's interests, including disclosure to him.

Perhaps the analysis in this last situation comes close to "piercing the corporate veil." But if so, it does less damage to the principle of Rule 1.13(a) than any other alternative. The corporate officers and directors, if they are acting in violation of their fiduciary obligations, no longer can speak for the corporation and the interests of the shareholders can be protected best by going to them as the only remaining constituents of the organization with authority to direct the attorney.

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Disaggregation of the corporation into its constituents may be necessary, but only in order to find someone within the organization who still has authority to speak for it. This entire analysis, of course, depends on the assumption that the directors or officers of the corporation have breached their fiduciary obligations to shareholders. If corporate counsel concludes that they have not, reasonably taking account of both their interests and the shareholders' interests, the ordinary processes of corporation representation should remain in place.

Conclusion

This essay has not attempted to resolve all the vexing issues of organizational representation. That would be too much for any one article or perhaps even an entire book. This essay has a narrower purpose: to show most aspects of organizational representation depend upon the principle of Rule 1.13(a) which, in turn, looks to the law governing the organization. Where that law, including the agreement or charter creating the organization, gives a determinate answer to the question of who is "its duly authorized constituent," the attorney's duties to the organization can be derived from the lawful actions of its constituents. In extraordinary situations, where the constituents of the organization act unlawfully, the attorney must first turn to other sources of authority within the organization. This approach confirms the wisdom of "reporting up the ladder" as now required by Rule 1.13(b) and the Sarbanes-Oxley Act. It also supports extended fiduciary obligations of the attorney, outside the normal channels of authority within the organization, if necessary to protect constituents, like shareholders in a closely held corporation, who are in a position meaningfully to control her actions.

Other steps, such as disclosure outside the organization, might be necessary if such constituents cannot protect themselves. Thus, the inability of shareholders in a publicly held corporation directly to safeguard their own interests argues for someone to have authority to act on their behalf. Rule 1.13(a) does not preclude giving such authority to the attorney as whistleblower or gatekeeper of management. It does make clear, however, how far such steps go beyond the ordinary principles of representation. For an organization, as much as for an individual client, these presuppose the ability to control the attorney. Existing law on disclosure outside the organization, whatever its merits, at least recognizes that this should be an option of last resort.

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