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CHILLING CLIMATE CHANGE DISCLOSURE: THE ENABLING ROLE OF CORPORATE COUNSEL IN MANAGEMENT MISSTATEMENTS OF ESG MATTERS

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I. INTRODUCTION

The Securities and Exchange Commission (SEC or Commission) has under consideration proposals that could result in rules requiring public companies to disclose information addressing the risks posed by climate change.[3] Comparable, reliable and complete disclosure of this type of information has long been sought by investors and shareholders.[4] The Commission's efforts, however, again bring to the surface growing concerns over the role of lawyers in the disclosure process.

Under the federal securities laws, legal obligations for accurate disclosure rest with the company and are typically the responsibility of

3. *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors, Exchange Act Release No. 34-94478 (proposed March 21, 2022) (available at https://www.sec.gov/rules/proposed/2022/33-11042.pdf).

4. *See* J. Robert Brown, Jr., *Essay: Mother Nature on the Run: The SEC, Climate Change Disclosure, and the Major Questions Doctrine*, __ SAN DIEGO L. REV. __ (forthcoming 2023) (draft available at SSRN: https://ssrn.com/abstract=4240980).

executive management.[5] Yet in making these determinations, management relies on lawyers. The presence of counsel in the corporate disclosure process is ubiquitous.[6] Few public companies would file periodic reports with the SEC without providing them to counsel for review.[7]

In making the required disclosure, materiality represents a core concept. The term requires disclosure of information important to "a reasonable investor."[8] The term material or materiality appears around 600 times in Regulation S-K, the master set of instructions for periodic reports and registration statements.[9] A determination of materiality is a mixed question of law and fact, and management commonly relies on counsel to determine whether information is or is not material.[10]

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5. Liability can attach to those that sign SEC filings, *see* Form 10-K, General Instructions to Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, SEC. & EXCH. COMM'N, https://www.sec.gov/files/form10-k.pdf (last visited Apr. 4, 2023) (requiring signatures from "principal executive officer or officers, its principal financial officer or officers, its controller or principal accounting officer, and by at least the majority of the board of directors or persons performing similar functions."), those who certify the contents, *see* 17 C.F.R. § 240.13a-14(a) (requiring certification of annual and quarterly reports by principal executive and financial officer), and those in "control" of the disclosure. *See* Janus Cap. Grp., Inc. v. First Derivative Traders, 564 U.S. 135, 142 (2011). *See also* Michel Rosenfeld, *The Transformation of the Attorney-Client Privilege: In Search of an Ideological Reconciliation of Individualism, the Adversary System, and the Corporate Client's SEC Disclosure Obligations*, 33 HASTINGS L.J. 495, 538 (1982) ("The ultimate determination of whether any given item of information is material and should be disclosed remains the responsibility of the client. The autonomous exercise of this responsibility by the client has been curtailed . . . as a result of the client's lack of expertise concerning the legal materiality of corporate information.").

6. *See* Allison Herren Lee, Living in a Material World: Myths and Misconceptions about "Materiality" (May 24, 2021) (transcript available at https://www.sec.gov/news/speech/lee-living-material-world-052421) ("That is, in part, why the system builds in checks and balances. Managerial judgments are usually subject to review by other professionals. Auditors examine the financial statements; lawyers review much of the narrative in SEC filings. Particularly with respect to materiality determinations and the content of SEC filings, management often relies extensively on the advice of legal counsel.").

7. Michele DeStefano Beardslee, *Advocacy in the Court of Public Opinion, Installment Two: How Far Should Corporate Attorneys Go?* 23 GEO. J. LEGAL ETHICS 1119, 1158–59 (2010) ("lawyers aid their corporate clients in drafting and preparing many types of public disclosure documents, including filings for the SEC, documents on securities offerings, and press releases of many sorts.").

8. *See* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 445 (1976).

9. *See* 17 C.F.R. Part 229.

10. "Materiality is a mixed question of law and fact, and [a] fraud claim may not properly be dismissed summarily on the ground that the alleged misstatements were not material unless they would have been so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance." Gross v. GFI Grp., Inc., 784 F. App'x 27, 29-30 (2d Cir. 2019) (quotations omitted). *See also* ECA & Local 134 IBEW Joint Pension Trust of Chi. v. JP Morgan Chase Co., 553 F.3d 187, 197 (2d Cir.2009) (alteration in original) (internal quotation marks omitted); Azrielli v. Cohen L. Off., 21 F.3d 512, 518 (2d Cir. 1994) ("[a] fraud claim may not properly be dismissed summarily on the ground that the alleged misstatements

Lawyers providing disclosure advice, however, sometimes get it wrong,[11] and when they do, there can be serious consequences.[12] Investors end up basing decisions on an inaccurate and incomplete set of facts. This can reduce returns, impair retirement savings, and misdirect capital. Eventual disclosure of the truth, if ever, will often not be sufficient to alleviate the harm that has already occurred.[13]

Companies' reliance on lawyers' materiality analysis and advice also has the effect of reducing accountability for false disclosure. Management can sometimes avoid liability for inaccurate corporate disclosure by pointing to the "presence" of lawyers in the process.[14] To the extent lawyers were involved in the disclosure process, an inevitability with respect to disclosure by public companies, management can use the fact to disclaim intent, a common element in actions for disclosure

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were not material unless they would have been so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance."); *In re* Craftmatic Sec. Litig., 890 F.2d 628, 641 (3d Cir. 1991) ("Only when the disclosures or omissions are so clearly unimportant that reasonable minds could not differ should the ultimate issue of materiality be decided as a matter of law."); Shapiro v. UJB Fin. Corp., 964 F.2d 272, 281 n. 11 (3d Cir.), cert. denied, 506 U.S. 934, 113 S .Ct. 365, 121 L.Ed.2d 278 (1992) ("[o]nly if the alleged misrepresentations or omissions are so obviously unimportant to an investor that reasonable minds cannot differ on the question of materiality is it appropriate for the district court to rule that the allegations are in actionable as a matter of law.").

11. *See* Allison Herren Lee, Commissioner, Sec. & Exch. Comm'n, Send Lawyers, Guns and Money: (Over-) Zealous Representation by Corporate Lawyers Remarks at PLI's Corporate Governance – A Master Class 2022 (March 4, 2022) (available at https://www.sec.gov/news/speech/lee-remarks-pli-corporate-governance-030422) ("Though these particular cases were not about disclosure under the securities laws, they are nevertheless emblematic of a dynamic—a kind of race to the bottom—that can occur when specialized professionals like securities lawyers compete for clients in high stakes matters and are pressured to provide the answers their clients seek.").

12. *See* George S. Georgiev, *The Human Capital Management Movement in U.S. Corporate Law*, 95 TUL. L. REV. 639, 719 (2021) ("The decision whether or not to disclose information is binary by necessity, but materiality itself is not–it often exists in a gray, probabilistic space where an argument can be made both that something is material and that it is not. In practice, this means that in many cases the disclosure decision is not the result of a conclusive finding of materiality, but, rather, of the weighing of the costs of disclosure against the risk of liability for non-disclosure.").

13. *See infra* Part II.C.

14. The issue is typically discussed in the context of the "reliance" on counsel defense. Use of this defense requires the waiver of the attorney-client privilege and is not common. *See* Susan B. Heyman, *Corporate Privilege and an Individual's Right to Defend*, 85 GEO. WASH. L. REV. 1112, 1129 (2017) ("in order to assert the defense, a defendant would be required to waive privilege and disclose all attorney-client communications relating to the subject matter of the advice."). That, however, vastly underestimates the role of lawyers and legal advice in exonerating management for false disclosure. The presence of lawyers in the drafting process – they draft most SEC documents – and their awareness of relevant disclosure issues can make it difficult to show bad faith on the part of management even absent invocation of the defense. Management, therefore, benefits from the role of lawyers without allowing for an exploration of the actual advice provided to them, something that would require waiver of the privilege.

violations of the federal securities laws.[15] Mistaken legal advice, therefore, often has the effect of *de facto* exonerating executive management,[16] without transferring responsibility for inaccurate disclosure to counsel.[17] The resulting lack of accountability reduces deterrence and contributes to incidences of false disclosure.[18]

Bad legal advice on disclosure matters happens and, at some level, is a cost of doing business. Mistakes may occur because lawyers lack adequate expertise or have an insufficient understanding of the facts. But they may also occur because of a fundamental misconception about the role lawyers, implicitly or explicitly, play and see themselves playing in the disclosure process.

Lawyers are often under extraordinary pressure to merely justify or confirm management's decision with respect to disclosure. Particularly in grey areas such as materiality,[19] this goal of "management confirmation" results in an approach that focuses more on assessing litigation risk of nondisclosure and amassing factors that support a finding of immateriality than actually determining the importance of the information to reasonable shareholders and investors.

Lawyers take this approach because management benefits from the advice and there is little accountability where the advice ultimately proves to be incorrect. The lack of accountability has a number of sources. The SEC does not bring actions for bad legal advice,[20] and

15. Heyman, *supra* note 14, at 1128 ("Where intent is not an element of the alleged offense, such as in strict liability cases, reliance on advice of counsel is irrelevant.").

16. *BANK OF AMERICA AND MERRILL LYNCH: HOW DID A PRIVATE DEAL TURN INTO A FEDERAL BAILOUT?: Joint Hearing before the Comm. on Oversight and Gov't Reform and the Subcomm. on Domestic Pol'y,* 111th Cong. (2009) (hereinafter "*Joint Hearing*") (statement of Rep. Dennis J. Kucinich, Chairman, Subcomm. On Domestic Pol'y) ("Now when I asked Ken Lewis about this at our first hearing, he told us he relied on advice of counsel. Protecting shareholders is often, in the final instance, the responsibility of corporate general counsels and/or outside counsel.").

17. *See infra* Part II.B.

18. *See* Lee, *supra* note 11 ("Also a lack of individual accountability greatly undermines the deterrent effect of a potential enforcement action or private litigation . . . . In still another category of cases, however, we know who within the company was responsible, but face significant risks in charging them due to the involvement of lawyers in the disclosure decision that forms the basis of the enforcement action"). *See also* Opinion & Order, Sec. & Exch. Comm'n v. Bank of Am. Corp., 109-cv-06829 (S.D.N.Y. Feb. 21, 2010) ("Where management deceives its own shareholders, a fine most directly serves its deterrent purposes if it is assessed against the persons responsible for the deception. If such persons acted out of negligence, rather than bad faith, that should be a mitigating factor, but not a reason to have the shareholder victims pay the fine instead.").

19. *See* Georgiev, *supra* note 12.

20. Liability under the antifraud provisions for false disclosure applies to the "maker" of the statement. The term has been applied not to those who draft the relevant statement but who have control over the disclosure. Lawyers, therefore, determine materiality but do not become "makers" under the prevailing approach. *See* Marc I. Steinberg, *Corporate Lawyers: Ethical and*

state bar associations and state disciplinary agencies are not equipped to deal with the issue.[21] Even where a regulator is willing to address the concerns, the existing set of professional standards, usually states' rules of professional conduct,[22] are not adequate. Reflecting a historical litigator bias, that is, a focus on the conduct of litigators and trial attorneys as opposed to that of transactional lawyers, the Model Rules do not set out meaningful requirements for securities lawyers providing disclosure advice to public companies.[23]

This management confirmation bias, coupled with a lack of accountability for incorrect legal advice, which has long undermined the accuracy of the periodic reporting process, will have the same effect on the system of climate change disclosure proposed by the SEC. The SEC put out guidance in 2010 that emphasized the need to disclose climate change matters when material.[24] In the aftermath of the guidance, the quality of climate change disclosure actually declined.[25] Presumably legal advice played some role in that result.

Given this failure, the SEC has now proposed a rule that would mandate climate-change related disclosure. While including a number of specific requirements, the proposal continues to rely on materiality determinations, including the assessment of climate-change related risks,[26] the impact of the risks on the company's business,[27] and the

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Practical Lawyering with Vanishing Gatekeeper Liability, 88 FORDHAM L. REV. 1575, 1581–82 (2020) ("Construing the term 'make' narrowly, the Court reasoned that the term is confined to those who have control over the contents of the subject statements and the manner in which such statements are disseminated. Because attorneys rarely have such control, the decision provides another avenue for liability avoidance.").

21. *See infra* Part III.A–C.

22. Most states' rule of professional conduct are based on the American Bar Association Model Rules of Professional Conduct (Model Rules), *see*, *Jurisdictional Rules Comparison Charts*, AM. BAR ASS'N, https://www.americanbar.org/groups/professional_responsibility/policy/rule_charts/ (last visited Apr. 5, 2023) (showing that most states follow the Model Rules).

23. John S. Dzienkowski, *Lawyering in a Hybrid Adversary System*, 38 WM. & MARY L. REV. 45, 49–50 (1996); Eli Wald, *Resizing the Rules of Professional Conduct*, 27 GEO. J. LEGAL ETHICS 227, 245–7 (2014).

24. *See* Commission Guidance Regarding Disclosure Related to Climate Change, Exchange Act Release No. 61469 (Interpreted Feb. 2, 2010).

25. JIM COBURN & JACKIE COOK, COOL RESPONSE: THE SEC & CORPORATE CLIMATE CHANGE REPORTING: SEC CLIMATE GUIDANCE & S&P 500 REPORTING –2010 TO 2013 (Feb. 2014) (available at https://www.ceres.org/sites/default/files/reports/2017-03/Ceres_SECguidance-append_020414_web.pdf) ("Results show that more companies are saying something about climate in their 10-K filings but, of those that are disclosing something, they are not reporting more useful information. In fact, their disclosures appear to be getting briefer and less specific.").

26. *See* Exchange Act Release No. 34-94478, *supra* note 3 (Risk Management, Proposed Item § 229.1503(1), "When describing any processes for identifying and assessing climate-related risks, disclose, as applicable, how the registrant: . . . .(iv) Determines the materiality of climate-related risks, including how it assesses the potential scope and impact of an identified climate-related risk, such as the risks identified in response to § 229.1502.")

disclosure of Scope 3 emissions.[28] Particularly where this information will not be well received by the investing public, management has an incentive to avoid disclosure. To the extent lawyers contribute to this goal by employing a management confirmation approach in assessing materiality, investors and the public will end up with a misguided view of the company's contribution to climate change.[29]

The problem we identify in this Article is different than the familiar, if unresolved, discourse about the gatekeeping role of lawyers in companies' wrongdoing.[30] Judges, commentators, and legal scholars have argued that lawyers ought to play this type of role with regard to corporate decision-making, dissuading companies from wrongdoing and harmful conduct.[31] Opponents of lawyers-as-gatekeepers have retorted that although lawyers cannot assist clients in criminal and

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27. *See id.* ("The proposed rules would require information about a registrant's climate-related risks that are reasonably likely to have a material impact on its business, results of operations, or financial condition."). *See also* Strategy, business model, and outlook, Proposed Item § 229.1502(a) ("Describe any climate-related risks reasonably likely to have a material impact on the registrant, including on its business or consolidated financial statements, which may manifest over the short, medium, and long term.").

28. *See id.* (GHG emission metrics, Proposed Item § 229.1504(c)(1) (Disclose the registrant's total Scope 3 emissions if material); § 229.1504 (e) (4) (". . . (i) When disclosing its GHG emissions for its most recently completed fiscal year, if actual reported data is not reasonably available, a registrant may use a reasonable estimate of its GHG emissions for its fourth fiscal quarter, together with actual, determined GHG emissions data for the first three fiscal quarters, as long as the registrant promptly discloses in a subsequent filing any material difference between the estimate used and the actual, determined GHG emissions data for the fourth fiscal quarter."); § 229.1504(e)(5) ("A registrant must disclose, to the extent material and as applicable, any use of third party data when calculating its GHG emissions, regardless of the particular scope of emissions. When disclosing the use of third-party data, it must identify the source of such data and the process the registrant undertook to obtain and assess such data."); § 229.1504(e)(6) ("A registrant must disclose any material change to the methodology or assumptions underlying its GHG emissions disclosure from the previous fiscal year."); § 229.1504(e)(7) ("A registrant must disclose, to the extent material and as applicable, any gaps in the data required to calculate its GHG emissions."); § 229.1504(e) (8) ("When determining whether its Scope 3 emissions are material, and when disclosing those emissions, in addition to emissions from activities in its value chain, a registrant must include GHG emissions from outsourced activities that it previously conducted as part of its own operations, as reflected in the financial statements for the periods covered in the filing.").

29. *See* Cynthia A. Williams & Donna M. Nagy, *ESG and Climate Change Blind Spots: Turning the Corner on SEC Disclosure*, 99 TEX. L. REV. 1453 (2021) ("Yet, over ten years later the results show that materiality principles alone have not produced high-quality, decision-useful climate disclosure.").

30. *See generally* JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE (2006); John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293 (2003); Sung Hui Kim, *Lawyer Exceptionalism in the Gatekeeping Wars*, 63 SMU L. REV. 73 (2010); Reinier Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53 (1986).

31. *See, e.g.*, Lincoln Sav. & Loan Ass'n v. Wall, 743 F. Supp. 901, 920 (D.D.C. 1990) ("[W]ith all the professional talent involved," observed Judge Sporkin, "why [didn't] at least one. . . [blow] the whistle to stop the overreaching that took place in this case[?]").

fraudulent conduct, they ought not otherwise play a role in corporate decision-making. Gatekeeping, argue the opponents, usurps the decision-making autonomy of companies acting through management and boards of directors, making lawyers kings and queens of corporate decision-making.[32]

The gatekeeping discourse is about what the job of corporate lawyers *should* be. This Article, in contrast, is about what the task of securities lawyers *is*. Put differently, the management confirmation bias with respect to corporate disclosure is not a theoretical one about what lawyers ought, or ought not, do. Rather, it is about what happens when lawyers do not do their job under existing securities laws and regulations.

There is, we assert, a solution to the problem of lawyers' poor disclosure advice. The SEC has the authority to address the role of lawyers in the disclosure process. Congress in the Sarbanes-Oxley Act ("SOX") instructed the SEC to adopt and enforce "minimum standards of professional conduct" applicable to attorneys appearing before the SEC in the representation of public companies.[33] With one exception, the SEC has never used this authority.[34] The Commission should reconsider this inactivity and consider putting in place – and enforcing – standards applicable to securities lawyers practicing before the Commission and providing advice to public companies.[35]

While this recommendation may seem bold in the sense that it deviates from the traditional state-based approach to the regulation of lawyers,[36] it may not be bold enough. Almost two decades of experience with the oversight of auditors that represent public companies has shown the benefits of a dedicated regulator with the authority to

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32. *See, e.g.*, Lawrence A. Hamermesh, *Who Let You into the House*?, 2012 Wis. L. Rev. 359.

33. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 307, 116 Stat. 745, 784 (2002); *see also* 15 U.S.C. § 7245.

34. One Commissioner at the SEC has called on the SEC to revisit this authority. *See* Lee, *supra* note 11 ("we have never brought a single case finding a violation of the up-the-ladder rule under Section 307, a glaring fact of which market observers are well aware. Like a tree that falls in the forest with no one to hear, a rule that is not enforced may fairly be said to be no rule at all. Indeed this calls into question whether we have fulfilled even the narrowest expectations of Congress in adopting Section 307.").

35. Indeed, Commissioner Lee has called for the SEC to consider adopting minimum standards beyond the up the ladder requirements. *See* Lee, *supra* note 11.

36. Judith L. Maute, *Bar Associations, Self-Regulation and Consumer Protection: Whither Thou Goest?*, 2008 J. Prof. Law. 53, 58–66 (2008). *But see generally* Fred C. Zacharias, *Federalizing Legal Ethics*, 73 Tex. L. Rev. 335 (1994) (describing the state-based apparatus of attorney regulation and exploring options for the federalization of legal ethics); Eli Wald, *Federalizing Legal Ethics, Nationalizing Law Practice and the Future of the American Legal Profession in a Global Age,* 48 San Diego L. Rev. 489 (2011) (examining the state-based status quo and calling for the nationalization of law practice).

inspect, enforce and write relevant standards. If the Commission does not begin in earnest to promulgate and enforce rules designed to address the role of lawyers in the disclosure process, the time may be ripe for a Public Company Accounting Oversight Board (PCAOB) for lawyers.[37]

This Article starts with an examination of the problem of erroneous disclosure advice and its consequences. We include a demonstrative case study, exploring the failure of Bank of America to disclose the burgeoning losses by Merrill Lynch when shareholders were asked to approve the merger of the two companies. We then discuss how current mechanisms designed to ensure accountability for mistaken and negligent legal advice on disclosure matters are insufficient. Finally, we propose some steps that the SEC should take in order to reduce the risk of incorrect legal advice and discuss the possible need for a PCAOB for lawyers, to improve the quality of disclosure in the securities market and regarding environmental and social governance (ESG) matters.

II. Erroneous Legal Advice and its Consequences

A. *The Ubiquitous Role of Lawyers in the Disclosure Process*

Since its inception, the system of securities regulation has been oriented around complete and accurate disclosure. Eschewing merit review, the Securities Act of 1933 allowed offerings as long as investors received the information needed to make an informed decision. Under the approach, investors could for the most part accept "on faith" that SEC filings would be accurate.[38]

37. *Infra* Part V.

38. *In re* Emanuel Fields, 45 S.E.C. 262, 266 n.20 (1973), *aff'd without opinion*, 495 F.2d 46 1085 (D.C. Cir. 1974) ("Very little of a securities lawyer's work is adversary in character. He doesn't work in courtrooms where the pressure of vigilant adversaries and alert judges checks him. He works in his office where he prepares prospectuses, proxy statements, opinions of counsel, and other documents that we, our staff, the financial community, and the investing public must take on faith. This is a field where unscrupulous lawyers can inflict irreparable harm on those who rely on the disclosure documents that they produce. Hence we are under a duty to hold our bar to appropriately rigorous standards of professional honor."). *See also* Sec. & Exch. Comm'n v. Spectrum, Ltd., 489 F.2d 535, 541–42 (2d Cir. 1973) (stating that "[t]he legal profession plays a unique and pivotal role in the effective implementation of the securities laws," and "[q]uestions of compliance with the intricate provisions of these statutes are ever present and the smooth functioning of the securities markets will be seriously disturbed if the public cannot rely on the expertise proffered by an attorney when he renders an opinion on such matters"); United States v. Benjamin, 328 F.2d 854, 863 (2d Cir. 1964) (stating that "[i]n our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar."), *cert. denied*, 377 U.S. 953 (1964).

Involvement of lawyers in these filings and in the disclosure process is, understandably, common place. Few public companies would file required reports with the SEC without review by counsel. Given their legal expertise,[39] lawyers are often relied upon to draft required filings, ensure compliance with relevant regulatory requirements, and render views on disclosure issues, including materiality determinations.[40]

The importance of lawyers in the disclosure process has only grown, a consequence of the Commission's deliberate decision to make the disclosure system more management centric. Specific disclosure items[41] have been replaced with a more "principles based" approach,[42] which focuses on the materiality of the information.[43] The result is a system that increasingly relies on judgment[44] and leaves to management "to determine whether disclosure is necessary."[45] Nor

39. *See* Rosenfeld, *supra* note 5, at 537 ("The securities attorney, as an expert, is often in a better position than his or her client to evaluate the materiality of information for disclosure purposes.").

40. *See Joint Hearing*, *supra* note 16 ("Mr. Lewis. What I do know is that when our lawyers tell us we have a disclosable event, we disclose it.").

41. Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information, Exchange Act Release No. 34-90459 (Nov. 19, 2020) ("We are adopting changes to Items 301, 302, and 303 of Regulation S-K that would reduce duplicative disclosure and focus on material information.").

42. Modernization of Regulation S-K Items 101, 103, and 105, Exchange Act Release No. 34-89670 (Aug. 26, 2020) ("Our disclosure requirements, while prescriptive in some respects, are rooted in materiality and facilitate an understanding of a registrant's business, financial condition and prospects through the lens through which management and the board of directors manage and assess the performance of the registrant."). *See also* Business and Financial Disclosure Required by Regulation S-K, Exchange Act Release No. 34-77599 (Apr. 13, 2016) ("The concept of materiality has been described as 'the cornerstone' of the disclosure system established by the federal securities laws.").

43. Business and Financial Disclosure Required by Regulation S-K, Exchange Act Release No. 34-77599 (release Apr. 13, 2016) ("Many of our rules require disclosure when information is material to investors. These rules rely on a registrant's management to evaluate the significance of information in the context of the registrant's overall business and financial circumstances and determine whether disclosure is necessary."). *See also* Modernization of Property Disclosures for Mining Registrants, Exchange Act Release No. 34-84509 (Oct. 31, 2018) ("We are adopting the proposed provision that a registrant must provide the disclosure specified in subpart 1300 of Regulation S-K if its mining operations are material to its business or financial condition.").

44. *Id.* ("The requirements are often referred to as 'principles-based' because they articulate a disclosure objective and look to management to exercise judgment in satisfying that objective."). *See also* Georgiev, *supra* note 12, at 719 ("A principles-based approach to HCM disclosure can work only if the SEC supplies principles that are sufficiently clear to guide firms' disclosure decisions.").

45. Modernization of Regulation S-K Items 101, 103, and 105, Exchange Act Release 34-86614 (Aug. 8, 2019) ("Principles-based rules rely on a registrant's management to evaluate the significance of information in the context of the registrant's overall business and financial circumstances and to determine whether disclosure is necessary."). The emphasis on materiality was not limited to matters decided by management. *See* Qualifications of Accountants, Ex-

has the SEC tempered this shift with guidance designed to limit managerial discretion.[46]

This approach can result in an insufficiently rigorous process that fails to adequately take into account the differences in perspective between management and shareholders.[47] The approach can also make enforcement of the disclosure requirements more difficult.[48] Management can often avoid liability for an incorrect exercise of judgment by obtaining explicit or even tacit approval from counsel.

Lawyers in theory act as an independent, professional check on management's decision-making. Yet this may not always be the case in practice.[49] Lawyers may provide incorrect advice because they do not fully understand the applicable test,[50] including the obligation to pro-

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change Act Release No. 34-90210 (Oct. 16, 2020) ("The Commission proposed amending the definition of an affiliate of the audit client set forth in Rule 2-01(f)(4)(i) to include a materiality qualifier with respect to operating companies, including portfolio companies, under common control.").

46. Modernization of Property Disclosures for Mining Registrants, Exchange Act Release No. 34-84509 (Oct. 31, 2018) ("In a change from the proposed rules, and as suggested by one commenter, we are not including an instruction to the materiality provision stating that a registrant's mining operations are presumed to be material if they consist of 10% or more of its total assets. Even as a presumption, we are concerned that such an instruction could become a *de facto* threshold. We also believe that an assessment that takes into consideration all relevant facts and circumstances will lead to better materiality determinations. For similar reasons, we are not adopting a quantitative measure of materiality based on the reportable segment disclosure thresholds in U.S. GAAP. Rather than referring to a specific U.S. GAAP provision, we believe it is appropriate to rely on a more principles-based approach to the materiality provision.").

47. *See* Lee, *supra* note 6 ("Although dependent upon the views of the reasonable investor, materiality determinations are typically made in the first instance by management. In doing so, management may rely on a 'gut' feeling, anecdotal interactions, and even their own experience as investors. We know that in making these determinations, management frequently sees things differently from investors. Academic literature indicates that preparers and auditors often employ higher materiality thresholds than do investors. SEC enforcement cases likewise reveal infirmities in materiality determinations, as year after year the SEC brings scores of cases for negligence in making these assessments. The difference is perhaps not entirely unexpected. Management may view matters with an enthusiasm that reflects a belief in the nature and direction of their business. Developments that investors may see as negative and in need of disclosure may be viewed by management as a temporary aberration or even a positive development.").

48. *See* Exchange Act Release No. 77599, *supra* note 43 ("The study noted that principles-only standards may present enforcement difficulties because they are, by their nature, imprecise. They can also result in a significant loss of comparability among reporting entities. Prescriptive standards, on the other hand, can be circumvented more easily by structuring around the bright-line requirements of the standard.").

49. Lee, *supra* note 6 ("Yet, lawyers and auditors can also get the decision wrong. As with managers, they may see materiality differently from investors. Academic studies reveal the consequences of this tendency. Studies of restatements and the obligation to disclose material loans, for example, suggest that material information may be incorrectly characterized as immaterial.").

50. Final Report of the Advisory Committee on Improvements to Financial Reporting to the US Securities and Exchange Commission (Aug. 1, 2008) (hereinafter "Final Report") (available at https://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf) ("We believe that those who judge the materiality of a financial statement error should make the

vide "full consideration" of the interests of investors,[51] do not adequately investigate[52] or do not ask the right questions.[53]

Lawyers may also, however, get the advice wrong because they have incentives to tell management what they want to hear – validating management's decision not to disclose material information. This can occur for a number of reasons. In an increasingly competitive market for corporate legal services,[54] lawyers are under "extreme pressure" to help clients achieve the desired goal of non-disclosure.[55]

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decision based upon the interests, and the viewpoint, of a reasonable investor and based upon how that error impacts the total mix of information available to a reasonable investor. Preparers, audit committees, and auditors must 'step into the shoes' of a reasonable investor when making these judgments. We believe that too many materiality judgments are being made in practice without full consideration of how a reasonable investor would evaluate the error.").

51. *Id.* ("We believe that those who judge the materiality of a financial statement error should make the decision based upon the interests, and the viewpoint, of a reasonable investor and based upon how that error impacts the total mix of information available to a reasonable investor. Preparers, audit committees, and auditors must 'step into the shoes' of a reasonable investor when making these judgments. We believe that too many materiality judgments are being made in practice without full consideration of how a reasonable investor would evaluate the error.").

52. *See Joint Hearing*, *supra* note 16 ("This subcommittee's investigative findings demand the question: Where were the lawyers, the glaring omissions, inaccurate financial data, and the critical November 12th forecast so obvious that they should have alerted the attorneys to a necessity of a reasonable investigation before making a decision on Bank of America's legal duties to disclose. The apparent fact they did not mount such an investigation makes the decision not to disclose Merrill's loss to the shareholders an egregious violation of security laws.")

53. Am. Bar Ass'n, *Report of the NY City Bar Association Task Force on the Lawyer's Role in Corporate Governance–November 2006*, 62 BUS. LAW. 427, 456–7 (2007) ("some of the recent scandals do suggest that occasionally lawyers have bent to management pressures, and failed to ask the questions or take the actions that might have prevented or mitigated corporate misconduct.").

54. Eli Wald, *Glass-Ceilings and Dead Ends: Professional Ideologies, Gender Stereotypes, and the Future of Women Lawyers at Large Law Firms*, 78 FORDHAM L. REV. 2245, 2264–73 (2010).

55. *See* Wald, *supra* note 23, at 271–72 ("Yet at the same time, Schmidt readily acknowledges the existence of disagreement about disclosure between lawyers and their corporate clients, as well as the increased marginalization of lawyers' input and lawyers' incentives to align themselves with the views of their clients."). *See supra* note 53 ("We also agree that there are pressures on lawyers to acquiesce in wrongful client conduct, reflecting in part the increased competitiveness of the profession. Outside lawyers are pressed to attract and retain clients. A law firm partner's compensation—or even a small law firm's survival—may depend on the business referred by the CEO of a major client. The mobility of clients insures a heightened sensitivity to client satisfaction. The 'client,' for this purpose, is logically perceived as the corporate manager who has retained the lawyer to represent the company, making problematic the willingness of the lawyer to advise against or report misconduct by that same manager, or a law firm's willingness to monitor its leading rainmakers who have 'portable' business. These pressures have increased over the past three decades. Many firms, in order to retain 'star' partners, have adjusted their compensation systems away from 'lock-step' seniority models to performance-based models that reward business generation and client retention. For in-house lawyers, the obvious pressure is to retain their compensation and their jobs, and their role as a valued member of the management 'team,' rather than incur the wrath of a CEO or other high-ranking officer."); Beardslee, *supra* note 7, at 1132 ("Lawyers are under extreme pressure today to help their clients reach legal and business objectives that are often inextricably intertwined.").

This pressure is fueled by four related trends in the corporate hemisphere of the legal profession:[56] (1) the rise of client-centered service ideology in the context of deference to management as the authorized constituent speaking for the client, (2) the rise of in-house lawyers at the expense of outside counsel, (3) increased competition in the market for corporate legal services, and (4) the increased emphasis on the financial bottom line – profits per equity partner – at BigLaw.[57] This can result in "management-preferred conclusions,"[58] or result in "a contrived effort to generate the client's desired result when real-world facts would not support it."[59]

Understanding the extreme pressure securities lawyers are under requires unpacking the four related trends informing and shaping their practice. First, since the mid-twentieth century, the hired gun, client-centered ideology has become increasingly dominant, replacing the lawyer-statesperson ideal.[60] Whereas the lawyer-statespersons of the past understood their job to include advising about the wisdom of

56. On the individual and corporate hemispheres of the legal profession, *see* JOHN P. HEINZ & EDWARD O. LAUMANN. CHICAGO LAWYERS: THE SOCIAL STRUCTURE OF THE BAR 319–20 (1982) (finding that the legal profession consists of two categories of lawyers whose practice settings, socioeconomic and ethno-religious backgrounds, education, and clientele differ considerably); JOHN P. HEINZ ET AL., URBAN LAWYERS: THE NEW SOCIAL STRUCTURE OF THE BAR 30–31, 44 (2005) (documenting that lawyers work in two fairly distinct hemispheres – individual and corporate – and that mobility between these hemispheres is relatively limited).

57. Robert Eli Rosen, *The Inside Counsel Movement, Professional Judgment and Organizational Representation*, 64 IND. L.J. 479, 489–90 (1989); Eli Wald, *Getting In and Out of the House: The Worlds of In-House Counsel, Big Law, and Emerging Career Trajectories of In-House Lawyers*, 88 FORDHAM L. REV. 1765 (2020).

58. Elizabeth C. Altiero et al., *Motivated Perspective Taking: Why Prompting Auditors to Take an Investor's Perspective Makes Them Treat Audit Differences as Less Material*, 39 CONTEMP. ACCT. RSCH. 339, 345–6 (2022) (discussing studies that show "auditors, on average, have pre-existing directional goals to justify management-preferred conclusions.").

59. Bandera Master Fund LP v. Boardwalk Pipeline Partners, C.A. No. 2018-0372-JTL (Del. Ch. Nov. 12, 2021), *rev'd on other grounds*, 288 A.3d 1083 (Del. 2022) ("But here, the record as a whole depicts a contrived effort to generate the client's desired result when the real-world facts would not support it."). A concurring opinion in the case did take issue with the Chancery Court's analysis of the role of lawyers. *See Id*. at 1124 (Valihura, J., concurring, joined by Legrow, J., sitting by designation). *See also* Lee, *supra* note 11 ("The 'bad advice' I refer to arises from a type of 'can-do' approach to lawyering that is ill-suited to lawyers in a gatekeeping role. It is born from a desire to give management the answer that it wants.").

60. William H. Simon, *The Ideology of Advocacy: Procedural Justice and Professional Ethics*, 29 WIS. L. REV. 29 (1978).

the goals of the representation,[61] hired guns defer to clients relating to the objectives, subject only to the bounds of the law.[62]

In some circumstances, the rise to prominence of the client-centered ideology has been desirable. In the individual hemisphere, for example, in which vulnerable clients were sometimes dominated by their attorneys,[63] empowering clients to exercise their autonomy instead of having lawyers tell them what's in their best interest has been a positive development.[64] In other circumstances, however, the hired gun ideology has been more problematic. In the corporate hemisphere, in which large entity clients enjoy ample power, the growing deference of lawyers has removed a valuable check from clients' decision-making processes.

Moreover, lawyers' increased deference to clients is especially noteworthy in the case of corporate clients, for two reasons. To begin with, lawyers who represent organizations represent the entities, not their constituents.[65] Yet, because the entities cannot speak and make decisions for themselves, authorized constituents – management and the board – the very parties who have the power to hire and fire lawyers, act for the entities-clients. Thus, practically speaking, growing deference to clients, including corporate clients, means increased deference to management, who is not the client.

Next, the import of client-centered ideology from the adversarial system and litigation into the corporate sphere and the conference room in which, at least initially, no neutral judge or jury are watching, means that the increased deference to entity clients practically results in greater unscrutinized deference to management, and an environment in which corporate lawyers are less likely to tell corporate clients

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61. On the lawyer-statesman ideal, *see* Robert W. Gordon, *Lawyers as the 'American Aristocracy,' : A Nineteenth-Century Ideal that May Still Be Relevant*, 20 Stan. Law., 1985, at 4–7; Robert W. Gordon, *The Independence of Lawyers*, 68 B.U. L. Rev. 1 (1988); Robert W. Gordon, *The Citizen Lawyer—A Brief Informal History of a Myth with Some Basis in Reality*, 50 Wm. & Mary L. Rev. 1169, 1176 (2009); Robert W. Gordon, *The Return of the Lawyer-Statesman?* 69 Stan. L. Rev. 1731 (2017); Anthony T. Kronman, The Lost Lawyer: Failing Ideals of the Legal Profession (1993).

62. Robert W. Gordon, *Corporate Law Practice as a Public Calling*, 49 Md. L. Rev. 255, 265–66 (1990).

63. David B. Wilkins, *Everyday Practice Is the Troubling Case: Confronting Context in Legal Ethics*, *in* Everyday Practices and Trouble Cases 68, 70–79 (Austin Sarat et al., eds., 1998) (describing the "traditional model" of the law governing lawyers as relying on four sets of assumptions about lawyers, clients, the nature of legal advice, and the workings of legal ethics).

64. William H. Simon, *Lawyer Advice and Client Autonomy: Mrs. Jones's Case*, 50 Md. L. Rev. 213, 223 (1991).

65. *See* Model Rules of Pro. Conduct r. 1.13(a) (Am. Bar Ass'n 2021).

in appropriate circumstances that they are damn fools and should stop.[66]

Second, such increased deference is taking place at the same time as outside corporate counsel have lost power and influence vis-à-vis entity clients and their increasingly powerful in-house lawyers, making outside corporate lawyers even less likely to push back in appropriate circumstances against management's expectations of non-disclosure. The return of in-house counsel in the last quarter of the twentieth century is a well-documented phenomenon.[67] As General Counsel gained power and influence,[68] overtook outside counsel's seat at the corporate decision-making table,[69] replaced BigLaw's equity partners in some tasks and micromanaged and supervised other tasks,[70] outside corporate counsel were not only less inclined to try to act as lawyer-statespersons, they were less able to do so.[71] And although some General Counsel have vowed to become the new lawyer-statespersons and corporate guardians,[72] many have not done so, in part because of the pressures of serving but one client-employer and the corresponding demands to act as a team player and please management.[73]

Third, BigLaw practice has become increasingly competitive. Increased competition in the market for outside corporate legal services combined with the increased power of in-house lawyers has had some positive consequences for entity clients, including stopping the annual increase of BigLaw's hourly rates and slowing down the growth of

66. PHILIP C. JESSUP, ELIHU ROOT 133 (1938) (quoting Elihu Root's famous words, telling the clients that "'they are damn fools and should stop.'").

67. *See supra* note 57.

68. Rosen, *supra* note 57, at 489–90.

69. KRONMAN, *supra* note 61.

70. *Id.*

71. As late as 1963, for example, Erwin Smigel surveyed Wall Street lawyers and found that they considered themselves primarily "guardians of the law" who counseled their clients on not only the letter of the law, but also the spirit of the law and the public good. ERWIN O. SMIGEL, THE WALL STREET LAWYER: PROFESSIONAL ORGANIZATION MAN? 8–10 (1963).

72. BEN W. HEINEMAN, JR., THE INSIDE COUNSEL REVOLUTION: RESOLVING THE PARTNER-GUARDIAN TENSION 317–57 (2016).

73. Beardslee, *supra* note 7, at 1132–33 ("The concerns are even more poignant with respect to inside lawyers. For example, Robert Nelson and Laura Nielson conducted research that suggested that in-house lawyers 'were willing to 'discount . . . their gatekeeping function in corporate affairs' in order to be seen as part of the company, rather than as obstacles to getting things done.' This study, along with research conducted by Kimberly Kirkland, suggests that 'despite their sense of professional independence, it is sometimes difficult for lawyers to separate themselves and their professional ethical obligations from organizational objectives and the norms elevated by the most powerful players in those organizations.' This appears to be true of both inside and outside counsel.") (internal citations omitted).

corporate legal budgets.[74] Yet at the same time this increased competition has further curtailed the ability and willingness of corporate lawyers to push back against management's non-disclosure pressure. As the number of large law firms has increased and spread nationally and globally, BigLaw has lost their exclusive, stable relationships with large entity clients.[75] Consequently, as large law firms increasingly compete for the corporate and securities work they used to be able to take for granted, they are more likely to try to please management.

Fourth and finally, as BigLaw have become more of an "eat what you kill" institutions,[76] emphasizing the financial bottom line in terms of profits-per-equity-partners and profits-per-partner, as well as associate salaries and bonuses,[77] relationship partners have faced increased pressures to please management or risk losing business and face reduced compensation, standing and power within their law firm. Clients after all "pay their bills."[78] Indeed, the failure to give this type of management pleasing disclosure advice can result in reputational harm to the lawyer.[79]

B. The "Benefits" of Lawyers' Erroneous Advice – Management Escapes Liability for Misleading Non-Disclosure

Management can benefit from erroneous advice. Non-disclosure for the most part is a serious concern with respect to developments that can have an adverse effect on a company's share prices. While incentives can sometimes arise to withhold positive developments,[80] management is usually incentivized to make these disclosures.

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74. David B. Wilkins, *The In-House Counsel Movement, Metrics of Change*, LEGAL BUS. WORLD (Jan. 20, 2017), https://www.legalbusinessworld.com/single-post/2017/01/20/The-In-House-Counsel-Movement-Metrics-of-Change [https://perma.cc/ERK5-X5L8]; Wald, *supra* note 57, at 1784.

75. *See generally* David B. Wilkins, *Team of Rivals? Toward a New Model of the Corporate Attorney-Client Relationship*, 78 FORDHAM L. REV. 2067 (2010).

76. MILTON C. REGAN JR., EAT WHAT YOU KILL: THE FALL OF A WALL STREET LAWYER (2006).

77. William D. Henderson, *An Empirical Study of Single-Tier Versus Two-Tier Partnerships in the Am Law 200*, 84 N.C. L. REV. 1691 (2006).

78. Prepared Statement, Richard L. Kaplan, Professor, University of Illinois, Urbana-Champaign, Public Meeting on Auditor Independence and Audit Firm Rotation, available at https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket037/ps_kaplan.pdf?sfvrsn=662a412e_0 (last visited Apr. 5, 2023) ("auditors are prone to bias their conclusions to best preserve the client relationship that pays their bills.").

79. *See* Lee, *supra* note 11 ("Lawyers view themselves as problem-solvers for their clients, and failing to give management what it wants can actually be what causes reputational harm.").

80. Controlling shareholders seeking to buy out the remaining owners may benefit from the undervaluing of a company's shares. In those circumstances, positive developments may be detrimental to their interests and provides incentives to encourage non-disclosure of this sort of information.

Negative information that can adversely affect share prices, in contrast, provides management with the opposite incentive. First, because compensation is often tied to the share performance, depressed prices reduce executive pay. Second, lower share prices understood by investors to mean poor executive performance can shorten an officer's tenure. Third, non-disclosure reduces public and investor scrutiny and management criticism. Fourth, negative developments can raise the cost of capital, result in shareholder pressure to alter a company's business model, or affect corporate reputation.

To be sure, management remains responsible for the accuracy of the information disclosed by the company.[81] The liability exposure for non-disclosure of material information may in theory counteract some of these benefits for management from non-disclosure. Yet non-disclosure can buy time to alter the consequences of negative developments or delay their effect until after turnover in the C-Suite.[82] Moreover, management's personal exposure to liability can be reduced through the participation of counsel.

In cases brought by the SEC alleging inaccurate disclosure by public companies, responsible officers are often not charged[83] or found lia-

81. *See* Lee, *supra* note 6 ("The difference is perhaps not entirely unexpected. Management may view matters with an enthusiasm that reflects a belief in the nature and direction of their business. Developments that investors may see as negative and in need of disclosure may be viewed by management as a temporary aberration or even a positive development."). The Commission had issued reminders of this obligation. *See* Rule 10b5-1 and Insider Trading, Exchange Act Release No. 93782 (Jan. 2022) ("We recognize that this certification involves important considerations, especially because directors and officers are often aware of material nonpublic information. Subject to their confidentiality obligations, directors and officers can consult with experts to determine whether they can make this representation truthfully. Legal counsel can assist directors and officers in understanding the meaning of the terms 'material' and 'nonpublic information.' However, the issue of whether a director or officer has material nonpublic information is an inherently fact specific analysis. Thus, a director or officer's completion of this certification would reflect their personal determination that they do not have material nonpublic information.").

82. The average term for CEOs in companies in the S&P 500 is five years. *See* Dan Marcec, Equillar, Inc., *CEO Tenure Rates*, HARV. L. SCH. F. CORP. GOVERNANCE (Feb. 12, 2018), https://corpgov.law.harvard.edu/2018/02/12/ceo-tenure-rates/.

83. David Rosenfeld, *Admissions in SEC Enforcement Cases: The Revolution That Wasn't*, 103 IOWA L. REV. 113, 145 (2017) ("in the vast majority of cases where an entity admitted to wrongdoing in settling a case, there were no individuals charged. This is true even though the SEC has been severely criticized for failing to charge individuals in significant cases, particularly those involving major financial institutions, and even though. . . the SEC [announced that it] would seek to hold individuals accountable."). *See also* Urska Velikonja, *Leverage, Sanctions, and Deterrence of Accounting Fraud*, 44 U.C. DAVIS L. REV. 1281, 1290 (2011) ("Individuals 'almost never contribute personally to settlements' in securities fraud class actions, even though they are often named as defendants. Instead, the firm and the liability insurer pay the bulk of the settlement amounts. The SEC targets individual defendants more frequently, but nevertheless settles most cases and imposes only minor, if any, sanctions on individuals.").

ble. Settled cases by the SEC against a number of well-known companies for disclosure violations have not been accompanied by allegations against individuals, including General Electric,[84] HP,[85] Fiat-Chrysler,[86] Mylan,[87] Yahoo,[88] Under Armor,[89] and Credit Suisse.[90]

The failure to charge individuals may arise from the inability to adequately identify persons responsible for the false disclosure.[91] The failure can also occur because of the inability to show that the responsible officer had the requisite state of mind.[92] Importantly, the presence of lawyers in the disclosure process can make this showing difficult.[93] Mere presences is enough; management need not actually invoke reliance on counsel.[94] Indeed, SEC cases show the risks associated with the failure to consult lawyers on disclosure decisions.[95] Nor does the SEC typically charge lawyers, even when the allegations suggest ex-

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84. *In re* Gen. Elec. Co., Exchange Act Release No. 90620 (Dec. 9, 2020).

85. *In re* HP, Inc., Exchange Act Release No. 90060 (Sept. 30, 2020).

86. *In re* FCA US LLC & Fiat Chrysler Auto. N.V., Exchange Act Release No. 87134 (Sept. 27, 2019).

87. Sec. & Exch. Comm'n v. Mylan N.V., No. 19-civ -2904 (D.D.C. filed Sept. 27, 2019).

88. *In re* Altaba Inc., F/D/B/A Yahoo Inc., Exchange Act Release No. 83096 (Apr. 24, 2018).

89. *In re* Under Armour, Inc., Exchange Act Release No. 91741 (May 3, 2021).

90. *In re* Credit Suisse AG, Exchange Act Release No. 79044 (Oct. 5, 2016).

91. *See* Velikonja, *supra* note 83, at 1315 ("Top managers, particularly in larger firms, can reduce their likelihood of capture by delegating overt acts of fraud to lower-level employees.").

92. *See* 17 C.F.R. § 240.10b-5.

93. *See* Rosenfeld, *supra* note 5, at 538 ("The ultimate determination of whether any given item of information is material and should be disclosed remains the responsibility of the client. The autonomous exercise of this responsibility by the client has been curtailed, however, as a result of the client's lack of expertise concerning the legal materiality of corporate information."). *See also* Lee, *supra* note 11 ("That is, in part, why the system builds in checks and balances. Managerial judgments are usually subject to review by other professionals. Auditors examine the financial statements; lawyers review much of the narrative in SEC filings. Particularly with respect to materiality determinations and the content of SEC filings, management often relies extensively on the advice of legal counsel.").

94. *See* Final Report *supra* note 50, at 81–2 ("Many of the issues with materiality in practice are caused by misunderstandings by preparers, auditors and regulators. Elimination of these misunderstandings would be a significant step toward reducing restatements that do not provide useful information to investors."). *See also* Lee, *supra* note 11 ("Perversely, in addition to inflicting harm on investors and potentially exposing the company to costly litigation, contrived legal advice can actually insulate from liability those individuals within a company who are responsible for false or incomplete disclosure. This turns the role of gatekeeper on its head.").

95. *See In re* Clug et al., Exchange Act Release No. 90385 (Nov. 9, 2020) ("Clug claims further that he did not act with scienter because he 'consulted with and relied on counsel throughout the production of all these documents.' An advice-of-counsel defense requires that Clug prove he 'made complete disclosure to counsel, sought advice as to the legality of his conduct, received advice that his conduct was legal, and relied on that advice in good faith.' The record contains no evidence that Clug (or anyone else at Aurum) sought or received legal advice regarding the adequacy of the PPM's disclosures or that any lawyers consulted were even aware of Crow's disciplinary history.").

tensive knowledge or involvement by legal departments. For example, in *In re Altaba*,[96] the Commission alleged that the company did not disclose a "massive breach of its user database" until two years after the event. The Commission asserted that the failure to disclose the information rendered a number of periodic reports filed from 2014 through 2016 misleading.

According to the allegations in the settlement order, the Yahoo in-house legal department had knowledge of at least some aspects of the event. As the release stated:

- Within days after Yahoo's information security team reached these conclusions, members of Yahoo's senior management and legal teams received various internal reports from Yahoo's Chief Information Security Officer stating that the theft of hundreds of millions of Yahoo users' personal data had occurred.
- As Yahoo has stated, the company's "relevant legal team had sufficient information to warrant substantial further inquiry in 2014, and they did not sufficiently pursue it."
- Yahoo senior management and relevant legal staff did not properly assess the scope, business impact, or legal implications of the breach, including how and where the breach should have been disclosed in Yahoo's public filings or whether the fact of the breach rendered, or would render, any statements made by Yahoo in its public filings misleading.
- Yahoo's senior management and legal teams did not share information regarding the breach with Yahoo's auditors or outside counsel in order to assess the company's disclosure obligations in its public filings.

Neither counsel nor responsible officers were charged in the case.

Other cases illustrate this approach.[97] Individuals, whether management or counsel, were not charged where the company allegedly applied the wrong legal standards with respect to a disclosure matter.[98]

96. *In re* Altaba Inc., Exchange Act Release No. 83096 (Apr. 24, 2018). Altaba Inc. was the successor corporation of Yahoo! Inc.

97. *See also In re* The Brink's Co., Exchange Act Release No. 95138 (June 22, 2022) (allegations that confidentiality agreement signed by thousands of employees contained language inconsistent with whistleblower rules; settled order suggested possible responsibility of company's legal department for the language used in the agreement).

98. *In re* Hilton Worldwide Holdings, Exchange Act Release No. 90052 (Sept. 30, 2020) ("Contrary to Item 402 of Regulation S-K and the Commission's guidance in the Adopting Release, Hilton's system for identifying, tracking and calculating perquisites incorrectly applied a standard whereby a business purpose would be sufficient to determine that certain items were not perquisites or personal benefits that required disclosure."). *See also In re* Dow Chem. Co., Exchange Act Release No. 83581 (July 2, 2018) (alleging that "Dow incorrectly applied a standard whereby a business purpose related to the executive's job was sufficient to determine that a benefit would not be a perquisite that required disclosure. The Commission considered, but ultimately decided not to adopt, a business purpose standard to determine whether a benefit provided to an executive should be disclosed as a perquisite.").

Nor were lawyers charged in a case where the Commission felt compelled to require remedial changes in the legal department.[99]

In this Part we have shown the ubiquitous role of lawyers in the disclosure process, the extreme pressures outside and in-house lawyers face to please management by advising non-disclosure and the resulting public harm of allowing management to escape liability for its non-disclosure decisions. The extent of this disclosure chilling problem cannot be over-stated. We conclude this Part with a detailed case study of the problem.

C. A Non-Disclosure Case Study: Bank of America's Acquisition of Merrill Lynch

An example of a lawyer's role in corporate disclosure alleged to be materially inaccurate took place in Bank of America's (BofA) acquisition of Merrill Lynch.[100] Occurring during the worst moments of the Great Recession, shareholders of BofA were asked to approve the merger with the broker-dealer. They did not receive updated information on the burgeoning losses at Merrill Lynch. Lawyers involved in the process concluded, based upon the information they received with respect to the losses, that the information was immaterial or otherwise not subject to disclosure.

The decision not to disclose the losses ultimately proved to be expensive. BofA agreed to a settlement with the SEC for a number of disclosure related issues, including the undisclosed losses, that resulted in a $150 million penalty.[101] Private litigation relating to the losses as well as other disclosure claims settled for $2.4 billion.[102] No

99. *In re* Key Energy Services, Inc., Exchange Act Release No. 78558 (Aug. 11, 2016) (remedial efforts included "implementing a new business opportunities protocol to help Key Energy legal better understand business risks including the role played by agents, consultants or other vendors/business partners, so as to enable better assessment of corruption-related risks in future business opportunities.").

100. We note that while there is extensive information in the public domain about this acquisition, in no small part because of the number of investigations and lawsuits, there was never a determination on the merits. As a result, throughout this section we are describing allegations rather than findings.

101. *See* Sec. & Exch. Comm'n v. Bank of Am. Corp., Litigation Release No. 214017 (Feb. 4, 2010) (available at https://www.sec.gov/litigation/litreleases/2010/lr21407.htm). The settlement also addressed allegations about the failure to disclose information about the payment of year-end bonuses at Merrill Lynch prior to the closing of the acquisition.

102. Martha Graybow & Rick Rothacker, *BofA pay $2.4 billion to settle claims over Merrill*, REUTERS (Sept. 28, 2012), https://www.reuters.com/article/us-bofa-lawsuit/bofa-pays-2-4-billion-to-settle-claims-over-merrill-idUSBRE88R0PR20120928.

individuals were charged by the SEC or were made part of settlement in the private litigation.[103]

We use this example not because it is necessarily unusual but mostly because of the rare degree of insight into the role played by counsel in the process. After initially not doing so,[104] BofA ultimately waived the attorney-client privilege.[105] As a result, we have available a variety of sources about the role of counsel, including testimony in Congress by some of the individuals involved in the disclosure decision. The SEC produced a "statement of facts"[106] and "supplemental statement of facts." Notably, however, none of the details or findings with respect to materiality were ever determined by a factfinder and should, therefore, be viewed as allegations rather than facts.[107] Finally, some of the settlements and decisions involved multiple disclosure issues. The set-

103. Individuals did settle with the NY Attorney General. *See* Karen Freifeld, *Bank of America, ex-CEO Lewis settle NY lawsuit over Merrill*, REUTERS (Mar. 26, 2014), https://www.reuters.com/article/us-bofa-merrill-nyag-idUSBREA2P20120140326

104. Louise Story, *Bank Firing of Counsel Is Examined*, N.Y. TIMES (Sept. 8, 2009), https://www.nytimes.com/2009/09/09/business/09bank.html ("Bank of America issued a statement that said it had not in fact defended itself by saying it relied on its lawyers. The bank said it believed it had followed disclosure rules.").

105. Opinion & Order, Sec. & Exch. Comm'n v. Bank of Am. Corp., 109-cv-06829 (S.D.N.Y. Feb. 21, 2010) ("Since then, the parties have conducted extensive discovery, assisted by the helpful decision of defendant Bank of America Corp. (the 'Bank') to waive attorney-client privilege, resulting in the S.E.C.'s presentation to this Court of a 35-page Statement of Facts and a 13-page Supplemental Statement of Facts, the accuracy of which is not contested here by the Bank.") (available at http://www.law.du.edu/documents/corporate-governance/sec-and-governance/bank-of-america/Opinion-and-Order-SEC-v-BofA-109-cv-06829-SD-NY-Feb-21-2010.pdf).

106. Final Consent Judgment as to Defendant Bank of America Corporation, Statement of Facts, Exhibit A at Para. 14, Sec. & Exch. Comm'n v. Bank of Am. Corp., 09 Civ. 6829-JSR; 09 Civ 0215-JSR (S.D.N.Y. Feb. 2010) (hereinafter "Final Consent Judgment") ("Defendant BAC acknowledges that there is an evidentiary basis for the statements in the Statement of Facts, prepared by the SEC based on discovery in the action 09 Civ. 6829, that is attached as Exhibit A to this Consent.").

107. The Commission alleged that BofA had a duty to disclose and that the failure to disclose the "extraordinary" losses "deprived shareholders of up-to-date information that was essential to their ability to evaluate whether to approve the merger upon the terms presented to them". *See* Amended Complaint at Para. 5, Sec. & Exch. Comm'n v. Bank of Am. Corp., 09-Civ-6892-JSR (S.D.N.Y. Jan. 12, 2010) ("Despite its representation that it would update shareholders about fundamental changes to the information previously disclosed, Bank of America kept shareholders in the dark as they were called upon to vote on the proposed merger at the end of a quarter of nearly unprecedented volatility and uncertainty. The absence of any disclosure concerning Merrill's extraordinary losses deprived shareholders of up-to-date information that was essential to their ability to evaluate whether to approve the merger upon the terms presented to them, which had principally been negotiated before Merrill sustained these losses. Bank of America's failure to make any disclosure concerning Merrill's October and November losses violated Bank of America's express undertaking to apprise investors of fundamental changes and rendered its prior disclosures materially false and misleading in violation of the federal securities laws.").

tlement amounts, therefore, were not always related entirely to the disclosure issue concerning the losses at Merrill Lynch.

1. The Allegations

Contemporaneous with the collapse of Lehman Brothers in September 2008, BofA announced the acquisition of Merrill Lynch, the third largest investment bank in the United States, for $50 billion or $29 a share, a premium of about 70% over the market price.[108] A meeting of shareholders of BofA was scheduled for December 5, 2008, to approve the acquisition.

After the acquisition was announced, Merrill Lynch disclosed to the public net losses for the third quarter of $5.2 billion. With respect to the fourth quarter, at least some analysts expected either positive earnings[109] or significantly reduced losses.[110] Management of BofA also thought that the investment bank would be "close" to braking even for the quarter.[111]

In fact, the red ink continued. Merrill Lynch's losses in October 2008 reached $4.5 billion.[112] Internal estimates at the time put total losses for the entire quarter at approximately $5 billion.[113] With re-

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108. For a copy of the merger agreement, *see* https://www.sec.gov/Archives/edgar/data/65100/000095012308011151/y71399exv2w1.htm.

109. *See* Final Consent Judgment, *supra* note 106, at Para. 13 ("After Merrill released its third-quarter results, the price of its publicly-traded stock rose slightly. In the days that followed, analysts covering Merrill issued reports estimating that Merrill's fourth-quarter performance would be an improvement over the firm's $5.2 billion loss in the third quarter. According to a summary of analyst reports that was available to Bank of America, Sanford C. Bernstein analyst Bradley Hintz issued a report on October 17 estimating that Merrill would have a net gain of approximately $900 million in the fourth quarter; Oppenheimer analyst Meredith Whitney estimated on October 20 that Merrill's net income in the fourth quarter would exceed $500 million; and UBS analyst Glenn Schorr estimated that Merrill would have a quarterly net gain of approximately $400 million.").

110. *Id.* at Para. 13 ("Other analysts forecasted a loss at Merrill in the fourth quarter of 2008, but on a smaller scale than the $5.2 billion loss sustained in the third quarter. For example, Kenneth Worthington of J.P. Morgan estimated a net loss of $280 million; James Mitchell of Buckingham Research estimated a loss of approximately $875 million; and Douglas Sipkin of Wachovia Capital estimated a net loss of approximately $1.85 billion.").

111. *Id.* ("As of the end of the third quarter of 2008, Lewis expected Merrill to approximately break even – i.e., neither lose money nor make a profit – in the fourth quarter of 2008. Joe Price, Bank of America's then-Chief Financial Officer, expected at the time the merger was negotiated that Merrill would 'close to break even' in the fourth quarter of 2008.").

112. *Id.* at Para. 15 ("By the second week of November 2008, Cotty and Price were informed that Merrill had closed its books for the month of October with a net loss of $4.5 billion . . . The $4.5 billion monthly loss almost equaled the $5.2 billion loss that Merrill had reported for the entire preceding quarter and represented more than one-third of the $11.7 billion in losses that Merrill had reported for the first nine months of 2008.").

113. *Id.* at Para. 16 ("in the weeks that followed, Bank of America received further forecasts estimating that Merrill sustained additional multi-billion dollar losses in the month of November. On November 12, 2008, Merrill's finance department provided Cotty with an internal document

spect to disclosure of these losses to shareholders of BofA, some apparently viewed disclosure as "warranted."[114] Nonetheless, after consulting with outside lawyers,[115] reviewing other materials,[116] including Merrill Lynch's earning history,[117] and discussing matters with

that forecasted a fourth-quarter net loss of approximately $5.4 billion . . . . After receiving the November 12 forecast, Cotty noted certain adjustments to add, including, among other items, an estimated pre-tax loss of $1 billion in November in potential markdowns (identified as the "neil gut") from, among other things, the distressed part of Merrill's correlation book and CVA, as well as an expected $1.7 billion tax benefit, resulting in a projected quarterly loss of approximately $5 billion"). *See also Joint Hearing supra* note 16 (statement of Timothy J. Mayopoulos, Former General Counsel, Bank of America) ("To the best of my recollection, this issue first arose around November 12, 2008. On that date or shortly thereafter, I was provided with a written forecast projecting that Merrill Lynch would have a fourth-quarter after-tax loss of approximately $5 billion.").

114. Supplemental Statement of Facts, Sec. & Exch. Comm'n v. Bank of Am. Corp., 109-cv-06829 (S.D.N.Y. Feb. 17, 2010) (hereinafter "Supplemental Statement") (available at http://www.law.du.edu/documents/corporate-governance/sec-and-governance/bank-of-america/Supplemental-Statement-of-Facts-SEC-v-BofA-109-cv-06829-SD-NY-Feb-17-2010.pdf) ("On November 13, Mayopoulos and Teresa Brenner, a senior in-house attorney at Bank of America with experience handling corporate and disclosure matters, participated in a call with partners Herlihy, Nicholas Demmo and Eric Roth of Wachtell Lipton. Mayopoulos's initial reaction was that 'disclosure might be well warranted,' and on the call the lawyers' preliminary view was that some disclosure should be made.")

115. *Id.* ("Mayopoulos determined that he would gather relevant information and told the Wachtell Lipton lawyers that he and they needed to give 'serious consideration to [a] possible disclosure." Mayopoulos instructed the Wachtell Lipton attorneys to "do some work on [the matter] and to think about it and do whatever they thought was necessary' so that they could provide 'an informed opinion about what we should do.'"). *See also Joint Hearing supra* note 16 (statement of Timothy J. Mayopoulos, Former General Counsel, Bank of America) ("I had several conversations with [outside counsel] related to whether the $5 billion projected loss should be disclosed.").

116. *See*, Supplemental Statement, *supra* note 114 ("On November 13 and continuing over the following days, Bank of America's attorneys and executives reviewed materials that they deemed relevant to the question of disclosure, including Merrill's results in the preceding six quarters, the disclosures concerning adverse financial conditions and their likely impact on results contained in Bank of America's and Merrill's recent public filings, the November 3 Proxy Statement, analyst projections for Merrill's fourth quarter results, public statements announcing the merger, and data about the possible impact of Merrill's forecasted quarterly losses on the capital ratio of the combined company.").

117. *See also Joint Hearing, supra* note 16 (statement of Timothy J. Mayopoulos, Former General Counsel, Bank of America) ("In addition, I asked [a long time BofA lawyer] and others to provide me with a significant amount of information to evaluate this question, including to the best of my recollection: Merrill Lynch's earnings results over the prior five quarters, the materials Bank of America and Merrill Lynch disseminated announcing the merger, the proxy statement, and the Merrill Lynch and Bank of America public disclosures that are incorporated by reference into the proxy statement.").

disclosure counsel,[118] BofA officials determined[119] that "no additional disclosure was necessary."[120]

On December 3, two days before the shareholder meeting, estimated losses for the quarter increased to around $7 billion for the quarter.[121] Actual losses for November would not be known until after the shareholder meeting and, in fact, would prove "worse than forecasted."[122] The increase to $7 billion did not, apparently, change the materiality analysis or the decision with respect to disclosure.[123]

118. *See id.* ("To my recollection, I personally reviewed relevant portions of these materials and discussed them with [the long time BofA lawyer].").

119. *See id.* ("On November 20, Mr. Price, other senior Bank of America business executives, [outside counsel], and [a long time BofA lawyer] and I had a conference call to address the disclosure issue. . . . All of the lawyers and business executives involved concluded that disclosure of the projected loss was not warranted."). *See also* Supplemental Statement, *supra* note 114 ("On November 20, Herlihy and Demmo of Wachtell Lipton and Mayopoulos, Price, Brenner, and other executives of Bank of America participated in a conference call to discuss whether disclosure might be required; by the end of the call, all participants, including Mayopoulos, Price, Brenner and the Wachtell Lipton attorneys, concluded that no additional disclosure was necessary.").

120. *See*, Supplemental Statement, *supra* note 114 (lawyers at outside firm "expressed their views and concurred that no additional disclosure was necessary. None of the participants on the call suggested making any additional disclosure."). *See also Joint Hearing*, *supra* note 16 (statement of Timothy J. Mayopoulos, Former General Counsel, Bank of America) ("For all of these reasons, [outside counsel] and I concluded no disclosure of the projected $5 billion loss was legally required. No one on the November 20 conference call disagreed with that conclusion.").

121. *See* Final Consent Judgment, *supra* note 106, at Para. 22 ("With the November placeholder and December forecast, Cotty estimated that Merrill's fourth-quarter net loss would be $7.4 billion, and Cotty added that 'you could easily take another $1.0 billion off on an after tax basis.'").

122. *Id.* ("The actual November results, which were finalized after the December 5, 2008 shareholder meeting, turned out to be worse than forecasted. . . . On December 7, 2008, Gary Carlin, Merrill's then-Controller, forwarded a report providing an update on the November results to Cotty showing a pre-tax monthly loss of $5.8 billion.").

123. *See Joint Hearing, supra* note 16 (statement of Timothy J. Mayopoulos, Former General Counsel, Bank of America) ("Sometime on December 3, 2008, I learned from Joe Price that Merrill Lynch's projected after-tax loss for the fourth quarter had increased to approximately $7 billion. Mr. Price told me about the new forecast; I do not recall ever receiving or reviewing a copy of this forecast. I reviewed with Mr. Price the relevant facts and the applicable legal principles that we had discussed in the November 20 conference call with Wachtell Lipton. Based on the new forecast Mr. Price described to me, we concluded that disclosure of the $7 billion projected loss was not warranted for the same reasons as the $5 billion projected loss."). *See also* Final Consent Judgment, supra note 106, at Para. 26 ("Mayopoulos advised that no disclosure was required because, in his view, the fundamental facts on which the analysis was based had not changed, including the rationale that the forecasted quarterly loss, although larger than the loss he had previously been consulted upon, was still within the $2 billion to $10 billion range of net losses that Merrill had sustained in prior quarters."). Outside counsel did not apparently participate in this determination. *See* Supplemental Statement of Facts, *supra* note 114 ("According to Wachtell Lipton, the last forecasted loss that Wachtell Lipton was informed of before the December 5 shareholder meeting was the approximately $5 billion quarterly loss that was discussed with Wachtell Lipton attorneys in November.").

Forecasts made later in the day increased the projected losses for the quarter to \$8.9 billion.[124] Although advice from counsel was apparently not sought on "whether the updated losses affected the previous conclusion that no additional disclosure was necessary",[125] the increase, had it been known, would not necessarily have altered the legal conclusions.[126] The projected losses for the quarter ultimately proved low, with net losses for the quarter exceeding \$15 billion.[127]

In considering the legal obligation to disclose the losses, counsel apparently relied on a combination of factors, including an absence of a duty to disclose and the immateriality of the information. More specif-

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124. *See* Final Consent Judgment, *supra* note 106, at Para. 23 ("Lewis and Thain agreed that the \$3 billion in losses should be added to the forecast and, later that day, Merrill's finance department generated a revised forecast that projected a quarterly net loss at Merrill of \$8.9 billion.").

125. *See* Final Consent Judgment, *supra* note 106, at Para. 25 ("With this update, the known and estimated losses at Merrill in October and November were over \$7.5 billion. After receiving this update, Bank of America did not consider, or seek the advice of counsel to determine, whether the updated losses affected the previous conclusion that no additional disclosure was necessary."). *See also Joint Hearing, supra* note 16 (statement of Timothy J. Mayopoulos, Former General Counsel, Bank of America) ("My recollection is that the first I learned of a \$9 billion projected loss was at the Bank of America Board of Directors meeting the following week on December 9.").

126. *See* Supplemental Statement *supra* note 114 ("According to Mayopoulos, he first learned of the forecasted after tax loss of nearly \$9 billion on December 9. While he did not recall receiving or reviewing the report containing the forecasted \$9 billion loss, he stated that if the increase from \$7 billion was in fact attributable in large part to a 'wild ass guess' of estimated November and potential December results, his 'legal advice would have been that such a guess was not an appropriate basis for a public disclosure'; Mayopoulos recognized, however, that "the closer you got to \$10 billion" in after-tax forecasted losses, "or once you got to a point where you exceeded \$10 billion . . . I think the disclosure question became much more difficult. There was a more compelling case to make a disclosure."); *see also Joint Hearing, supra* note 16 (statement of Timothy J. Mayopoulos, Former General Counsel, Bank of America) ("While I do not recall receiving or reviewing the \$9 billion forecast, if in fact a big part of it was a 'Wild Ass Guess,' I believe my legal advice would have been that such a guess was not an appropriate basis for a public disclosure. The law is clear that public disclosures to shareholders must be based on information that is reasonably reliable.").

127. *See* Final Consent Judgment, *supra* note 106, at Para. 30 ("On January 16, 2009, two weeks after the merger closed, Bank of America disclosed Merrill's performance in the fourth quarter of 2008. The Bank issued a release reporting that Merrill had sustained a net loss of \$15.3 billion in the fourth quarter of 2008, the largest quarterly loss in the firm's history, and that the Bank had obtained \$20 billion in funds under the U.S. Treasury Department's Troubled Asset Relief Program to assist in the acquisition of Merrill. On the next trading day, Bank of America's stock price dropped by 29 percent, although it recovered some of its value in the following days."). *See also Joint Hearing, supra* note 16 (statement of Timothy J. Mayopoulos, Former General Counsel, Bank of America) ("I understand from media reports that, after my departure from the Company, Merrill Lynch's projected losses continued to increase to levels that were much higher than previous estimates, and much higher than the losses Merrill Lynch had experienced in the fourth quarter of 2007 and in the first three quarters of 2008. Ultimately, on January 16, 2009, Merrill Lynch reported a \$15.31 billion after-tax loss for the fourth quarter of 2008."); Form 8-K, BOFA, Jan. 16, 2008, https://www.sec.gov/Archives/edgar/data/70858/000119312509007109/dex991.htm ("*\$15.31 Billion Fourth-Quarter Net Loss at Merrill Lynch*").

ically, disclosure was not thought to be necessary because among other things:

- neither the materials announcing the merger nor the proxy statement contained any projections or estimates of Merrill Lynch's future performance that were required to be updated;[128]
- Merrill Lynch had experienced significant losses since the financial crisis began in 2007 and had put reasonable investors on notice that the investment bank "might well suffer multi-billion dollar losses in the fourth quarter of 2008;"[129] and
- "the proxy statement and public documents incorporated into the proxy statement unambiguously disclosed to investors that adverse business and market conditions could continue to impact Merrill Lynch negatively"[130]

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128. *See*, *Joint Hearing*, *supra* note 16 (statement of Timothy J. Mayopoulos, Former General Counsel, Bank of America) ("First, neither the materials announcing the merger nor the proxy statement contained any projections or estimates of Merrill Lynch's future performance."). *See also* Supplemental Statement of Facts, Sec. & Exch. Comm'n v. Bank of Am. Corp., 1:09-cv-06829-JSR (S.D.N.Y. Feb. 17, 2010) (available at http://www.law.du.edu/documents/corporate-governance/sec-and-governance/bank-of-america/Supplemental-Statement-of-Facts-SEC-v-BofA-109-cv-06829-SD-NY-Feb-17-2010.pdf) ("First, the lawyers concluded that because the proxy statement, public filings, and materials announcing the merger did not contain 'projections or estimates of Merrill Lynch's future performance,' Bank of America 'had no legal duty to update past disclosures.'").

129. *See*, Joint Hearing, *supra* note 16 (statement of Timothy J. Mayopoulos, Former General Counsel, Bank of America) ("Over the 12-month period beginning with the fourth quarter of 2007, Merrill Lynch had experienced after-tax losses of approximately $22 billion, for an average quarterly after-tax loss of more than $5 billion. Merrill's after-tax losses in those four quarters ranged from $2 billion to nearly $10 billion. The projected losses of which I was advised were no greater."). *See* Final Consent Judgment, *supra* note 106, at Para. 19 ("An important reason for the lawyers' conclusion that no additional disclosure was necessary was that the forecasted $5 billion quarterly loss at Merrill was within the range of losses that Merrill had sustained in prior quarters. In the five quarters preceding the fourth quarter of 2008, Merrill's results ranged from a net loss of approximately $10 billion (in the fourth quarter of 2007) to a net loss of approximately $2 billion (in the first quarter of 2008)."); *see also* Supplemental Statement *supra* note 114 ("the lawyers concluded that 'a reasonable investor would have been on notice' of Merrill's 'multi-billion dollar losses' because the firm's after-tax losses in the prior five quarters ranged from $2 billion to nearly $10 billion; further, the lawyers believed that the Proxy Statement and public filings contained cautionary language that 'unambiguously disclosed to investors that adverse business and market conditions could continue to impact Merrill Lynch negatively.'").

130. *See* Supplemental Statement *supra* note 114 ("finally, according to Mayopoulos, 'numerous highly publicized events throughout 2008,' including major bank failures, the announcement of the Troubled Asset Relief Program, and Lehman Brothers' bankruptcy, warned investors that financial firms were "under great stress and might continue to incur significant losses."). *See also* Final Consent Judgment, *supra* note 106, at Para. 20 ("In addition to looking to Merrill's prior quarterly results, the lawyers concluded that the Proxy Statement and related filings, which described the challenging market environment and the adverse impact that Merrill could experience as a result, provided sufficient warning to shareholders, as did the distressed condition of the financial markets at the time. Merrill's Form 10-Q for the third quarter of 2008 stated that

The uncertainty of the reliability of the estimates projection[131] and the resulting concerns over liability[132] also apparently influenced the analysis.

2. *The Analysis*

The approach taken by counsel appears to meet all required standards applicable to lawyers. Moreover, the matter appears to have been thoroughly considered and involved the application of significant expertise. Counsel may not have been informed of all relevant information but the omissions may not have affected the legal analysis.[133] Ultimately, however, the actions of regulators suggest that they viewed the ultimate decision with respect to materiality as incorrect.

Moreover, although settling with BofA over the failure to disclosure the losses, the SEC did not bring actions against any individuals involved in decision.[134] The settlement did not explain the reasons for the decision.[135] We do not know if the SEC did so because of the

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'[t]urbulent market conditions in the short- and medium-term will continue to have an adverse impact on our core businesses.'").

131. *See Joint Hearings*, *supra* note 16 (statement of Timothy J. Mayopoulos, Former General Counsel, Bank of America) ("With regard to the earlier $5 billion and $7 billion forecasts I had discussed with Mr. Price, I was concerned that they were also based in part on guesses that might not be sufficiently reliable for investors to make an investment decision. Indeed, it is obvious in hindsight that, if any of the estimates had been publicly disclosed to shareholders at the time, shareholders would have been misled. All of the estimates that were developed through December 3 turned out to be materially incorrect when compared against Merrill Lynch's actual reported fourth quarter after-tax loss of $15.31 billion. If we had made a disclosure of any of these forecasts, shareholders would have likely sued the Company for misleading them as to the extent of the fourth quarter losses.").

132. *See* Supplemental Statement of Facts, *supra* note 114 ("According to Mayopoulos, the lawyers were also concerned that an unwarranted disclosure could expose Bank of America to liability if the disclosure turned out to be inaccurate.").

133. *See supra* note 126.

134. Opinion and Order, Sec. & Exch. Comm'n v. Bank of Am. Corp., 1:09-cv-06829-JSR (S.D.N.Y. Feb. 22, 2010) (available at http://www.law.du.edu/documents/corporate-governance/sec-and-governance/bank-of-america/Opinion-and-Order-SEC-v-BofA-109-cv-06829-SD-NY-Feb-21-2010.pdf) ("the Court, after a careful review of voluminous materials, determines only that the S.E.C.'s conclusion that the Bank and its officers acted negligently, rather than intentionally, in causing the nondisclosures that are the predicates to the settlement here proffered, is a reasonable conclusion, supported by substantial evidence, that a reasonable regulator could draw."); ("The S.E.C. and the Bank have consistently taken the position that it was, at worst, the product of negligence on the part of the Bank, its relevant executives, and its lawyers (inside and outside), who made the decisions (such as they were) to nondisclose on a piecemeal basis in which inadequate data coupled with rather narrow parsing of the disclosure issues combined to obscure the combined impact of the information being withheld. In particular, it appears that the relevant decision-makers took the position that neither the bonuses nor the mounting fourth quarter losses had to be disclosed because the bonuses were consistent with prior years' bonuses and the losses were uncertain and, in any case, roughly consistent with prior quarters.").

135. The SEC routinely considers the role of individuals in cases alleging inaccurate disclosure by public companies. *See* Lee, *supra* note 11 ("In fact, I can say with confidence that in cases

presence of lawyers in the determination. We do know, however, that the CEO of BofA testified that he was not a "securities lawyer,"[136] did not participate in the relevant conversations,[137] and relied on the analysis of lawyers.[138]

III. The Risk of Erroneous Decisions and the Absence of Consequences

As we have discussed, lawyers face significant incentives to support management's disclosure and non-disclosure decisions. The involvement of lawyers makes it less likely that managers will face liability for their getting the disclosure wrong. This would not be necessarily troubling if lawyers faced the prospect of liability, disciplinary enforcement or reputational harm in the marketplace, which could counteract the incentives they face to please management and get materiality wrong.

In general, lawyers' conduct is regulated by a mix of disciplinary controls, liability controls (such as malpractice suits), market controls (such as reputation), legislative controls, institutional controls and social norms.[139] In practice, however, there are few consequences to securities lawyers that provide incorrect legal advice with respect to disclosure decisions made by public companies. State disciplinary agencies are not set up to oversee lawyers advising public companies on disclosure decisions. Nor do the Model Rules impose meaningful and specific obligations on lawyers in these circumstances, despite the impact of erroneous advice on investors and the public. The SEC has

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alleging disclosure violations by a public company, staff carefully investigates and considers whether individuals are responsible and should be charged.").

136. *See*, *Joint Hearing*, *supra* note 16 ("Mr. Welch. If I can ask just one final question. If there is an event that you consider so significant that it may allow you to invoke the material adverse consequence contract clause, do you not think that same event is of interest to shareholders and requires you, in your fiduciary duty, to disclose it? Mr. Lewis. I leave that decision to our security lawyers and our outside counsel. Mr. Welch. You are not CEO? Mr. Lewis. I am not a securities lawyer.").

137. *Id.* ("Mr. Lewis. Again, I don't decide on disclosures; we have securities lawyers, and many times they talk to external counsel to determine that. Mr. Connolly. Well, presumably, you—I mean, I worked for a company. Presumably, you, as the CEO, are in those conversations. Mr. Lewis. No. They come to me and they are done.").

138. *See also* Supplemental Statement *supra* note 114 ("After the November 20 call, Price advised Lewis of the lawyers' conclusion that no additional disclosure was required."). *See*, *Joint Hearing*, *supra* note 16 ("Mr. Welch. And do you think after the fact information is not of interest to investors? Mr. Lewis. What I do know is that when our lawyers tell us we have a disclosable event, we disclose it.").

139. David B. Wilkins, *Who Should Regulate Lawyers?*, 105 Harv. L. Rev. 799, 804-09 (1992). *See generally* David B. Wilkins, *How Should We Determine Who Should Regulate Lawyers?—Managing Conflict and Context in Professional Regulation*, 65 Fordham L. Rev. 465 (1996).

the authority to police erroneous advice but has, as a matter of policy, declined to do so. As we show below, market control consequences are unlikely. The threat of civil liability for malpractice, by either the corporate clients or to affected third parties is minimal. The result is that lawyers who give bad advice on disclosure issues to management of public companies mostly receive a free pass.

The baseline for lawyer regulation is state-based.[140] After graduation from law school, law students apply for admission and are licensed by individual states and are subjected to the state's rules of professional conduct. Violation of the state's rules constitutes misconduct,[141] and avails lawyers of discipline, usually imposed by disciplinary agencies which are organs of or authorized by the state's supreme court.[142] In the individual hemisphere, this state-based apparatus makes some sense. Criminal law practice, for example, continues to be a predominantly state law area of law, practiced mostly by state prosecutors and local defense counsel.[143] Similarly, most of civil litigation takes place in state courts and is practiced by state licensed attorneys.[144]

In some areas, however, the practice of law in the United States has gradually grown more national, and, in the corporate hemisphere, more global.[145] Entity clients, big and small, do business throughout the United States and outside of it, and increasingly have legal needs that span outside of state borders.[146] Large law firms, the dominant providers of legal services in the corporate hemisphere, essentially practice nationally and globally.[147] And although in the second half of the twentieth century, the era of large law firms' rapid growth and expansion, some BigLaw opened new offices all over the United

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140. Judith L. Maute, *Bar Associations, Self-Regulation and Consumer Protection: Whither Thou Goest?*, 2008 J. PROF. L. 53, 58–66.

141. MODEL RULES OF PROF'L CONDUCT, R. 8.4(a) (AM. BAR ASS'N 2021).

142. Maute, *supra* note 140, at 58–66 (2008).

143. LESLIE C. LEVIN & LYNN MATHER, LAWYERS IN PRACTICE: ETHICAL DECISION MAKING IN CONTEXT 3–24 (Leslie C. Levin & Lynn Mather eds., 2012).

144. Nora Freeman Engstrom, *She Stood Up: The Life and Legacy of Deborah L. Rhode*, 74 STAN. L. REV. ONLINE 1, 8 n.36 (2021); Judith Resnik, *A2J/A2K: Access to Justice, Access to Knowledge, and Economic Inequalities in Open Courts and Arbitrations*, 96 N.C. L. REV. 605, 607–08 (2018); Gillian K. Hadfield & Jamie Heine, *Life in the Law-Thick World: Legal Resources for Ordinary Americans*, *in* BEYOND ELITE LAW – ACCESS TO CIVIL JUSTICE IN AMERICA 37 (Samuel Estreicher & Joy Radice eds., 2017).

145. Daniel R. Coquillette & Judith A. McMorrow, *Zacharias's Prophecy: The Federalization of Legal Ethics Through Legislative, Court, and Agency Regulation*, 48 SAN DIEGO L. REV. 123 (2011); Wald, *supra* note 36.

146. Wald, *supra* note 36, at 494–8.

147. Wilkins, *supra* note 75, at 2089–90.

States and the world,[148] the twenty-first century has featured more diverse approaches with many large firms practicing nationally and globally without having geographical footprints in every local legal market.[149]

This demand side push for the nationalization of law practice has led to some changes in the regulatory approach. Although licensing continues to be state-based, many jurisdictions have joined the Uniform Bar Exam,[150] allowing those who can bear multiple licensing fees and requirements to more easily be admitted in several states.[151] Moreover, the Model Rules, adopted by the ABA in 1983, have become de facto the national code of conduct, having been adopted by the vast majority of states' supreme courts, with relatively minor deviations.[152] Yet enforcement of the rules continues to be predominately a state-based affair.

State oversight of lawyers advising public companies is an anachronism. In the development of the securities markets, most aspects of oversight started at the state level. Blue sky statutes preceded the federal securities laws. Auditors of public companies were regulated at the state level as certified public accountants. The national nature of the markets and the inadequacies of relying on 50 different states to ensure sufficient investor protection, however, resulted in a transfer of oversight to a federal regulator.[153]

Yet, lawyers advising public companies are regulated at the state level, are subject to state rules and to oversight of state disciplinary agencies. The state-based apparatus raises two related sets of questions: are state-based rules, grounded in the Model Rules, suitable for securities lawyers advising public companies, and, if so, are such state-rules adequately enforced by state-based disciplinary agencies?

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148. MARC GALANTER & THOMAS PALAY, TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM (1991).

149. Marc Galanter & William Henderson, *The Elastic Tournament: A Second Transformation of the Big Law Firm*, 60 STAN. L. REV. 1867 (2008); Eli Wald, *The Other Legal Profession and the Orthodox View of the Bar: The Rise of Colorado's Elite Law Firms*, 80 U. COLO. L. REV. 605 (2009).

150. *See Jurisdictions That Have Adopted the UBE*, NAT'L CONF. BAR EXAM'RS, https://www.ncbex.org/exams/ube/ (last visited Apr. 5, 2023) [https://perma.cc/K3Y2-7FYP].

151. *Id.*

152. *Jurisdictional Rules Comparison Charts*, AM. BAR ASS'N, https://www.americanbar.org/groups/professional_responsibility/policy/rule_charts/ (last visited Apr. 4, 2023)(showing that most states follow the Model Rules).

153. *See* 15 U.S.C. § 7211. *See also* J. Robert Brown, Jr., Grading the PCAOB: Transparency, Accountability and Investor Protection, Address Before the Fall Conference of the Council of Institutional Investors (Sept. 17, 2019) (available at https://pcaobus.org/news-events/speeches/speech-detail/grading-the-pcaob-transparency-accountability-and-investor-protection_703).

A. The Insufficiency of the Model Rules and their State Counterparts

Following corporate debacles which caused great harm to the investing public, including the Savings and Loans and the accounting meltdowns,[154] critics of lawyers' roles in these scandals have argued that the Model Rules fall short of adequately regulating the practice of transactional lawyers practicing in the corporate hemisphere. To begin with, a lawyer advising a multi-trillion dollar public company is subject to the standards set by the state where he or she has been licensed. Because the company is doing business nationally and globally, lawyers advising the same corporation may be licensed in different states and therefore subject to different standards.[155] This concern, however, is partially addressed by the fact that most states follow the Model Rules.

Next and more importantly, the Model Rules, which inform state rules, were originally promulgated for trial lawyers and have a built-in litigator bias.[156] This critique is not merely an historical one. The litigation bias of the Model Rules means that they were not designed for and therefore poorly fit the contemporary practice realities and ethical challenges faced by corporate lawyers. The Model Rules assume the adversary system, in which each side has counsel and a neutral fact-finder decides the facts and applies the law. Within the institutional confines of the adversary system,[157] the Model Rules cultivate an expectation of lawyers' zeal on behalf of clients.[158]

Incredibly, at the same time as the Model Rules have tried to curb litigators' zealous advocacy, for example, by deleting references to zeal from the Rules and retaining just a handful of such references

154. William H. Simon, *The Kaye Scholer Affair: The Lawyer's Duty of Candor and the Bar's Temptations of Evasion and Apology*, 23 LAW & SOC. INQUIRY 243 (1998); Robert W. Gordon, A New Role for Lawyers?: The Corporate Counselor After Enron, 35 CONN. L. REV. 1185, 1204 (2003); *see generally* William H. Simon, *After Confidentiality: Rethinking the Professional Responsibilities of the Business Lawyer*, 75 FORDHAM L. REV. 1453 (2006).

155. *See, e.g.*, Steel v. Gen. Motors Corp., 912 F. Supp. 724 (D. N.J. 1995).

156. *See* Wald, *supra* note 23, at 245 ("Most *Rules* formally address lawyers broadly and not specifically litigators. But a close reading of the Comments often reveals the litigation bias inherent in the *Rules*."); Milton C. Regan, Jr., *Professional Responsibility and the Corporate Lawyer*, 13 GEO. J. LEGAL ETHICS 197, 201 (2000) ("A second disjunction between corporate practice and ethical rules is the fact that the latter traditionally have been formulated primarily with the litigator in mind. Yet transactional work, a staple of corporate practice, raises questions that do not always fit easily within this paradigm.").

157. Richard Wasserstrom, *Lawyers As Professionals: Some Moral Issues*, 5 HUM. RTS. 1 (1975).

158. David Luban, *Fiduciary Legal Ethics, Zeal, and Moral Activism*, 33 GEO. J. LEGAL ETHICS 275, 279 (2020).

only in the Preamble and the Comments,[159] by imposing mandatory disclosure obligations on lawyers to prevent fraud on the court,[160] and by imposing disclosure of controlling authority contrary to the client's position,[161] zeal has spread to the corporate sphere, in which the institutional features of the adversary system that explain and justify it are absent, without a corresponding expansion of mandatory disclosure duties.

This litigation bias has resulted in what John Dzienkowski has called a "hybrid" system: "Our legal system has evolved from a primarily adversarial system to a hybrid system without an equivalent evolution in the ethics rules governing lawyer behavior."[162] As Dzienkowski explains, "In litigation and non-litigation, the duty of zeal plays a role in justifying adversarial tactics."[163] Moreover, "The duty of zeal also plays a significant role in lawyer interpretation of confidentiality and disclosure obligations. Lawyers justify nondisclosure as necessary to protect the client."[164] This culture of nondisclosure is particularly harmful outside of the adversary system, because the typical practice of corporate lawyers advising clients in conference rooms, over the phone and virtually does not feature the built in protections to the public present in the former, such as a judge and jury. Dzienkowski concludes: "Essentially, I argue that the ABA and state ethics authorities have failed to properly deal with the harms resulting from misuse and misinterpretation of the duty of zeal and this failure has undercut the implementation of many aspects of regulating lawyers' behavior."[165]

Finally, and relatedly, the Model Rules rely on a one-size-fits-all approach[166] that applies equally to the solo practitioner with local clients and the largest corporate law firms that represent entities on a global basis.[167] The long-standing commitment of the ABA to the one-

159. *See, e.g.*, MODEL RULES R. 1.3 cmt. 1 ("A lawyer must . . . act with . . . zeal in advocacy upon the client's behalf.").

160. MODEL RULES R. 3.3(a)(3); (b).

161. MODEL RULES R. 3.3(a)(1).

162. John S. Dzienkowski, *Ethical Decisionmaking and the Design of Rules of Ethics*, 42 HOFSTRA L. REV. 55, 75 (2013). *See also* John S. Dzienkowski, *Lawyering in a Hybrid Adversary System*, 38 WM. & MARY L. REV. 45, 49–50 (1996).

163. Dzienkowski, *supra* note 162, at 73.

164. *Id*. at 74.

165. *Id*. at 74–75.

166. *See* Wald, *supra* note 23, at 228 ("the *Rules* are explicitly meant to be a on-size-fits-all model for all lawyers, irrespective of context.")

167. Jack A. Guttenberg, *Practicing Law in the Twenty-First Century in a Twentieth (Nineteenth) Century Straightjacket: Something Has to Give*, 2012 MICH. STATE L. REV. 415, 460–61 (2012) ("The time has come to give up the ghost that all lawyers and all law practices are the same, and, concomitantly, that all clients are the same. Equating the multinational corporate

size-fits-all regulatory approach has little to do with corporate lawyers. Instead, it is explained in terms of the desire to retain control over the regulation of the legal profession.[168] Nonetheless, the result is rules of professional conduct that are often broad and largely a poor fit vis-à-vis corporate lawyers.[169] Similarly, the Model Rules' general, one-size-fits-all approach is a poor fit for the work of increasingly specialized attorneys, such as securities lawyers, and provides little guidance for the particular challenges these lawyers experience.

B. *The Slim Ethical Obligations of a Securities Lawyer*

The litigation bias and one-size-fits-all critiques of the Model Rules are well-taken. Thomas Morgan, however, has correctly pointed out that several rules of professional conduct, "taken individually and together, define what state law has understood to be a corporate lawyer's duties."[170]

First, Model Rule 1.2(d) provides that "[a] lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent . . . "[171]. Accordingly, corporate lawyers' knowing involvement in, or giving advice that assists, a client's crime or fraud is a clear violation of the rule.

Second, Model Rule 1.13(a) specifies that "[a] lawyer employed or retained by an organization represents the organization . . . "[172], not

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client with the individual seeking a divorce or wanting to form a small business, and, therefore, devising rules that apply equally to lawyers representing those very different clients, does a grave disservice to both clients and lawyers alike.").

168. Limor Zer-Gutman & Eli Wald*, Is the Legal Profession Too Independent?* 105 MARQUETTE L. REV. 341 (2021).

169. *See* Lawrence A. Hamermesh, *Preliminary Report of the American Bar Association Task Force on Corporate Responsibility* (2002) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=321701) ("These broad and aspirational principles, while of profound importance, do not afford a sufficient guide to the corporate lawyer confronted with aberrant conduct by corporate officers and insiders."); MODEL RULE 2.1 ("In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation."). *See also* Anna Colby, *A Path to More Sustainable Corporations in the United States*, 34 GEO. J. LEGAL ETHICS 861 (2021).

170. Thomas D. Morgan, *Sarbanes-Oxley: A Complication, Not a Contribution, in the Effort to Improve Corporate Lawyers' Professional Conduct*, 17 GEO. J. LEGAL ETHICS 1, 3 (2003).

171. MODEL RULES R. 1.2(d).

172. Lawyers represent the organization, not the individuals who run the organization. MODEL RULES R. 1.13(a) ("A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents."). *See also* MODEL RULES R. 1.13 cmt. 1 ("Officers, directors, employees and shareholders are the constituents of the corporate organizational client."). *See* Elizabeth Chambliss, *Professional Responsibility: Lawyers, a Case Study*, 69 FORDHAM L. REV. 817, 847–48 (2000) ("'This presumably would include . . . systems for checking conflicts of interest . . . [and] a means for updating conflicts of interest data. . . ;

the officers who provided the assignments.[173] Thus, a corporate lawyer represents the corporation itself, not its managers or directors, and advising the corporation in a manner that advances the interests of management over the interests of the corporation constitutes a prohibited conflict of interest in violation of Model Rules 1.7(a)(2).[174] Practically speaking, counsel is retained by, and answers to, someone who is not the client.[175] Nothing in the rule acknowledges this tension by including requirements designed to ensure that the advice meets the needs of the entity rather than the source of the assignment. Lawyers advising public companies are not, therefore, required to assess the impact of the advice on the shareholders investing in the company.[176]

Third, Model Rule 1.4(b) establishes a duty to take information about the matter on which any lawyer is working to duly authorized constituents of the client "to the extent reasonably necessary to permit the client to make informed decisions regarding the representation."[177] Under the rule, corporate lawyers cannot keep information about corporate crime or fraud to themselves and must inform the authorized constituents of the client about it.

Fourth, building on Model Rule 1.4(b), Model Rule 1.13(b) spells out the appropriate manner of communications between a corporate lawyer and the authorized constituents of the entity client:

> If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organiza-

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procedures for quality control of product created by new associates. . . ; and adequate systems for ensuring proper and appropriate billing of clients and the proper handling of clients' funds. . .'").

173. Ralph Jonas, *Who is the Client?: The Corporate Lawyer's Dilemma*, 39 HASTINGS L.J. 617, 617 (1988) ("It is axiomatic that a corporation is a distinct, discrete legal entity that exists separate and apart from its officers, agents, directors, and shareholders. It is almost equally axiomatic that a lawyer who is retained to represent a corporation owes his allegiance solely to that legal entity, and not to the corporation's officers, directors, and shareholders.").

174. MODEL RULES R. 1.7(a)(2).

175. Jonas, *supra* note 173, at 617. ("Therefore, we have the perverse situation in which the lawyer who represents a publicly held corporation is selected and retained by, and reports to and may be fired by, the principal officers and directors of the corporation—who are not his clients.").

176. Quite the reverse. In general, the standards emphasize the "hired gun" approach without countervailing weight given to the consequences to public. *See* Wald, *supra* note 23, at 249 ("The *Rules* thus feature a hired gun bias in that they put in place and celebrate attorney duties to clients as the core of what it means to be a lawyer, dominating and rendering as secondary duties to the legal system and the public.").

177. MODEL RULES R. 1.4(b).

> tion, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law.[178]

As rule 1.13(b) makes clear, a corporate lawyer may have to go up the corporate ladder to the board of directors, if management insists on an unlawful course of conduct that is likely to result in substantial injury to the corporation. Where this is ultimately unsuccessful, the lawyer may reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.[179]

Moreover, Model Rule 1.13(c) grants corporate lawyers the discretion to reveal confidential information in limited circumstances to protect the best interests of the corporate client. Indeed, read together, rules 1.13(b) and 1.13(c) set up a reporting up the corporate ladder regime, with discretion to reveal confidential information in some circumstances in which management's conduct will cause significant harm to the client. Yet, once again, disclosure per Rule 1.13(c) is permissive, such that lawyers cannot be disciplined for deciding not to exercise their discretion to reveal.

Fifth, Model Rule 1.16(a)(1) requires a corporate lawyer to withdraw from any case in which "the representation will result in violation of the rules of professional conduct or other law," including rule 1.2(d), 1.13(a), 1.4(b), 1.13(b) and 1.13(c).[180] As Morgan explains, "while the lawyer need not withdraw from representing the client if the lawyer's own work would not involve counseling or assisting criminal or fraudulent conduct — for example, because the improprieties involve the work of some other lawyer or law firm — when the lawyer's own services are involved, withdrawal is mandatory."[181]

Sixth, while Model Rule 1.6(a) defines confidentiality broadly, stating that "[a] lawyer shall not reveal information relating to the representation of a client,"[182] and suggesting that a corporate lawyer may never reveal confidential information outside of the corporation,

178. MODEL RULES R. 1.13(b).
179. MODEL RULES R. 1.13(c).
180. MODEL RULES R. 1.16(a)(1).
181. Morgan, *supra* note 170, at 5.
182. MODEL RULES R. 1.6(a).

Model Rule 1.6(b) lists two exceptions relevant to the typical work of corporate lawyers:

> (b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary: . . .
>
> (2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;
>
> (3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services."[183]

Moreover, although the Model Rules include another limited exception to confidentiality in rule 1.6(b)(1) to prevent death and substantial bodily harm,[184] many states have retained the broader language of the predecessor Model Code, which permitted disclosure of otherwise confidential information about "[t]he intention of [the lawyer's] client to commit a crime and the information necessary to prevent the crime."[185] Thus, in many states, corporate lawyers are authorized to disclose the intention of their corporate client to commit a criminal financial fraud and the information necessary to prevent it.

Seventh and finally, Model Rule 4.1(b) requires a lawyer not to knowingly "fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6."[186] As Morgan explains, while seemingly the reference to Rule 1.6 swallowed up the rest of Rule 4.1(b), "however, given the actual state law versions of Rule 1.6[(b)(1)], that was not true in most jurisdictions, and given the ABA's . . . Rule 1.6(b)(2) & (3), it is clearly not true. Corporate lawyers thus are now required by Model Rule 4.1 to disclose outside the corporation any material fact . . . necessary to avoid assisting a criminal or fraudulent act by a client."[187]

Admittedly, following Morgan, criticizing the Model Rules for regulating corporate lawyers with a litigation bias and with a limiting com-

183. Model Rules R. 1.6(b)(2); (3).

184. Model Rules R. 1.6(b)(1)("A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary to prevent reasonably certain death or substantial bodily harm,").

185. Model Code of Pro. Resp. DR 4-101(C)(3) (Am. Bar Ass'n 1980).

186. Model Rules R. 4.1(b).

187. Morgan, *supra* note 170, at 7.

mitment to a one-size-fits-all approach, one need not under-state the extent to which the Model Rules do purport to regulate the conduct of corporate lawyers, even if critics believe that the Model Rules ought to mandate, as opposed to permit, disclosure in 1.13(c), 1.6(b)(2) and 1.6(b)(3). Importantly, putting aside whether these rules adequately regulate the conduct of *corporate* lawyers in general,[188] we argue that the Model Rules do not adequately regulate the conduct of *securities* lawyers giving disclosure advice.

Materiality advice is a mixed question of law and fact.[189] As we explained above, the very involvement of lawyers in the decision insulates management, and, in turn, the corporate client from liability for fraud.[190] Thus, because the client's conduct will, by definition, not amount to fraud, Model Rule 1.2(d) never comes into play and securities lawyers can always explain the state of the law and their advice to the client.[191] Next, the communication rules, 1.4(b) and 1.13(a)-(c), are unhelpful and inapplicable to disclosure advice. Because lawyers' advice insulates the client from liability, the nondisclosure favored by management does not meet the stringent conditions of 1.13(b), in particular, the conduct is not a clear violation of the law, and thus securities lawyers do not have discretion to reveal it outside of the corporation in the client's best interests. Similarly, because the conduct is not criminal or fraudulent, a securities lawyer does not have discretion to reveal it per rule 1.2(d) and subsequently per rules 1.6(b)(2) and (b)(3).

The one Model Rule that seems to directly apply to disclosure advice by securities lawyers is rule 1.1 on competence, which states: "A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation."[192] Applying rule 1.1 to disclosure advice, one could argue that securities lawyers who yield to pressure from management and give erroneous disclosure advice violate the rule, yet incompetence is hard to show in cases which call for the exercise of professional judgment given complicated facts. Unfortunately, Rule 1.1 contains no specific competency requirements that apply to those representing public companies. Instead, the Comment makes clear that "[a] lawyer need not necessarily

188. Many critics believe, contrary to Morgan, that they do not. *See, e.g.,* Gordon, *supra* note 62, at 265–66. Simon, *supra* note 154; Gordon, *supra* note 154.

189. *See*, *supra* note 10.

190. *Supra* Part II.B.

191. Model Rules R. 1.2(d).

192. Model Rules R. 1.1.

have special training or prior experience to handle legal problems of a type with which the lawyer is unfamiliar,"[193] or can achieve "the requisite level of competence" through "reasonable preparation."[194]

A troubling stalemate has emerged when it comes to the regulation of the corporate hemisphere. Critics argue that the Model Rules and their state counterparts are tainted by a litigation bias and a commitment to the one-size-fits-all approach and therefore insufficiently regulate the conduct of corporate lawyers who advise and assist clients' fraudulent or criminal conduct. The ABA and some commentators retort that critics under-state the regulation of corporate lawyers. We assert that this traditional discourse is a red herring when it comes to securities lawyers giving materiality disclosure advice. Assuming, *argumentum*, that the Model Rules sufficiently regulate the practice of corporate lawyers advising clients regarding fraudulent conduct, they do not adequately regulate the conduct of securities lawyers giving disclosure advice. Indeed, given the hybrid nature of the Rules and their commitment to zeal, the Model Rules underregulate securities lawyers. Worse, as we show in the next section, even if the Model Rules were sufficient, they are under-enforced vis-à-vis securities lawyers.

C. *State Disciplinary Agencies and Lawyer Non-Accountability*

Even if the Model Rules were to effectively regulate corporate and securities lawyers, state disciplinary agencies systematically underenforce the state rules of professional conduct.[195] Specifically, state agencies tend to concentrate their enforcement efforts on lawyer mishandling of client funds, to the exclusion of most other misconduct. "The result is that many rules simply go unenforced or are patently underenforced."[196] In turn, because the rules are systematically underenforced, lawyers do not fear discipline for violating them.[197] As David Luban explains, "even lawyers who believe in the ethical supe-

193. *See* Model Rules R. 1.1., cmt. 2.

194. *Id*. at cmt. 4. *See also* Guttenberg, *supra* note 167, at 471.

195. Richard L. Abel, *Why Does the ABA Promulgate Ethical Rules?* 59 Tex. L. Rev. 639, 648 (1981) (noting that "study after study has shown that the current rules of professional conduct are not enforced."). *See also*, David B. Wilkins, *Legal Realism for Lawyers*, 104 Harv. L. Rev. 468, 493 (1990) (noting "the rules of professional conduct . . . tend to be systematically underenforced.").

196. Milan Markovic, *Advising Clients After Critical Legal Studies and the Torture Memos,* 114 W. Va. L. Rev. 109, 115 (2011).

197. Dzienkowski, *supra* note 162, at 81 (most lawyers simply do not view violations of the rules as leading to any significant risk of discipline); Fred C. Zacharias, *The Future Structure and Regulation of Law Practice: Confronting Lies, Fictions, and False Paradigms in Legal Ethics Regulation*, 44 Ariz. L. Rev. 829, 861–62 (2002).

riority of a certain course of conduct will engage in substandard behavior if they perceive other lawyers will so behave without sanction."[198] Similarly, Tanina Rostain concludes that "In a rational-actor model of legal ethics, enforcement–the detection of wrongdoing, apprehension of the wrongdoer, and conviction–bears the full weight of ensuring compliance with rules. Even with well-drafted rules and appropriate sanctions, a regulatory regime will flounder unless the rules are enforced at a sufficient level to deter wrongful conduct."[199] The reasons for this underenforcement include lack of sufficient resources[200] and insufficient subject matter expertise.[201] During the hearings on SOX, this failure was acknowledged.[202]

Although underenforcement of the rules of professional conduct is a system-wide problem, the failure is especially acute vis-à-vis securities lawyers practicing in the corporate hemisphere for several interrelated reasons. To begin with, due to their limited resources, state disciplinary agencies tend to predominantly enforce formal, clear and specific rules, as opposed to open-ended standards.[203] Yet, as we have

198. David Luban, *Calming the Hearse Horse: A Philosophical Research Program for Legal Ethics*, 40 Md. L. Rev. 451, 460 n.24, (1981).

199. Tanina Rostain, *Ethics Lost: Limitations of Current Approaches to Lawyer Regulation*, 71 S. Cal. L. Rev. 1273, 1307–08 (1998).

200. *See* Quintin Johnstone, *An Overview of the Legal Profession in the United States, how that Profession Recently has been Changing, and Its Future Prospects*, 26 Quinnipiac L. Rev. 737, 759 (2008) ("A major problem, however, in enforcement of lawyer disciplinary and unauthorized-practice laws is inadequate state funding of the enforcement process, with resulting inadequate enforcement staffing."). *See also* Sung Hui Kim, *Lawyer Exceptionalism in the Gatekeeping Wars*, 63 SMU L. Rev. 73, at n. 86 (2010) ("State bar disciplinary systems lack both the funding and the expertise to go after securities lawyers.").

201. *See* Susan P. Koniak, *When the Hurlyburly's Done: The Bar's Struggle with the SEC*, 103 Colum. L. Rev. 1236 (2003) ("neither I nor any of my colleagues in this area of law know of one single case in which a lawyer from a major law firm has been disciplined by state authorities for aiding a client's securities fraud. Despite all the settlements after the savings and loan crisis, all the press coverage, and a number of court opinions describing egregious lawyer conduct, there has been not one case of state discipline. The state disciplinary systems lack the expertise in securities law, the staff, and the monetary resources to take on a major securities firm. They can't do it and they don't. Thus, when the bar says leave securities lawyers to the states, it means leave them unregulated.").

202. 148 Cong. Rec. S 6524, S 6551, S 6554-6555 (daily ed. July 10, 2002) (statement of Sen. Enzi) ("I am usually in the camp that believes States should regulate professionals within their jurisdiction. However, in this case, the State bars as a whole have failed. They have provided no specific ethical rule of conduct to remedy this kind of situation. Even if they do have a general rule that applies, it often goes unenforced. Most States also do not have the ability to investigate attorney violations involved with the complex circumstances of audit procedures within giant corporations.").

203. Leslie C. Levin, *The Ethical World of Solo and Small Law Firm Practitioners*, 41 Hous. L. Rev. 309, 382 (2004) (under enforcement of formal bar rules that are clear and specific aggravates the perception of underenforcement); Fred C. Zacharias, *What Lawyers Do When Nobody's Watching: Legal Advertising as a Case Study of the Impact of Underenforced Professional*

seen, Model Rule 1.1 as applied to securities lawyers giving materiality disclosure advice is exactly the kind of open-ended, non-specific standard, which is likely to be underenforced.

Moreover, "[t]he hesitation to pursue resource-intensive prosecutions also helps explain the apparent preference of disciplinary agencies to sanction solo practitioners and small law firms, rather than pursuing violations by large firms,"[204] which are more likely to challenge the allegations of misconduct in a costly battle. Yet, it is exactly BigLaw lawyers who provide the bulk of materiality disclosure advice to large public companies and who therefore face the least enforcement. As a result, "large law firm lawyers may feel insulated from professional regulation and conclude that such constraints only apply to 'lower order' lawyers," and may come to believe "that their conduct is beyond reproach."[205]

Next, lack of subject matter expertise is especially constraining vis-à-vis securities lawyers giving materiality advice because their practice consists of exercising judgment and applying specialized knowledge to complex mixed questions of law and fact.

As a result, state disciplinary agencies are not set up to oversee lawyers representing public companies.[206] Just as Susan Koniak argued that "It is fanciful to imagine state bar authorities, notoriously underfunded and under-staffed, succeeding in establishing assistance of

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Rules, 87 IOWA L. REV. 971, 1003, 1005–07, 1014 (2002) (noting that when lawyer advertising regularly violates rules and those rules are underenforced, it sends the message that formal rules need not be obeyed. Moreover, failure to enforce formal rules causes distrust of the entire regulatory structure.).

204. Fred C. Zacharias, *The Purposes of Lawyer Discipline*, 45 WM. & MARY L. REV. 675, 697 n.76 (2003). *See also* Leslie C. Levin, *The Emperor's Clothes and Other Tales About the Standards for Imposing Lawyer Discipline Sanctions*, 48 AM. U. L. REV. 1, 62 n.275 (1998) ("Solo practitioners, who are on the bottom of the lawyer status ladder, are . . . disciplined more often than lawyers who work in other practice settings."); SHARON TISHER ET AL., BRINGING THE BAR TO JUSTICE: A COMPARATIVE STUDY OF SIX BAR ASSOCIATIONS 103 (1977) ("[T]he vast majority of lawyers investigated and punished . . . practice alone or in two or three person firms."); Ted Schneyer, *On Further Reflection: How "Professional Self-Regulation" Should Promote Compliance with Broad Ethical Duties of Law Firm Management*, 53 ARIZ. L. REV. 577, 603 (2011) ("Lawyer disciplinary agencies receive many complaints every year. Most are filed by unsophisticated clients against lawyers who practice alone or in small firms."); AM. BAR ASS'N SPECIAL COMM. ON EVALUATION OF DISCIPLINARY ENFORCEMENT, PROBLEMS AND RECOMMENDATIONS IN DISCIPLINARY ENFORCEMENT 41 (Prelim. Draft, Jan. 15, 1970) ("The majority of complaints submitted to disciplinary agencies concern the single or small-firm, low-income practitioner.").

205. John Sahl, *Behind Closed Doors: Shedding Light on Lawyer Self-Regulation – What Lawyers Do When Nobody's Watching*, 48 SAN DIEGO L. REV. 447, 458 (2011).

206. Guttenberg, *supra* note 167, at 471 (2012) ("The profession does little to punish incompetence and very few lawyers are disciplined for incompetence.").

fraud by a big-time corporate law firm,"[207] it would be naïve and unreasonable to expect state disciplinary agencies to successfully enforce poorly articulated competence standards against BigLaw securities lawyers. Indeed, even commentators who believe that the Model Rules sufficiently address the practice realities of corporate lawyers, concede the problem of underenforcement:

> It is true that few, if any, lawyers for major corporations have been disbarred or otherwise disciplined for violations of state professional standards. However, that is not because corporate lawyers have been granted special immunity from compliance. One unfortunate reality about the legal profession has been the general breakdown of the lawyer disciplinary process nationwide. According to the ABA, a traditional defender of state regulation, a charge filed with a state lawyer disciplinary agency has a 70% chance of being dismissed without serious investigation. Of the remaining 30% of complaints, five out of six will be investigated but not tried. Thus, only 5% of the original total will be brought to trial, and of those, only 2% will produce significant professional discipline. The cases that do get that far will tend to be ones in which the offense is clear and the evidence unambiguous, features not common in most cases involving corporate lawyers.[208]

D. The Implausibility of Market Controls

An extensive body of literature documents the powerful impact of market controls over the conduct of lawyers,[209] including lawyers' concern for their reputation.[210] Applied to securities lawyers' disclosure advice with respect to materiality, one might have expected fear of loss of reputation in the market for corporate legal services to counteract management's pressure to advise nondisclosure. Yet loss of reputation for giving the wrong disclosure advice is unlikely and the reason – a race to the bottom or a market failure – demonstrates a shortcoming of market controls in general.

When lawyers in a competitive situation must choose between obeying underenforced rules of conduct and satisfying a client, there is good chance that the ideals will be set aside.[211] This is, in theory, the

207. Susan P. Koniak, *Corporate Fraud: See, Lawyers*, 26 HARV. J.L. & PUB. POL'Y 195, 2015 (2003).

208. Morgan, *supra* note 170, at 7.

209. Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239 (1984) (discussing the value of business lawyers in reducing transaction costs in negotiations); Karl S. Okamoto, *Reputation and the Value of Lawyers*, 74 OR. L. REV. 15 (1995) (refining Gilson's hypotheses).

210. Fred C. Zacharias, *Effects of Reputation on the Legal Profession*, 65 WASH. & LEE L. REV. 173 (2008).

211. *Id*. at 211.

power of market controls: lawyers are likely to yield to market forces. Indeed, market controls require only that clients know what they want, that clients insist upon receiving what they want, and that lawyers and clients communicate about those desires on a routine basis.[212] This is, perversely, exactly what happens in the market for disclosure advice.

Management, speaking for entity-clients, pressures lawyers to advise nondisclosure. Management makes it abundantly clear what it wants and lawyers well understand the likely consequences for refusing management's pressure.[213] So long as securities lawyers have little fear of discipline or civil liability and yield to economic incentives and pressures, no harmful market consequence follows. Quite the contrary, a severe market consequence – loss of business in a highly competitive environment – awaits those securities lawyers that might attempt to defy management.

This reasoning also explains why institutional controls, such as BigLaw's ethical infrastructure,[214] as well as social norms, such as peer pressure, are unlikely to influence securities lawyers' conduct. BigLaw has gradually put in place an ethical infrastructure, encroaching on individual partners' exercise of individualized professional discretion, at least in areas of conflict checking and risk management, for fear of liability.[215] Yet, what large law firms can hardly afford to do in a highly competitive market for corporate legal services, and, indeed what they will find near impossible to do, is to substantively monitor the exercise of subject-matter professional judgment, for example, that of securities lawyers' materiality calls. Similarly, elite securities lawyers are unlikely to be pressured by their peers to stand up to management when, to loosely quote David Luban, everybody else is doing it (giving nondisclosure advice) and getting away with it.[216]

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212. *Id.*

213. Given the obvious consequences of disclosure and nondisclosure, securities lawyers will likely know the preferences of management even without explicit discussion.

214. Ted Schneyer, *On Further Reflection: How "Professional Self-Regulation" Should Promote Compliance with Broad Ethical Duties of Law Firm Management*, 53 ARIZ. L. REV. 577 (2011).

215. Elizabeth Chambliss & David B. Wilkins, *A New Framework for Law Firm Discipline*, 16 GEO. J. LEGAL ETHICS 335 (2003); Elizabeth Chambliss, *The Nirvana Fallacy in Law Firm Regulation Debates*, 33 FORDHAM URB. L.J. 119, 138–39 (2005); Anthony V. Alfieri, *The Fall of Legal Ethics and the Rise of Risk Management*, 94 GEO. L.J. 1909 (2006); Anthony E. Davis, *Legal Ethics and Risk Management: Complementary Visions of Lawyer Regulation*, 21 GEO. J. LEGAL ETHICS 95 (2008); Milton C. Regan, Jr., *Risky Business*, 94 GEO. L.J. 1957 (2006).

216. Luban, *supra* note 198.

E. The Non-Threat of Malpractice Liability

Securities lawyers pressured by management to advise nondisclosure of material information are not likely to face discipline because state rules of professional conduct based on the Model Rules, especially Model Rule 1.1, poorly regulate their conduct, and because state-based disciplinary agencies are unlikely to attempt to prove their misconduct. Nor are securities lawyers likely to face market consequences for incorrectly advising nondisclosure because theirs is the very advice sought by powerful actors in the market for corporate legal services, management. Perhaps, however, underenforcement of the rules would be inconsequential if securities lawyers faced malpractice lawsuits following mistaken nondisclosure advice. "[W]hile a corporate lawyer is not likely to receive professional discipline for a failure to prevent or disclose a client's crime or fraud,"[217] and similarly is unlikely to face discipline for giving the wrong materiality advice, "statistics about professional discipline ignore the fact that civil liability has long replaced professional discipline as the principal means of enforcement of professional standards. And in the liability arena, judgments and settlements have been substantial enough to throw fear into the heart of the least risk-averse corporate lawyer."[218]

Potential malpractice liability, however, is unlikely to deter securities lawyers' deference to management for two reasons. First, the very same management that is pressuring securities lawyers to advise nondisclosure would be the authorized constituent authorized to bring a malpractice claim, an unlikely turn of events. Second, even if a malpractice lawsuit were to be filed, for example, following a shareholders' derivative claim, by new management, or by third parties claiming a reliance interest, establishing liability, in particular that the nondisclosure advice fell below the standard of care, would be difficult. Unlike civil liability for assisting or advising fraud, which as we document above can rely on showing the violation of numerous clear rules of professional conduct, including 1.2(d), establishing a breach of the duty of care based on a violation of the open-ended, non-specific, and infused with the exercise of professional judgment Model Rule 1.1 would be unlikely.

Specifically, plaintiffs trying to establish that nondisclosure advice fell below the standard of care are likely to run against the attorney judgment rule. Briefly, while the standard of care stands for the proposition that lawyers owe clients a duty to exercise "that degree of

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217. Morgan, *supra* note 170, at 8.
218. *Id.*

care, skill, diligence and knowledge commonly possessed and exercised by a reasonable, careful and prudent lawyer,"[219] courts routinely acknowledge that "[a]n attorney is never bound to exercise extraordinary diligence, or act beyond the knowledge, skill, and ability ordinarily possessed by members of the legal profession."[220] Specifically, courts have been especially protective of lawyers' so-called "judgment calls:" "[A]n attorney is not held to the rule of infallibility and is not liable for an honest mistake of judgment, where the proper course is open to reasonable doubt."[221]

Choosing one of " 'several reasonable courses of action" ' is not legal malpractice.[222] "Otherwise, every losing litigant would be able to sue his attorney if he could find another attorney who was willing to second guess the decisions of the first attorney with the advantage of hindsight."[223] Applied to securities lawyers' materiality advise, a complex question of fact and law, which requires by definition a judgment call, without further concrete guidance from the Model Rules or the SEC about the applicable standard, courts are likely to be receptive to defendants' claim that if at all, they made an honest mistake of judgment.

F. The Non-Threat of SEC Enforcement

The SEC can and does bring actions against lawyers who violate the federal securities laws.[224] This has occurred where the SEC feels comfortable alleging something amounting to reckless or intentional misbehavior. The SEC has brought actions alleging that lawyers "purposely hid" facts in an SEC filing,[225] authored "sham" agreements,[226] provided misleading statements to auditors,[227] or assisted in

219. J. Mark Cooney, *Benching the Monday-Morning Quarterback: The "Attorney Judgment" Defense to Legal-Malpractice* Claims, 52 WAYNE L. REV. 1051, 1054-55 (2006).

220. *Id.*

221. *Id.*

222. *Id.*

223. *Id.*

224. *See* Sec. & Exch. Comm'n v. Shkreli et al., Litigation Release No. 25065 (E.D.N.Y. Apr. 6, 2021) (hereinafter "Litigation Release No. 25065") (settlement of case alleging that outside counsel "aided and abetted" securities violations by drafting "sham consulting agreements" and failing to disclose to the board of directors "the true purpose of the agreements.").

225. *In re* Lubin, Exchange Act Release No. 83897 (Aug. 21, 2018) ("By omitting material facts related to the status of the Form S-1 shares in the public filings he drafted, signed, and caused to be filed, [respondent] purposefully hid the true beneficial ownership of the Form S-1 shares.").

226. *See*, Litigation Release No. 25065, *supra* note 224 ("This alleged misconduct was, according to the complaint, aided and abetted by Greebel, who was Retrophin's outside counsel and served as corporate secretary. The complaint alleged that Greebel drafted sham consulting

a fraud.[228] In general, these violations require evidence of intent[229] and do not cover negligent behavior.[230] In disclosure cases, the allegations will often involve theories of secondary liability in part because the lawyers are not typically the "makers" of a false statement by the corporation.[231]

The SEC has the authority to bring actions against lawyers for negligent behavior.[232] Under Rule of Practice 102(e), the SEC can sus-

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agreements and failed to disclose to Retrophin's Board of Directors the true purpose of the agreements.").

227. *See In re* James R. Thompson, Esq., Exchange Act Release No. 97045 (Mar. 6, 2023) (allegations that CEO/General Counsel made materially false statements to auditor in "audit inquiry responses and management representation letters").

228. *In re* Gregory L. Kelly, Esq., Exchange Act Release No. 87968 (Jan. 15, 2020) (alleging that lawyer while in company's legal department and afterwards provided substantial assistance in efforts to conceal "from public disclosure more than $90 million in compensation to be paid to" the CEO).

229. *See In re* Altman, Exchange Act Release No. 63306 (Nov. 10, 2010) ("Fourth, Altman argues that, while he 'understood that he was bound by New York's disciplinary rules, he could not reasonably have expected that the Commission would seek to enforce those rules in the first instance.' . . . That the Commission generally has refrained from initiating this type of proceeding does not deprive it of its authority to do so.").

230. *In re* Clug, Exchange Act Release No. 90385 (Nov. 20, 2020) (aiding and abetting liability requires showing of scienter). *See also In re* Grogan, Exchange Act Release No. 84197 (Sept. 19, 2018) ("To establish causing liability, the Commission must find: (1) a primary violation; (2) the respondent's act or omission contributed to the violation; and (3) the respondent knew or should have known that the act or omission would contribute to the violation."). The SEC does have the authority to police intentional or reckless behavior. *See* Sec. & Exch. Comm'n v. Sargent, Litigation Release No. 24900 (D. Mass Sept. 16, 2020) ("Mintz and Fraade, who were licensed lawyers at that time, prepared false attorney opinion letters to help Sargent and others facilitate the merger of BMP into PixarBio Corporation, a private company that the SEC previously charged, along with three other individuals, in a separate action. Mintz and Fraade consented to the entry of a final judgment that permanently enjoins them from violating the antifraud provisions of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and the registration provisions of Sections 5(a) and 5(c) of the Securities Act. The judgment further prohibits Mintz and Fraade from providing legal services pertaining to federal securities law exemptions from registration. Mintz and Fraade have consented to pay, jointly and severally, disgorgement plus prejudgment interest for a total of $28,785.96. No civil penalty was imposed against Mintz and Fraade based on their financial condition.").

231. For actions brought under Rule 10b-5, liability rests with the "maker" of the statement. *See* Janus Cap. Grp., Inc. v. First Derivative Traders, 564 U.S. 135, 142 (2011). The maker in turn is not the one who actually drafts the document or makes recommendations about the content but instead is the person in "control." A lawyer giving advice generally does not meet this definition. *See* id. at 143 ("[W]hen a speechwriter drafts a speech, the content is entirely within the control of the person who delivers it. And it is the speaker who takes credit—or blame—for what is ultimately said.").

232. *In re* Grogan, Exchange Act Release No. 84197 (Sept. 19, 2018) ("Negligence is sufficient to establish 'causing' liability."). This is the case where the underlying violation does not require a showing of scienter. *See In re* Anton & Chia, Sec. &Exch. Comm'n Release No. 1407 (Feb. 8, 2021) ("Negligence is sufficient to show causing liability if the underlying violation does not require a showing of scienter.").

pend or bar attorneys from practicing before the Commission for failing to possess the requisite qualifications and engaging in "unethical or improper professional conduct,"[233] an undefined standard that encompasses "generally recognized norms of professional conduct"[234] that can include state ethical or professional standards.[235]

The SEC did attempt to bring at least one such case alleging violations of professional standards in the 1970s.[236] The effort drew a predictably hostile response from the legal profession. Moreover, while in *In re Carter* the Commission indicated that lawyers "with significant responsibilities in the effectuation of a company's compliance with the disclosure requirements of the federal securities laws" could violate professional standards to the extent becoming aware of a client's "substantial and continuing" noncompliance without taking "prompt steps" to end the noncompliance,[237] the General Counsel of the SEC two decades later was comfortable acknowledging that "the Commission has not brought Rule 102(e) proceedings against lawyers based on allegations of improper professional conduct, or otherwise used the Rule to establish professional responsibilities of lawyers" and that "there are also good reasons why consideration of such a significant change in established practice should be undertaken in the context of Congressional legislation, as opposed to agency rulemaking."[238]

233. The phrase is not defined in Rule 102(e). *See* SEC. & EXCH. COMM'N r. 102(e). *See also* Julie Anderssen Hill, *Divide and Conquer: SEC Discipline of Litigation Attorneys*, 22 GEO. J. LEGAL ETHICS 373 (2009) ("The phrase "improper professional conduct" first appeared in the Rules of Practice in 1938.").

234. In re Carter, 47 S.E.C. 471 (1981) ("At the same time, however, we perceive no unfairness whatsoever in holding those professionals who practice before us to generally recognized norms of professional conduct, whether or not such norms had previously been explicitly adopted or endorsed by the Commission. To do so upsets no justifiable expectations, since the professional is already subject to those norms.").

235. Edward F. Greene, General Counsel, SEC, Lawyer Disciplinary Proceeding Before the Securities and Exchange Commission, The New York County Lawyers' Association, New York, New York, Jan. 13, 1982 (available at https://www.sec.gov/news/speech/1982/011382greene.pdf) (" My initial tentative view is that as a general matter the Commission should ordinarily only institute Rule 2(e) proceedings if the misconduct alleged is (i) a violation of established state law ethical or professional misconduct rules and (ii) has a direct impact on the Commission's internal processes, such as where the lawyer participates directly or indirectly in the preparation of disclosure documents filed with the Commission."). *But see In re* Altman, *supra* note 229 ("The first statement, a 1982 speech by Edward F. Greene, the Commission's then-General Counsel, concerned attorney disciplinary proceedings brought under Rule 2(e), the predecessor to Rule 102(e). The views expressed by Greene — regardless of their content — cannot be attributed to the Commission.").

236. *See In re* Carter, *supra* note 234 (reversing the Administrative Law Judge's decision to suspend lawyers from practice before the SEC).

237. *Id*, at *30.

238. Morgan, *supra* note 170, at 14 (quoting from Letter from David Becker, General Counsel, SEC, to Richard Painter, Professor, University of Illinois at Urbana-Champaign, College of

Since *In re Carter* and its authority notwithstanding,[239] the SEC has not brought cases for negligence against lawyers involved in the disclosure process,[240] including cases involving incorrect legal advice.[241] The Commission did not bring actions against lawyers who allegedly provided approvals "without adequate review"[242] or accepted "perfunctory" explanations,[243] that drafted proposed disclosure resulting in an incorrect impression,[244] that expressed "no concerns" following the review of "sham" contracts,[245] and that "failed to investigate po-

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Law (Mar. 28, 2002). *See also* Disciplinary Proceedings Involving Professionals Appearing or Practicing Before the Commission, Exchange Act Release No. 25893 (July 7, 1988) ("The great majority of Rule 2(e) proceedings against attorneys involve allegations of violations of the law (not of professional standards); thus, the Commission, as a matter of policy, generally refrains from using its administrative forum to conduct de novo determinations of the professional obligations of attorneys.").

239. *See In re* Altman, *supra* note 229 ("Fourth, Altman argues that, while he "understood that he was bound by New York's disciplinary rules, he could not reasonably have expected that the Commission would seek to enforce those rules in the first instance." . . . That the Commission generally has refrained from initiating this type of proceeding does not deprive it of its authority to do so.").

240. John C. Coffee, Jr., *The political Economy of Dodd-Frank: Why Financial Reform Tends To Be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019, 1045 (2012) ("The SEC has long (and perhaps unwisely) resisted entering this zone, based on the overbroad rationale that to discipline attorneys for negligence or inaction would chill the attorney-client relationship and might dissuade clients from seeking legal advice."). *See In re* Monson, Sec. & Exch. Comm'n Release No. 28323 (June 30, 2008) ("As far as we are aware, we have not sanctioned attorneys in litigated enforcement proceedings based on alleged negligent acts or omissions they may have committed in providing non-public legal advice to clients.").

241. *See In re* Monson, *supra* note 240 ("we have refrained from bringing disciplinary proceedings against lawyers under Rule 2(e) and its successor, Rule 102(e), based on negligent legal advice.").

242. *In re* Juniper Networks Inc., Exchange Act Release No. 46812 (Aug. 29, 2019) ("The sales employees submitted these falsified and misleading trip agendas to Juniper's Legal Department to obtain event approval. In contravention of Juniper's travel policies, Juniper's Legal Department approved numerous trips without adequate review and after the event had taken place.").

243. *In re* United Technologies Corp., Exchange Act Release No. 84087 (Sept. 12, 2018) ("In September 2014, the head of the Otis Russia Legal Department ("Russia lawyer") initially refused to approve the contract and requested information about the ownership of the new intermediary and a written explanation from Liftremont as to why it needed the intermediary. . . . Ultimately, in December 2014, the Russia lawyer gave the Regional lawyer a letter from the Liftremont Senior Official containing a perfunctory explanation for why Liftremont needed the new intermediary inserted into the contract.").

244. *In re* Nissan Motor Co., Ltd, Exchange Act Release No. 87054 (Sept. 23, 2019) (alleging that employee in legal department provided "proposed disclosure" that "gave the impression that the increase benefited multiple directors and statutory auditors, when in fact the entire approximately $29 million increase only benefitted" the CEO).

245. *In re* Lan Airlines SA, Exchange Act Release No. 78402 (July 25, 2016) ("LAN's legal department reviewed the sham contract with the consultant's company and raised no concerns.").

tential issues when they arose".[246] Some cases have involved clauses in agreements viewed by the SEC as problematic – such as limitations on an employee's ability to communicate whistleblower complaints to the SEC – despite apparent involvement of lawyers in the agreements.[247]

Weaknesses in the standards may explain some of this hesitancy. Yet even where this is not an issue, the SEC does not bring actions for violations.[248] This includes the one professional standard adopted by the Commission,[249] perhaps a consequence of the desire to avoid "high conflict" with the corporate bar.[250] And while the Commission

246. *In re* JP Morgan Chase & Co., Exchange Act Release No. 79335 (Nov. 17, 2016) ("JPMorgan APAC legal and compliance staff did not understand the actual nature and operation of the Client Referral Program, and did not take adequate steps to fully investigate the extent and purpose of the Program during the relevant time period. This was due in part to JPMorgan APAC investment bankers failing to share complete information on the Client Referral Program with legal and compliance personnel. It was also due to a fundamental misunderstanding of the Client Referral Program by JPMorgan APAC legal and compliance, and a failure to investigate potential issues when they arose.").

247. *In re* Bluelinx Holdings Inc., Exchange Act Release No. 78528 (Aug. 10, 2016) ("By including those clauses in its Severance Agreements, BlueLinx raised impediments to participation by its employees in the SEC's whistleblower program. By requiring departing employees to notify the company's Legal Department prior to disclosing any financial or business information to any third parties without expressly exempting the Commission from the scope of this restriction, BlueLinx forced those employees to choose between identifying themselves to the company as whistleblowers or potentially losing their severance pay and benefits.").

248. Even the Commission has noted that it "has generally refrained" from bringing these actions. *See In re* Altman, *supra* note 229 ("Altman argues that, while he 'understood that he was bound by New York's disciplinary rules, he could not reasonably have expected that the Commission would seek to enforce those rules in the first instance.' . . . That the Commission generally has refrained from initiating this type of proceeding does not deprive it of its authority to do so.").

249. Steinberg, *supra* note 20, at 1584 ("Perhaps most telling is that, since the adoption in 2003 of its standards of professional conduct, mandated by the Sarbanes-Oxley Act of 2002, the SEC has not instituted a single proceeding against an attorney based on an alleged violation of these standards. Hence, for several years, the SEC has refused to invoke statutory and regulatory mechanisms that clearly come within the ambit of its authority."); *see also* Coffee, Jr., *supra* note 240, at 1044 ("Total silence on the enforcement front has followed the SEC's aspirational Standards of Professional Conduct. Despite numerous instances in which lawyers were clearly aware of executive misconduct—and both the stock-option backdating scandal and the mutual-fund-market timing scandal followed the adoption of these standards and presented instances in which misconduct involving violations of the federal securities laws deeply implicated attorneys—the SEC appears to date never to have charged an attorney representing a public corporation with violating this rule.").

250. Coffee, Jr., *supra* note 240, at 1044 ("Sanctioning attorneys for failure to report violations up the ladder within the corporate structure would again place the SEC in a position of high conflict with the bar. In contrast to prosecutions of attorneys for insider trading or other scienter-based offenses, the SEC's enforcement of reporting rules would reach attorneys who acted only negligently or who declined to act, in either case without any clear element of self-dealing.").

could use the administrative process to define professional standards, it has for the most part declined to do so.[251]

This approach was reaffirmed in *In re Monson*, a case involving alleged negligent advice by an attorney.[252] According to the allegations, counsel drafted an agreement that authorized "late trading," an impermissible practice for mutual funds.[253] Although unnecessary to the outcome of the case,[254] the Commission took the opportunity to reiterate its ban on bringing negligence actions against lawyers. The Commission would not use its disciplinary authority to "expose an attorney to professional discipline merely because his advice, followed by the client, is ultimately determined to be wrong."[255] In other words, actions would not be brought in the case of "errors in judgment" or "carelessness.'"[256] Individual commissioners have also disclaimed any kind of "public watchdog" role for lawyers providing securities advice.[257]

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251. *See* Disciplinary Proceedings Involving Professionals Appearing or Practicing Before the Commission, Exchange Act Release No. 25893, 1988 WL 1000021, at *10 (July 7, 1988) ("the Commission, as a matter of policy, generally refrains from using its administrative forum to conduct de novo determinations of the professional obligations of attorneys.").

252. *See In re* Monson, *supra* note 240 ("The Division essentially contends that, by not having requisite knowledge of the securities laws and by failing to conduct further legal inquiry regarding trade timing issues in connection with the drafting of the Agreement, Monson was negligent in providing legal advice to his client.").

253. *Id.* ("The Division contends that 'the ultimate question in determining Monson's negligence,' and therefore whether he can be found to have caused his company's violation, 'is what a reasonable attorney in Monson's position, acting with due care, would have done.' Monson allegedly 'failed to conform to basic professional standards regarding competence.'")

254. *Id.* ("The present case, however, does not require us to address further the appropriate parameters of lawyer liability in administrative enforcement actions because the record does not show by a preponderance of the evidence that Monson acted negligently in drafting the Agreement."). The decision has been criticized. *See* Coffee, Jr., *supra* note 240, at 1045–46 (2012) ("Arguably, these concerns are overblown when applied to an attorney who drafts an agreement expressly authorizing unlawful conduct. Late trading is not a gray offense.").

255. Note the non-gender nature of the statement. *See id.* ("The charges against Monson as framed by the Division – that Monson departed from professional standards of competence in rendering private legal advice to their clients – raise the same risks we identified in Carter and other proceedings: an encroachment by the Commission on regulation of attorney conduct historically performed by the states; interference with lawyers' ability to provide unbiased, independent legal advice regarding the securities laws; and chilled advocacy on behalf of clients in proceedings before the Commission.").

256. *See id.* ("Given these considerations, we eschewed a standard that would expose an attorney to professional discipline 'merely because his advice, followed by the client, is ultimately determined to be wrong.' The intent requirement, we said, is crucial to an allegation of wrongdoing by a lawyer because it 'provides the basis for distinguishing between those professionals who may be appropriately considered as subjects of professional discipline and those who, acting in good faith, have merely made errors of judgment or have been careless.'"

257. *See* Edward H. Fleischman, Commissioner, Sec. & Exch. Comm'n, Address to the Seventh Annual Ray Garrett Jr. Corporate and Securities Law Institute: Aligning the Compass for the SEC's Relationship with its Practicing Bar (Apr. 30, 1987) (available at: https://www.sec.gov/

IV. Fixing the Chilling Disclosure and Lawyers' Non-Accountability Problems

As we have discussed at length, lawyers play a critical role in the disclosure process, particularly materiality determinations. Nonetheless, they may get the law wrong and are often under pressure to provide the advice that management wants to hear. Despite the harm to the investing public, there is little accountability for lawyers who provide erroneous advice.

Creating adequate accountability foremost requires a clear set of standards. The SEC has the authority to do so and in fact was instructed by Congress to adopt "minimum standards" in this area. With one exception, however, the authority remains unused.[258] This must change. We recommend that the SEC consider standards in seven specific areas to make securities lawyers accountable for the advice they give their clients.

Before turning to the specifics of our proposal, an important caveat, to situate and distinguish our recommendations from the current discourse. Most academic commentators, hailing from both corporate law and the law governing lawyers, assessing the role and conduct of corporate lawyers in the context of clients' fraudulent or criminal conduct, frame the discourse in terms of lawyers acting as gatekeepers or as hired guns. Responding to lawyers' arguments that their clients' conduct was not clearly fraudulent or criminal, or that they did not have discretion to reveal it, proponents of reform assert that lawyers must act as gatekeepers in the public interest: not only must they refrain from assisting and advising clients from fraudulent or criminal conduct and attempt to dissuade clients from such conduct, lawyers must also dissuade clients from pursuing conduct that is arguably lawful but inconsistent with the spirit of the securities statutes or the public interest.[259] Opponents of such reform proposals reply that lawyers

news/speech/1987/043087fleischman.pdf) ("Unlike accountants, whose role is analyzed in the [*Arthur Young*] opinion, it seems to me that lawyers do not assume such a public responsibility as to transcend their relationships with their several clients, nor do lawyers undertake a special ultimate role as "public watchdogs", in the Supreme Court's phrase, on behalf of creditors and the investing public generally. Congress recognized that professional difference in its ban on licensing by federal agencies, which applies to lawyers but not accountants.").

258. The Commission has already brought a climate change case involving the impact of "warmer weather" on sales of "higher priced cold weather apparel within North America." *See In the Matter of* Under Armour, Inc., Exchange Act Release No. 10940 (May 3, 2021). Individuals were not charged in the case.

259. Model Rules R. 1.6, cmt. 2. Sung Hui Kim, *Inside Lawyers: Friends or Gatekeepers?*, 84 Fordham L. Rev. 1867 (2016); *see, e.g.*, Sung Hui Kim, *The Banality of Fraud: Re-Situating the Inside Counsel as Gatekeeper*, 74 Fordham L. Rev. 983 (2005).

ought not serve as gatekeepers and must defer to the lawful objectives of their clients.[260]

Although we have both previously written about aspects of corporate law practice, corporate lawyers and gatekeeping,[261] here we do not take a position in the gatekeeping debate, because it is unnecessary for purposes of addressing the chilling disclosure problem of securities lawyers. Instead, we merely advocate for lawyers to get materiality right, that is, to act competently and avoid giving negligent advice. In this sense, our fix is more modest than the traditional posture of reform proponents. To be blunt, staying clear of the debate over what lawyers *should* do when their clients seek to behave in lawful but harmful ways, we simply insist in this Article that lawyers must comply with the law as it *is*, and give accurate disclosure advice to their clients.

A. Section 307 of the Sarbanes-Oxley Act

The problems associated with inaccurate advice by disclosure lawyers are nothing new. In adopting SOX, Congress recognized the ubiquitous role played by lawyers in the financial frauds occurring at the time. As Senator Edwards noted, whenever wrongs by corporate executives and auditors surfaced, "lawyers [were] virtually always there looking over their shoulder[s]."[262] In providing advice, counsel often acted in the interests of executive officers[263] rather than shareholders "to whom" the duty and responsibility was owed.[264] Congress also understood that lawyers could not police themselves.[265]

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260. *See, e.g.*, Lawrence A. Hamermesh, *Who Let You into the House?,* 2012 WIS. L. REV. 359.

261. Eli Wald, *Lawyers and Corporate Scandals*, 7 LEGAL ETHICS 54 (2004); J. ROBERT BROWN, JR., THE REGULATION OF CORPORATE DISCLOSURE (4th ed.).

262. 148 Cong. Rec. S 6524, S 6551 (daily ed. July 10, 2002) (statement of Sen. Edwards) ("The truth is that executives and accountants do not work alone. Anybody who works in corporate America knows that wherever you see corporate executives and accountants working, lawyers are virtually always there looking over their shoulder. If executives and/or accountants are breaking the law, you can be sure that part of the problem is that the lawyers who are there and involved are not doing their jobs.").

263. *Id.* at S6555 (statement of Sen. Enzi) ("It is important to understand the corporate attorney's client is the whole corporation and its shareholders, and not just the CEOs or some of the executives, accountants, or auditors. As a result, their ultimate duty of representation is not to the people to whom they normally report but to the shareholders through the board of directors."). *See also id* at S6556 (statement of Sen. Corzine) ("The lawyer's client is the corporation's shareholders, not the manager.").

264. *Id.* at S6551 (statement of Sen. Edwards) ("The lawyers who represent corporations have the same kind of responsibility, but it is to a different entity and a different group of people. They have a responsibility, though, to represent that corporation, their client, zealously, the same way I had the responsibility to represent kids and families.").

265. Id. at S6552 (statement of Senator Edwards) ("With Enron and WorldCom, and all the other corporate misconduct we have seen, it is again clear that corporate lawyers should not be

Congress addressed these concerns in SOX. The SEC was instructed to adopt "minimum standards" applicable to securities lawyers advising public companies. There was a specific expectation that these standards would require lawyers to "do something" when they learned about misbehavior[266] but the expectations were much broader.[267] Minimum standards were more broadly intended to protect "investors from unprofessional conduct by lawyers"[268] and to ensure that advice was in the interests of the company rather than executive management.

The Commission ultimately ignored most of the concerns and defined "minimum standards" as a single requirement for attorneys appearing and practicing before the Commission in the representation of

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left to regulate themselves no more than accountants should be left to regulate themselves. There has been a lot of debate, rhetoric, and discussion—rightfully so—about the necessity about not 'letting the fox guard the chicken coop.' The same is true with lawyers. This has become clear through various acts of misconduct. The lawyers have involvement and responsibility, and they also cannot be left to regulate themselves."). *See also* Harvey L. Pitt, Chairman, Sec. & Exch. Comm'n, Remarks Before the Annual Meeting of the American Bar Association's Business Law Section (Aug. 12, 2002) (available at http:// www.sec.gov./news/speech/spch579.htm) (noting that "Sarbanes-Oxley reflects some skepticism about the degree to which the legal profession can police itself, by making explicit the Commission's ability, *and our obligation*, to regulate how lawyers appear and practice before us, including minimum standards of professional conduct for corporate lawyers.").

266. 148 Cong. Rec. S 6552 (daily ed. July 10, 2002) (statement of Sen. Edwards) ("One of the most critical responsibilities that those lawyers have is, when they see something occurring or about to occur that violates the law, breaks the law, they must act as an advocate for the shareholders, for the company itself, for the investors. They are there and they can see what is happening. They know the law and their responsibility is to do something about it if they see the law being broken or about to be broken.").

267. *See also* Roger C. Cramton et al., *Legal and Ethical Duties of Lawyers after Sarbanes-Oxley*, 49 VILL. L. REV. 725, 789–90 (2004) ("Section 307 refers to 'minimum standards of professional conduct,' which means that the SEC was required to adopt not simply the two rules referred to, but a set of rules governing the conduct of lawyers who appear and practice before the SEC. Rules concerning disclosure are not unusual, either for 'standards of professional conduct' governing lawyers generally or for rules promulgated by the SEC under the securities laws, which of course are all about disclosure of various types. The use of the word 'including' reinforces the idea that the two rules mentioned in Section 307 were not the only ones Congress authorized the SEC to adopt. Moreover, there is no language in Section 307 that purports to limit in any way the type of 'standards of professional conduct' the SEC is authorized to adopt.").

268. 148 Cong. Rec. S 6552 (daily ed. July 10, 2002) (statement of Sen. Edwards) ("First, the SEC shall establish rules to protect investors from unprofessional conduct by lawyers, conduct that violates the legal standards of the profession."); *see also* Coffee, Jr., *supra* note 30, at 1301–02 ("Although the only specific reform mandated by section 307 was up-the-ladder reporting, the breadth of the phrase 'minimum standards of professional conduct' sweeps far more broadly and easily could encompass other, potentially more extensive gatekeeping duties, at least to the extent that any such duty can be fairly characterized as a 'minimum standard of professional conduct.'").

an issuer[269] to report[270] certain legal violations "up the corporate ladder."[271] The standards focused on "material" violations.[272] The single standard was not followed with any meaningful enforcement. To date, no successful action has been brought for violations of the "up the ladder" requirements.

B. Minimum Standards

Particularly given the shift to a more managerial centric system of disclosure, and the substantive silence of the Model Rules, which offer the open-ended, nonspecific rule 1.1 as the only meaningful guidance for securities lawyers construing and advising clients regarding materiality, the need for "minimum standards" governing the obligations of securities lawyers practicing before the SEC and advising issuers has only increased.[273] These standards need to address the specific concerns raised by Congress in adopting Section 307, including the need for counsel to ensure that advice is in the interests of the company rather than the officers providing the assignment.

Such minimum standards also need to include regulations that govern advice on disclosure issues, particularly materiality determinations to address the chilling disclosure problem examined in this Article – the deference of securities lawyers to managerial pressure to advise nondisclosure of material information to the investing public. The standards should be sufficient to provide investors and the public with greater confidence in the quality of the advice. Finally, as a practical matter, the standards should provide regulators with a mechanism to challenge advice through the adequacy of the process, a common enforcement approach that allows an agency to avoid acting as the arbiter of the actual advice.

In light of these concerns, we recommend that the SEC consider standards in seven specific areas:

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269. For the most part the definition applies to public companies, those required to file periodic reports under the federal securities laws. *See* 17 C.F.R. § 205.2(h).

270. 17 C.F.R. § 205.1.

271. Final Rule: Implementation of Standards of Professional Conduct for Attorneys, Exchange Act Release No. 34-47276 (Aug. 5, 2003).

272. Ironically, the reporting obligations under the up the ladder rules also require an assessment of materiality. 148 Cong. Rec. S 6552 (daily ed. July 10, 2002) (statement of Sen. Edwards) ("the way we have drafted the bill, the duty to report applies only to evidence of a material violation of the law. That means no reporting is required for piddling violations or violations that don't amount to anything. The obligation to report is triggered only by violations that are material—violations that a reasonable investor would want to know about.").

273. *Id*. The Commission has already brought a climate change case involving the impact of "warmer weather" on "sales of higher priced cold weather apparel within North America." Individuals were not charged in the case, *see*, *supra* note 258.

First, the SEC's standards already specify that securities lawyers representing public companies must operate in the interests of the corporation, not its management.[274] This standard, however, provides no insight into how this should be accomplished. It should.

Second, the standards should embody a concept of completeness with respect to advice. Most specifically, this means a lawyer's obligation to convey any significant uncertainties in the analysis. Particularly with respect to materiality determinations, this would include the risk that the information may be later viewed as material and the consequences should that occur.

Third, the standards should clarify the obligation to have an adequate factual predicate for the advice.[275] Before providing disclosure advice, lawyers should be required to employ some type of process to make sure that the facts they have under consideration are sufficient to render an opinion or provide the requisite advice. Where they know the information may not be accurate, either because of red flags or because of a rapidly changing environment, they should have an obligation to investigate.

Fourth, much like the audit evidence standard, lawyers making determinations should be required to keep sufficient contemporaneous records to support the reasonableness of the legal advice provided.[276]

Fifth, lawyers providing disclosure advice should have a minimum level of training and expertise making materiality assessments. This should require more than a general understanding of the federal securities laws or the belief that because lawyers also invest, they inherently understand the informational needs of institutional and other investors. Disclosure lawyers opining on the informational needs of "reasonable shareholders" should have adequate expertise to make these determinations.

Sixth, standards should require policies and procedures at the law firm level that are designed to ensure the quality of the advice. Much the way auditing firms must put in place a system of quality control with respect to the audits of public companies, this concept should be applicable to law firms giving opinions to public companies.

Finally, standards should require disclosure outside of the entity in limited circumstances in which management refuses to follow the ad-

274. *See* 17 C.F.R. § 205.3(a).

275. Coffee, Jr., *supra* note 30, at 1301 ("Few norms are less controversial among securities attorneys than that they should perform some due diligence in preparing prospectuses or other disclosure documents. Yet no SEC rule actually requires this.").

276. *AS 1105: Audit Evidence*, Pub. Co. Acct. Oversight Bd., https://pcaobus.org/oversight/standards/auditing-standards/details/AS1105 (last visited Apr. 5, 2023).

vice of disclosure counsel and insists on acting in a manner which will make the corporation liable. In essence, the SEC could track rules 1.13(b) and 1.13(c), except that instead of the "may disclose" in rule 1.13(c), it should have a "shall disclose" standard.

1. *A Duty to Represent the Corporation*

The legal obligation to make accurate and complete disclosure for the most part rests with the corporation. In practice, executive management, particularly the CEO, has control over the process and responsibility for determining the content of the filings. And while officers and directors have an obligation to act in the best interests of shareholders, they may not always do so.[277]

The Commission has already specified in the "up-the-ladder" standard that lawyers "appearing and practicing before the Commission in the representation of an issuer" owe a duty to the company "as an organization" and that advising officers, directors or employees . . . "does not make such individuals the attorney's clients."[278] The standard, however, provides no insight into how this objective should be accomplished.

The standard could require explicit consideration and weighing of any possible conflicts of interest, both by the lawyer providing the advice and the executive officers asking for the review.[279] This could include the impact of the decision on an officer's compensation or tenure. Likewise, counsel could consider the overall financial nature of the relationship with the company by the firm.

The standard should preempt an aspect of the Model Rules, inconsistent with the objective consideration and weighing of possible conflicts of interest. Like 17 CFR 205.3(a), Model Rule 1.13(a) states that

277. We note that there is a tendency to discuss this issue in terms of a duty to investors and the public. *See* REPORT OF THE NEW YORK CITY BAR ASSOCIATION TASK FORCE ON THE LAWYER'S ROLE IN CORPORATE GOVERNANCE (Nov. 2006) (available at https://www.nycbar.org/pdf/report/CORPORATE_GOVERNANCE06.pdf) [Excerpted for Publication in *The Business Lawyer*], 62 BUS. LAW. 427, 457 (2007)] ("Given that there is some foundation for the above two premises, the argument for a broader duty urges that the public interest requires that lawyers be held responsible for protecting shareholders and the investing public from client wrongdoing."). We limit our discussion to a duty to shareholders, as owners of the corporation, and do not address the broader duty to investors and the public.

278. 17 C.F.R. § 205.3(a).

279. *See* Wald, *supra* note 23, at 245 ("Univertext rules could caution against too quick a deference to clients in circumstances in which clients' conduct is likely to impose a significant economic harm on third-parties and against boilerplates, and perhaps mandate disclosure in subsections 1.6(b)(2) and 1.6(b)(3) in appropriate circumstances. Univertext rules could also specify the relevant considerations a lawyer should contemplate in terms of making disclosure, and highlight the cardinal importance of building client relationships as necessary infrastructure for informing client decision making.").

a lawyer for the corporation represents the corporate entity, not its authorized constituents.[280] However, Model Rule 1.13(g) blurs this distinction, stating that: "A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7 [the conflict of interest rule]."[281] Moreover, "If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders."[282]

Although we agree that corporate counsel may in general also represent constituents of the corporate clients if the conflict of interest has been adequately resolved, that is, if an appropriate official of the organization has given the organization's informed consent, we argue that disclosure counsel may not also represent constituents of the corporate clients. Such a conflict would undermine the ability of disclosure counsel to objectively consider and weigh any possible conflicts of interest, both by the lawyer providing the advice and the executive officers asking for the materiality review.

We note that while our position would require a revision of rules 1.13(a) and 1.13(g) or at least clarifying the application of these rules to disclosure counsel in the Comment, it may be consistent with the Model Rules' overall approach to resolving conflicts of interest.[283] Our recommendation may be consistent with Rule 1.7(b) because subsection 1.7(b)(1) may be read to mean that disclosure counsel's conflict of interest cannot be cured because no securities lawyers could reasonably believe that s/he will be able to provide competent disclosure advice to both the entity and management.

We rather err on the side of caution and make sure the Model Rules explicitly adopt this interpretation in a Comment to Model Rule 1.13.

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280. MODEL RULES R. 1.13(a) ("A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents."). The Comment adds that "An organizational client is a legal entity, but it cannot act except through its officers, directors, employees, shareholders and other constituents. Officers, directors, employees and shareholders are the constituents of the corporate organizational client . . . . This does not mean, however, that constituents of an organizational client are the clients of the lawyer." Model Rules R. 1.13, cmts. 1–2.

281. MODEL RULES R. 1.13(g).

282. *Id.*

283. Model Rule 1.7(b) states that "Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client [here, the entity and its constituents] if: (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client; (2) the representation is not prohibited by law; (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and (4) each affected client gives informed consent, confirmed in writing." MODEL RULES R. 1.7(b)

In the Alternative, the SEC can spell it out in a standard such that per subsection 1.7(b)(2) the representation of both the entity and its constituents by disclosure counsel would be prohibited by law – the federal securities statutes as interpreted by the SEC. Either way, securities counsel vested with the duty to consider and weigh any conflict of interest between the interests of the entity and the interests of management could not be representing both the entity and management. It must only represent the corporation and its interests.

2. A Duty to Convey Uncertainties

With respect to disclosure advice, legal advice may sometimes be clear. Regulation S-K, for example, has a number of thresholds that are relatively objective.[284] The computation of executive compensation is, with the exception of perks, scripted to a high degree, with little discretion.[285] Where, however, disclosure focuses on standards such as materiality, the analysis can be less certain.

Courts recognize this. Judges decline to dismiss cases alleging that information was immaterial unless the resolution is clear. They therefore only do so where the information is "obviously unimportant."[286] They recognize that information above this threshold is a matter for factfinders, not judges. Said another way, judges in these circumstances lack the ability to definitely make conclusions about materiality.

Lawyers should apply the same standard. Advice on materiality should make definitive conclusions about materiality only if meeting the "obviously unimportant" standard. Information that does not meet the standard is at risk for being found to be material by a fact finder in the event of litigation. At a minimum, this possibility should be conveyed to management. This will leave in the hands of management the final say on materiality, reducing the use of the presence of counsel as a defense.

3. A Duty to Have an Adequate Factual Predicate

Lawyers opining on materiality determinations and other disclosure issues should have an adequate factual predicate.[287] Representations

284. *See* Item 103 of Regulation S-K, 17 C.F.R. § 229.103.

285. *See* Item 402 of Regulation S-K, 17 C.F.R. § 229.402.

286. *See supra* note 10.

287. *Bandera Master Fund LP*, C.A. No. 2018-0372-JTL ("It is also self-evident that an opinion giver must act in good faith when establishing the factual basis for an opinion, including when making assumptions. Legal opinions 'do not address the law in the abstract. Rather, they apply the law to real companies in real transactions.' Id. § 4.1 at 82. Legal opinions accordingly 'require grounding in the facts as well as the law.' Id. The opinion giver usually will have first-

by management that the company had provided all information "relevant to the matter," standing alone, should not invariably be enough to discharge disclosure counsel's duty of ensuring an adequate factual background.

The standard should certainly provide that advice or opinions may not rely on "information known to be untrue or which has been provided under circumstances that would make reliance unreasonable"[288] Counsel also may be aware of conflicting information from any number of sources, including through other legal work done for the company.[289] And while advice can rely on assumptions, it cannot do so to the extent contrary to known facts.[290] Where accuracy cannot be ascertained or the opinion is based upon "counterfactual assumptions," this should be "explicitly" identified.[291]

The standard should also impose an explicit duty to inquire in certain circumstances. Such investigation could be required, for example, where the circumstances are dynamic and rapidly evolving.[292] A determination of materiality of earnings or losses in the middle of a report-

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hand knowledge of some of the facts necessary to render the opinion, but rarely will the opinion giver have firsthand knowledge of all of the necessary facts.").

288. *Id.* ("To establish the factual basis for an opinion, the opinion giver can rely in good faith on factual information provided by others. An opinion giver cannot act in good faith by relying on information known to be untrue or which has been provided under circumstances that would make reliance unreasonable. For example, an opinion giver could not rely in good faith on information if the opinion giver knew that the person providing the information had not done the work required to support it.").

289. Notably, if disclosure counsel would be charged with considering other information the law firm as a whole learned about through other legal work done for the company, this might encourage the use of "independent" disclosure counsel.

290. *See Bandera Master Fund, supra* note 287 ("Although an opinion giver cannot rely on factual information known to be untrue, an opinion giver can base an opinion in good faith on an assumption that is contrary to existing fact. The flexibility to rely on a counterfactual assumption enables an opinion giver to render an opinion based on facts that do not exist on the date of the opinion but that the giver and recipient are confident will exist in the future. See Glazer et al., *supra*, § 4.3.6 at 119. For example, an opinion giver might assume that stock will be duly authorized after the closing of a transaction once necessary filings are made. *Id.* Or the opinion giver may use counterfactual assumptions to address situations that are not expected to arise, but which the recipient wants the opinion giver to address, such as the possibility that the law of a particular jurisdiction may govern the transaction.").

291. *See Bandera Master Fund, supra* note 287 ("To rely in good faith on a counterfactual assumption, the opinion giver must identify the assumption explicitly. The opinion giver cannot rely in good faith on an unstated factual assumption that is known to be untrue.").

292. *See*, *supra* note 16 (statement by Rep. Kucinich) ("This subcommittee's investigative findings demand the question: Where were the lawyers, the glaring omissions, inaccurate financial data, and the critical November 12th forecast so obvious that they should have alerted the attorneys to a necessity of a reasonable investigation before making a decision on Bank of America's legal duties to disclose. The apparent fact they did not mount such an investigation makes the decision not to disclose Merrill's loss to the shareholders an egregious violation of security laws.")

ing period may necessitate inquiries about what management anticipates or sees as a trend.[293] The same could be true where the circumstances are undergoing rapid change and that raise doubts about the continuing accuracy of the facts provided.

Moreover, the duty to investigate ought to be triggered where the known "facts" or inquiry give rise to "red flags" about accuracy or completeness. Thus, for example, additional investigation could be required where, in drafting the biographical sections for a private placement memorandum, counsel becomes aware that the client has a "colorful past."[294]

The standards should also impose an obligation to correct where counsel learns the advice was wrong on the date the advice was given.[295] The SEC suggested something like this in *In re Ernst & Young,*[296] at least with respect to auditors. According to the order, the SEC asked the auditing firm to report any complaints with respect to

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293. With respect to our BofA case study, for example, the general counsel may not have had complete information when making the final materiality determination, although whether this would have changed the analysis is not clear. Supplemental Statement of Facts, Sec. & Exch. Comm'n v. Bank of Am. Corp., 1:09-cv-06829-JSR (S.D.N.Y. Feb. 17, 2010) (available at http://www.law.du.edu/documents/corporate-governance/sec-and-governance/bank-of-america/Supplemental-Statement-of-Facts-SEC-v-BofA-109-cv-06829-SD-NY-Feb-17-2010.pdf) ("Mayopoulos recalls that Price informed him on December 3 of the $7 billion forecasted after tax loss, and he has no recollection of learning of the nearly $9 billion forecasted after tax loss — which included the placeholder — until a December 9 meeting of the Bank's Board of Directors. Supplemental Statement of Facts, SEC v. BofA, 109-cv-06829, SD NY, Feb. 17, 2010, http://www.law.du.edu/documents/corporate-governance/sec-and-governance/bank-of-america/Supplemental-Statement-of-Facts-SEC-v-BofA-109-cv-06829-SD-NY-Feb-17-2010.pdf ("Mayopoulos recalls that Price informed him on December 3 of the $7 billion forecasted after tax loss, and he has no recollection of learning of the nearly $9 billion forecasted after tax loss — which included the placeholder — until a December 9 meeting of the Bank's Board of Directors.").

294. *In re* Ottimo, Exchange Act Release No. 83555 (Admin. Proc. Aug. 28, 2017) ("Although lawyers at [Counsel] knew, based on a review of his BrokerCheck report, that [Respondent] had what [Counsel] lawyers described as a "colorful past," there is no evidence that, at the time the PPM was drafted, the [Counsel] lawyers knew any negative information about the companies mentioned in [Respondent]'s biography. Indeed, although [Respondent] was required to report Wheatley's bankruptcy on his Form U4, he failed to do so until April 19, 2012, after the PPM was distributed to potential investors. [Respondent] stated explicitly that he "didn't provide [Counsel] with any information but the statement that appears in the biography.").

295. The antifraud provisions distinguish between a duty to correct a statement false when made and a duty to update a statement that subsequently becomes untrue. A duty exists with respect to the former but generally not the latter. *See* BROWN, JR., *supra* note 261, at Chapter 10, Duty to Disclose, 10.04[C] Duty to Update versus Duty to Correct ("Some courts distinguish between a duty to correct and a duty to update. A duty to correct involves a statement inaccurate at the time of disclosure. A duty to update encompasses statements true when issued that subsequently become false. To the extent of accepting the division, courts tend to impose a duty to correct but not a duty to update except in narrow circumstances.").

296. *In the Matter of* Ernst & Young LLP, Exchange Act Release No. 95167 (Admin. Proc. June 28, 2022) (available at https://www.sec.gov/litigation/admin/2022/34-95167.pdf).

"cheating on training exams,"[297] an inquiry not made pursuant to a subpoena but characterized as a "formal request."

The same day the SEC made the request, the firm allegedly received a "tip" about cheating on the ethics portion of the CPA exam.[298] The following day, the firm provided a response to the SEC that did not include references to the tip. The SEC described the response as creating "the impression that EY [Ernst & Young] did not have current issues with cheating – either on training programs and assessments or CPA ethics exams." The response was characterized as "materially misleading."[299]

Nothing in the release suggested that those involved in the response knew about the "tip" or the "misleading" nature of the response at the time of submission.[300] Concern over possible cheating did, according to the order, eventually become known within the upper reaches of the firm. An internal investigation was launched and "the matter was discussed among senior lawyers at the firm and with members of the firm's senior management." Moreover, "senior attorneys" at the firm "understood" that the SEC had asked "about tips it had received involving exam-related misconduct" and that the firm "had received a tip about sharing answer keys" to the ethics exam.[301]

The SEC took the position that the firm had a duty to correct the "misleading" initial submission and failed to do so.[302] The Commis-

297. The SEC's requests was made on June 19, 2019. The SEC sought to know "whether EY had received any ethics or whistleblower complaints regarding testing associated with any EY training program or continuing professional education course."). *Id.*

298. *Id.* ("On the same day EY received this request, the firm received a tip that an audit professional had shared an answer key to a CPA ethics exam.").

299. *Id.* ("In light of the tip it had received, EY's June 20 submission was materially misleading. But EY never corrected its submission.").

300. The release suggests that the "tip" took some time to make its way up the managerial chain. *Id.* (noting that the tip was reported to a manager and "the manager informed an EY human resources employee of the tip, which was then relayed to others in EY's human resources group.").

301. *Id.* ("EY's General Counsel's Office discussed the firm's investigation as it was ongoing with the firm's Executive Committee in October 2019. By then, members of the firm's senior management and various EY senior attorneys understood that (i) the SEC had sanctioned another large audit firm for exam cheating by its professionals, (ii) SEC staff had asked EY about tips it had received involving exam-related misconduct, (iii) EY had received a tip about sharing answer keys to a CPA ethics exam, (iv) the cheating involved more than a small number of individuals in a single office; and (v) the firm had not disclosed the tip to the SEC.").

302. The settlement imposed a penalty of $100 million. A cheating scandal at another accounting firm alleging cheating resulted in a penalty of $50 million, something noted in the E&Y case. *See In the Matter of* Ernst & Young LLP, Exchange Act Release No. 95167 (June 28, 2022). ("On June 17, 2019, the SEC issued an order finding that another large audit firm engaged in misconduct that included, among other things, cheating on internal training exams. The SEC imposed a $50 million penalty on that firm."). This suggested that the difference was due at least in part to the failure to correct the allegedly misleading submission.

sion grounded the duty in the firm's obligation to maintain a system of quality control that required personnel to "perform all professional responsibilities with integrity."[303]

The SEC, therefore, did not explicitly create a general duty to correct submissions to the agency that were inaccurate at the time made. Although the obligation only applied to accounting firms, professionals who must maintain a system of quality control, one commissioner described the duty as a "non-existent"[304] and suggested that the interpretation could also apply to lawyers,[305] a concern apparently noted by the corporate bar.[306] Standards should make this duty for lawyers explicit.

4. A Duty to Maintain Contemporaneous Records

Lawyers should be required to maintain a contemporaneous record that includes the basis for advice, at least for disclosure matters reported to, and discussed with, management. The degree of record keeping would presumably depend upon the circumstances, including the importance of the advice. This should also include the basis for important disclosure decisions, including the basis for any legal deci-

303. While no individuals were charged in the case, the settlement required the firm conduct an investigation into the failure to correct the submission to the SEC, including the involvement if any of the General Counsel's Office. *Id.* ("EY shall, within 30 days after the entry of this Order, designate a three-person committee of EY senior personnel who had no involvement in EY's conduct relating to the June 2019 Enforcement Division Request, including its failure to correct its submission, and who will have authority to direct and oversee employment and other remedial actions on behalf of the firm . . . . EY's Special Review Committee shall require that the Remedial IC conduct a review (the "Remedial IC Review") of EY's conduct relating to the Commission staff's June 2019 Information Request, including whether any member of EY's executive team, General Counsel's Office, compliance staff, or other EY employees contributed to the firm's failure to correct its misleading submission.")

304. Commissioner Hester M. Peirce, *When Voluntary Means Mandatory and Forever: Statement on In the Matter of Ernst & Young LLP*, SEC. & EXCH. COMM'N (June 28, 2022), https://www.sec.gov/news/statement/peirce-statement-ernst-and-young-062822 ("This implicit directive to find attorneys and compliance personnel to blame for not complying with a non-existent obligation to correct the June 20 submission is particularly troubling.").

305. *Id.* ("other than its curt references to compliance 'with ethics standards' and 'maintain[ing] integrity', the Order fails to offer any analysis of whether and how EY's failure to correct the June 20 submission violated any of the cited provisions. One is simply left adrift in a sea of accounting standards, wondering how lawyers responding to voluntary requests for information are to navigate using the polestars of ethics and integrity.").

306. *See SEC Imposes Largest-Ever Audit-Firm Penalty in Exam-Cheating Case: Imposes Unique Compliance Consultant to Investigate Firm's Response to SEC Inquiry*, CLEARY GOTTLEIB (July 6, 2022), https://www.clearygottlieb.com/news-and-insights/publication-listing/sec-imposes-largest-ever-audit-firm-penalty-in-exam-cheating-case (describing the failure to correct as "a novel claim since the response seems to have been managed mostly by lawyers, not auditors.").

sion. Auditors already must do this.[307] In creating a record, the SEC will subsequently be able to better examine the rational for these decisions and avoid after the fact rationalizations.[308]

5. *A Duty to Develop Required Specific Securities Law Expertise*

Lawyers practicing before the Commission and providing advice to public companies, particularly on disclosure matters, should have adequate knowledge of the relevant legal requirements. This is not always easy. The test for the disclosure of perks, for example, is precise, technical, and mostly buried in the accompanying releases rather than the actual rule.[309] Expertise, however, may require more than an ability to recite the appropriate standard and also include an ability to properly apply the standard. Materiality is an example of a test that would benefit from expertise in application.

Nothing in the existing standards requires this level of expertise. One way to address the area is through education related standards. Training or education requirements mostly emanate from state versions of the Model Rules. They may but do not always impose continuing legal education requirements.[310] When they do, they are undifferentiated,[311] and mostly "document attendance."[312] Moreover, while Model Rule 1.1 requires some level of legal competence, such

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307. *See AS 1215: Audit Documentation*, Pub. Co. Acct. Oversight Bd., https://pcaobus.org/oversight/standards/auditing-standards/details/AS1215 (last visited Apr. 5, 2023).

308. *In re* Ottimo, *supra* note 294 ("Although [counsel]'s Submission argued that the omissions were not material, it was written years after the PPM was distributed and never claimed that the firm's lawyers made a contemporaneous determination regarding the materiality of the alleged omissions.")

309. *See In re* Altaba Inc., Exchange Act Release No. 83096 (April 24, 2018).

310. Model Rules R. 1.1, cmt. 8 ("To maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, including the benefits and risks associated with relevant technology, engage in continuing study and education and comply with all continuing legal education requirements to which the lawyer is subject."); CPR Policy Implementation Committee, *Variations of the ABA Model Rules of Professional Conduct*.

311. Some courts have recognized the need for adequate expertise in the subject matter of an opinion, relying on the obligation to act in good faith. *See Bandera Master Fund LP*, C.A. No. 2018-0372-JTL.

312. Guttenberg, *supra* note 167, at 471 ("Once licensed, there are no licensure renewal requirements at any time throughout one's career regardless of how long one practices. A license derived from the education at the beginning of a lawyer's career remains in effect throughout regardless of changes that may have occurred over that time period. The continuing education requirements, which in most instances only document attendance, do not require any proof that attendees have learned anything, that the programs attended are relevant to the areas they practice in, that they obtained any benefit by attending, and, in many instances, do little to ensure competence.").

minimal competency can be accomplished on the spot through "necessary study."[313]

SEC standards could create national continuing education requirements that were specific to securities lawyers representing public companies.[314] Mandatory courses could include those related to SEC disclosure requirements, including areas that are particularly important, such as materiality determinations,[315] or particularly complicated, such as climate change matters.[316]

Training and continuing education should also reinforce the investor centric nature of the analysis,[317] something that is frequently missing.[318] Moreover, because materiality is a mixed question of law and fact, courses could better educate lawyers with respect to the use of facts by reasonable investors.[319] The SEC has identified factors that

313. *See* Model Rules, R. 1.1, cmt. 4.

314. The PCAOB has done this to some degree with respect to continuing education requirements for auditors through the quality control standards. *See SEC Practice Section (SECPS) – Requirements of Membership:* Section 1000.08(d) – Continuing Professional Education of Audit Firm Personnel, Pub. Co. Acct. Oversight Bd., https://pcaobus.org/oversight/standards/qc-standards/details/sec-practice-section-(secps)—-requirements-of-membership_13 (last visited Apr. 5, 2023).

315. *See* Lee, *supra* note 6 ("Although dependent upon the views of the reasonable investor, materiality determinations are typically made in the first instance by management. In doing so, management may rely on a "gut" feeling, anecdotal interactions, and even their own experience as investors. We know that in making these determinations, management frequently sees things differently from investors. Academic literature indicates that preparers and auditors often employ higher materiality thresholds than do investors. SEC enforcement cases likewise reveal infirmities in materiality determinations, as year after year the SEC brings scores of cases for negligence in making these assessments.").

316. United States Government Accountability Office Report to Congressional Requesters, Climate-Related Risks: SEC Has Taken Steps to Clarify Disclosure Requirements (Feb. 2018) (available at https://www.gao.gov/assets/gao-18-188.pdf ("Most SEC staff we interviewed said training on materiality assessment was part of staff training or their ongoing on-the-job learning in their day-to-day work. Our review of some SEC training materials showed that training discussions covered federal securities laws and disclosure requirements, disclosure review, and materiality but did not focus specifically on climate-related issues.").

317. Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission (Aug. 1, 2018) (available at https://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf) ("*Chapter 3 – Audit Process and Compliance.* 16. Recommendation 3.1: The FASB or the SEC, as appropriate, should supplement existing guidance to reinforce the following concepts: Those who evaluate the materiality of an error should make the decision based upon the perspective of a reasonable investor. Materiality should be judged based on how an error affects the total mix of information available to a reasonable investor, including through a consideration of qualitative and quantitative factors.").

318. *Id.* ("We believe that too many materiality judgments are being made in practice without full consideration of how a reasonable investor would evaluate the error.").

319. I*d.* ("The FASB or the SEC, as appropriate, should also conduct both education sessions internally and outreach efforts to financial statement preparers and auditors to raise awareness of these issues and to promote a more consistent application of the concept of materiality.").

investors may take into account when assessing the importance of information.[320]

6. *A Duty to Maintain Firm Level Controls*

Professional standards generally regulate the behavior of individual lawyers. They do not for the most part impose obligations at the firm level.[321] At least with respect to securities lawyers giving disclosure advice to public companies, this should change.[322] Quality control at the firm level would require a centralized system designed to ensure that relevant standards are being met at the client level by all firm lawyers giving disclosure advice.

A centralized system of quality control can affect behavior,[323] particularly in global law firms that represent the largest public companies.[324] It also can recognize "contextual distinctions" based upon the nature of the firm.[325] Mostly though it can provide a separate system of accountability within the firm with respect to the advice provided to

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320. SEC Staff Accounting Bulletin No. 99, 17 C.F.R. Part 211 (Aug. 12, 1999).

321. Rule 5.1, for example, requires firms to make "reasonable efforts to establish internal policies and procedures designed to provide reasonable assurance that all lawyers in the firm will conform to the Rules of Professional Conduct." In other words, there needs to be an internal system of quality control designed to ensure that lawyers meet their professional requirements. The Model Rules, however, do not require firms to put in place a system of quality control. Standards governing quality control merely require that "lawyers with managerial authority within a firm" engage in "reasonable efforts to establish internal policies and procedures designed to provide reasonable assurance that all lawyers in the firm will conform to the Rules of Professional Conduct." Moreover, the commentary on the provision merely notes a modest set of possible policies that, with respect to competency and expertise, speak only to supervision of "inexperienced lawyers." While the provision contemplates the possibility of "[o]ther measures" they "can depend on the firm's structure and the nature of its practice." Model Rules, R. 5.1.

322. Wald, *supra* note 23, at 278–79 ("Finally, univertext rules should abandon the individualistic bias of the *Rules* and add, alongside individual level regulation, firm level regulation in appropriate circumstances.").

323. *See id.* at 245 ("Kirkland shows that corporate litigators' discovery conduct is influenced and shaped by their firms in ways much more complex than the status of a corporate litigator as an associate, partner or equity partner (although such status is of course relevant to the understanding of a lawyer's conduct). For example, Kirkland finds that a corporate litigator's conduct is to an extent a product of the firm's "practice norms" (for example, approaches toward opposing counsel) and ""management norms" (for example, policies by firm management, department heads and practice groups), as well as the lawyer's role within the "case team.'")

324. *See id.* at 245 ("Second, John Flood finds that global law firms practicing transnational law are managed professional bureaucracies, and argues that "[w]ith increasing bureaucratic control, however, comes greater internal regulation of action and behavior. The effect of the growth of the law firm is to diminish professional autonomy while instead permitting only degrees of discretion in behavior," which suggests that need to regulate law firms alongside individuals.").

325. *Id.* at 245 ("the individual level is misguided and inconsistent with the practice realities many lawyers experience. Moreover, it suggests that contextual distinctions may be appropriately drawn between different types of "firms," such as private law firms, public interest law firms and governmental agencies.").

the client. Such a centralized system could also ensure adequate training and expertise and monitor compliance.

The system of quality control should address whether counsel is able to give advice with sufficient independence.[326] While this is an area that would require significant development, one can imagine instances where counsel's compensation turned on the nature of the advice, for example, a bonus offered to disclosure counsel if the contemplated merger closes could encourage advice designed to achieve that result. The need for independence already applies to accounting firms conducting a company's audit and the Commission has recognized the importance of the concept with respect to other disclosure issues.[327]

In re Pauciulo, Esq., illustrates the potential relevance of such a system.[328] In that case, the SEC alleged that a lawyer violated the federal securities laws through involvement in a fraudulent offering. The lawyer was described as having made "material misstatements and omissions in private placement memoranda" that he prepared. According to the order, the lawyer was described as the "chair of his law firm's Financial Transactions Group." In addition, he was alleged to have used the law firm affiliation in connection with the alleged fraud.[329] The SEC's order did not address the role of the law firm in the case. Moreover, the case involved allegations of fraud, something no system of quality control could entirely prevent. Nonetheless, quality control standards could be designed to ensure greater awareness of this type of behavior within the firm, allowing the firm to better prevent the behavior.

Despite the likely resistance to a firm level system of quality control, the concept is already in the Model Rules, albeit with implementation mostly limited to systems for checking conflicts. The Model Rules require that "[a] partner in a law firm, and a lawyer who indi-

326. *See* Coffee, Jr., *supra* note 30, at 1301 ("If some level of independence is necessary for an attorney to function as a gatekeeper (as A.A. Sommer, Jr. recognized over a quarter century ago), SEC rules of professional conduct could define these limits . . . Accordingly, the SEC should read section 307 to grant it authority to define the point at which the attorney is not sufficiently independent of the client to perform certain sensitive tasks.").

327. *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors, Exchange Act Release No. 34-94478 (proposed March 21, 2022) (available at https://www.sec.gov/rules/proposed/2022/33-11042.pdf) (proposing that attestation provider for greenhouse gas emissions meet "minimum qualifications and independence requirements").

328. *In the Matter of* John W. Pauciulo, Exchange Act Release No. 95205 (Admin. Proc. July 7, 2022) (available at https://www.sec.gov/litigation/admin/2022/33-11080.pdf).

329. *Id.* ("In the video, [counsel] tells potential investors about his specialized experience as a securities law attorney and assures them that: (1) he and his law firm ". . . work very hard to make sure things are done the correct and appropriate way;").

vidually or together with other lawyers possesses comparable managerial authority in a law firm, shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct."[330] Moreover, the Comment to Rule 1.7 states that "To determine whether a conflict of interest exists, a lawyer should adopt reasonable procedures, appropriate for the size and type of firm and practice, to determine in both litigation and non-litigation matters the persons and issues involved . . . . Ignorance caused by a failure to institute such procedures will not excuse a lawyer's violation of this Rule."[331]

Practically speaking, the comment is often complied with by law firms adopting a firm-wide conflict checking apparatus. A similar apparatus can be put in place to ensure firm wide quality controls for securities lawyers. Indeed, law firms adopt such policies to assess and monitor risk at the firm level.[332]

Moreover, a few states have already put in place firm wide rules of professional conduct, alongside their traditional regulation at the individual lawyer level. For example, in New Jersey's version of rule 5.1(a), law firms, as opposed to individual lawyers, have the duty to ensure compliance with the rules of professional conduct.[333] Similarly, in New York's version of rule 5.1(a), the duty applies to a firm, alongside a "lawyer with management responsibility in a law firm."[334] Moreover, the concept of a firm level system of ethical quality controls, or an ethical infrastructure, is well-vetted in the law governing lawyers scholarship.[335]

330. MODEL RULES R. 5.1(a).

331. MODEL RULES R. 1.7, cmt. 3.

332. Regan, Jr., *supra* note 215.

333. N.J. RULES OF PROF'L CONDUCT R. 5.1(a) (2021).

334. N.Y. RULES OF PROF'L CONDUCT R. 5.1(a), (b)(1) (2021).

335. Ted Schneyer, *Professional Discipline for Law Firms*, 77 CORNELL L. REV. 1, 4 (1991). *See generally* Ted Schneyer, *A Tale of Four Systems: Reflections on How Law Influences the "Ethical Infrastructure" of Law Firms*, 39 S. TEX. L. REV. 245 (1998); Douglas N. Frenkel, *Ethics: Beyond the Rules*—Questions and Possible Responses, 67 FORDHAM L. REV. 875, 878 (1998); Transcript, *How Should We Regulate Large Law Firms? Is a Law Firm Disciplinary Rule the Answer?*, 16 GEO. J. LEGAL ETHICS 203 (2002); *Collective Sanctions and Large Firm Discipline*, 118 HARV. L. REV. 2336 (2005); Ted Schneyer, *On Further Reflection: How "Professional Self-Regulation" Should Promote Compliance with Broad Ethical Duties of Law Firm Management*, 53 ARIZ. L. REV. 577, 619–28 (2011); Laurel S. Terry, *The Power of Lawyer Regulators to Increase Client & Public Protection Through Adoption of a Proactive Regulation System*, 20 LEWIS & CLARK L. REV. 717, 771–72 (2016).

7. *A Duty to Disclose Confidential Information Outside the Corporation and/or to Withdraw*

The implementation of the standards we propose in this Article will likely increase the instances where counsel will disagree with management's materiality determination. Management may nonetheless reject the advice or opinion. In general, disclosure counsel who represents the corporation, equipped with the required specific securities law expertise, having advised the client after acquiring an adequate factual predicate and pursuant to the law firm's quality control system, can defer to the disclosure decision made by the company.[336]

Nonetheless, there are likely to be increased instances where counsel may conclude that the decision will result in securities fraud.[337] When the decision made by the client constitutes fraud, and after attempting to dissuade the client from pursuing the fraudulent course of conduct,[338] existing standards already provide for the mandatory withdrawal of representation.[339] While this may address counsel's compliance with the Model Rules, withdrawal without disclosure outside of the entity often results in harm to the corporation. With the attorney-client relationship resting not with management but with the corporation, the SEC standards should require that counsel disclose the existence of the fraud.[340]

The SEC standard can track Model Rules 1.13(c), replaying the "may" with a "shall," to ensure the narrow application of disclosure. For example, the standard might read:

> If disclosure counsel for a public company knows that an officer, employee or other person associated with the company is engaged

336. Model Rules R. 1.2(a).

337. The non-disclosure of material information can violate the securities laws without constituting fraud. Rule 12b-20 requires the inclusion of material information in SEC filings and does not condition a violation on the speaker's state of mind. 17 C.F.R. § 240.12b-20. Fraud in actions brought by private parties, in contrast, requires scienter. *See generally* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 US 308 (2007).

338. Model Rules R. 1.2(d); 1.6, cmt. 7.

339. Model Rules R. 1.2(d); 1.16(a)(1).

340. The SEC already has a model for how this can work. When an auditor resigns, a report must be filed with the SEC. *See* Item 4.01, Current Report (Form 8-K). The report must describe any "disagreements" with management. 17 C.F.R. § 229.304(a)(1)(iv) ("State whether during the registrant's two most recent fiscal years and any subsequent interim period preceding such resignation, declination or dismissal there were any disagreements with the former accountant on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreement(s), if not resolved to the satisfaction of the former accountant, would have caused it to make reference to the subject matter of the disagreement(s) in connection with its report."). The former accountant must be given a copy of the planned disclosure and an opportunity to provide "a letter addressed to the Commission stating" its agreement or any disagreements with the disclosure. 17 C.F.R. § 229.304(a)(3).

in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the company, or a violation of securities laws that reasonably might be imputed to the company, and that is likely to result in substantial injury to the company, then disclosure counsel shall proceed as is reasonably necessary in the best interest of the company. Unless disclosure counsel reasonably believes that it is not necessary in the best interest of the company to do so, disclosure counsel shall refer the matter to higher authority in the company, including, if warranted by the circumstances to the highest authority that can act on behalf of the company as determined by applicable law.

If despite disclosure counsel's efforts the highest authority that can act on behalf of the company insists upon or fails to address in a timely and appropriate manner an action, or a refusal to act, that is clearly a violation of the securities laws, and disclosure counsel reasonably believes that the violation is reasonably certain to result in substantial injury to the company, then disclosure counsel *shall* reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.

C. *Final Thoughts*

Our effort in this section was to provide some insight into what minimum standards adopted by the SEC for disclosure counsel could include. The Article would have been substantially easier to write by calling for standards and leaving their formulation to others. We decided, however, to identify areas where we think the obligations of lawyers should be clarified or enhanced. We do not pretend to have addressed every issue and recognize that our formulations will need to be reworked to the extent specific standards are developed. What we have done is identify ways in which lawyers are contributing to harm to corporations and the investing public, and provide some mechanisms for reducing this possibility.

V. A Public Company Accounting Oversight Board for Lawyers

Our suggested approach may sound radical enough. After all, we are calling for the federalization of standards applicable to securities lawyers who provide disclosure advice to public companies. In fact, however, our views are probably insufficient. We wonder, frankly, whether the SEC is up to the task.

Concern over the SEC's ability to adequately oversee a profession has come up before. Congress in SOX subjected auditors to the oversight of the Public Company Accounting Oversight Board (PCAOB), a "strong independent" regulator that has the authority to write standards, conduct inspections and bring enforcement actions. Congress considered giving the responsibility to the SEC. This did not happen at least in part because of the general belief that the SEC was poorly equipped to handle the task. The risk also existed that the task would get lost in the bureaucratic labyrinth at the Commission.

The same could happen with respect to oversight of lawyers. The SEC has long had some level of oversight of lawyers providing securities advice but chosen not to use it. Section 307 of SOX gave the SEC the authority to adopt comprehensive standards which, the "up the ladder" requirements aside, has remained unused. And the one standard adopted to date has been unenforced. All of this suggests a hesitancy to take on the legal profession and police the behavior of lawyers.

An alternative would be to assign primary oversight responsibility over securities lawyers to an independent regulatory body. The approach has affirmative advantages. With almost twenty years of experience, the PCOAB model has been shown, at least by some measures, to work. Singularly focused on oversight of a profession, the PCAOB has a reliable source of funding and can use inspections to identify deficiencies in audits without having to rely on the more adversarial enforcement process. The result has been an improvement in audits, at least when measured against existing auditing standards.

This is not to say that the PCOAB model is perfect. Moreover, any regulator overseeing the legal profession would need to have a process designed to minimize interference with confidentiality, the work-product doctrine and the attorney-client privilege.[341] A statutory framework enforced by a new regulator should mandate a much higher degree of transparency than is in place at the PCAOB.[342] Unlike government agencies, the PCAOB is exempt from the federal laws that ensure a minimum level of transparency, including the Freedom of Information Act, the Sunshine Act or the Administrative Pro-

341. *See* Rosenfeld, *supra* note 5, at 536 ("In view of the apparent flexibility of the materiality standard, all confidential attorney-client communications made in connection with a corporate client's disclosure obligations under the federal securities laws arguably should be protected by the privilege.").

342. *See* 15 U.S.C. § 7215(b); *see also* J. Robert Brown Jr., *The Future of Audit Oversight*, Pub. Co. Acct. Oversight Bd. (Jan. 15, 2021), https://pcaobus.org/news-events/speeches/speech-detail/the-future-of-audit-oversight. Legislation has been proposed that would address this concern. *See* PCAOB Enforcement Transparency Act of 2021, S.2009, 117th Cong. (2021) (available at https://www.congress.gov/bill/117th-congress/senate-bill/2009?s=1&r=79).

cedure Act.[343] A statute should also include mandatory mechanisms for investor and public involvement[344] and provisions designed to protect and reward whistleblowers.[345]

VI. Application of the Proposed Minimum Standards to Climate Change Disclosure

We bring this Article a full circle and return to the issue of climate change disclosure and the SEC. Reducing greenhouse gas emissions is at the heart of the fight to stop global warming and as attention expands from the conduct of nation-states to that of private actors, investors increasingly seek information about companies' carbon footprint. The SEC has proposed regulations to ensure disclosure of climate change information to investors, and materiality is a core component of the SEC proposal.[346]

Yet we predict that, absent the implementation of meaningful standards of professional responsibility for securities lawyers providing advice to public companies on their disclosure obligations, the new rules will not yield the disclosure results anticipated by the proposal or investors. As is the case with periodical disclosures, counsel will in many cases justify management's finding of immateriality and provide opinions that allow for the non-disclosure of greenhouse gas emissions and climate change related risks.

A. Climate Disclosure and Materiality

Materiality determinations play an important role in the SEC's climate change proposal. In the suggested rule, the SEC describes as the "central purpose" of the proposal the "identification and disclosure" of "material climate related risks." Moreover, materiality is essential to specific disclosure rules. For example, the proposal requires disclo-

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343. *See* J. Robert Brown, Jr., Grading the PCAOB: Transparency, Accountability and Investor Protection, Address Before the Fall Conference of the Council of Institutional Investors (Sept. 17, 2019) (available at https://pcaobus.org/news-events/speeches/speech-detail/grading-the-pcaob-transparency-accountability-and-investor-protection_703).

344. This could include an Office of the Investor Advocate (15 U.S.C. § 78d(g)) and an Investor Advisory Committee (15 U.S.C. § 78pp), requirements adopted in Dodd-Frank for the SEC. *See also* J. Robert Brown Jr., *Statement by Board Member J. Robert Brown, Jr. on His Service at the PCAOB*, Pub. Co. Acct. Oversight Bd. (Jan. 12, 2021), (available at https://pcaobus.org/news-events/speeches/speech-detail/statement-by-board-member-j.-robert-brown-jr.-on-his-service-at-the-pcaob).

345. *See* PCAOB Whistleblower Protection Act of 2019, H.R.3625, 116th Cong. (2019) (available at https://www.congress.gov/bill/116th-congress/house-bill/3625?s=1&r=31).

346. This is discussed at length in Brown, Jr., *supra* note 4.

sure of Scope 3 emissions[347] only if material or included in emissions reduction targets.[348]

Notably, the SEC's approach does reflect a clear skepticism over the proper application of the materiality test. In an unusual fashion, the proposal includes much greater specificity and boundaries that effectively limit management's traditional discretion with regard to materiality determinations. This includes the disclosure of the methodology used to determine emissions metrics[349] and "outsourced activities."[350]

The proposal sometimes specifies the relevant materiality tests,[351] along with examples,[352] and seeks to impose specific time periods in making the determination.[353] With respect to some industries,[354] and

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347. Scope 3 emissions are those that arise out of the upstream and downstream activities of a company's "value chain." The Enhancement and Standardization of Climate-Related Disclosures for Investors, Exchange Act Release No. 34-94478 (proposed March 21, 2022) (available at https://www.sec.gov/rules/proposed/2022/33-11042.pdf).

348. *Id.* ("The proposed rules would require a registrant to disclose any climate-related risks reasonably likely to have a material impact on the registrant's business or consolidated financial statements.").

349. *Id.* ("The proposed rules would require a registrant to describe the methodology, significant inputs, and significant assumptions used to calculate its GHG emissions metrics.").

350. *Id.* ("One proposed provision would provide that, when determining whether its Scope 3 emissions are material, and when disclosing those emissions, in addition to emissions from activities in its value chain, a registrant must include GHG emissions from outsourced activities that it previously conducted as part of its own operations, as reflected in the financial statements for the periods covered in the filing.").

351. For future transitional risks, companies would need to apply the probability/magnitude test. *Id.* ("Moreover, if a materiality analysis requires a determination of future impacts, *i.e.*, a transition risk yet to be realized, then both the probability of an event occurring and its magnitude should be considered. Even if the probability of an adverse consequence is relatively low, if the magnitude of loss or liability is high, then the information in question may still be material. If a registrant determines that its Scope 3 emissions are not material, and therefore not subject to disclosure, it may be useful to investors to understand the basis for that determination.").

352. *Id.* ("In the context of climate, the magnitude and probability of such risks vary and can be significant over such time periods. For example, wildfires in California, which recently have become more frequent and more intense, may be a material risk for wineries, farmers, and other property owners. Some insurance companies have withdrawn from certain wildfire prone areas after concluding the risk is no longer insurable. For many investors, the availability of insurance and the potential exposure to damage, loss, and legal liability from wildfires may be a determining factor in their investment decision-making. Moreover, registrants must bear in mind that the materiality determination is made with regard to the information that a reasonable investor considers important to an investment or voting decision.").

353. The Enhancement and Standardization of Climate-Related Disclosures for Investors, Exchange Act Release No. 34-94478 (proposed March 21, 2022) (available at https://www.sec.gov/rules/proposed/2022/33-11042.pdf) ("To help ensure that management considers the dynamic nature of climate-related risks, we are proposing to require a registrant to discuss its assessment of the materiality of climate-related risks over the short, medium, and long term.").

354. *Id.* ("For oil and gas product manufacturers, for example, Scope 3 emissions are likely to be material and thus necessary to an understanding of a registrant's climate-related risks.").

some lines of business,[355] the SEC effectively performs the materiality analysis or includes presumptive thresholds,[356] with the proviso that lesser amounts could also be material.[357]

Nonetheless, the proposal retains plenty of discretion and uncertainty with respect to the assessment of materiality, as the Commission noted.[358] Indeed, the agency characterized the determination of material climate risks as "similar" to the analysis done for Management Discussion & Analysis (MD&A),[359] a notoriously poor area of disclosure.[360] Moreover, the materiality analysis was complicated by a layering approach for Scope 3 emissions,[361] an obligation to update

355. *Id.* ("Like registrants in other sectors, registrants in the financial sector would be required to disclose their Scope 3 emissions if those emissions are material and to describe the methodology used to calculate those emissions. A financial registrant's Scope 3 emissions disclosures would likely include the emissions from companies that the registrant provides debt or equity financing to.").

356. *Id.* ("When assessing the materiality of Scope 3 emissions, registrants should consider whether Scope 3 emissions make up a relatively significant portion of their overall GHG emissions. While we are not proposing a quantitative threshold for determining materiality, we note that some companies rely on, or support reliance on, a quantitative threshold such as 40 percent when assessing the materiality of Scope 3 emissions.").

357. *Id.* ("However, even when Scope 3 emissions do not represent a relatively significant portion of overall GHG emissions, a quantitative analysis alone would not suffice for purposes of determining whether Scope 3 emissions are material. Consistent with the concept of materiality in the securities laws, this determination would ultimately need to take into account the total mix of information available to investors, including an assessment of qualitative factors.").

358. *Id.* ("We recognize that determining the likely future impacts on a registrant's business may be difficult for some registrants. Commenters have noted that the science of climate modelling has progressed in recent years and enabled the development of various software tools and that climate consulting firms are available to assist registrants in making this determination.").

359. The Enhancement and Standardization of Climate-Related Disclosures for Investors, Exchange Act Release No. 34-94478 (proposed March 21, 2022) (available at https://www.sec.gov/rules/proposed/2022/33-11042.pdf) ("The materiality determination that a registrant would be required to make regarding climate-related risks under the proposed rules is similar to what is required when preparing the MD&A section in a registration statement or annual report.").

360. *See* Brief for Professors at Law and Business Schools as Amicus Curiae in Support of Respondents, J. Robert Brown, Matrixx Initiatives, Inc.v. Siracusano, 131 S. Ct. 1309 (2011) (No. 09-1156) (U. Denver Legal Research Paper No. 10-26, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1710015) (quoting one former SEC official as describing MD&A disclosure as "elevator music.").

361. The Enhancement and Standardization of Climate-Related Disclosures for Investors, Exchange Act Release No. 34-94478 (proposed March 21, 2022) (available at https://www.sec.gov/rules/proposed/2022/33-11042.pdf). ("Although we have not proposed to exclude specific upstream or downstream activities from the scope of the proposed Scope 3 disclosure requirement, we have limited the proposed disclosure requirement to those value chain emissions that overall are material.").

methodologies or assumptions used in determining emissions,[362] and "gaps in the data."[363]

B. Climate Disclosure, Materiality and Disclosure Counsel

Assuming a final rule retains the extensive reliance on materiality, management will need to analyze the issue in multiple instances. Management will at least sometimes have an incentive to understate climate change related information if the information is or is likely to be interpreted by investors as negative. Counsel will likely play a role in reviewing these determinations, particularly in close cases. As discussed above, counsel has an incentive to confirm decisions made by management.[364] The result will be an understatement of the climate disclosure required by the proposed rule.

1. Chilling Climate Change Disclosure – The Confirmation Bias

Rather than assessing the actual importance of climate change information to reasonable investors, something that would presumably require a substantive understanding of the information and its importance in an investment decision, a confirmation approach seeks to provide a sufficient basis for the nondisclosure should the decision be subsequently challenged. The federal securities laws contain any number of doctrines that will facilitate this approach.

First, counsel may treat the information as sufficiently known to the market and therefore part of the already available "total mix" of information.[365] Second, counsel may focus on the uncertainties around the information[366] – something inherent in assessing Scope 3 emissions – characterizing the information as "aspirational,"[367] or puff-

362. *Id.* ("One proposed provision would require a registrant to disclose any material change to the methodology or assumptions underlying its GHG emissions disclosure from the previous fiscal year. For example, if a registrant uses a different set of emission factors, or develops a more direct method of measuring GHG emissions, which results in a material change to the GHG emissions produced from the previous year under (or assuming) the same organizational and operational boundaries, it would be required to report that change.").

363. *Id.* ("Another proposed provision would require a registrant to disclose, to the extent material and as applicable, any gaps in the data required to calculate its GHG emissions.").

364. *See*, *supra* Part II.A.

365. *See generally* John Armour, Luca Enriques &Thom Wetzer, *Green Pills* (Eur. Corp. Gov't Inst., Working Paper No. 657/2022, 2022) (available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4190268) (discussing the difficulty of applying the antifraud provisions to emissions targets).

366. For a discussion of the particular concerns with disclosure of emissions targets, *see* Brown, Jr., *supra* note 4.

367. *In re* BOFI Holding, Inc. Sec. Litig., Case No. 3:15-CV-02324-GPC-KSC, 2017 WL 2257980, *7 (S.D. Cal. May 23, 2017) ("Aspirational statements, that emphasize commitment to certain values or goals, are not capable of objective verification either."). *See also In re* Marriott

ery,[368] a category of information deemed immaterial as a matter of law. Broad risk factor disclosure may be deemed sufficient to the extent the specific problems arguably have not yet materialized[369] or were sufficiently encompassed by the disclosure.[370] Even where mate-

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Int'l, Inc., Customer Data Sec. Breach Litig. 543 F.Supp.3d 96 (D. Md. 2021) ("It is important to note that Starwood's and Marriott's goals and expectations are not predictions of actual performance.").

368. *In re* Federal-Mogul Corp. Sec. Litig., 166 F. Supp. 2d 559, 563 (E.D. Mich. 2001) (characterizing statement that "the Company is on target to achieve projected 'synergies' and cost savings" as puffery and therefore immaterial); Lasker v. N.Y. State Elec. & Gas Corp., 85 F.3d 55, 58–59 (2d Cir.1996) (per curiam) (affirming district court's determination that company's statements regarding future earnings, sales goals, and desire for continued prosperity constituted unactionable puffery); *see also* Sec. & Exch. Comm'n v. Ownzones Media Network, Inc., Case No.: CV 20-03108-CJC(JPRx) (C.D. Cal. Sept. 17, 2020) ("Forward-looking statements of corporate optimism or statements about a company's vision, strategic direction, and goals are non-actionable puffery." *In re* Adient plc Sec. Litig., No. 18-CV-9116 (RA), 2020 WL 1644018, at *19 n.14 (S.D.N.Y. Apr. 2, 2020) ("Statements about Adient's progress with respect to certain goals, including it being 'on track,' also constitute [no]nactionable puffery."); Villare v. Abiomed, Inc., 19 Civ. 7319 (ER) (S.D.N.Y. Sept. 21, 2021) (statements that "our goal remains to be one of the fastest-growing, most profitable med-tech companies in the market" treated as puffery and immaterial); *In re* Restoration Robotics, Inc. Secur. Litig., 417 F.Supp.3d 1242 (N.D. Cal. 2019) ("Investors neither rely on phrases like 'goal' nor 'increased utilization"—these are too vague and constitute 'non-actionable puffing.'"); *In re* Winn-Dixie Stores, Inc. Sec. Litig., 531 F. Supp. 1334 (M.D. Fl. 2007) ("As with the other statements alleged to be false, this statement is replete with statements of future goals, puffery, vague statements of corporate optimism, and other immaterial and unverifiable statements."); Rochester Laborers Pension Fund v. Monsanto Co., 883 F. Supp. 2d 835, 890 (E.D. Mo. 2012) (finding statement that defendant was " 'committed to' reaching the predicted goals" unactionable puffery).

369. Oklahoma L. Enf't Ret. Sys. v. Papa John's Int'l, Inc., 517 F. Supp. 3d 196, 211 (S.D.N.Y. 2021) ("The Court holds that, even drawing all inferences in favor of Plaintiff, its allegations still fail to show that the risks described above had already materialized at the time the Company filed its 2016 and 2017 10-K statements.")

370. In re Bank of Am. AIG Disclosure Sec. Litig., 980 F. Supp. 2d 564, 579 (S.D.N.Y. 2013) ("[W]here there is disclosure that is broad enough to cover a specific risk, the disclosure is not misleading simply because it fails to discuss the specific risk."); Emp.s' Ret. Sys. of City of Baton Rouge & Parish of East Baton Rouge v. Macrogenics, Inc., Case No.: GJH-19-2713, 2021 WL 4459218, *12 (D. Md. Sept. 29, 2021) ("But if the risk warned of has not actually 'transpired' or made a 'near certainty,' then it is not misleading."); Ind. Pub. Ret. Sys. v. Pluralsight, Inc., Case No. 1:19-cv-00128-JNP-DBP, 2021 WL 1222290, *14 (D. Utah Mar. 31, 2021) ("Even when a generic risk factor cannot protect a company 'from liability for other misstatements or omissions,' such does not mean that the generic risk factor can 'be the basis for liability.'"); Bondali v. Yum! Brands, Inc., 620 F. App'x 483, 491 (6th Cir. 2015) (unpublished) ("Risk disclosures like the ones accompanying 10-Qs and other SEC filings are inherently *prospective* in nature. They warn an investor of what harms *may* come to their investment. They are not meant to educate investors on what harms are currently affecting the company . . . . For these reasons, a reasonable investor would be unlikely to infer anything regarding the current state of a corporation's compliance, safety, or other operations from a statement intended to educate the investor on *future* harms."); *In re* LeapFrog Enters., Inc. Sec. Litig., 527 F. Supp. 2d 1033, 1048 (N.D. Cal. 2007) ("[Risk Factors in SEC filings] constitute defendants' cautionary statements and are not actionable to the extent plaintiffs contend defendants should have stated that the adverse factors 'are' affecting financial results rather than 'may' affect financial results." (citations omitted)); *In re* Lions Gate Ent. Corp. Sec. Litig., 165 F. Supp. 3d 1, 19 (S.D.N.Y. 2016) ("In any event, any

rial on a quantifiable basis, counsel may use qualitative factors to determine otherwise.[371]

Our point in analyzing aspects of management's materiality decisions that are susceptible to the confirmation bias is not to suggest that they in fact justify nondisclosure of climate change risks or Scope 3 emissions, only that they can be relied upon by securities lawyers already under pressure to side with management to justify an opinion supporting management's determination of immateriality. Moreover, these arguments, particularly when used collectively, will often be sufficient to render the advice unlikely to be challenged even if ultimately shown to be incorrect. The result, as we establish above, is a systematic tendency for erroneous advice by counsel and a chilling climate change disclosure problem.

2. Erroneous Advice and Our Proposed Minimum Standards

To the extent the minimum standards we have proposed were in place, the outcome could in at least some circumstances be very different.

First, the confirmation approach is inherently management focused. Our proposed minimum standards, however, would require that disclosure counsel expressly acknowledge the obligation to represent the corporation and shareholders. Consistent with this approach, an opinion would not start with the goal of confirming management but would need to focus on how reasonable investors might use the information and whether the information had the potential to influence investment or voting decisions.

Second, the opinion would need to apprise management of any uncertainty with respect to the advice and any risk associated with the advice, including litigation risk. The uncertainty analysis would in part be based upon an application of the "obvious unimportant" standard used by courts in assessing materiality.[372] To the extent that the mate-

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claim under Item 103 fails for failure to make a plausible allegation of materiality under [*Basic*].").

371. The doctrine of qualitative materiality may provide a basis for finding quantitatively material information immaterial. Qualitative materiality has traditionally been understood to require consideration of additional factors that can render quantitatively immaterial information material. The most notable example has been the use of a 5% presumption of quantitative materiality with respect to financial statements. James J. Park, *Assessing the Materiality of Financial Misstatements*, 34 J. Corp. L. 513 (2009) ("Under a qualitative standard, a financial misstatement under five percent can still be material if it meets certain qualitative criteria, such as allowing the company to meet earnings targets or affecting management compensation."). Qualitative materiality, however, could potentially also be used to do the opposite.

372. *See supra* note 10.

riality determination did not meet this standard, the advice would need to so state.

Third, counsel would need to have an adequate factual predicate for the materiality determination. At a minimum, this would require awareness of the surrounding circumstances, including whether the information provided is subject to rapid change and whether there are red flags suggesting that the data was incomplete or inaccurate. Red flags could arise from analysis of prior disclosures, conversations with management, information in the public domain, or details learned through representation by the same firm in other matters.

Fourth, the process would entail the maintenance of records showing the basis for the opinion. The existence of this record could constitute a counterincentive to defer to management. Moreover, while this does not preclude other arguments should the issue of materiality be litigated, it does create a contemporaneous record that provides a basis for assessing the quality of the lawyer's advice.

Fifth, per our minimum standards, counsel would need to have the necessary expertise to advise public companies about their disclosure decisions. It is not enough to assume that someone with a retirement plan or other experience as an individual investor can speak about the materiality of information to large institutional and other professional investors. Instead, assessing the importance of disclosure to reasonable investors would require some understanding of the nature of the information, the impact on the business, and the qualitative factors used by investors in assessing the importance of information. For example, investors can find as important even small shifts in emissions or climate risks that suggest a trend or that cause a company to miss a target.[373]

Sixth, firm level controls would presumably ensure that this process was undertaken properly and in good faith. These controls could, for example, make certain that the specific counsel within the firm assigned to these areas had the requisite expertise, something that could include regular training and education in relevant topics. Opinions could require the review of a second partner, something sometimes compelled by insurance carriers but not ethical standards.[374]

373. SEC Staff Accounting Bulletin: No. 99, 17 C.F.R. Part 211 (August 12, 1999) (available at https://www.sec.gov/interps/account/sab99.htm) ("As a result of the interaction of quantitative and qualitative considerations in materiality judgments, misstatements of relatively small amounts that come to the auditor's attention could have a material effect on the financial statements.").

374. Audits of public companies are subject to oversight by an engagement partner but also must be reviewed by another person within the firm. *See AS 1200: Engagement Quality Review*,

Application of the standards could, therefore, result in a qualitatively different opinion. By focusing on the importance of the information to reasonable investors and applying the "obviously unimportant" standard, the likelihood would be that opinions would more often emphasize the relevance of the information to investors and the possibility that the information could be material. Including the uncertainty surrounding the analysis would more squarely leave responsibility for the final decision in the hands of management, increasing accountability and reducing the frequency of the "presence of counsel" defense.

VII. Conclusion

Lawyer involvement in the public company disclosure process is, as Congress realized in SOX, too important to leave to the legal profession to police. Yet there it remains. Despite the requisite authority, the SEC has not put in place a minimum set of standards for securities lawyers advising public companies, has left the lone standard that was adopted entirely unenforced, and has, as a matter of policy, declined to bring actions against securities lawyers for negligent legal advice. The result is a system that often exonerates both management and counsel for disclosure violations by public companies, reducing deterrence and harming investors and shareholders.

The harm from this lack of meaningful standards and enforcement is likely to grow. The SEC's proposed climate change rule is possibly only the beginning of a substantial revision of the mandatory system of disclosure imposed on public companies.[375] These revisions are likely to continue to rely on materiality and management judgement. As this Article shows, given the under-regulation and under-enforcement of the current rules against securities lawyers and given the incentives of securities lawyers to defer to management's preference for under-disclosure, without some kind of new standards designed to ensure appropriate quality of advice, management will be able to avoid adverse disclosure, investors will not receive the information they need to make informed investment decisions, and capital will be misallocated.

We have proposed a solution that calls for the adoption of minimum standards for disclosure lawyers, something ordered by Congress with the adoption of SOX but largely ignored. To some degree, our sugges-

Pub. Co. Acct. Oversight Bd., https://pcaobus.org/oversight/standards/auditing-standards/details/AS1220 (last visited Apr. 5, 2023).

375. *See* Brown, Jr., *supra* note 4.

tion should seem anodyne, almost unimaginative. We are only asking the Commission to do what Congress mandated in 2002.

Nonetheless, the approach is controversial and will likely cause tension with the corporate and securities bars. Moreover, as we concede in the Article, some aspects of our proposed regulatory regime are complex and will require careful implementation, for example, there may be a need to rethink some aspects of confidentiality, the work-product doctrine and the attorney-client privilege in the corporate context.[376] After all, the SEC will sometimes need to investigate whether the relevant standards have been met, something that may require an examination of privileged materials. The tension needs to be considered, including the reasons for the exercise of the privilege and the scope of confidentiality in the corporate context.[377]

We are not sanguine that the SEC will take up our recommendations, although a recent speech suggests at least some commission level support for the idea.[378] The SEC has a long and unsuccessful history of oversight of professionals who review management's disclosure decisions. The complete and utter lack of enforcement of the lone standard for lawyers adopted by the Commission and the continued refusal to bring cases alleging negligent legal advice suggests that the agency is not equipped, structurally or psychologically, to oversee the legal profession in connection with its role in the disclosure process.

Perhaps the time has come to skip to the end. As with self-regulation for auditors, SEC oversight would likely represent an interim but ultimately unsuccessful approach. The need for Congress to step in and create a PCAOB for lawyers seems clear enough even if those operating in the area will not like it. Auditors did not either but over time attitudes changed and audit quality improved. The same would presumably occur with respect to oversight of securities lawyers.

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376. *See* Rosenfeld, *supra* note 5, at 536 ("In view of the apparent flexibility of the materiality standard, all confidential attorney-client communications made in connection with a corporate client's disclosure obligations under the federal securities laws arguably should be protected by the privilege.").

377. Grace M. Giesel, *The Legal Advice Requirement of the Attorney-Client Privilege: A Special Problem for In-House Counsel and Outside Attorneys Representing Corporations*, 48 MERCER L. REV. 1169, 1181 (1997) ("Commentators have criticized the attorney-client privilege as applied to corporations specifically as a situation in which the rationales fail. These commentators suggest that in the corporate sphere the privilege does not increase candor, and that the burden of undisclosed information is huge in part because alternative avenues to facts in the corporate environment are costly and corporations and corporate actors have a tendency toward evasiveness. Critics argue that deontological theories do not apply to corporations because ideas of rights peculiar to individuals form the basis of those theories.")

378. Lee, *supra* note 6.