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Duties to Organizational Clients

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ARTICLES

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ABSTRACT

Loyalty to an organizational client means fidelity to the substantive legal structure that constitutes it. Although this principle is not controversial in the abstract, it is commonly ignored in professional discourse and doctrine. This article explains the basic notion of organizational loyalty and identifies some mistaken tendencies in discourse and doctrine, especially the "Managerialist Fallacy" that leads lawyers to conflate the client organization with its senior managers. The article then applies the basic notion to some hard cases, concluding with a critical appraisal of the rationale for confidentiality with organizational clients.

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INTRODUCTION

Most American lawyers work for organizational clients.[1] Yet, lawyers often think and speak of those clients in individual terms. So does doctrine. Before the 1980s, doctrine rarely acknowledged any differences between organizational and individual clients, and it still only does so intermittently. When doctrine tries to confront the distinctive questions presented by organizational representation, it often lapses into circumlocution or incoherence.

The tendency to think of organizational clients in individual terms arises in part from psychological and economic pressures that encourage lawyers to identify these clients with the managers who retain and instruct them. Responding to criticism that it facilitated Enron's deceptive financial reporting, attorneys at Vinson & Elkins asserted, "When clients ask us [if they can do something] our job is to . . . figure out if there is a legally appropriate way to do it. That's what we do."[2] Such talk begs the question of whether managers asking for help with accounting manipulations intended to deceive shareholders can be plausibly understood to speak for the "client."

Question-begging recurs even in disinterested debate. In 2000, Cynthia Ossias, counsel to the California Department of Insurance, gave information about apparent unlawful activity by the Commissioner of Insurance to a legislative

1. The most rigorous estimate comes from a survey of Chicago lawyers. It found that in 1994 at least sixty-four percent of the work of these lawyers was performed for organizational clients (not counting "small business" organizations) and that the trend was toward greater organizational representation. John P. Heinz et. al, *The Changing Character of Lawyers' Work: Chicago in 1975 and 1995*, 32 L. & SOC'Y REV. 751, 765–67 (1998).

2. Patti Waldmeir, *Don't Blame the Lawyers for Enron*, FIN. TIMES, Feb. 21, 2002, at 14.

oversight committee.[3] A vigorous debate ensued. Some asserted that confidentiality forbade her from disclosing the information. Others asserted that there was some relevant "exception" to confidentiality. Even without an exception, however, Ossias's duty would be owed to the client. To assume that disclosure would breach such a duty begs the question of what the client's interests were and who had authority to assert or waive confidentiality on the client's behalf. Just because disclosure was plainly against the interest of the incumbent commissioner does not mean that it was against the *client's* interest. Nor does it mean that the incumbent commissioner had authority to decide the issue in a situation where he had a large conflict of interest.

Even when lawyers ask the right questions, doctrine is often unresponsive. The key initiatives in professional responsibility doctrine—two similar provisions of the Model Rules of Professional Responsibility and the Restatement of the Law Governing Lawyers—are tortuous and incoherent, and it is unclear whether they mandate anything that is not independently required by other law.

Professional responsibility doctrine depends in important ways on the laws that constitute the organizational client. With Enron, this would mean corporation and securities law. With the California Department of Insurance, it would mean a congeries of constitutional, administrative, and statutory law. Here the lawyer does find dense and relatively coherent bodies of doctrine. Unfortunately, they are often elusive on issues that most concern lawyers. Yet, grappling with the substantive ambiguities is inescapable.[4]

Part II elaborates the principle that loyalty to the organization means respect for the substantive legal structure that constitutes it and identifies some common ways in which discussion mistakenly departs from this principle. Part III shows that these mistakes infect the contributions of the Model Rules and the Restatement. Parts IV and V consider two classes of cases that remain difficult even when analyzed under the approach proposed here because the substantive law that constitutes the client is indeterminate. The first class involves questions of "reporting out"–disclosure outside the organization for the benefit of the client. The second involves conflict and confidentiality issues that require difficult distinctions between organizational insiders and outsiders. Part VI addresses the grounds for attorney-client privilege with organizations. It demonstrates that, when the substantive law that constitutes the clients is adequately considered,

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3. RICHARD ZITRIN ET. AL, LEGAL ETHICS IN THE PRACTICE OF L. 665–66 (4th ed. 2013) (summarizing the Ossias story and reprinting the disciplinary counsel letter); Marisa Huber, *Ethics Year in Review*, 47 SANTA CLARA L. REV. 867, 904–05 (2007) (reporting State Bar opposition to "exceptions" to confidentiality for cases such as Ossias's).

4. The growth of organizational representation is one reason why legal ethics is "falling apart"— that is, being absorbed into various fields of substantive law. *See* John Leubsdorf, *Legal Ethics Falls Apart*, 57 BUFF. L. REV. 959 (2008).

strong confidentiality protection is harder to justify for organizational clients than for individual ones.

I. THE BASIC ANALYSIS

To responsibly represent a client, a lawyer needs the ability to answer three questions: Who speaks for the client, and can thus instruct the lawyer? Who listens for the client, and thus should receive the information the lawyer is obliged to communicate? Who acts for the client, and can thus take the actions needed to make commitments on behalf of the client?

To appreciate the distinctive professional responsibility issues in organizational representation, it is helpful to start by considering the lawyer's duties to jointly represented individuals in the absence of organization. Professional responsibility doctrine demands sensitivity to potential conflicts among individuals who seek joint representation, and it forbids joint representation when the conflicts are too severe.[5] Even sophisticated clients are sometimes deemed incapable of deciding to run the risks of joint representation in situations of conflict.[6]

A major reason for wariness about joint representation is that it tends to be both cumbersome and fragile. It is cumbersome because, with joint representation, the answer to our three questions is likely to be: everyone. Decision or action by the group requires unanimity, and notice to the group requires notice to each member.[7] Joint representation is fragile because any disagreement within the group can end the representation. Each client can terminate her relation to the lawyer at will. She then becomes a former client who can veto the lawyer's continued representation of the others in any substantially related matter in which her interests are adverse.[8] And, the lawyer is advised to end the joint representation on her own initiative when conflict, actual or potential, intensifies beyond the threshold of consentability.

These at least are the presumptive rules. There may be some room for individuals to commit contractually to binding less-than-unanimous decisions, notice to designated representatives, and waiver of the right of a withdrawing participant to veto continued representation of the others. But, the permissible range of such agreements is unclear, and they are likely to be scrutinized skeptically after collaboration has collapsed. Moreover, there are no standard,

5. *E.g.*, Baldessarre v. Butler, 625 A.2d 458 (N.J. 1993) (holding joint representation of buyer and seller in a complex real estate transaction nonconsentable).

6. *E.g.*, *id.*

7. Opdyke v. Kent Liquor Mart, Inc., 181 A.2d 579, 583–84 (Del. 1962).

8. *E.g.,* Brennans', Inc. v. Brennans' Restaurants, Inc., 590 F.2d 168, 172 (5th Cir. 1978) (holding that when one or more clients withdraw from a joint representation the lawyer may not continue to represent one without consent of the others).

broadly recognized forms for such agreements in many situations.[9]

Once the collaborators adopt an established organizational form, everything changes. Doctrine insists that the subject of the representation is now an "entity" rather than an "aggregate" of individuals. It assumes that internal conflict virtually never requires the lawyer to withdraw.

It is arguable that doctrine is excessively sensitive to conflict in the joint representation situation and under-sensitive to it in the organizational situation.[10] But, some general difference in orientation is justified by a basic difference between unorganized and formally organized collaborators: formal organization entails adoption of explicit norms designed to make it possible for a group to speak, listen, and act without unanimity. These norms are of three general types. There are decision rules that allocate presumptive responsibility and specify procedures. There are fiduciary duties that require that decision-making responsibility be exercised in the interests of the organization, rather than in the individual interests of the decision-makers. And, there are property norms that distinguish the organization's assets from the personal assets of the constituents and delineate the relative claims on organizational assets by constituents. The fiduciary norms qualify the decision rules, making authority conditional on its exercise in the interest of the organization. The property norms give definition to fiduciary duties, indicating which constituent interests should be deemed interests of the organization.

The move to formal organization makes it possible to speak of loyalty to an entity. Loyalty to an entity means fidelity to the legal structure that constitutes it. It is this structure that gives "legal personality" to the group. The structure enables the group to speak, listen, and act as a unity without consensus. In principle, the structure enables determination in situations of conflict which of the contesting positions should be treated as that of the client.

Sometimes the move to organizational form is too hasty or casual to produce an institutional structure sufficiently dense to perform these functions. Or sometimes, the structure is never integrated into the actual operation of the organization. Small groups may adopt an organizational form for reasons peripheral to the basic purposes of their collaboration. Small businesses often

9. *E.g.*, Abbott v. Kidder Peabody & Co., 42 F. Supp.2d 1046, 1051 (D. Colo. 1999) (holding void contract among 200 individual plaintiffs giving settlement authority to representative sub-group); Tax Authority, Inc. v. Jackson Hewitt, Inc., 898 A.2d 512, 514–15 (N.J. 2006) (holding void contract among 154 individual plaintiffs providing that each would accept settlement approved by weighted majority).

10. Consider the famous episode in which Louis Brandeis undertook to negotiate a forbearance agreement at the request of a distressed debtor and his creditors. Asked whom he represented, Brandeis characterized himself as "counsel to the situation." Bar leaders accused Brandeis of violating conflicts norms, and some ethicists would do so today. John Frank admonished: "Lawyers are not retained by situations, and the adversary system assumes they represent one interest at a time." John P. Frank, *The Legal Ethics of Louis D. Brandeis*, 17 STAN. L. REV. 683, 702 (1965). But lawyers represent organizations routinely, and organizations of substantial size virtually always involve multiple interests with potential for conflict.

incorporate to gain limited liability without expecting any basic change in their informal modes of operation. Just as corporate doctrine sometimes "pierces the corporate veil" in order to deny limited liability in such situations, professional responsibility doctrine sometimes disregards organizational form. It does so where constituents seem to have assumed that unanimity would continue to be the basis for their collaboration and the move to legal formality has not produced meaningful answers to our three questions. The courts then default to joint representation norms.[11]

Commonly, however, the move to organization will produce answers to the lawyer's questions across a broad range of situations. Take the business corporation. State law gives virtually plenary authority to the board. The corporation, it says, is managed "by and under the direction" of the board.[12] Shareholder approval is needed for a few major matters, such as mergers and article amendments.[13] Senior managers have presumptive authority over ordinary business matters and sometimes more specialized tasks like certification of records, but, in general, authority ultimately derives from the board. The board makes some decisions itself and delegates others. It specifies who will execute decisions on behalf of the organization. The allocation of authority to decide and execute will usually answer at least implicitly our three questions.

Complexity is added by fiduciary duties—the duty of care, which requires minimal competence, and the duty of loyalty as it applies to conflicts of interests.[14] Decisions that an agent would normally have authority to make may be unauthorized if made recklessly or in the selfish interests of the agent.[15] The generally hierarchical nature of corporate authority indicates the proper course of action in situations of doubt. The lawyer can move up the ladder to the next level. As long as the officer at that level has decisional authority and there are no questions about her ability to decide with care and loyalty, she can assess the conflicted decision of the subordinate on behalf of the organization. Until we get to the top, hierarchy provides recourse in difficult situations.

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11. *E.g.*, Hecht v. Superior Court, 237 Cal. Rptr. 528 (Cal. Ct. App. 1987) (treating representation of two-person corporation as joint representation for confidentiality purposes); Woods v. Superior Court, 197 Cal. Rptr. 185 (Cal. Ct. App. 1983) (treating representation of two-person corporation as joint representation for conflicts purposes); Opdyke v. Kent Liquor Mart, 181 A.2d 579, 583–84 (Del. 1962) (treating representation of three-person corporation as joint representation for the purpose of lawyer's fiduciary duty to provide information to clients).

12. DEL. CODE ANN. tit. 8, § 141(a) (2014); *see generally* REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW 55–88 (2d ed. 2009).

13. *See* KRAAKMAN ET AL., *supra* note 12.

14. DEL. CODE ANN. tit. 7, § 6425 (2014) (denying directors right to vote on matters with respect to which they have financial interests); Schnell v. Chris-Craft Indus., 285 A.2d 437 (Del. Super. Ct. 1971) (holding that, although statute and by-laws gave directors authority to schedule shareholders meeting, they could not use their power strategically to thwart a shareholder challenge to board).

15. DEL. CODE ANN. tit. 7, § 6425; *Schnell*, 285 A.2d at 439.

Thus, in the private sector the basic approach to entity representation has three elements. We start with the rules that allocate authority to instruct, listen, and act. We then consider whether actions under these rules are consistent with fiduciary duty, interrogating decisions that seem reckless or self-interested. With hard cases, we move up the ladder seeking to induce senior agents to resolve ambiguity or discipline misconduct.

In the public sector, the same basic analysis applies, though there are distinct problems and ambiguities. There is more variation across jurisdictions in the organizational structure of public organizations than of private ones. Moreover, hierarchies tend to get narrower at the top; so, the prospect of moving up the ladder is less often plausible in the public sector. For example, the President presides formally over the entire federal executive branch and cannot attend to more than a tiny fraction of the matters over which he has authority. It would rarely be plausible to tell a government lawyer to refer difficult questions to the President, as corporate lawyers are expected in some situations to refer them to the board of directors. Moreover, there are ambiguous limitations on the President's authority to control some executive decisions where Congress (or perhaps custom) has allocated decisional authority to specific officers.[16]

In addition, there is more ambiguity in the public sector about horizontal authority relations. Federal statutes give the Solicitor General and the Attorney General control over federal litigation to a degree that is ambiguous but clearly exceeds that accorded lawyers for private organizations.[17] States have multiple elected executive officials whose relative authority is often disputed. State attorneys general often have constitutional authority to make litigation decisions on behalf of agencies or officers over the objection of senior administrators and even governors.[18] In both federal and state systems, prosecutors have great autonomy with respect to decisions to bring criminal charges. Public whistle-blower statutes that mandate or permit reporting outside the reporter's line of authority to the attorney general further complicate the picture.[19]

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16. *See* Peter Strauss, *Overseer, or "The Decider"?: The President in Administrative Law*, 75 GEO. WASH. L. REV. 696 (2007).

17. 28 U.S.C. § 516 (2012) ("[T]he conduct of litigation in which the United States, an agency, or officer thereof is a party . . . is reserved to officers of the Department of Justice"); 28 U.S.C. § 518 (2012) ("[T]he Attorney General and the Solicitor General shall conduct and argue suits and appeals" in the higher federal courts). The Solicitor General frequently refuses requests from line officials to file appeals and occasionally confesses error and agrees to vacate judgments in favor of the government. Cornelia T.J. Pillard, *The Unfulfilled Promise of the Constitution in Executive Hands*, 103 MICH. L. REV. 676, 709 (2005).

18. William Marshall, *Break Up the Presidency? Governors, State Attorneys General, and the Lessons of the Divided Executive,* 115 YALE L. J. 2446 (2006).

19. Kathleen Clark, *Government Lawyers and Confidentiality Norms*, 85 WASH. U. L. REV. 1033, 1073–91 (1985).

Such concerns make cases like Cynthia Ossias's hard, but they should not distract attention from the fact that the most common situations public lawyers encounter involve relations with middle and lower-level officials operating within fairly well-defined hierarchical authority structures. As Geoffrey Miller says, the government "lawyer's duties run to the officer who has the power of decision over the issue. In the vast majority of cases, that officer will be the head of the department in which the attorney works."[20] Here the basic analysis—looking first to decision-making rules, then to fiduciary duties, with climbing the ladder as a resort in doubtful cases—applies.[21]

The basic analysis explains a doctrinal mystery that often goes unremarked—why authority to invoke or waive the organization's confidentiality rights usually belongs to organizational agents different from those who made the confidential communications. The mystery arises from the inconsistency of this norm with the rationale for confidentiality. The rationale is that confidentiality is necessary to induce disclosure to the lawyer. Disclosure is valued because it leads to more and better legal advice, and legal advice is valued because it tends to deter wrongdoing.[22] However, once control over confidentiality is given to the organization rather than the communicating agent, confidentiality cannot play an important role in inducing disclosure to the lawyer. Confidentiality will not block the lawyer from disclosing within the organization, and it will not prevent the organization from disclosing outside, no matter how harmful internal or external disclosure is to the agent. It would be a simple matter to re-assign control to the agent, and if the conventional rationale for confidentiality were correct, doing so would have a net deterrent effect on wrongdoing. However, such a revision would require the lawyer to take instruction on disclosure with respect to each communicating agent's statements from someone different from those authorized to instruct him on other issues. The communicating agents might have interests different from those of the organization, and the relevant substantive law does not provide any mechanism for reconciling differences. Thus, the lawyer would be in

20. Geoffrey P. Miller, *Government Lawyers' Ethics in a System of Checks and Balances*, 54 U. CHI. L. REV. 1293, 1298 (1987).

21. The analysis here should be distinguished from a pioneering effort by Geoffrey Hazard, Jr., in *Triangular Lawyer Relationships: An Exploratory Analysis*, 1 GEO. J. LEGAL ETHICS 15, 40 (1987). Hazard suggests that organizational constituents should be treated as joint clients in "normal circumstances" but that, in situations of conflict, a "rule of precedence" should dictate who instructs the lawyer. This approach is not viable. First, even in absence of conflict, the lawyer needs answers to the three questions. The only answer joint representation gives is unanimity, which is often impractical or undesirable. Second, the source and content of Hazard's "rule of precedence" is mysterious. It is not discoverable in professional responsibility doctrine, and substantive organizational doctrine provides, not a single rule, but a congeries of rules. This early Hazard approach is called the "group theory" in GEOFFREY C. HAZARD ET. AL, THE LAW OF LAWYERING § 18.03, at 13–18 (4th ed. 2015) [hereinafter HAZARD ET AL., THE LAW OF LAWYERING]. The authors interpret Model Rule of Professional Conduct 1.13 to reject the group theory in favor of an "entity" theory. My argument should be understood as an interpretation of the "entity" theory.

22. MODEL RULES OF PROF'L CONDUCT R. 1.6, cmt.¶ 2 (2010) [hereinafter MODEL RULES].

a position that resembles joint representation. However, joint representation is impermissible without informed consent, which generally requires a sharing of information, and it collapses when severe conflict arises. Assigning control over disclosure to the organization's general authority structure avoids these dangers.

The basic analysis also allows us to identify two common ways of thinking and talking about organizational representation as mistaken. The first is the Managerialist Fallacy. It involves the failure to observe the distinction between the organization's interests and those of its senior managers. Vinson & Elkins's statement that it was merely doing what the "client asked us to do" when it facilitated Enron's misleading financial reporting is an example. The lawyers were asked for help by Enron senior managers, including some who were later convicted of financial fraud. Whether their requests can plausibly be attributed to "the client" depends on whether they had authority to make such requests. Those who criticize the firm assume that they did not have authority, and Vinson & Elkins's response begs this question.

A more subtle manifestation of the Managerialist Fallacy occurs in discussions of corporate attorney-client privilege in derivative suits. The influential Fifth Circuit case *Garner v. Wolfinbarger* holds that management cannot routinely assert privilege to block a derivative plaintiff's effort to discover pertinent conversations with corporate counsel.[23] The case holds that the trial court should evaluate the situation contextually in terms of such factors as the number of shares represented by the plaintiff, the facial plausibility of the claim of managerial wrongdoing, the importance of the information to the plaintiff's case, and the likelihood that disclosure might reveal publicly trade secrets or other proprietary information.

Garner is not strongly deferential to managerial discretion, but the Managerialist Fallacy enters in the common characterization of its doctrine as an exception to the attorney-client privilege.[24] The doctrine does not, in fact, function as an exception, and that is not how the *Garner* court described it. An exception to privilege characteristically makes information discoverable by any litigant,[25] but only shareholders can invoke the *Garner* rule. In explaining the rule, the court emphasized that the plaintiffs are constituents of the organization, and they are purporting to speak in its interest. To allow management routinely to invoke privilege would "preserve [managerial judgment] from being questioned by those for whom it is, at least in part, exercised."[26]

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23. Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970).

24. *E.g.*, Robert Summerhays, *The Problematic Expansion of the Garner v. Wolfinbarger Exception to the Corporate Attorney-Client Privilege*, 31 TULSA L. J. 275 (1996); WalMart Stores v. Ind. Elec. Workers Pension Tr., 95 A.3d 1264, 1270 (Del. 2014).

25. That is the effect, for example, of the best-recognized example—the "crime-fraud exception." *E.g.*, United States v. Zolin, 491 U.S. 554 (1989).

26. *Garner*, 430 F.2d at 1101. The court says further, "[t]he attorney-client privilege still has viability for the corporate client . . . . But where the corporation is in suit against its stockholders on charges of acting inimically

Garner, then, is not about *the availability* of the privilege to organizations but about *who decides* on behalf of the organization whether to assert the privilege during internal disputes. Clients often choose to waive the privilege, and the shareholder plaintiff asserts that waiver is in the organization's interest. The law presumes that the board speaks for the organization on such matters, but the function of the shareholder suit is to enable rebuttal of that presumption. When the plaintiff demands the information, management may have a conflict of interest, and corporate law generally qualifies managerial authority when there are conflicts.

The same analysis applies to the position of the Restatement of Trusts and some courts that a trustee may not assert privilege to block discovery by a beneficiary.[27] The doctrine is often referred to as the "fiduciary exception," but, again, the term is inappropriate. Where the fiduciary is alleged to have breached his duty, the question is not whether there is a privilege but whether the fiduciary has authority to invoke it. The privilege does not belong to the fiduciary *simpliciter.* It belongs to the trust, and the question becomes, who speaks for the trust? Or alternatively, it belongs to the trustee in his official capacity, and the question is whether he should be recognized as speaking in his official capacity.

The second mistaken tendency can be called the Collectivist Fallacy. It assumes that a corporation's property interests are limited to the preservation or maximization of its aggregate wealth and that interests in relative claims on that wealth are no more than individual constituent interests. The Collectivist Fallacy is on display in cases that dismiss claims against corporate lawyers for assisting unlawful dilution or outright expropriation of shareholder interests by saying that the organization's lawyer owes duties only to the entity and not to the constituent plaintiff.[28] Such cases seem to assume that an agent does not violate a duty to the organization when she impairs a constituent's interests as long as aggregate

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to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show cause why it should not be invoked in the particular instance." *Id.* at 1103–04.

27. RESTATEMENT (SECOND) OF TRUSTS § 173; *accord*, RESTATEMENT OF THE LAW GOVERNING LAWYERS § 84 (2000). Case law on whether the trustee can assert privilege against the beneficiary is divided. *See* David L. J.M. Skidmore & Laura E. Morris, *Whose Privilege is it Anyway? The Fiduciary Exception to the Attorney-Client Privilege*, PROB. PROP., Sept.–Oct. 2013.

28. An extreme example is Skarbrevik v. Cohen England & Whitfield, 282 Cal. Rptr. 627, 699–700 (Cal. Ct. App. 1991), where in order to facilitate the wrongful dilution of a minority shareholder, the lawyer filed Articles of Amendment to eliminate the pre-emptive rights clause in the charter with a declaration reciting falsely that the amendment had been approved by a shareholder vote. For a similar holding, see also Felty v. Hartung, 523 N.E. 2d 555, 557–58 (Ill. App. Ct. 1988). Some cases recognize potential lawyer liability in these situations. *See, e.g.*, Chem-Age Indus. v. Glover, 652 N.W.2d 756, 767–68 (S.D. 2002).

Some courts characterize the lawyer's wrong as aiding and abetting a managerial breach of fiduciary duty. *E.g.,* Granewich v. Harding, 985 P.2d 788 (1999). Since lawyers have fiduciary duties to their organizational clients, it is not clear why these courts do not speak of the lawyers as directly violating their own fiduciary duties. However, the distinction is probably unimportant practically as long as the jurisdiction recognizes secondary liability for fiduciary breach.

wealth is unaffected. To put it differently, they assume that an organization has no interest in the integrity of its distributive arrangements.

The assumption recurs in comments to Section 96 of the Restatement of the Law Governing Lawyers on organizational representation. In distinguishing between harm to the organization and harm to a constituent, the drafters offer two examples involving a corporate repurchase engineered by a controlling shareholder and his nominees on the board at the expense of a minority.[29] The discussion stipulates that the controlling shareholder's actions might violate a fiduciary duty that the shareholder owes to the minority.[30] The question is whether the corporation's lawyer has a duty to resist. Although the response is hedged with evasive ambiguity, it says in essence that the lawyer's duty substantially depends on whether the minority will sue and the "[c]lient will likely occur substantial litigation expense."[31] If the company is likely to suffer litigation expense, the lawyer has a duty to resist the plan; otherwise, she is not obliged to even advise against it. The implication is that unauthorized managerial action is no concern of the lawyer unless it affects aggregate wealth.

It is true that all constituent interests are not corporate interests, but ultimately, all organizational interests must be the interests of at least some constituents. Corporate interests are the constituent interests incorporated into the corporation's legal structure. With or without litigation expense, the expropriation of a minority's stake in violation of that structure should be deemed harm to the organization. Distributive norms are among those that make it possible for us to treat the organization as a unity, or legal person. People's willingness to invest and work in organizations depends on the distributive norms just as much as on the others.[32]

II. THE IRRELEVANCE (AT BEST) OF MODEL RULE 1.13 AND RESTATEMENT SECTION 96

If we put hard cases aside for the moment, the basic analysis seems straightforward and uncontroversial. Yet, it is important to articulate it because

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29. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96, cmt. g, illus. 2–3 (AM. LAW INST. 1998).

30. *Id.*

31. *Id.* My complaint about evasive ambiguity arises from the fact that, in addition to distinguishing the two cases by the likelihood of litigation expense, the drafters stipulate that in the case with the high likelihood the lawyer "has reason to know that the plan violates applicable corporate law," while in the other case there is merely a shareholder claim of illegality about the merits of which the drafters say nothing. Since greater confidence about the illegality of board action obviously weighs toward intervention, the addition of this second factor does nothing other than generate ambiguity about the extent to which the likelihood-of-expense factor is driving the difference in conclusions.

32. The corporate doctrine that imposes a fiduciary duty on controlling shareholders to respect minority interests is itself a rejection of the Collectivist Fallacy, which sometimes led earlier substantive cases to treat the corporation as indifferent to the distributive effects of procedurally valid decisions. For an influential critique of these earlier cases, see Victor Brudney & Marvin Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974).

much prominent professional responsibility authority on these matters not only fails to do so but addresses the issues in an ambiguous and circuitous way.

The most important sources are Model Rule 1.13 and Restatement of the Law Governing Lawyers section 96. Both of them state that the lawyer representing an organization should understand the client through the actions of its authorized constituents. So far, so good. Then, they proceed to address the lawyer's responsibilities where she encounters potentially unauthorized or harmful agent behavior.[33] However, instead of addressing this situation generally, they proceed to treat as paradigmatic what is in fact a specialized situation. And they fail to treat this situation consistently with the basic analysis. At critical points, they lapse into circularity, qualifying their specific directives by the general norm—"best interest of the client"—that the directives were supposed to elucidate. These rules would be merely trivial were it not for the possible negative implication that their precepts set out fully lawyer duties in situations involving potentially unauthorized or harmful behavior. Understandably, Rule 1.13 is sometimes read as exhaustive.[34] This is a mistake.

Rule 1.13 and Restatement section 96 direct our attention to situations where the lawyer "knows" that (1) an agent of the client is behaving unlawfully and (2) the agent's conduct is likely to harm the organization. When these conditions are satisfied, the rule says, anti-climactically, that the lawyer is supposed to act in the "best interest of the organization." The pre-2003 (old) version of Rule 1.13, still in use in many states, and section 96 say that the lawyer "may" then take certain actions, including reporting to "higher authority" or "supervisory authority" in the organization. The new Rule 1.13 says the lawyer "shall" report to "higher authority" unless she believes such reporting is not "necessary" to protect the organization's interests. The Rule (but not the Restatement[35]) then addresses the situation where the "highest authority" fails to act or ratifies the illegal-harmful

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33. The statement that the lawyer represents the organization acting through its duly authorized constituents is in subsection (a). The reporting-up and -out provisions are in 1.13(b) and (c). All subsequent references to Rule 1.13 refer to subsections (b) and (c).

34. *See, e.g.*, BRADLEY WENDEL, PROFESSIONAL RESPONSIBILITY: EXAMPLES AND EXPLANATIONS 117–19 (4th ed. 2013). This widely used (and generally excellent) text appears to assert that, in a case where "a crucial predicate for up-the-ladder reporting" under 1.13 is missing (because unlawful conduct is unlikely to be discovered and thus harm the corporation), the lawyer has no duty to report upward, or even discretion to do so. The discussion acknowledges that the Sarbanes-Oxley rules might dictate a different result if the client were a public corporation, but it does not consider at all the relevance of the duty under Model Rule 1.4 to report material information to "the client" or common law fiduciary duties. *See* Oasis West Realty v. Goldman, 51 Cal. 4th 811 (Cal. 2011) (holding that disciplinary rules do not pre-empt common law fiduciary duties); FDIC v. Clark, 978 F.2d 1541, 1546–48 (10th Cir. 1992) (holding on fiduciary grounds that lawyer can be liable for failure to inform corporate client's board of officers' wrongdoing).

35. The comments say that the Restatement "does not take a position" on whether and when reporting out is permissible. But the same paragraph says, inconsistently, that the issue "is determined primarily by" the general confidentiality provisions. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 96, cmt. ¶ 9 (AM. LAW INST. 1998). The general confidentiality provisions would rarely, if ever, authorize disclosure in the situation on which Rule 1.13 focuses. See notes 40-41 below and accompanying text.

conduct. Old Rule 1.13 says that in this situation the lawyer "may resign." New Rule 1.13 says that the lawyer "may" report outside the organization to the extent necessary to prevent harm.[36]

Note how oddly limited and qualified these rules are. In the first place, they apply only when the lawyer "knows" of harmful wrongdoing, and the rules define knowledge as "actual knowledge of the fact in question," which implies a high degree of conviction.[37] Yet, under traditional fiduciary principles, the lawyer's disclosure duties are defined in terms of materiality; the fiduciary should disclose information the client needs or wants to make decisions.[38] Information that only *suggests* a significant possibility of wrongdoing or harm often requires investigation or consideration by the client and should thus be reported when the relevant client decision-makers are not aware of it.[39]

Second, in defining the core case, the rules unaccountably depart from the authority principle, which they earlier and plausibly invoke. The authority principle suggests that the key concern about agent behavior is with *unauthorized behavior*. But the Rule 1.13 reporting duty is triggered only with illegality and likely harm. In fact, managerial misconduct could be material without satisfying either condition. Imagine, for example, a case in which a manager is committing large sums of money in violation of specific instructions from the board. The conduct is not otherwise illegal, and the lawyer has no idea whether it will prove harmful. This case is outside Rule 1.13, though it is surely within the fiduciary duty to inform. Moreover, even if illegal and harmful behavior were the exclusive concerns, there would be no justification for demanding *both* as conditions for climbing the ladder.

Third, even in the urgent situation where both persistent illegality and likely harm are present, old Rule 1.13 and section 96 mention reporting-up only as something the lawyer "may" do. Both say the lawyer should act in the "best interest" of the client; so they imply that reporting up is mandatory when the "best interest" requires it. However, they do not suggest any strong likelihood

36. Fifteen states, including the four most populous (California, Texas, Florida, and New York) have rules resembling old Model Rule 1.13 that use permissive language with respect to reporting up and do not authorize reporting out unless disclosure is permitted by the general confidentiality Rule 1.6. Twenty-nine states have rules resembling new Model 1.13 that make reporting up presumptively mandatory and use permissive language with respect to reporting out. The remaining states and the District of Columbia have rules that depart from old 1.13 either by making reporting up presumptively mandatory or by authorizing reporting out but not in both ways. *See* Appendix.

37. MODEL RULES R. 1(f).

38. *See, e.g.*, RESTATEMENT (THIRD) OF TRUSTS § 82(c) (AM. LAW INST. 2005) (stating that trustee has a duty to provide "material information needed by the beneficiaries for the protection of their interests"); RESTATEMENT (SECOND) OF AGENCY § 381 (AM. LAW INST. 1957) (stating that the agent has a duty to give the principal "information that is relevant to the affairs entrusted to him and which [the agent knows] the principal would desire to have").

39. *See* In re Caremark Int'l Derivative Litig., 698 A.2d 959, 970 (Del. Ch. (1996)) (holding that corporate managers have duty to seek "sufficient information. . . to enable them to reach informed decisions").

that reporting up will be in the client's best interest. Yet, it is difficult to think of a situation satisfying the two conditions in which reporting up would *not* be the "best interest" course, and the comments give no examples of such a situation. New Rule 1.13 seems to recognize this and sets out a presumption that reporting up is the best-interest course. It provides that the lawyer "shall" report up unless doing so is not in the client's "best interest." However, like the old rule, it implies that there are situations where reporting-up would not be required without giving any examples.

Fourth, old Rule 1.13 implies that, where the "highest authority" persists in or ratifies the conduct in question, the lawyer cannot report-out even when that would be in the client's best interests. The only option it mentions is resigning. More plausibly, new Rule 1.13 says that the lawyer "may" report out if "necessary to prevent substantial injury" to the client. If reporting out is necessary to prevent substantial harm, how can it not be a duty?

A further layer of incoherence is added in versions of old Rule 1.13 that refer to Rule 1.6, the general rule on confidentiality, as governing reporting out.[40] The exceptions to confidentiality in Rule 1.6 are designed to enable the lawyer to prevent harm to third parties (and to the lawyer herself). They make no sense in the reporting-out context. The versions of Rule 1.6 that allow disclosure to prevent non-bodily harm—the only kind of harm that organizations can suffer—typically limit permission to harms arising from illegal acts *by the client*.[41] In the reporting-out scenario, the client organization is the *victim* of the act. The constituent perpetrator whose acts threaten harm to the organization is not the client. Thus, Rule 1.6 would seem irrelevant to reporting-out scenarios.

For clarity and coherence, Rule 1.13 and section 96 compare unfavorably with two other rules. The Sarbanes-Oxley attorney rule partly pre-empts Rule 1.13 for

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40. *See, e.g.*, N.Y. RULES OF PROF'L CONDUCT R. 1.13(c) (N.Y. BAR ASS'N 2009) (stating that where the "highest authority" persists after the lawyer has reported up in illegal and harmful conduct, "the lawyer may reveal confidential information only if permitted by Rule 1.6"); OHIO RULES OF PROF'L CONDUCT R. 1.13(c) (OHIO ST. BAR ASS'N 2007) ("The discretion or duty of the lawyer for an organization to reveal information relating to the representation outside the organization is governed by Rule 1.6(b) and (c).").

41. N.Y. RULES OF PROF'L CONDUCT R. 1.6(b)(2) (N.Y. BAR ASS'N 2009); OHIO RULES OF PROF'L CONDUCT R. 1.6(b)(2)-(3) (OHIO ST. BAR ASS'N 2007). RESTATEMENT (SECOND) OF THE LAW GOVERNING LAWYERS § 67 (AM. LAW. INST. 1998) has the same limitation. Under substantive law an agent's unauthorized act is sometimes attributed to the organizational principal even when it turned out to be harmful to the principal. *See generally* Samuel Wasserman, *Can the Trustee Recover? Imputation of Fraud to Bankruptcy Trustees in Suits Against Third-Party Service Providers*, 77 FORDHAM L. REV. 365 (2008) (discussing the bankruptcy doctrine that estops claims on behalf of the corporation against agents whose illegal behavior was intended to benefit the corporation). So in applying the Rule 1.6 exception for criminal acts by the client to the reporting-out situation, we might distinguish between agents who harm the organization directly from agents whose unlawful acts are intended to benefit the organization but turn out to harm it because they are discovered. Arguably, the latter could be deemed acts by the client that trigger permission to report under the relevant versions of Rule 1.6. Note, however, that this approach results in broader permission to report out when the organization is complicit in the wrongdoing than when it is an innocent victim. Where reporting out is designed to protect the client, this makes no sense.

public company clients and requires securities counsel to report up whenever she encounters evidence of a violation of fiduciary duty or the securities laws.[42] It provides generally clear and specific directives about how to do so. Only when we get to the situation where the highest authority persists in or ratifies wrongful conduct does it waffle, providing that the lawyer "may" report out without offering any guidance about when and how to do so.[43]

More generally, Rule 1.4 formulates the lawyer's duty of communication to clients generally and provides that the lawyer "shall" "keep the client informed" about the representation and shall "explain a matter to the extent necessary the client to make informed decisions." This Rule embraces all the reporting-up scenarios of Rule 1.13, has no eccentric limitations, and clearly makes disclosure a duty.

Since Rule 1.4 and the common law duty of care cover all the situations that Rule 1.13 addresses, whether Rule 1.13 does any work depends on whether it pre-empts these other rules. Again, the rules are coyly ambiguous on this point. Some features of 1.13—notably the negative implication in the old rule that where the board persists or ratifies the constituent's conduct, the lawyer's only option is to withdraw—seem designed to preclude broader duties. On the other hand, the Rules do not pre-empt anything explicitly, and the comments state that responsibilities under Rule 1.13 are "concurrent" with "those provided in other Rules."[44] If the Rule does not pre-empt, it is superfluous.

The contortions and ambiguities of Rule 1.13 are largely due to the Managerialist Fallacy. Commentators report that discussion of the Rule within the bar persistently conflates reporting to protect the client with reporting to protect third parties.[45] Thus, lawyers speak of reporting-up under this Rule as an exception to the duty of confidentiality, and they oppose reporting out as compromising client loyalty. The insistence on harm and illegality as preconditions for reporting up reflect an inapposite analogy to Rule 1.6, which makes these factors preconditions for disclosure to protect third-party interests. These positions assume that the manager is the client to whom loyalty is owed.

III. HARD CASES: REPORTING OUT

Sometimes it may be clear that constituent activity is unauthorized or harmful but not clear to whom the lawyer should report the activity. This will usually be

42. 17 C.F.R. § 205.3(b) (2004).

43. *Id.*

44. MODEL RULES R. 1.13, cmt § 6 (AM. BAR ASS'N 1983). The comment states further on that "in particular" 1.13 does not "limit or expand" responsibilities under four specified rules dealing with conflicts, withdrawal, and misrepresentation. Strangely, the list does not include Rule 1.4 on informing the client, even though Rule 1.13(b) is primarily concerned with informing organizational clients.

45. *See generally* Stephen Gillers, *Model Rule 1.13(c) Gives the Wrong Answer to the Question of Corporate Counsel Disclosure*, 1 GEO. J. LEGAL ETHICS 289 (1987); HAZARD ET AL., THE LAW OF LAWYERING, *supra* note 21, at 8.02, 18.15.

the situation when the lawyer has exhausted options for reporting up and there is no specified path for reporting out.

The lawyer has exhausted options for reporting up when she reaches what Rule 1.13 calls the “highest authority that can act on behalf of the organization.” This term is itself ambiguous. In the private sector, the board is usually thought of as the highest authority. However, there are a few actions that the board cannot authorize without shareholder approval, such as article amendments, mergers, dissolutions, and certain conflict-of-interest transactions. Moreover, the shareholders can take initiative to limit the authority of the board in various ways. So, at least under substantive law, the shareholders are sometimes part of the “highest authority.”

If shareholders are sometimes the “highest authority” or part of it, could the lawyer plausibly be expected to report to them? With small corporations, it may be feasible for the lawyer to communicate directly with shareholders, and cases that treat small-corporation representation as joint representation of constituents legitimate this approach. In the Restatement stock-repurchase scenario, the lawyer’s duty to disclose to the corporate client could reasonably be interpreted to require him to report information to the minority shareholder. Disclosure to the minority might seem the best way to protect the client’s interest in the integrity of its distributive arrangements, and managers engaged in an unlawful course of action would lack authority to instruct the lawyer otherwise. However, with large corporations, communicating with the shareholders would be tantamount to going public. It would often be less disruptive to report out to the Securities Exchange Commission (SEC) or an attorney general.[46]

In the public sector, the top of the ladder will often be an elected official. For instance, in the Ossias case, the Commissioner of Insurance was an elected official not subject to instruction or removal by the Governor; so, he could plausibly be understood to be the top of the client ladder. But, other situations are more ambiguous. Often, the official who seems formally at the top, such as the President or a Governor, will not be practically accessible. Thus, it makes sense to think of the top as the highest officer on the ladder to whom the lawyer has effective access. When the lawyer reaches this point without achieving a resolution of the matter, the issue shifts from reporting up to reporting out.

As we have seen, old Rule 1.13 and Restatement section 96 speak of reporting out as optional. Yet, both fiduciary principle and new Rule 1.13 suggest that reporting-out is sometimes a duty. None of these norms provides any guidance as to when the lawyer should report-out, other than an unhelpful invocation of the “best interest of the client.”

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46. Going public would often be appropriate where managers had failed to make an important mandated public disclosure. For example, lawyers can appropriately force the managers to make public disclosures by refusing to provide third-party opinions necessary to close a transaction, as they did in SEC v. Nat’l Student Mktg., 430 F. Supp. 639 (D.D.C. 1977).

There are three possible approaches to clarifying the matter: a categorical prohibition, a categorical duty, and a contextual duty.

A. A CATEGORICAL PROHIBITION: ROUTINE DEFERENCE TO INCUMBENTS

This approach enjoins the lawyer to defer to senior agents. Once the lawyer reaches the top of the ladder, she should go no further even where she believes that further disclosure is in the interest of the organization.

California takes this approach in its version of Rule 1.13.[47] Where either of the Rule 1.13 conditions (illegality or likelihood of organizational harm) exist, the rule says that the lawyer "may" take actions "in the best interest of the organization" to prevent harm, but that in any event she "shall not" violate confidentiality. I have suggested that confidentiality is not necessarily violated by refusal to respect an agent's unauthorized decision to assert it. However, the California rule seems designed to override this point by adding that, when the "highest authority" insists on illegal and harmful conduct, "the member's response is limited to" resigning.[48] Rules providing that reporting out is governed by the (largely irrelevant) confidentiality exceptions of Rule 1.6 seem similarly restrictive.[49]

To the extent that these rules reflect an assumption that incumbent officers speak for the client even when they are acting without authority, they involve the Managerialist Fallacy. There is, however, a possible rationale for a non-disclosure norm that does not depend on this fallacy. Forbidding outside disclosure would make sense if (1) disclosure would sometimes be harmful to the client, and (2) lawyers' ability to identify the situations in which it would be beneficial is so poor that on average the harmful effects of disclosure would outweigh the good ones. Outside disclosure would be harmful where the lawyer was wrong in his judgment that the relevant constituent conduct was unlawful or where disclosure caused disruption or expense that were disproportionate to the value of remedying the wrongdoing.

Yet, it would not seem plausible for the bar to portray lawyer judgments as consistently poor. Organizational lawyers tend to market themselves as offering reliable complex judgment in high-stakes situations. When professional responsibility doctrine defines the core of professional expertise—for example, for delimiting unauthorized practice prohibitions—it emphasizes the capacity for complex judgment.[50] Moreover, the duty of care to clients, as elaborated in

47. *See* CAL. RULES OF PROF'L CONDUCT § 3-600(A) (CAL. BAR ASS'N 1989).
48. *Id.*
49. *See supra* notes 33, 34.
50. *See, e.g.*, *In re* First Escrow, 840 S.W.2d 839, 841 (Mo. 1992) (distinguishing "simple" legal judgment permissible for lay providers from more complex forms requiring bar membership); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS, § 72, illus. 2 (AM. LAW INST. 2000) (stating that whether lawyer's preparation of tax returns constitutes privileged legal advice depends on whether issues involved were "complex").

malpractice actions, typically presupposes that lawyers will make all-things-considered judgments on behalf of their clients.

B. A CATEGORICAL DUTY: ROUTINE OUTSIDE DISCLOSURE

If on average the correct decision in hard cases would require outside disclosure, it would be appropriate to enact a presumption in favor of disclosure, as new Rule 1.13 does for cases that satisfy its conditions. If we distrusted contextual lawyer judgments, we might make disclosure a categorical rule.

Mandated external reporting is rare, and when it appears, it is generally intended to protect third parties. Key examples include the mandated reporting under disciplinary rules in a few states to protect non-clients from "death or substantial bodily injury," and the requirement in a few states that attorneys report information necessary to protect against child abuse.[51]

Perhaps the broadest instance of mandatory external reporting to protect the organizational client is the statute requiring federal government lawyers to report "[a]ny information . . . relating to violations of [the federal criminal code] involving Government officers and employees" to the Attorney General.[52] Such reporting is external in a weak sense. It circumvents the chain of command. On the other hand, it is not external in a strong sense because the client of the federal government lawyer is sometimes considered to be "the relevant branch of government."[53] Nevertheless, without the rule, these cases would be hard, since there would be no clear reporting path beyond the agency head.

A mandatory external reporting norm has some advantages in common with a mandatory internal reporting norm. A categorical norm undercuts the material and cognitive pressures that are likely to bias the lawyer against reporting. Moreover, while any reporting that jumps or circumvents the chain of command will impair the lawyer's relation with the officer with whom he has been dealing, perhaps terminally, a mandatory norm may actually do less damage. The lawyer can argue plausibly that he has no choice and that his report implies no personal judgment about the officer.

However, some costs of a mandatory external reporting norm may be higher than those of a mandatory internal norm. External intervention will usually be more disruptive and costly. It will often entail harmful publicity. The intervention will normally provide benefit to the organization only where it concludes that agent conduct was improper or finds some ground for improving practice. If costs

51. HAZARD ET AL., THE LAW OF LAWYERING, *supra* note 21; Comment, *Attorneys' Duty to Report Child Abuse*, 19 J. AM. ACAD. MATRIM. LAW. 59, 72–73 (2004).

52. 28 U.S.C. § 535(b) (2012). The provision does not mention lawyers specifically but is generally understood to apply to them. *In re* Lindsey, 148 F.3d 1100, 1100 (D.C. Cir. 1998).

53. *Lindsey*, 148 F.3d at 1100; MODEL RULES R. 1.13, cmt. ¶ 7.

are high and benefits low in a significantly large number of cases, the mandatory rule may prove inefficient.

The bar would no doubt also worry about costs from diminished managerial candor, but as elaborated below in Part VI, the incremental effect of enhanced reporting requirements on managerial candor are unlikely to be great.

C. A CONTEXTUAL DUTY

As discussed, Rule 1.13 uses permissive language with respect to both inside and outside reporting. To the extent that they apply to lawyers, state laws protecting reporting of government wrongdoing also make reporting permissible. These rules are potentially valuable shields against claims of breach of loyalty or confidentiality, but they do not involve the kind of norm most commonly used to define professional responsibilities to clients. The key norms that protect clients typically involve *duties* to act in accordance with all relevant circumstances.

The common law duty of reasonable care is the paradigm. It is unimaginable that a judge in a malpractice case would characterize as optional (that is, as something the lawyer "may" do) a low-cost action that the lawyer believed was necessary to protect the client's legal interests from serious harm. But, neither Rule 1.13 nor the state government reporting laws specify a duty to report out, and they provide no guidance as to how decisions to report are to be exercised or assessed.

There is sometimes reluctance to create duties for hard cases. One concern is that duty implies liability, and it seems unfair to subject professionals to liability for judgments in situations where people disagree about the right thing to do. But, what makes a case hard is that it demands complex judgment, not necessarily that people disagree. When competent professionals make the effort to analyze hard cases, they often arrive at fairly consistent conclusions. Moreover, a liability regime can take account of the degree of professional consensus on a matter in deciding whether to sanction. Sometimes a good faith, procedurally adequate effort is enough, even if it works out badly.[54]

If the idea that lawyers should have a duty to make a responsible contextual judgment seems appealing, two sources of authority offer guidance as to how such a duty might be defended and elaborated. Neither source directly addresses the responsibilities of organizational counsel, but each is obliquely relevant and offers an analytical clarity and coherence that is hard to find among more directly pertinent authorities.

The first source is *Garner*,[55] which, as previously noted, rejects the position that management can categorically assert the corporation's attorney-client

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54. The "business judgment" rule for corporate managerial decisions is a good example. It limits liability for decisions without modifying the underlying duty, and its protections depend on good faith effort.

55. Garner v. Wolfinbarger, 430 F.2d 1093, 1093 (5th Cir. 1970).

privilege against a derivative plaintiff and demands that control over the privilege be decided by a contextual judgment about the organization's best interests. *Garner* is about judicial rather than lawyer decision-making. But, there is a strong analogy to the situation of the lawyer considering whether to make disclosures to constituents in situations of internal organizational dispute. The standard the case ascribes to the judge is, in principle, the one that governs the lawyer—the "best interest" of the organization. *Garner* recognizes that to defer to management routinely would involve either the Managerialist Fallacy or the assumption that management, conflicted as it is, is the most plausible guardian of organizational interests.[56] The doctrine responds by prescribing contextual judgment. It makes this judgment a duty, and it prescribes plausible standards to guide it.

In the situation specifically addressed by *Garner*, the professional responsibility issue for the lawyer is usually moot. The court will usually be in a good position to make a judgment to protect the client. But, there are other situations where constituents cannot put the matter before a judge because they lack information needed to identify the issue and bring a claim. In these situations, the lawyer could use the *Garner* factors to structure her decision whether to disclose to the constituents or to some outsider charged with protecting them, such as the SEC or the Attorney General.

The other pertinent source of authority for contextual judgment on outside disclosure is Rule 1.14, which addresses a lawyer's duties with regard to a "client with diminished capacity." The rule was not enacted with organizational clients in mind, and it is unlikely to be applied to them. Nevertheless, both its language and its logic are applicable to the organizational context.[57]

Rule 1.14 says that when a client is at risk of harm "unless some action is taken" and the client because of "diminished capacity" cannot act in his own interest, "the lawyer may take reasonably necessary protective action." It says further that such action may include "consulting with individuals or entities that have the ability to protect the client."

This language literally describes the problematic organizational situation. Of course, in the organizational situation, diminished capacity arises not from physical or psychiatric impairment but from the bad faith or conflicted interests of those with presumptive decision-making authority. However, the effect of the two types of impairment is similar—an inability to make reliable self-protective decisions. And, there is no reason to think the lawyer is any less able to identify one type of impairment than another. In this situation, Rule 1.14 suggests that

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56. *Id.*

57. *See* George C. Harris, *Taking the Entity Theory Seriously: Lawyer Liability for Failure to Prevent Harm to Organizational Clients Through Disclosure of Constituent Wrongdoing*, 11 GEO. J. LEGAL ETHICS 597, 637 (2003) (noting the analogy between an organizational client incapacitated by agent misconduct and a disabled individual client).

added responsibility falls to the lawyer to take protective action. Although Rule 1.14 resembles Rule 1.13 in its debatable permissive language, it is remarkably different in its absence of arbitrary qualifications. The lawyer is clearly able to make any disclosures necessary to protect the client.

One way to look at Rule 1.14 is as a specific application of a more general principle giving the lawyer implied authority to make disclosures of otherwise confidential information necessary to protect the client's interests. Restatement Section 61 says, "A lawyer may disclose client information when the lawyer reasonably believes that doing so will advance the interests of the client in the representation." And, Rule 1.6 exempts from confidentiality restrictions "disclosure[s] impliedly authorized in order to carry out the representation."

These rules do not create duties. Rather, they are designed to align the confidentiality norms with the duty of care expressed in Rule 1.1 (requiring "competent" representation) and the common law. They preclude confidentiality objections when client interests require disclosure. Thus, they seem highly pertinent to cases like Ossias's where the lawyer takes initiative to disclose to protect client interests. Yet, they were not mentioned in the Ossias discussion and are generally ignored in discussions of reporting out. Why?

The Managerialist Fallacy may be at work here. With unimpaired individuals, the client can define her own interests, and implied authority rests on assumptions about what the individual would instruct in situations where it is not practical to consult her. Where we know that the individual client would instruct us not to disclose, we cannot think of the lawyer as disclosing in the client's interests, unless she is impaired. There is a tendency to analogize organizational to individual clients by assuming that when we know that senior managers would oppose disclosure, disclosure cannot be seen as in the client's interests. But of course, the presumed or expressed views of the managers count as evidence of client interest only if the agents are authorized to speak for the organization, which in our scenario they are not. Organizations do not suffer physical or mental disabilities. But, the condition in which agent ignorance or irresponsibility leaves the organization without legitimate direction is a disability to which organizations are distinctively prone. It makes sense in this situation to give lawyers the kind of discretion contemplated by Rule 1.14 and the more general rules on implied authority.

A second reason why we may not think of the Ossias case in terms of implied authority is our tendency to assume that *co*mmission weighs more heavily in a moral calculus than *o*mission. So, we fret over whether Ossias had authority to disclose, while taking it for granted that she had authority to remain silent. This distinction would make sense in a case involving responsibility to people with whom the actor had no special relation. The distinction, though, is foreign to the fiduciary idea, which charges the duty holder with proactive responsibility, not just with avoiding harm.

IV. HARD CASES: BOUNDARY PROBLEMS

It is sometimes ambiguous whether activity is occurring inside or outside of the organizational client. A corporate manager's materially incomplete disclosure to shareholders, though not actionable as fraud, might be a breach of fiduciary duty if the shareholders were considered part of the corporate entity. Cindy Ossias's report to a legislative oversight committee might not have implicated client confidentiality if, as some defenders argued, her client was the state of California. We can consider these situations as illustrations of problems that arise from the indeterminacy of organizational boundaries. Sometimes defining the lawyer's duties requires clarifying ambiguities of substantive law. Conversely, sometimes the substantive law draws lines that do not take account of the practical stakes in professional responsibility questions, and effective resolution requires disregarding formal boundaries.

A. FINANCIAL DISCLOSURE IN PUBLICLY HELD CORPORATIONS

In surveys, large fractions of public company executives say they engage in both accounting techniques and "real" activities manipulation in order to produce earnings reports that "meet or beat" analyst estimates or the firm's own predictions.[58] "Real" activities manipulations include deferring research or capital expenditures, timing the sale of assets, or cutting prices of goods already produced in order to boost sales prior to the close of an accounting period. Managers acknowledge that these tactics often "sacrifice economic value."[59]

Managers engage in earnings management because they think that it will support or raise the stock price. As a technical matter their judgments on such matters would seem entitled to deference. But there is concern that they have a bias because their compensation and their tenure tend to depend strongly on short-term prices. Moreover, the benefits to managers of even long-term positive price effects might not be widely shared if they resulted from sustained deception that caused a misallocation of capital to the corporation. Managers are disproportionately invested in the corporation, whereas the typical shareholder is diversified. If the corporation succeeds by diverting capital from more productive enterprises, diversified shareholders may suffer net losses from the deception.

In order to simplify a complex matter, let us assume (plausibly, I believe) that accounting rules often give managers substantial discretion with respect to financial reporting. Managers can exercise this discretion in ways that influence stock price, at least in the short term. However, tactics that raise stock prices frequently depart from the managers' judgments as to what presentation would

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58. John Graham, Campbell R. Harve, & Shiva Rajgopal, *The Economic Implications of Corporate Financial Reporting*, 40 J. ACCT. & FIN. 3, 40 (Dec. 2005).

59. *Id.*

most informatively portray the company's economic condition. The managers would prefer that such tactics not be used by advisors preparing reports on which they themselves rely. Should the managers feel obliged or permitted to adopt the tactics that maximize short-term share price, or should they feel obliged to use those they regard as most informative?

From the point of view of the lawyer advising the manager on his responsibilities or assessing the manager's compliance with them, the question would turn on whether a manager's preference for aggressive reporting is consistent with the interests of the client. Lawyers properly defer to managerial and auditor judgments on some accounting matters, but they have a responsibility to induce compliance with legal disclosure norms that cabin managerial discretion and sometimes trump auditor judgment.[60]

It would seem relevant to these issues whether the beneficiaries of corporate disclosure duties are considered in fiduciary terms.[61] The practices in question do not satisfy the fiduciary norm of "utmost candor" or the requirement that the fiduciary deal with the beneficiary "as he would deal with himself."[62] Yet, if the addressees of financial reporting are strangers entitled only to ordinary duties, then managers have more limited responsibility to protect them from foreseeably misleading but not literally false disclosure.

Relevant substantive law is inconsistent. On the one hand, fiduciary themes are salient in modern corporate doctrine on share repurchases and reorganizations and on insider trading. In these cases, insiders make use of corporate information to benefit themselves at the expense of other shareholders. Older doctrine tended to reject liability where the conduct did not involve misrepresentation and the only harm was to the entity's distributive norms.[63] Modern cases tend to repudiate such views as manifestations of the Collectivist Fallacy.[64]

This tendency might support a fiduciary approach to disclosure more generally. Under such a view, managers should exercise discretion to maximize transparency rather than reported earnings. Departures from transparency should be justified by some specific, articulated non-paternalistic and generalizable shareholder interest (for example, a need to keep information from non-shareholder constituencies, such as competitors). The demand for a non-accounting business purpose for practices that influence financial reports would seem to follow.

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60. *See* United States v. Simon, 425 F.2d 796 (2d Cir. 1969) (holding that compliance with accounting standards does not establish that financial statements meet securities act prohibitions of misleading statements).

61. It is unimportant whether we characterize disclosure duties as duties to the entity or to the constituents. The key question is whether the duties to the entity require fiduciary-type disclosure to constituents.

62. Burdett v. Miller, 957 F.2d 1375, 1381 (7th Cir. 1992); United States v. Dial, 757 F.2d 163, 168 (7th Cir. 1985), *cert denied*, 474 U.S. 838 (Posner, J.).

63. Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L. J. 879, 915–23 (1988); A.C. Pritchard, *United States v. O'Hagan: Agency Law and Justice Powell's Legacy for the Law of Insider Trading*, 78 B.U. L. REV. 13 (1998).

64. DeMott, *supra* note 63, at 915–23; Pritchard, *supra* note 63, at 13.

Adopting this view would add some clarity to existing doctrine and would probably condemn at least some common practices.[65]

Yet, managers and lawyers often speak as if their relation to the recipients of financial disclosure was arm's length. John Coffee, explaining the bar's resistance to responsibility for the integrity of financial reporting, writes, "Law firms . . . remain in their own minds the zealous champions of their clients, not gatekeepers."[66] This may be simply the Managerialist Fallacy—identifying the client with management. If not, then it assumes that the client entity has some interests in tension with optimal disclosure. But, Coffee does not consider what those interests might be.[67] To take a more dramatic example, the Fifth Circuit reversed a conviction for "theft of honest services" under the Mail and Wire Fraud statutes based on blatantly fraudulent securities reporting because it found that managers had not been disloyal to the corporation (deeming disloyalty an element of the offense).[68] "We do not presume that it is in a corporation's legitimate interests ever to misstate earnings—it is not," the court wrote.[69] But, it then went on to presume that the defendants could have non-recklessly believed as much.[70] Aside from insider trading, disclosure doctrine does not consistently adopt fiduciary terms. It remains unclear to what extent practices involving strategic silence, half-truths, and evasiveness that would not be permissible under

65. *See* Steven E. Bochner & Douglas J. Clark, *Securities Disclosure: When is Managing to a Forecast Illegal Earnings Management?*, CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES, PRACTISING LAW INSTITUTE, Nov. 2008, at 165 (noting ambiguity with respect to the permissibility of earnings management). One implication of the fiduciary perspective is that, where accounting rules give managers discretion as to how to present data, they should be able to explain to auditors how they have exercised that discretion in the interests of shareholders. However, as things now stand, auditors are largely concerned with "consistency" rather than "preferability." JOHN C. COFFEE JR., GATEKEEPERS: THE PROFESSIONS & CORPORATE GOVERNANCE 129–30 (2006).

66. *Id*. at 369. See also the letter from virtually every large firm in New York protesting a proposed SEC rule that would have required lawyers to withdraw when management insisted on illegal courses of conduct and to report that they withdrew for professional reasons ("noisy withdrawal"). The firms argued that such a proposal would "drive a wedge between *client* and the counsel who advised it on a matter." Letter from 77 Law Firms to Jonathan G. Katz, Secretary, SEC (Dec. 18, 2002), https://www.sec.gov/rules/proposed/s74502/77lawfirms1.htm [https://perma.cc/UG8C-5MJ4] (emphasis added).

67. In a rare discussion of the issue, Steven Schwarcz tries to square soft deception and fiduciary duties by saying that duties should further the interests of current shareholders rather than future ones. Since current shareholders are prospective sellers, they benefit from soft deception if it raises prices. Steven Schwarcz, *Temporal Perspectives: Resolving the Conflict Between Current and Future Investors*, 89 MINN. L. REV. 1044 (2005). However for at least some purposes, securities doctrine takes a very different approach: (1) insider trading doctrine explicitly based on fiduciary norms extends relief to deceived buyers even though they are not shareholders before the purchase is concluded; (2) disclosure norms have sometimes been elaborated with respect to a hypothetical "reasonable" shareholder so that perverse or idiosyncratic interests of actual shareholders can be ignored. TSC Industries v. Northway Inc., 426 U.S. 438, 449 (1976).

68. United States v. Brown, 459 F.3d 509 (5th Cir. 2006).

69. *Id.* at 522.

70. *Id.*

fiduciary norms are allowed under the securities laws.[71]

When the substantive law relevant to the client is ambiguous, it is difficult for the lawyer to assess the authority of those who purport to speak for the client. In this situation, default to managerial deference seems inevitable, but this is not a principled solution where the norms in question are intended to cabin managerial discretion.

Such problems call for doctrinal clarification. It seems unlikely that the bar could achieve this alone, and it is debatable whether the bar has anything at all to contribute. The Sarbanes-Oxley rules show that murky evasiveness of Rule 1.13 is not inevitable. For the most part, the Sarbanes-Oxley rules are clear and coherent. Nonetheless, they were enacted without much help, and over some opposition, from the bar.[72]

Arguably a more pertinent, and perhaps more inspiring, example is the recent tax compliance regime of the Internal Revenue Service, especially the part designed to inhibit tax shelters.[73] The regulations provide a good deal of clarity with respect to both substantive requirements and lawyer practices to induce compliance. A norm that is especially pertinent to financial reporting is the treatment of "business purpose" in the tax regime. The recent regime elaborates a long-standing doctrine that transactions that lack a non-tax business purpose are presumptively disregarded in calculating tax liability. Lawyers have a duty to insist that managers provide a non-frivolous explanation of such a purpose before providing certain kinds of assistance with relevant transactions.[74] Such a "business purpose" norm would seem equally appropriate in the securities sphere. It would mandate disregard of the accounting effects of practices that lacked a non-accounting business purpose (or more modestly, separate disclosure of all practices affecting reported figures that were motivated by accounting goals).[75] Yet, such a norm has not been elaborated as clearly or generally in the securities area as in tax. The tax regime is largely a matter of administrative regulation, but the bar played an important role in its development. To an important extent, the regulations codify principles enunciated by the tax sections of the American Bar Association (ABA) and the New York State Bar and by the ABA Standing Committee on Legal Ethics and Professional Responsibility.[76]

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71. Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 VAND. L. REV. 1639 (2004); Donald C. Langevoort, *Half-Truths: Protecting Mistaken Inferences by Investors and Others*, 52 STAN. L. REV. 87 (1999).

72. Clifton Barnes, *ABA, States, and SEC Hash Out Lawyers' Responsibility in Corporate Settings*, BAR LEADER (Nov./Dec. 2003), http://www.americanbar.org/publications/bar_leader/2003_04/2802/corporate.html [https://perma.cc/Y5X4-8HJP].

73. MICHAEL GRAETZ & DEBORAH SCHENK, FEDERAL INCOME TAX 790–823 (6th ed. 2009); Tanina Rostain, *Sheltering Lawyers: The Organized Tax Bar and the Tax Shelter Industry*, 23 YALE J. ON REG. 77–120 (2006).

74. *E.g.,* Gregory v. Helvering, 239 U.S. 465 (1935).

75. Bochner & Clark, *supra* note 65 propose a requirement that all practices undertaken for earnings management purposes be identified in the Management Discussion & Analysis section of the report.

76. *See* Dennis Ventry, *Cooperative Tax Regulation*, 41 CONN. L. REV. 431 (2008).

Such a collaborative initiative would be the best way to clarify lawyer responsibilities with respect to financial reporting norms.

B. GOVERNMENT CLIENT ISSUES

The Managerialist Fallacy operates in the public sector as well as the private. However, the public sector seems uniquely susceptible to an opposed tendency in which the client is defined so generally and abstractly that practical interests are obscured. Rule 1.13's comment states, "Although the [government lawyer's] client may be a specific agency, it may also be a branch of government, such as the executive branch, or the government as a whole."[77] Such grandiose conceptions of the client are encouraged by customary practices in which lawyers appear on behalf of the "United States" or the "State of Iowa" or the "People" of California, implying that the represent the entire nation or state. Such rhetoric is useful to the extent that it undermines the tendency to identify the client with managers, but it can be troublesome. We can see this by considering issues that arise, first, about authority to instruct the lawyer, and second, about the scope of confidentiality and conflicts protection.

1. AUTHORITY TO SPEAK FOR THE GOVERNMENT CLIENT

Geoffrey Miller emphasized the danger that lawyer judgments based on contested and ambiguous conceptions of the client as the public interest or the government as a whole might become undisciplined and unaccountable. Thus, Miller invokes the principle we have emphasized that the lawyer should look to the allocation of authority within the broader institutional structure.

Miller's main example concerns a hypothetical lawyer in the Department of Education asked by the Secretary to defend a school aid program that includes parochial schools. The lawyer believes to a high degree of confidence that the statute is unconstitutional but there are non-frivolous arguments that can be made in defense of the program. The lawyer should proceed to advance the Secretary's position despite his own view of the merits. The Secretary, Miller assumes, has the authority to decide the position that the executive branch will take. The Constitution contemplates that the dispute will ultimately be worked out through the interaction of the three branches. For the lawyer to block the defense of the program would short-circuit this process.

Miller's conclusion about the education case is plausible.[78] But his analysis has three critical limitations. First, in some cases, the authority structure will lead back to the lawyer herself. Government lawyers are sometimes charged with

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77. MODEL RULES R. 1.13, cmt. ¶ 9.

78. But the position is not beyond debate. A complex analysis of "constitutional nondefense" has emerged in recent years that sometimes reaches different conclusions. Katherine Shaw, *Constitutional Nondefense in the States,* 114 COLUM. L. REV. 213 (2014).

making decisions on behalf of the client in terms of public-interest standards. This is true generally of prosecutors in criminal cases. In addition, the federal Solicitor General and many state attorneys general have such authority with respect to initiation and defense on behalf of the government of civil claims.[79] At best, Miller's argument applies to situations where neither enacted authority nor custom give lawyers this kind of autonomy. Second, Miller focuses on the relatively easy case where an official has clear authority. Third, the separation-of-powers principle proves much less helpful than Miller suggests. The second and third limitations are demonstrated by the Ossias case.

In Miller's scenario, because the manager has a plausible claim of authority and all relevant activity is occurring in public, there is no tension between the agent's instructions to the lawyer and the lawyer's duty to the institutional client. The Ossias case was different. Recall that Ossias, a staff lawyer in the California Department of Insurance, discovered that the Commissioner of Insurance had negotiated settlements with penalties much more lenient than staff had recommended in return for agreement by the insurance companies to make contributions to nongovernmental organizations controlled by the Commissioner. The organizations were ostensibly devoted to the public interest but in practice focused on promoting the Commissioner's career. When a member of a Senate oversight committee asked about the matter, Ossias provided him with information about the settlements. The Commissioner fired Ossias, claiming she had breached her duty of confidentiality. However, the Commissioner himself resigned under pressure when the facts became public, and his successor re-hired Ossias.

Although both the state Attorney General and the State Bar disciplinary counsel opined on the case, they addressed the matter in question-begging ways. The Attorney General opined only as to whether one or more of the state whistle-blower protection laws superseded the attorney's duty of confidentiality. The Attorney General concluded that the statutes did not affect confidentiality, reasoning that the legislature would not have altered a well-established norm without more explicit indication than these statutes contained.[80] The State Bar Office of the Chief Trial Counsel explained its decision not to seek discipline against Ossias by saying that her conduct was "consistent with the spirit" of the statutes and "advanced important public policy considerations."[81] The letter left ambiguous whether the Office considered the conduct justified or merely excused, and gave no general guidance about the circumstances in which disclosure is appropriate.

We have already pointed out in connection with derivative suits that the question of an exception arises only after it has been decided that loyalty to the

79. See text accompanying *supra* notes 17-18.
80. OFF. OF THE CAL. ATT'Y GEN., Opinion No. 00-1203 (May 23, 2001).
81. Reprinted in ZITRIN ET AL., *supra* note 3.

client requires silence. The incumbent Commissioner cannot speak with authority for the client in this situation. If Ossias had superiors within the agency who were not conflicted, it might have been appropriate to defer to them. If not, then it fell to Ossias herself to decide whether the interests of the client required disclosure and to whom. As a fiduciary, Ossias could not use the lack of instruction from the client as a reason to default to silence. She had an affirmative duty to take action to protect the client.

No part of the analysis depends on whether we characterize the client as the Department of Insurance, the executive branch, or the state of California. For any of these characterizations, the Commissioner would have had authority in some circumstances to instruct the attorney not to communicate with state officers outside the department. And, for any of these characterizations, under the circumstances of the actual case, the Commissioner lacked authority to instruct her. Ossias thus had responsibility for making her own assessment of the client's interests, and the most plausible assessment suggests disclosure.

Nor does the characterization of the client tell us much about to whom disclosure should be made. The most plausible candidates would appear to be the Attorney General and the legislative oversight committee. The state Constitution makes the Attorney General "the chief law enforcement officer of the state" with the duty "to see that laws shall be uniformly and adequately enforced."[82] The legislature has oversight responsibilities, which one of its committees was actively asserting at the time. The key question is which official seems most likely to respond effectively to protect the relevant client interests. We do not know enough to make a confident choice, although the fact that the legislative committee was already engaged weighed in favor of it. As presently informed, we have no reason to question Ossias's decision. Whether the disclosure is deemed within or outside the client organization is at most one factor in this determination.

2. PRIVILEGE AND CONFLICTS ISSUES

Boundary concerns are sometimes invoked in attorney-client privilege and conflicts cases. Privilege will be available only if the communication in question was made by someone speaking on behalf of the client and was made in confidence, meaning not in the presence of someone outside the attorney-client relationship.[83] Thus, privilege issues sometimes appear to turn on whether some participant was an unauthorized agent or an outsider. Such issues are often raised in conflicts disputes, since conflicts doctrine is heavily driven by confidentiality concerns.

Generally, courts at least start with formal legal boundaries. In the private sector, affiliated businesses are usually treated as independent for confidentiality

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82. California Constitution, Art. V, §13.

83. RESTATEMENT OF THE LAW GOVERNING LAWYERS, §§ 68, 70 (AM. LAW INST. 2000).

and conflicts purposes. A lawyer for a parent corporation is not per se disqualified from a representation adverse to a subsidiary.[84] By the same logic, the client's disclosure of privileged information to agents of a subsidiary would waive the privilege (absent a common interest agreement).

But courts often disregard formal boundaries when the relevant practical contingencies seem out of alignment with them. Where formally separate organizations have common management and integrated operations, courts will disregard the corporate form for conflicts purposes, much as they do for liability purposes.[85] Information provided in confidence by a client affiliate for the benefit of the client may be privileged even where the affiliate is not a client agent.[86] In a suit between parties to the sale of a corporation, former managers who negotiated the sale may be able to assert the corporation's attorney-client privilege against the survivor even where substantive law treats the survivor as equivalent to the original entity. The interests of the selling and current constituents (and those of the formerly separate entities for which they acted) were opposed at the time of the negotiation; so, if the selling managers are to be provided meaningful confidentiality, the buyer cannot be allowed to inherit control over their communications.[87]

In the public sector, relying on formal boundaries is more difficult because the boundaries are more ambiguous and broader to begin with. It seems a clumsy response to confidentiality and conflicts issues to say that the client is the executive branch, much less the entire federal or state government. Two appeals court cases arising from the Whitewater investigation gesture in that direction. They held that the President and the First Lady could not assert privilege against federal grand jury subpoenas. Although both courts gave multiple reasons for the holding, both seemed influenced by the fact that these were "dispute[s] within the federal government."[88] Each opinion suggested that privilege would be available

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84. Reuben Donnelly v. Sprint Publ'g & Advert., Inc., No. 95 C. 5825, 1996 WL 99902 (N.D. Ill. Feb. 29, 1996), at *2–3 (holding that Jones Day, by representing one subsidiary, does not thereby have conflict in representation adverse to separate subsidiary; court notes that parent has more than 250 affiliated corporations).

85. Traveler's Indem. Co. v. Gerling Glob. Reins. Corp., No. 99 CIV. 4413 (LLM), 2000 WL 1159260, at *5 (S.D.N.Y. Aug. 15, 2000) (client and affiliate were in same business, had same senior officers, shared common offices, payroll and HR departments, computer systems, travel agents, credit card issuers, and employee gatherings).

86. *See* Westinghouse Elec. Co. v. Kerr-McGee Corp., 580 F.2d 1311, 1322 (7th Cir. 1978) (disqualifying counsel from representation adverse to constituents of former client where constituents provided material information to counsel to assist former representation).

87. Tekni-Plex, Inc. v. Meyner & Landis, 674 N.F.2d 663, 671–72 (N.Y. 1996); Int'l Elec. Corp. v. Flanzer, 527 F.2d 1288, 1292 (2d Cir. 1975). This case plausibly distinguishes confidences concerning matters as to which sellers' and buyers' interests were adverse at the time of the acquisition from confidences concerning the acquired corporation's conflicts with third parties, as to which seller and buyer may be assumed to have common interests. The case holds that the acquiring corporation does inherit control over the latter type of confidence.

88. *In re* Grand Jury Subpoena Duces Tecum, 112 F.3d 910, 915 (8th Cir. 1997); *In re* Lindsey, 158 F.3d 1263, 1272 (D.C. Cir. 1998).

against a non-federal litigant. Thus, they implied that the relevant disclosure was internal to the larger government client. In this sense, the cases resembled derivative suits, in which all parties in interest purport to represent the client interests.

However, any broad use of the whole-government-as-client idea would disrespect the reality of division and diversity within administrative government. Many government offices are designed to act independently of and sometimes even adversely to other offices. In such situations, there is often an argument for an approach that defines the client more narrowly for confidentiality or conflicts purposes. Some cases take such an approach. Instead of trying to reason to a conclusion from a formal definition of the client, they assess the unit's practical need for confidentiality. In litigation between different constituents of the same government, the courts will sometimes examine constitutive law to see how much decisional autonomy the constituents have. Where the court finds a substantial amount, it may treat them as separate for confidentiality or conflicts purposes.

For example, in *Civil Service Commission v. Superior Court*,[89] the issue was whether the County Counsel was disqualified from representing the County in an action against the Civil Service Commission, a county agency. The lawyer had previously advised the Commission on related matters, so the Commission claimed it was a former client entitled to disqualify the lawyer from a current adverse representation. The lawyer responded that his client had always been the County even when he advised a constituent agency, and hence the Commission was not a separate former client. The court disqualified the lawyer. It held that, while "normally" the county as a whole is deemed to be the client, in this case the practical circumstances of autonomy of the Commission warranted treating the Commission as a separate entity for conflicts purposes.

V. THE IMPLAUSIBILITY OF STRONG CONFIDENTIALITY PROTECTION FOR ORGANIZATIONS

The legal profession's confidentiality norms are harder to justify with respect to organizations than with respect to individual clients. The case for strong confidentiality norms—norms that preclude disclosures necessary to prevent serious injustice or underserved harm—is fragile in any context, but it is especially weak with organizational clients.[90]

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89. Civ. Serv. Comm'n v. Sup. Ct., 209 Cal. Rptr. 159, 161 (Cal. Ct. App. 1985). For discussion of this and related cases, see Clark, *supra* note 19, at 1056–62.

90. *See* William H. Simon, *After Confidentiality: Rethinking the Professional Responsibilities of the Business Lawyer*, 75 FORDHAM L. REV. 1453, 1460 (2006); William H. Simon, *Managerial Confidentiality Is Overrated*, N.Y. L. J. (Oct. 2, 2003). "Strong confidentiality" can be contrasted to *moderate* confidentiality, which forbids disclosure of client information where not necessary to prevent injustice or undeserved harm. *See, e.g.*, RESTATEMENT (THIRD) OF AGENCY § 8.05, cmt c (AM. LAW INST. 2006) (stating that an agent's duty "not to

The general argument for confidentiality rests on two propositions. First, confidentiality induces client disclosures that are necessary for well-informed legal advice—the disclosure premise. And second, well-informed legal advice induces socially desirable behavior—the channeling premise.

So stated, the argument is incomplete. The fact that confidentiality has *some* socially desirable effects does not establish its value. The key issue is its *net* effects—whether the desirable effects of increased disclosure *to* lawyers outweigh the undesirable ones of decreased disclosure *by* lawyers. We have virtually no evidence on the matter, and the proposition that net effects are positive is not strong as a matter of intuition. It is a mystery how the channeling function allegedly enabled by strong confidentiality works. A client who is independently motivated to obey the law does not need confidentiality to induce full disclosure to the lawyer. So, the channeling argument depends on clients who have some propensity to disrespect the law. What does the lawyer say to such a client that induces respect? Telling her of the penalty will tend to induce respect only if it exceeds what she expected; if it is lower, it will tend to induce disrespect. If there are costs other than legal penalties that the client has failed to consider (for example, reputational or relational costs), the lawyer may be able to deter a lawless course of action by drawing attention to them. Yet, again, the candid lawyer will have to advise the client when he has over-estimated such costs as well as when he has under-estimated them, and the former advice will tend to induce disrespect. At this point, the lawyer is free to bring up ethical and prudential considerations, but there is no reason to think that this discourse, for which the lawyer has no special training and for which he will often be unrewarded, will be effective.[91]

For present purposes, the more important problem concerns the disclosure premise—the proposition that confidentiality is necessary to induce the client to fully inform the lawyer. Whatever the case with respect to individuals,

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use or communicate confidential information of the principal for the agent's own purposes or those of a third party" is "not absolute" and that "[a]n agent may reveal otherwise privileged information to protect a superior interest of the agent or a third party"). Of course, confidentiality under the legal profession's norms is not as strong as it was in the past, but there are still many situations where the norms mandate silence in the face of serious harm or injustice. *See, e.g.*, State v. Macumber, 582 P.2d 162 (Ariz. 1978) (refusing to find grounds for disclosure of a deceased client's secrets even where it might be necessary to vindicate a wrongly convicted person).

91. Of course, many lawyers disclaim the channeling idea even as a matter of aspiration, as the quotation from the Vinson & Elkins partner shows. Waldmeir, *supra* note 2. While the channeling or "gatekeeping" role comes up routinely in defenses of privilege, it is more often than not resisted in other contexts. Moreover, some suggest that any version of this function going beyond appeals to informed self-interest would be overwhelmed by economic trends (increasing competition and the tendency of outside counsel engagements to be short-term) and psychological forces (the tendency of lawyers to identify with the managers who instruct and retain them). *See* Robert W. Gordon, *The Citizen Lawyer: A Brief Informal History of a Myth With Some Basis in Reality*, 50 WM. & MARY L. REV. 1169, 1195–96 (2009) (noting lawyer resistance to channeling duties); Sung Hui Kim, *Naked Self-Interest? Why the Legal Profession Resists Gatekeeping*, 63 FLA. L. REV. 129, 131–32 (2011) (same).

organizations are different in two fundamental respects. First, as previously noted, control of the privilege in the organizational context usually resides with agents different from the ones who make the communications. This means that the lawyer cannot assure the agent that confidentiality will protect her from adverse consequences from her communications. The lawyer may have to disclose material facts she learns from the agent within the organization no matter how harmful those disclosures are to the agent. And, the organization can waive confidentiality and disclose the agent's communications to outsiders, like law enforcement officials, no matter how harmful the disclosure is to the agent. Even top-level agents cannot be confident their communications will not harm them. Conflict of interest may disqualify them from making decisions about whether to waive privilege with respect to their own statements. If the board turns over or the company goes into bankruptcy, a successor board or bankruptcy trustee may decide to waive.[92] And we have seen that a shareholder plaintiff can often overcome the board's assertion of privilege.

Second, organizations are enmeshed in mandatory disclosure regimes, such as civil litigation discovery or reporting requirements of the securities, environmental, or health and safety laws. Confidentiality has little effect on duties under such regimes. When the lawyer learns of information that must be disclosed in a confidential communication from an agent of the client, confidentiality may protect the communication, but it typically will not protect the underlying information.[93] If the lawyer has responsibility for the client's compliance with disclosure duties, she will have to insist on disclosure of the information no matter how disadvantageous disclosure is to the client.

Therefore, confidentiality is unlikely to motivate much disclosure to lawyers that would not have been made in its absence. However, since at least *Upjohn v. United States*,[94] there has been a second argument in favor of confidentiality in the organizational context —inducing senior managers to monitor the conduct of their subordinates. Managers will not monitor, the argument goes, if the information they collect is discoverable by regulators, prosecutors, and plaintiffs' lawyers. The argument does not depend on the more general justification of inducing agent communications. Even if confidentiality does not enhance agents' willingness to communicate, agents will still provide information that does not reflect badly on them, such as information about other agents' wrongdoing. Without the assurance of confidentiality, Upjohn reasoned, senior managers might not seek such information, and the quality of legal advice and corporate governance would suffer.

92. Commodity Futures Trading Comm'n v. Weintraub, 471 U.S. 343, 349 (1985).
93. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 69, cmt. par. d (AM. LAW INST. 2000).
94. Upjohn Co. v. United States, 449 US 383, 391 (1981).

Viewed in isolation and in the abstract, the *Upjohn* argument carries some weight, and, when the case was decided in 1981, it may have had some practical effect in encouraging monitoring. However, the *Upjohn* rationale quickly became obsolete. Developments in substantive law have made it unlikely that senior managers would fail to make reasonable monitoring efforts regardless of confidentiality protections.

In various cases decided since *Upjohn*, the Delaware courts have emphasized that fiduciary duties require managers to seek out relevant professional advice and to proactively monitor the conduct of subordinates. Notably, the courts repudiated earlier statements suggesting that managers had broad discretion with respect to monitoring and emphasized the duty to institute compliance processes and to follow up "red flags" suggesting misconduct.[95] The cases also indicated that the protections of the business judgment rule would not be available where managers failed to make reasonable efforts to acquire information relevant to their decisions, including relevant professional advice.[96] In addition, in 1991 the Federal Sentencing Guidelines Commission promulgated guidelines for the sentencing of organizations convicted of crimes. These guidelines provide as a mitigating factor that the crime occurred despite "an effective ethics and compliance program."[97] These and other initiatives[98] have fostered a managerial pre-occupation with compliance, monitoring, and investigation. Given the powerful incentives they create, it is highly unlikely that the inducements of *Upjohn* play an important role.[99]

The objections to strong confidentiality are even weightier with government organizations because mandatory disclosure regimes are even more extensive in that context. Statutes give broad public access to government information with only narrowly defined exceptions. The federal statute requiring the reporting of illegal conduct to the Attorney General has been interpreted to apply to lawyers, and some federal and state whistleblower protection statutes include lawyers. In addition, there have been trends in the public sector similar to those that have induced greater monitoring in private organizations. For example, under the Government Performance and Results Act, federal agencies are obliged to make periodic plans that include active monitoring measures. Additionally, more than

95. Stone v. Ritter, 911 A.2d 362, 367–70 (Del. 2006).

96. Smith v. Van Gorkom, 488 A.2d 858, 867–68, 876–77 (Del. 1985) (emphasizing the duty to seek relevant professional advice). Note that while corporate charters commonly purport to exempt directors from duty-of-care liability, monitoring is considered an element of the requirement of "good faith", which cannot be waived. DEL. CORP. CODE ANN. tit. 8, § 102(b)(7) (2015); *Stone*, 911 A.2d at 368–70.

97. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1 (U.S. SENTENCING COMM'N 2015).

98. For example, the Sarbanes-Oxley Act of 2004, 15 U.S.C. § 7262 (2012), which requires public company senior managers to attest individually to the accuracy of financial reports and auditors to certify the effectiveness of "internal controls."

99. Andrew Higgins makes a similar argument with respect to the English privilege on the basis of developments in British company and regulatory law. Andrew Higgins, *Legal Advice Privilege and Its Relevance to Corporations,* 73 MOD. L. REV. 371, 383–88 (2010).

70 federal agencies have inspector generals who engage in monitoring full time. There should be no more concern in the public than in the private sector that confidentiality is necessary to motivate supervision.[100]

The main cost of strong confidentiality is to preclude lawyer disclosures that would prevent or mitigate harm to third parties by the client. (Strong confidentiality does not prevent disclosures to protect the client). However, it is possible that strong confidentiality has two sorts of indirect costs to organizational clients. First, the main effect of *Upjohn* was to give lawyers a monopoly over corporate investigations by enabling them to promise more confidentiality than competing professions.[101] This result could be harmful to clients if lawyers are not the professionals best equipped to run investigations. Confidentiality aside, there is no reason to think lawyers are distinctively equipped for this role. The relevant skills are not taught in law schools or tested on the bar. Accountants or engineers are more likely to have received relevant training for some investigations.

Second, it is possible that strong confidentiality inhibits the exchange of information within the organization in ways that compromise core management functions. *Upjohn* limits privilege in ambiguous and non-intuitive ways that create vague risks that internal communications will result in waiver. For example, communications may lose privilege under *Upjohn* if they are not made "in order to secure legal advice" and "at the direction of corporate superiors."[102] Even under more protective standards than *Upjohn*, the privilege can be lost if the communication involves agents that a court decides did not "need to know."[103] Lawyers are inclined to advise against internal communications that risk loss of privilege.[104] The resulting inhibitions may compromise discussion of such matters as product defects or risky business practices. The General Motors Cobalt

100. Clark, *supra* note 19, at 1035; U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GAO 04-38, RESULTS-ORIENTED GOVERNMENT: GPRA HAS ESTABLISHED A SOLID FOUNDATION FOR ACHIEVING BETTER RESULTS (2004); Shirin Sinnar, *Protecting Rights From Within? Inspectors General and National Security Oversight*, 65 STAN. L. REV. 1027 (2012).

101. *See* LAWRENCE FOX ET AL., THE ETHICS OF REPRESENTING ORGANIZATIONS 112 (2009) ("[W]hen [a catastrophe] occurs, any investigation into the cause and how the organization should respond is best conducted under the direction and control of counsel so the . . . the results themselves are protected from having to be shared with those who do not have the organization's best interests at heart.").

102. Upjohn Co. v. United States, 449 US 383, 394 (1981).

103. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 73(4) cmt. d (AM. LAW INST. 2015).

104. *See, e.g.*, FOX ET AL., *supra* note 100, at 112–14 (2009) (advising that in an investigation communications with counsel "should be shared, if at all, only with those who have a need to know" and that employees should discuss such communications among themselves only "with the permission of counsel"); Jennifer Chunias & Roberto M. Braceras, *Conducting Effective Internal Investigations: A Corporate Counsel Guide*, MCLE (Goodwin Procter LLP, Boston) (Jan. 2015) (advising investigating counsel "not to record interviews," to "minimize the presence of observers" at interviews, and to "[t]hink twice about addressing sensitive topics with employees").

airbag non-deployment case may be an example.[105] GM did not act for nearly 10 years to remedy a major life-threatening defect in large part because of failures of information exchange within the organization. Lawyers controlled some of the relevant information because it related to pending lawsuits. Engineers trying to figure out the problem did not ask for the information because they believed (wrongly according to the lawyers) that privileged information was not available to them.[106]

Even more troubling is the occasional practice of advising boards not to ask for a written report of an investigation because the government or a plaintiffs' lawyer may be able to discover and make use of it.[107] The absence of a written report on a matter of any complexity has a high probability of lowering the quality of analysis and discussion. There is some irony here. The whole rationale of *Upjohn* confidentiality is to encourage investigation. Even if this effect were substantial, it would be vitiated if efforts to preserve confidentiality impeded thoughtful consideration of the results of the investigation.

Of course, a client aware of the costs of protecting confidentiality can make its own decision about how to trade it off with competing values. However, concern arises from the fact that lawyers have economic interests and cultural predispositions that may lead them to exaggerate the value of confidentiality and thus bias the client's consideration.[108]

CONCLUSION

Lawyers know that, in principle, an organizational client is not identical to its managers. But, they often seem unclear about how to understand and assist with the client other than by deferring to the managers who retain and address the lawyers. Recognizing that the organization is a structure of decision rules, fiduciary duties, and property rules is essential to sound analysis. It follows that professional duties will turn strongly on substantive law issues and often require

105. Anton R. Valukas, *Report to Board of Directors of General Motors Company Regarding Ignition Switch Recalls* (May 29, 2014), http://www.beasleyallen.com/webfiles/valukas-report-on-gm-redacted.pdf [https://perma.cc/7NXF-CU62].

106. *Id.* In the course of the Valukas investigation, the in-house lawyers said that, if the engineers had asked, they would have provided the information.

107. I am aware from informal conversations of several complex cases in which counsel advised against written reports. General published advice is often neutral on the question of writing but warns that "[t]here are a number of problems associated with reducing a report to writing." Daniel S. Reinberg, *Conducting Internal Investigations*, Foley & Lardner LLP, at 17.

108. *See, e.g.*, FOX ET AL., *supra* note 100, at 113 ("Everyone within the organization who communicates with the organization's lawyers should be advised on a regular basis of . . . the importance of each individual in the organization conducting himself or herself in a way that maximizes the chance that the privilege will be maintained.").

resolution of substantive law ambiguities. Moreover, many issues present a choice between formal and functional definitions of the client. The trend seems to be toward functional definition. When the lawyer's role is situated in the broader context of relevant law, it is apparent that the value of confidentiality is much smaller than discussion usually suggests and that related objections to reporting-out duties are overblown.

APPENDIX: VARIATIONS ON MODEL RULE 1.13

Rules Resembling old Rule 1.13 that refer to reporting up as permissive and do not authorize reporting out:

Alabama
Alaska
California
Delaware
Florida
Kansas
Maine
Mississippi
Missouri
Montana
New York*
Pennsylvania
South Dakota
Texas
Virginia

Rules Resembling new Rule 1.13 that refer to reporting up as presumptively mandatory and reporting out as permissive:

Arizona
Arkansas
Colorado
Connecticut
Georgia
Hawaii
Idaho
Illinois
Indiana
Iowa
Kentucky
Louisiana
Maryland
Massachusetts
Nebraska
Nevada
New Hampshire
New Mexico
North Dakota
Oklahoma

Oregon
Rhode Island
South Carolina
Utah
Vermont
Washington
West Virginia
Wisconsin
Wyoming

Rules that refer to reporting up as presumptively mandatory but do not authorize reporting out:

District of Columbia
North Carolina*
Ohio*
Tennessee*

Rules that refer to reporting up and reporting out as permissive:

Michigan
Minnesota
New Jersey

* = Reporting out permitted only if allowed by Rule 1.6.