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# SARBANES – OXLEY

## DISCLOSURE AND CONFIDENTIALITY

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### *EXECUTIVE SUMMARY*

THE 2003 LEXISNEXIS™ – IBA LEGAL SURVEY

SECTION TWO



the global voice of  
the legal profession

Few people could identify them, the senior U.S. Democratic senator from Maryland and the Republican U.S. Congressman from Ohio. But Sen. Paul Sarbanes and Rep. Michael Oxley placed their names on a landmark piece of U.S. legislation that became law in July 2002. The U.S. Securities & Exchange Commission subsequently adopted regulations that pertain to the Act, including a code of conduct for lawyers whose corporate clients fall under its jurisdiction.

The Sarbanes-Oxley Act already has altered profoundly — like the effect of a 7.0 earthquake on the Richter scale — the landscape of corporate governance and investor protection in the U.S. and elsewhere. And the SEC regulations also promise to change dramatically the relationship of lawyers and their corporate clients as well as the relationship of U.S. lawyers and those outside the U.S.

What triggers those statements? A survey by the International Bar Association (IBA) and LexisNexis of 700 lawyers — 100 from each of seven different geographic areas — who were interviewed for 20 minutes apiece.

The survey's findings punctuate the enormous impact that Sarbanes-Oxley already has had and will continue to have on the legal profession — in the U.S. and internationally. According to the survey, the Act:

- Raises severe risks for justice by prompting clients to be less open with their lawyers
- Undermines the long-held tradition of client-lawyer confidentiality, a belief that reverberates worldwide and that undoubtedly will be debated for years, and underscores the belief that the general public really doesn't understand this tradition
- Sparks fears that the SEC seeks to override regulatory authorities in countries around the world through the extraterritorial nature of its rules, placing non-U.S. lawyers especially in difficult situations concerning their ethical responsibilities with corporate clients
- Triggers deep confusion among lawyers everywhere that won't subside until it's clear what the act means and how courts in the U.S. and abroad will rule in lawsuits generated by the Act
- Won't result in more honesty among corporate executives even though that is a principal goal of the legislation; only 1 in 10 lawyers thinks it will bring more honesty
- Will increase corporate legal expenses by, among other things, leading executives to hire their own attorneys to advise them on corporate decision-making and communications
- Promises to reduce the legal work U.S. law firms gain abroad because lawyers outside the U.S. will decide strategically not to do business with U.S. lawyers until they understand sufficiently the ramifications of Sarbanes-Oxley on them

"We understand what has driven Congress and the SEC to adopt their legislation and regulations," emphasizes Fernando Pelaez-Pier, a Caracas, Venezuela, attorney and chair of the IBA's Section on Business Law. "All of us have an interest in ensuring that corporations and their executives act correctly — for the sake of their investors, employees, customers and the public in general."

But, Pelaez-Pier adds: "All of us must focus on how we regulate lawyers appropriately and consistently, wherever they reside."

What follows is an executive summary of the survey results from the standpoint of U.S. lawyers and, separately, from the standpoint of lawyers in other countries. Highlights from section one of the 2003 LexisNexis-IBA Legal Survey are also included in this summary.

## U.S. Lawyers Expect Major Impact of Corporate Disclosure Rules

*Attorneys Also See Fallout from SEC's New Code-of-Conduct Regulations*

Lawyers usually embrace major changes in their legal specialties. Tax-law overhaul triggers lots of new business. So do passage of new environmental legislation or measures affecting the commercial code or real-estate law. But then there's the 2002 Sarbanes-Oxley Act — the resulting fallout from international corporate accounting scandals.

The year-old U.S. law that regulates corporate disclosure and client confidentiality already has had a major impact on U.S. lawyer-client relationships, and further significant effects are anticipated from new SEC code-of-conduct rules that went into effect August 5. The U.S. legal profession, however, isn't welcoming the changes.

A survey of 100 U.S. attorneys by the IBA and LexisNexis underscores the profound influence of the Sarbanes-Oxley Act, passed by the U.S. Congress after scandals at Enron, Worldcom and many other companies uncovered the extent of questionable accounting practices. And the SEC's fresh rules are raising considerable anxieties among U.S. attorneys that the legal profession's traditional client-lawyer privilege rules will be undermined.

The new code of conduct rules apply to lawyers who represent companies regulated by the SEC. It sets minimum standards of professional responsibility that lawyers must follow when they confront evidence that a material violation of state or federal securities law or a breach of fiduciary duty has occurred at a client company that reports to the agency. They require a lawyer who finds wrongdoing in a company to alert top management. If an inadequate response results, the lawyer must then alert a sequence of directors' committees, leading potentially to the full board.

According to the LexisNexis-IBA survey, 90% of U.S. attorneys polled worry their clients will be "less open" with them, with 71% predicting the code-of-conduct rules will be "detrimental to justice." Among other results, the survey of American lawyers found that:

- 62% expect Sarbanes-Oxley to affect them and their law firms
- 1 in 4 attorneys thinks the most significant effect of the Act will be higher legal costs
- Another 1 in 4 believes tighter definition of legal responsibilities will be the most profound impact
- 13% anticipate that increased consumer costs will be the biggest effect of Sarbanes-Oxley, while 8% favor "more honesty" and 5% list "increased insurance costs" for company executives as the biggest anticipated impact of the Act

U.S. attorneys consider Sarbanes-Oxley and the further SEC rules on disclosure of corporate misdeeds to be watershed events in the history of regulations for corporate disclosure and client confidentiality. The LexisNexis-IBA survey also makes that clear:

- 80% of U.S. lawyers surveyed agree that society doesn't fully understand the reasons behind client confidentiality or legal privilege
- 55% say they would risk going to jail to protect client confidentiality or legal privilege
- 44% say current law requires them to report the illegal activity of clients to an outside agency
- 28% maintain that it is proper for the government and society to expect lawyers to report the suspicion of or actual illegal activity by their clients
- 23% would like to see the legal profession regulated by the government to help stop illegal activity, such as money laundering or terrorism by clients

U.S. lawyers familiar with the new regulations and rules and the survey results identify several significant anticipated repercussions. For one thing, they predict a spike in legal costs — for a variety of reasons — that will drive corporate clients toward fewer complex business transactions. “Companies will focus on transactions that add real value and make long-term business sense, not those that are driven by financial statements,” predicts Philip F. Zeidman of Washington, D.C., a counsel to a number of U.S. and foreign companies and trade associations. “That will dictate less complex transactions.” His reasoning: The more complex the transaction, the more potential exists for a major disagreement between lawyer and client. Furthermore, Zeidman asserts, “This may also dictate more private transactions and, in some cases, may even be a factor in persuading public companies to go private.”

Lawyers also say that corporate executives are apt to interpret the new rules as implying that when they are talking to a lawyer, they’re also talking to the SEC. As a result, executives will be far more wary with a corporate attorney, whether the lawyer is an outside counsel or in-house attorney. Says Zeidman: “The unfortunate part of this is that what the rules actually say may not be as important as the way business people interpret the rules. And they want a simple, easy message.” One overwhelming message emerges from the survey: Improve communications with clients about what the regulations do and don’t do.

The heaviest concerns pertain to the traditional client-lawyer confidentiality rules. For the most part, U.S. legal academics have criticized the new SEC rules for “reporting up” misdeeds as overly complex and difficult to apply. And U.S. lawyers worry the agency will expand the code to require lawyers to “report out” of possible wrongdoing, muddling the client-lawyer confidentiality rules even more. This rule change, that the SEC has been considering, would require a lawyer who already has “reported up” the corporate ladder but still gotten no satisfaction to resign and notify the SEC without explaining the reasons for the departure.

Lawyers overwhelmingly believe that violates attorney-client privilege. “It’s a matter of great interest and great concern,” says Los Angeles attorney Alan M. Kindred, long active in the Los Angeles County Bar Association’s international law section. The SEC’s code-of-conduct rules, he adds, “will have a major impact on foreign attorneys representing U.S. subsidiaries, and it’s going to put corporations in some difficulty.”

The SEC — which proposed an alternative that would require a company, not an attorney, to notify the SEC of the attorney’s resignation — hasn’t taken any action. And lawyer groups have been considering their own proposals for dealing with the issue.

Other issues have arisen — or are expected to emerge — as the courts mull legal challenges to the legislation and SEC regulations. What effect will the changes have on outside lawyers vs. in-house attorneys? On lawyers working on a company’s business abroad? And on the relationship within the legal profession itself, between, say, a U.S. firm and one in Europe or Asia? Already, U.S. lawyers report reluctance of some European firms to do business with them if they don’t know the lawyer or the firm he or she represents.

“The Sarbanes-Oxley Act and the SEC rules raise questions of freedom of association and freedom of speech. The issues raised will be resolved in the courts,” predicts Alan Kindred.

## **Non-U.S. Lawyers Fear Extraterritorial Nature of Sarbanes-Oxley Act**

*They Question How U.S. Act Can Override Their Own Countries’ Laws, Rules*

The opinions of the 600 lawyers outside the U.S. who participated in the LexisNexis-IBA survey overwhelmingly suggest that they are confused and uncertain of the effects of Sarbanes-Oxley and the SEC rules. These attorneys are from the United Kingdom, Canada, France, Germany, Australia and Argentina/Chile.

And a vast majority of them don’t see the benefits that U.S. authorities anticipate from the legislation. In each of the countries, at least 85% of the lawyers anticipate that clients will be less open with attorneys; in France, the percentage is 95% and, in Australia, 94%. The vast majority also expects Sarbanes-Oxley to be detrimental to justice.

“Lawyers outside the U.S. are very worried that the Act appears to want to override national regulatory authorities in other countries and, clearly, that’s a hopeless situation,” asserts Fernando Pelaez-Pier. “A lawyer can only go with his or her national regulatory authority, so it makes us believe that Sarbanes-Oxley is misconceived in terms of international lawyers.”

At the same time, says Pelaez-Pier, international lawyers understand what has triggered the legislation and regulations. “We understand that consumers and shareholders need protection from unscrupulous corporate executives, accountants and directors. That’s absolutely essential.”

The survey indicates that international lawyers think the Act puts them in a bizarre position. “It suggests that the people least able to report infringements of U.S. law — lawyers from other countries — have been given a responsibility to report infringements,” says Pelaez-Pier. Lawyers surveyed indicate that when their clients want to float securities on a U.S. exchange, they will now have to hire a U.S. lawyer to make sure they’re not violating Sarbanes-Oxley. “In the end, costs are going to rise and they will be passed on to consumers,” predicts Pelaez-Pier.

Overseas lawyers may decide strategically not to do business with U.S. firms because they don’t sufficiently understand what’s going on. Or, a law firm in, say, Germany, that advises German companies may well advise its clients not to raise money in the U.S. because of the Sarbanes-Oxley complications. There are indications that some of that narrowing of the market for U.S. investors already is emerging, foreign lawyers say.

They also foresee confusion continuing for a long time as courts and other bodies work out what the Act means. The European Union, for instance, already has expressed its dismay with aspects of the Act and a desire to take time to really absorb its ramifications.

Lawyers abroad as well as in the U.S. also express dismay at the potential for harming what many consider the sacred client-lawyer confidentiality rules. “It’s one of the things we’re taught to uphold and honor. Now someone comes along and asserts you have got to change that fundamental plank of what being a lawyer means — and you’ve got to do it now,” says Pelaez-Pier. He notes that cultural variations exist to client-attorney privilege in many countries but maintains that many lawyers abroad don’t believe the SEC is the right forum to change that near-sacred ethical rule for lawyers.

The survey indicates that a large majority of lawyers in the countries outside the U.S. think that society doesn’t fully understand the reasons behind client confidentiality or legal privilege. But, unlike the 55% of U.S. lawyers who claim they would risk going to jail to protect client confidentiality or legal privilege, far fewer lawyers abroad would accept that risk. In the United Kingdom, for instance, only 22% of lawyers surveyed would risk going to jail.

A big difference of opinion emerged in several questions and, for the most part, the differences seemed to reflect whether lawyers in certain countries are culturally more acceptable for government to regulate conduct. For instance, when asked if they would like to see the legal profession regulated by the government to help stop illegal activity, such as money laundering or terrorism by clients, 54% of lawyers in Argentina/Chile agreed they would, while 47% of French lawyers also agreed. People in those countries are more used to their governments intervening in societal issues, and they may be more acceptable to it.

Elsewhere, lawyers were far more reluctant to see government regulation to help stop illegal activity, including 20% in the United Kingdom and 27% in Canada and Germany.

When asked whether it is proper for the government and society to expect lawyers to report the suspicion of or actual illegal activity by their clients, a vast majority of lawyers disagreed, although in the United Kingdom, 46% agreed, compared to only 11% in France and 13% in Germany.

Interestingly, a majority of lawyers in Canada and France expect their countries to adopt similar legislation to Sarbanes-Oxley, while only 30% of lawyers in Argentina/Chile anticipate such a move.

A majority of lawyers in every country surveyed except those in Australia and Argentina/Chile believe Sarbanes-Oxley will have an effect on their law practice and firm. Asked what they see as the most significant impact of Sarbanes-Oxley on their organization, lawyers in the United Kingdom, France, Germany, Australia and Argentina/Chile listed a "tighter definition of responsibilities" as No. 1. In Canada, increased insurance costs for company executives was the most significant impact cited.

### Highlights from The 2003 LexisNexis-IBA Legal Survey: Section One

#### **Standardizing International Legal Issues — 70% of lawyers polled back international standardization of law; money laundering voted hottest issue**

Nearly 70% of lawyers polled in the survey agree that the legal profession will benefit from the convergence of law across borders. Money transmission and laundering was selected overwhelmingly as the top priority for international standardization, with 83% of attorneys citing the need for convergence. Laws on terrorism and security also ranked high among all countries as priorities for global standardization, with 81% agreeing in France, 79% in Argentina/Chile, 77% in Australia, 69% in Canada, 68% in the UK, 67% in Germany and 64% in the U.S.

#### **Globalization of the Legal Profession: Threat or Opportunity — Lawyers in U.S., UK, Latin America see largest prospects for international work; Canadian and German firms must specialize or lose relevance**

Lawyers in the U.S., UK, Argentina and Chile consider globalization an opportunity and not a threat to their firms. By contrast, lawyers in Australia, Canada and Germany are wary of the potential negative consequences of globalization, including the growing concentration of international legal work in select countries beyond their borders.

Do international firms provide strong competition that helps local markets and improves local firms? At least 50% of lawyers agreed in all countries surveyed except Canada (47%), Germany (33%) and Australia (45%). And, when asked if local firms' culture and values are threatened by the rise of international firms, only a majority of lawyers (53%) in Germany agreed to that. Asked if international law firms drive up the costs of legal services to business, 69% of lawyers in Germany and 68% in France believe they do, while a majority of lawyers in the other countries believe they don't.

#### **Gauging Adequacy of Anti-Terrorism Laws — Lawyers from UK, Germany, U.S. and France feel confident their legal systems can handle terrorism; other nations' attorneys not so sure**

The survey revealed that 81% of lawyers in the UK and Germany consider their respective legal processes to be "fairly" to "very-well" equipped to handle international terrorism, while 74% of U.S. lawyers and 73% of French lawyers felt the same. By contrast, confidence levels were 60% in Canada, 47% in Australia and 24% in Argentina/Chile.

Lawyers agreed that the legal battle's chief challenge reflects the limited ability to manage the practical enforcement of anti-terrorism legislation. This shortcoming was cited by 89% of lawyers in Australia, 86% in Germany, 76% in Canada, 74% in Argentina/Chile, 74% in France, 73% in the UK and 50% in the U.S.

### The LexisNexis-IBA Legal Survey: A New Pulse on the Global Legal Profession

LexisNexis and the International Bar Association have teamed to survey legal professionals around the world on critical issues shaping their profession. The 2003 LexisNexis-IBA Legal Survey represents the largest global effort to date to track legal trends.

The inaugural 2003 survey is segmented into four parts. Section two, detailed in this summary, examines the impact to lawyers of the U.S. Sarbanes-Oxley legislation and other corporate-disclosure requirements. The remaining sections of the 2003 survey focus on the how the Internet is changing law, major trends in law and technology, the globalization of the legal profession and priorities for setting international legal standards, among other issues.

#### *Who We Talked To*

The respondents included at least 100 IBA members from each of the following countries: Australia, Canada, France, Germany, the United Kingdom, and the United States. Due to sampling limitations, data collection in Argentina and Chile was conducted among both IBA members and non-members. For these two countries, 100 total interviews were conducted, using both an in-person and telephone interviewing methodology. Respondents participated in a 20-minute telephone interview. All surveys were conducted locally in each country with native language-speaking interviewers who were familiar with local language dialect and nuances, as well as the business practices and customs of the country. The margin of error for each country analyzed is  $\pm 10$  points.

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#### *About the International Bar Association*

The IBA is the global voice of the legal profession and the world's largest international law organization. It provides education, information, networking and strategy for the world of law and its 16,000-members, influencing the development of international law reform and shaping the future of the legal profession. For more information on the IBA, please visit [www.ibanet.org](http://www.ibanet.org).

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