

TRUSTED ADVISOR or WHISTLEBLOWER
Lawyer's New Rules on "Up The Ladder" Reporting

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Recent changes in the Rules of Professional Conduct for lawyers in Ontario might seem to put the corporate lawyer in an untenable professional position. Confidentiality has always been the hallmark of the solicitor-client relationship. So much so that, unlike any other professional relationship, communications between a client and his or her lawyer are privileged and cannot be disclosed, even in a court of law. How does a lawyer's duty of confidentiality now square with this professional obligation to blow the whistle in situations involving proposed misconduct by a client organization? With these new rules of conduct, the lawyer cannot ignore conduct of a dishonest or fraudulent nature or other serious illegal conduct.

Recent accounting scandals in the United States have shaken public and investor confidence in the corporate world. The legal profession has not escaped the public's scrutiny: Where were the corporate lawyers while this fraud was going on? What was their mandate in upholding legal and ethical behaviour? Why did they fail us?

These questions have caused the US Security and Exchange Commission, the Ontario Securities Commission and, most recently, the Law Society of Upper Canada to review the obligations of the lawyer to identify and take steps to prevent illegal corporate behaviour.

Against this backdrop is the long respected public policy that encourages individuals and corporations to seek legal advice. The quid pro quo for candour and disclosure in a solicitor-client relationship is the confidentiality of the discussions in the context of this relationship. The ultimate goal behind this policy is to ensure that the lawyer is available to assist clients in understanding improper conduct and advise against it.

Being a policy that is implemented through professional and ethical responsibilities, it presumes that lawyers put their responsibilities above the interests of the individuals

whom they represent, and above their own self-interest. It also presumes that self-regulation through the development of ethical rules and standards and self-policing by governing bodies is sufficient to enforce and promote the achievement of this goal.

Corporate lawyers owe a duty of loyalty to the corporation they represent as an entity, not to the individuals within the organization. But when corporate culture is such as to prefer the success of the individual, to put the highest priority on personal and corporate profit, it can become difficult to resist the pressures to enable the agenda of the individuals instructing the lawyer as opposed to pursuing the best interests of the organization.

Congress in the United States responded to perceived gaps in corporate and legal regulatory framework in this area by enacting the Sarbanes-Oxley Act. This Act is designed to make it more difficult for executives and other corporate agents to mislead investors about the company's performance. The Act requires lawyers to report evidence of a material security law violation or breach of fiduciary duty to the company's Chief Legal Officer or Chief Executive Officer. If the CLO or CEO does not respond appropriately, the lawyer must then report the incident to the Board of Directors or Audit Committee.

Even with the changes promulgated by the Sarbanes-Oxley Act, the lawyer is not permitted to "blow the whistle" to authorities outside of the organization. If no one within the corporation is willing to correct the breach, the lawyer must simply withdraw his/her representation.

Law Society of Upper Canada Rules

Much of what is contained in the Sarbanes-Oxley Act regarding lawyers' obligations has always been understood to be part of a lawyer's professional and ethical responsibilities in Ontario. However, in order to provide clear guidance as to what is expected of lawyers who advise corporate clients in the face of corporate wrong doing, the Law Society of Upper Canada has recently conducted a review of its Rules of Conduct and made a number of important changes in this area of professional responsibility.

The Law Society's review led to the conclusion that meaningful changes to the Rules would be helpful in order to clarify the duties and obligations that are unique to lawyers as professional advisors to corporations, both as outside and in-house counsel. These changes are applicable but not restricted to securities matters and have broader application than those under the Sarbanes-Oxley Act.

In approaching this issue, the Law Society has recognized the possible conflict that the lawyer faces on becoming aware that a client may commit a dishonest, fraudulent, criminal or illegal act. A fundamental question that the lawyer faces is whether to "blow the whistle" on the illegal conduct and, if so, to whom.

Existing Law Society Rules of Conduct require that the lawyer not "knowingly assist or encourage any dishonesty, fraud, crime or illegal act. On the other hand, the lawyer's duty of loyalty and confidence do not permit the disclosure to others of any information imparted in the course of the solicitor-client relationship. The answer to this conundrum lies, in part, in appreciating that in representing an organization, the lawyer's duty is owed to the organization and not to the individuals from whom the lawyer receives direction. Even before recent amendments to the Rules, it was understood that the lawyer had a duty to report misconduct to a higher authority within the organization itself.

It is important to remember that a corporation is a legal personality distinct from its shareholders, officers, employees and directors. While the organization must act and give instructions through its corporate agents, the lawyer must ensure that it is the interests of the organization that are served by his/her representation and not those of the individuals. For this reason, the Rules of Conduct provide that, notwithstanding the fact that instructions are received from representatives of the organization, the lawyer employed by an organization shall act for the organization in exercising his/her duties and providing professional services.

New Rules – Dishonesty, Fraud by Client Organization

The recent amendments to the Rules of Conduct now provide when a lawyer is employed or retained by an organization to act in a matter in which the lawyer knows that the organization intends to act dishonestly, fraudulently, criminally or illegally with respect to the matter then, in addition to other obligations under the Rules, the lawyer must:

- a. advise the person from whom the lawyer takes instruction that the proposed conduct would be illegal;
- b. if the proposed conduct is not abandoned, advise the organization's CLO or both the CLO and CEO that the proposed conduct would be illegal;
- c. if the CLO/CEO refuses to cause the conduct to be abandoned, then progressively advise the next highest persons or groups within the organization including, ultimately, the Board of Directors; and
- d. if, in spite of this advice, the organization refuses to abandon its course of conduct, the lawyer must withdraw from acting in the matter.

Similar "up the ladder" reporting requirements apply when the lawyer knows that the organization has acted or is acting illegally. In this case, however, the lawyer must, in the first instance, advise both the person from whom he/she takes instructions and the CLO/CEO that the conduct was or is illegal. In other words, the lawyer must always advise the CLO and/or CEO in addition to the person instructing him/her in the face of illegal conduct which has already taken place. The lawyer has a fiduciary obligation to the organization to disclose this knowledge internally, even if the conduct has stopped.

Harmful and Serious Consequences

Obviously it is not every incident of possible misconduct that will oblige the lawyer to report the conduct "up the ladder". Trivial misconduct and conduct that is not likely to result in any serious harm to the organization or others need not necessarily be reported. The Rule is designed to address misconduct that has a harmful and serious consequence for the organization and others who rely on the organization.

It is recognized that misconduct of public traded organizations is likely to have serious consequences to the public at large. It must also be recognized that the conduct

covered by the Rule includes acts of omission as well as commission. The failure to make required disclosures and the failure to correct inaccurate disclosures should always be seen as having the potential to cause harmful and serious consequences.

Resignation by Lawyer

Although the Rule provides that the lawyer may simply withdraw or resign from the particular matter in respect of which the illegal conduct arises, it may well be necessary for the lawyer to withdraw from all further representation of the organization. This might occur where the matter is so fundamental to the practice and/or affairs of the organization that, practically speaking, the lawyer simply cannot continue to advise the organization. This raises a particularly difficult situation for in-house counsel where his/her livelihood is at stake. The Rules permit the in-house lawyer to withdraw from the specific matter if this is possible. As a practical matter, however, after reporting to the CLO, CEO and Board and being unable to prevent the wrongful conduct, it will undoubtedly be the case that the in-house lawyer no longer has the confidence of the organization and vice versa, making it impossible for the lawyer to represent the organization in any capacity.

Confidentiality

The new Rule does not require (or permit) the lawyer to “blow the whistle” outside of the organization or to inform the authorities of past, existing or proposed misconduct. The Rule does not alter the role of the lawyer and the importance of maintaining confidentiality in the solicitor-client relationship.

The lawyer’s role depends on full disclosure and unreserved communication between lawyer and client. It is essential to the relationship that there be no fear of disclosure or breach of the confidence upon which this type of communication depends. Clients must feel secure and entitled to proceed on the basis that matters disclosed to and discussed with their lawyers will be held in strict confidence.

From a public policy point of view, it is important that members of the public seek and obtain legal advice and be advised of the consequences of their actions. This stems

from the fundamental belief that, when properly advised, clients will act legally. To require whistle blowing to third parties would violate the fundamental value of confidentiality and privilege in the solicitor-client relationship.

The Appropriate Balance

The Law Society's approach in adopting these amendments to the Rules of Conduct has been to strike a balance between the need to encourage the public to obtain legal advice and the possibility that lawyers will be used to assist in and/or facilitate illegal conduct. The Rules recognize that lawyers, as legal advisors, are in key positions to advise and encourage organizations to comply with the law. Lawyers, particularly in-house counsel, have the opportunity to guide organizations to act in ways that are legal, ethical, and consistent with the organization's responsibilities to its constituents and to the public. To require external disclosure of wrongdoing would compromise the openness and candour of the solicitor-client relationship such that the lawyer would be much less likely to become aware of improper conduct and be in a position to counsel the client against it.

Even with these changes to the Rules of Conduct, the lawyer remains a trusted and confidential advisor to organizations. The lawyer cannot be compelled to "blow the whistle" outside the organization in respect of conduct which appears to be illegal. On the other hand, the lawyer must report "up the ladder" within the organization to ensure that past, present and proposed illegal conduct comes to the attention of successively higher levels of authority within the organization if it is not dealt with appropriately. The recent amendments to the Rules of Conduct strike the proper balance required in order to encourage organizations to continue to seek legal advice, to preserve the confidentiality of the solicitor/client relationship, and at the same time prevent the lawyer from becoming an agent of the wrongful conduct.