'Ostrich' Theory Enforces Ill-Defined Duty to Investigate Clients' Conduct

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In recent years, the application of a "conscious avoidance" or "willful blindness" theory as the basis of attorneys' liability for clients' criminal conduct has been on the rise. In principle, this standard — commonly referred to as the "ostrich" theory — allows an attorney with no actual knowledge of a client's wrongdoing to be held liable for providing legal services if the attorney suspected criminality on the client's part and took deliberate steps to avoid learning the truth. In practice, however, the standard may be enforcing an ill-defined duty to investigate red flags in situations where the ethical rules governing attorneys would find misconduct only if an attorney had actual knowledge of a client's criminality.

Hypothetically, assume you are the general counsel of a major U.S. corporation controlled by a Canadian company. The U.S. corporation's CEO owns 65 percent of the shares in the Canadian company and therefore effectively controls both. You are asked by the CEO to prepare and sign, on behalf of a U.S. subsidiary, an agreement to pay the CEO a certain sum in exchange for not competing with the subsidiary's business for three years after he stops working for the U.S. corporation. While it seems unlikely that the CEO would compete with the subsidiary's business, that's a decision for the company's board of directors and audit committee, which is required to approve transactions between corporate executives and the company or its subsidiaries. So you prepare and sign the agreement.

If you look to the ethical rules governing attorney conduct, it appears you have done what you needed to do. The American Bar Association's (ABA) Model Rules of Professional Conduct Rule 1.2(a) allocates authority between clients and lawyers and states that "a lawyer shall abide by a client's decision concerning the objectives of a representation and ... shall consult with the client as to the means by which they are to be pursued." Here, the corporate leadership has decided to execute the noncompete agreement by having you prepare and sign it on behalf of the subsidiary.

Of course, ABA Model Rule 1.2(d) also states that a "lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent." Rule 1.0(k) defines "know" as "actual knowledge of the fact in question." You don't have actual knowledge of any fraud here.

Rule 1.0(k) adds that "[a] person's knowledge may be inferred from circumstances," but this simply describes what kind of evidence may be used to prove actual knowledge. It does not suggest a duty to inquire into a client's conduct. If the drafters of the rules had intended to create such a duty, they would have done so. Other rules of conduct suggest — using Rule 1.0(j)'s "reasonably should know" standard — or expressly indicate, in the case of the "should have known" standard for lawyer's supervisory responsibility under New York Rules of Professional Conduct Rule 5.1, a duty to investigate red flags in certain situations. And while it is true that Rule 8.4(c) does not have a knowledge requirement and states that it is misconduct for a lawyer to "engage in conduct involving dishonesty, fraud, deceit or misrepresentation," this general rule regarding attorney misconduct cannot reasonably be read to negate Rule 1.2's actual knowledge requirement in relation to attorneys assisting in a client's fraud.

Despite having complied with these rules, you may still face criminal liability. Let's say later it is discovered that the noncompete agreement was part of the CEO's scheme to receive what he alleges were management fees owed to the Canadian corporation in a manner that would avoid Canadian taxes. And the evidence as to whether the CEO ever obtained the required audit committee approval is conflicting. Now you have been indicted along with the CEO. But surely you can't be convicted of a fraud you didn't

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know about, especially when the ethical rules don't require you to investigate clients' conduct.

As it turns out, you may be, if the prosecution successfully introduces the ostrich theory. The U.S. Supreme Court has set forth two basic requirements for the "conscious avoidance" or "willful blindness" theory. In *Global-Tech Appliances, Inc. v. SEB S.A.*, it stated that the defendant must (i) "believe that there is a high probability that a fact exists" and (ii) "take deliberate actions to avoid learning of the fact." Some courts remain faithful to the second requirement that there be some evidence that the defendant took proactive steps to avoid confirming suspicions of criminality — for example, by adopting the classic approach, "Don't tell me. I don't want to know." Other courts, however, have explicitly veered away from requiring that the attorney took deliberate acts to avoid learning of a client's fraud, allowing the ostrich theory to be applied where an attorney simply failed to investigate. For example, in *United States v. Kozeny*, the U.S. Court of Appeals for the 2nd Circuit found the ostrich theory appropriate where the "defendant's involvement in the criminal offense was *so overwhelmingly suspicious* that the defendant's failure to question the suspicious circumstances establishes purposeful contrivance to avoid guilty knowledge."

Recently, Judge Richard A. Posner suggested that there may be situations in which a failure to investigate constitutes "deliberate action to avoid learning of the fact" where the defendant had a duty or responsibility to know. He stated in *U.S. v. Macias*: "[T]here indeed are circumstances in which a failure to ask questions is unnatural — a ducking of responsibility, a violation of duty, and perhaps therefore the equivalent of taking evasive action to avoid confirming one's suspicions." Our hypothetical is based on an earlier case decided by Judge Posner, *U.S. v. Black* (vacated on other grounds under the name *Black v. U.S.*), involving the felony wire fraud conviction of Mark Kipnis, the general counsel of Hollinger International. Kipnis appealed the conviction, arguing that allowing the jury to consider the ostrich theory was inappropriate because he didn't know anything about the illegality of the agreement and had nothing to gain from it.

The court rejected these arguments, holding that the jury was entitled to infer that the general counsel "suspected a fraud, which he facilitated by his preparation of the agreement, but asked no questions lest his suspicion rise to a certainty. He buried his head in the sand." As to whether the general counsel had anything to gain from the fraud, the court held that because the mastermind of the scheme — the CEO — controlled the corporation and thus the general counsel's professional fate, the general counsel stood to gain from the fraud, even if he didn't know about it. Under this logic, there would seem to be no occasion on which in-house counsel could be said to have nothing to gain from corporate executives' fraud. The court noted that although the general counsel was the "least culpable" of the defendants and received a lighter sentence than the others (probation with six months of home detention), any felony conviction is devastating for a lawyer.

The developing precedent of prosecutions based on the ostrich theory offers little guidance as to the scope of this duty to investigate, nor does it clarify how the imposition of such a duty can coexist harmoniously with the fiduciary nature of the attorney-client relationship (or the practical realities of in-house attorneys' relationships with their client-employers). What is clear is that all lawyers — whether in a corporate legal department or at a law firm — are well-advised to be wary that the failure to investigate what might be deemed a red flag in hindsight might later support an inference that the attorney knowingly assisted his client's crime. This trend also suggests that taking deliberate actions to avoid learning the truth (the true ostrich scenario) is becoming an increasingly riskier business. As Judge Posner noted in *Macias*, even "ostriches do *not* bury their heads in the sand when frightened; if they did, they would asphyxiate themselves."