

Lawyers and Fraud: A Better Question

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I. INTRODUCTION

The idea that lawyers enjoy a public trust and thus owe duties, not only to their client, but also to the public, has figured significantly in our professional discourse from the beginning. Running parallel to this idea has been a ceaseless critical response from those who see the profession as failing in that public responsibility.¹

The prominent financial frauds at the dawn of our new millennium, which have come to be identified by the shorthand reference to the most publicized of the scandals, “Enron,” have stirred up this debate.² Although the spectacular collapse of the accounting firm, Arthur Andersen, and the “perp walk” images of business executives in handcuffs dominated the popular media coverage, the lawyers representing Enron and the other scandalous entities, as well as the legal profession generally, have not escaped scrutiny. The congressional reaction to Enron, the Sarbanes-Oxley Act, implemented a set of reforms directed at corporate governance, auditing procedures, and reporting requirements, as well as directing the SEC to establish the Public Company Accounting Oversight Board to watchdog the accounting industry.³ Section 307 of the Act required the SEC to draft and implement new rules of professional conduct for securities lawyers. Not surprisingly, the SEC’s rulemaking process has become a flash point for the contemporary revival of the debate about the legal profession.⁴

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1. See, for example, Samuel Taylor Coleridge’s observations, published in 1831, to the effect that the advocate has no right to do that for his client which his client could not do for himself as a matter of conscience. DAVID LUBAN, *The Adversary System Excuse*, in *THE ETHICS OF LAWYERS* 140 (1994) (discussing SAMUEL TAYLOR COLERIDGE, *Duties and Needs of an Advocate*, in *THE TABLE TALK AND OMNIANA OF SAMUEL TAYLOR COLERIDGE* 140-41 (T. Ashe ed., 1888)). Geoffrey Hazard describes the moral criticism of lawyers as a “chronic grievance.” Geoffrey Hazard, *The Future of Legal Ethics*, 100 *YALE L.J.* 1239, 1239 (1991).

2. See, e.g., Jim Hopkins & Edward Iwata, *WorldCom Directors’ Credibility Doubted*, *USA TODAY*, July 11, 2003, at 3B; Stephen A. Ludsin, *Corporate Ethics Law Is a Needed Change*, *N.Y. TIMES*, Oct. 27, 2002, at 17; Andrew Ross Sorkin, *Fallen Founder of Adelpia Tries to Explain*, *N.Y. TIMES*, Apr. 17, 2003, at 1.

3. *SARBANES-OXLEY ACT OF 2002*, Pub. L. No. 107-204, 116 Stat. 745 (codified at 15 U.S.C. §§ 78d-3, 78o-6, 7201, 7202, 7211-7219, 7231-7234, 7241-7246, 7261-7266, 18 U.S.C. §§ 1348-1350, 1514A, 1519, 1520 (2002)). For a summary of the Act, see *Annual Review of Securities Regulation*, 58 *BUS. LAW.* 747 (2003).

4. John C. Coffee, Jr., *Corporate Securities: The Latest Sarbanes-Oxley Controversy: Section 307*, *N.Y. L.J.*, Nov. 21, 2002, at 5; Roberta S. Karmel, *Securities Regulation: A Bid to Regulate the Entire Bar*, *N.Y. L.J.*, Dec. 19, 2002, at 3. The academic journals have quickly responded. See, e.g., John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 *COLUM. L. REV.* 1293 (2003); Susan P. Koniak, *When the Hurlyburly’s Done: The Bar’s Struggle with the SEC*, 103 *COLUM. L. REV.* 1236 (2003); Hon. E. Norman Veasey, *The Social Responsibility of*

In this issue of the *Washburn Law Journal*, Mark Sargent has offered a thoughtful contribution to this debate, *Lawyers in the Perfect Storm*.⁵ Although I have no serious disagreement with the substance of that analysis, a part of his conceptual framework made me think about the alternative ways of looking at the lawyers' position in these cases. Sargent suggests that the lawyers caught in the Enron storm were in a uniquely difficult and conflicted position. The lawyers for Enron were both "advocates" for their client and "gatekeepers" to the capital markets. As advocates, the lawyers owed a duty to the client; as gatekeepers, the lawyers owed a duty to the public. Sargent tells us that this is "where the complexity lies."⁶

I agree that, as a general matter, thinking about the public responsibilities of lawyers can be worthwhile. Certainly, to ask whether the lawyers for Enron and the other scandal-ridden companies failed in their public responsibilities as "gatekeepers" to the capital markets is a coherent and pertinent question.

Yet, in these times, I would emphasize a different question, one that focuses less on the lawyers' responsibilities to the public and more on their loyalty and service to their own client. For the lawyers representing Enron and the other companies, their client was the entity and, in most cases, their client was left in ruin. Thus, as we gaze across the wreckage of this ruined corporate landscape, we might ask how lawyers can fail so utterly in their responsibilities, not to the public, but to their entity clients, and walk away.

The Enron narratives are merely the latest chapter in a long history of financial scandals in which lawyers have been enmeshed.⁷ This Essay thus explores the difference that a choice in perspective might make as part of a long and unsuccessful struggle for real reform in this area. Part II of this Essay will explore the nature of what might be called the "gatekeeper" perspective, as well as its limitations. In essence, the question, although coherent and pertinent, misdirects our focus. The debate easily becomes an interminable exploration of the paradoxical notion of the lawyer as concurrently a partisan agent and a public guardian instead of an inquiry into how lawyers fail to serve adequately their entity clients. An elaboration of the "better question" is the subject of Part III. In essence, the virtue of asking the

Lawyers: Reflections on Key Issues of the Professional Responsibilities of Corporate Lawyers in the Twenty-First Century, 12 WASH. U. J.L. & POL'Y 1 (2003).

5. Mark Sargent, *Lawyers in the Perfect Storm*, 43 WASHBURN L.J. 1 (2003).

6. *Id.* at 19.

7. For a recitation of the precursors to Enron, including the National Student Marketing saga of the 1970s, the savings and loan scandals of the 1980s, and the BCCI bank fraud of the early 1990s, as well as a very thoughtful analysis of the substantive issues, see Roger Cramton, *Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues*, 58 BUS. LAW. 143 (2002).

better question is that it takes us more directly to what seems the only real hope for meaningful change, i.e., the creation of liability rules that might make compliant and careless legal representation of companies that are being manipulated by fraud-doing constituents a lot more costly than is currently the case. Finally, Part IV will explore what all this means in the context of the new SEC Rules and the debate about those Rules.

II. THE LAWYER'S DUTY TO THE PUBLIC

Thirty years ago a different kind of scandal dominated the headlines. What came to be called the Watergate affair would ultimately topple President Nixon and further disillusion a generation of Americans already reeling from two failed "wars," the one in Southeast Asia and the one at home styled the "War on Poverty."⁸

Various lawyers in the Executive Branch during these times figured prominently, and disgracefully, in the Watergate affair.⁹ The organized bar, aware of the sinking public image of lawyers, responded. In August of 1973, as the Watergate disclosures cascaded, the ABA concluded that it would require the teaching of ethics in every ABA-accredited law school.¹⁰ Ethics remains, to date, the only required course in the ABA accreditation process.¹¹

The legal academy took note of all this as well. Although the issue of the morality of the very activity of lawyering was not a new topic, it took on a boost of interest in the late 1970s. One of the most cited and discussed examples was Richard Wasserstrom's 1975 article, *Lawyers as Professionals: Some Moral Issues*.¹² This essay explicitly responded to the participation of the White House lawyers in the Watergate cover-up. Wasserstrom identified two "fundamental" moral criticisms of lawyers. First, in representing clients, Wasserstrom

8. See CARL BERNSTEIN & BOB WOODWARD, *ALL THE PRESIDENT'S MEN* (1974); LEON JAWORSKI, *THE RIGHT AND THE POWER: THE PROSECUTION OF WATERGATE* (1976); JOHN J. SIRICA, *TO SET THE RECORD STRAIGHT* (1979).

9. JOHN W. DEAN III, *LOST HONOR* (1982); Robert Pack, *The Lawyers of Watergate*, *WASH. LAW.*, July/Aug., 1999, at 25.

10. For a discussion of the history of the ABA requirement, see Roger Cramton & Susan Koniak, *Rule, Story, and Commitment in the Teaching of Legal Ethics*, 38 *WM. & MARY L. REV.* 145, 148 (1996).

11. The ABA's commitment to that requirement, however, is weak. Law schools may satisfy the requirement, more or less, however they wish, including optional lectures and the illusory "pervasive method," which imagines that ethics is taught everywhere in the curriculum. *Id.* at 147-48.

12. Richard Wasserstrom, *Lawyers as Professionals: Some Moral Issues*, in 5 *HUM. RTS.* 1 (1975). Wasserstrom recounts the story of John Dean's drafting of a document containing the list of persons who had been involved in the cover-up. Dean had placed an asterisk beside many of the names. When asked what the asterisk signified, Dean replied that the names with an asterisk were conspirators who happened to be lawyers. According to Wasserstrom, Dean wondered whether there was something about being a lawyer that made one a more willing accomplice. Wasserstrom's essay is essentially an elaboration of Dean's musing. *Id.* at 3.

suggested that lawyers operate with essentially no regard for the negative impact of their efforts on the rest of the world.

Provided that the end sought is not illegal, the lawyer is, in essence, an amoral technician whose peculiar skills and knowledge in respect to the law are available to those with whom the relationship of client is established. The question . . . is whether this particular and pervasive feature of professionalism is itself justifiable. At a minimum, I do not think any of the typical, simple answers will suffice.¹³

Second, Wasserstrom turned to the lawyer-client relationship itself. "Here the charge is that it is the lawyer-client relationship which is morally objectionable because it is a relationship in which the lawyer dominates and in which the lawyer typically, and perhaps inevitably, treats the client in both an impersonal and a paternalistic fashion."¹⁴ Thus, in Wasserstrom's critique, the lawyer fails the client and the rest of the world at once.

In the intervening years, much of the debate about the profession has centered on the first of these two questions, namely, can we make sense morally of a line of work in which we ruthlessly advance our client's ends.¹⁵ Many excellent minds have struggled thoughtfully with this question. Geoffrey Hazard has developed an insightful and challenging corpus of writings, drawing on various sources, ranging from the work of Isaiah Berlin to the biblical parables, all in an effort to make sense morally of our strange way of making a living.¹⁶ A philosopher in his formal education, David Luban has methodically taken apart the intellectual foundations of what he calls the "adversary system excuse."¹⁷ At the same time, Monroe Freedman is an unabashed and eloquent defender of "zealous representation."¹⁸ These scholars are not alone in their thoughtful exploration of the conventional question.¹⁹

If so many good minds choose to engage this question, in what sense might it be the "wrong" question to ask? It is hardly an irrelevant, or even unimportant, question to explore. Lawyers do well to

13. *Id.* at 6.

14. *Id.* at 1.

15. See, e.g., PHILIP B. HEYMANN & LANCE LIEBMAN, *THE SOCIAL RESPONSIBILITIES OF LAWYERS-CASE STUDIES* (1988); THOMAS L. SHAFFER & ROBERT F. COCHRAN, JR., *LAWYERS, CLIENTS, AND MORAL RESPONSIBILITY* (1994).

16. Professor Hazard's corpus on this subject includes *Dimensions of Ethical Responsibility: Relevant Others*, 54 U. PITT. L. REV. 965 (1993); *Doing the Right Thing*, 70 WASH. U. L.Q. 691 (1992); *Personal Values and Professional Ethics*, 40 CLEV. ST. L. REV. 133 (1992); *The Future of Legal Ethics*, 100 YALE L.J. 1239 (1991).

17. See LUBAN, *supra* note 1.

18. See MONROE H. FREEDMAN & ABBE SMITH, *UNDERSTANDING LAWYERS' ETHICS* (2d ed. 2002).

19. See, e.g., Charles Fried, *The Lawyer as Friend: The Moral Foundations of the Lawyer-Client Relationship*, 85 YALE L.J. 1060 (1976); Stephen L. Pepper, *The Lawyer's Amoral Ethical Role: A Defense, a Problem, and Some Possibilities*, 1986 AM. B. FOUND. RES. J. 613 (1986); Ted Schneyer, *Moral Philosophy's Standard Misconception of Legal Ethics*, 1984 WIS. L. REV. 1529; William H. Simon, *Ethical Discretion in Lawyering*, 101 HARV. L. REV. 1083 (1988).

ponder the morality of their professional role, as should each of us, whatever our station in life. Nonetheless, the conventional question is the wrong question for those of us who now stand gazing at the wreckage of the Enron narratives and seek to discern how the lawyers could have done better. In fact, the conventional question, and the debate it invites, are well-structured to go nowhere in terms of any real reform.

First, the question fails to capture the actual problems presented, not only in Enron but also in Watergate and the intervening prominent scandals. The most prominent scandals that have implicated lawyers in recent decades exhibit a similar pattern. The lawyers involved did not represent an individual person as client, but rather, a corporation or, in the Watergate example, the “government.” Thus, the lawyers faced the dissonance experienced always by lawyers representing such entities.²⁰ Because their client existed as an intangible conception only, the lawyers likely came to think of the human constituents of the entity as the client. As Geoffrey Hazard explained, thinking of the human constituent as the client does no harm at all so long as the constituent is fulfilling his duties to the entity.²¹ That is, so long as Richard Nixon used the powers of his office to pursue lawful goals by lawful means, his lawyers could simply think of Nixon as their client. Yet, the moment that Nixon sought the White House lawyers’ help in an agenda that was inconsistent with the Office of the President, to continue to think of Nixon as the client was a mistake. In fact, in serving Nixon in his capacity as the President, the lawyers of the Nixon White House should have understood that they had undertaken duties to the very “office” itself, i.e., the duty to avoid assisting the man occupying the West Wing from abusing the powers of the Office of President.

In the corporate context, the situation is analogous. Corporate lawyers may understandably think of the human constituent as the client. Again, this misconception is harmless so long as the CEO and the other human constituents are fulfilling their fiduciary duties to the entity. The misconception becomes harmful when, as in the Enron narratives, the constituents violate those fiduciary duties and the lawyer goes along. The central failing of the lawyers for Enron was the failure to discern and intercept the hijacking of the entity by constituents who were shredding their duties to the entity, along with inconvenient documents. Thus, the first element of the pattern of the scandals is this essential failure of entity representation.

20. Geoffrey Hazard’s *Triangular Lawyer Relationships* remains as perhaps the most thoughtful exploration of the dissonance in entity representation. See Geoffrey C. Hazard, Jr., *Triangular Lawyer Relationships: An Exploratory Analysis*, 1 *GEO. J. LEGAL ETHICS* 15 (1987).

21. “If the other parties to the relationship conduct themselves as the law contemplates they should, then [they] can be considered ‘the client.’” *Id.* at 41.

The second important element of this pattern is that the scandals involved not only morally deficient behavior but outright illegality as well. Whatever the state of their souls, the wrongdoers in these narratives, at least some of them, suffered significant legal liability, and a few went to jail.²²

Thus, in the prominent historical examples, the problem is not that of lawyers helping their clients pursue lawful ends that hurt others. Focusing on the corporate context, these scandals are not about laying off workers while paying obscenely rich compensation to the executives or closing a plant and thus wrecking a community's economic structure or any of the other scenarios in which we might call into question the morality of the corporate client's conduct and of the lawyer's assistance. The Enron stories involve fraud and other illegality, not lawful acts that harm third parties. We will call on prosecutors and lawyers for the defrauded investors, rather than moral philosophers, to sort out these stories.

Recalling Wasserstrom's second fundamental moral criticism, it is interesting to note that the scandals from Watergate forward are also not stories of lawyers dominating their clients. In the case of entity representation, paternalistic lawyering takes the form of the lawyer dominating the CEO or other human constituent of the entity client. While each scandal is a complex narrative all its own, it seems safe to generalize and conclude that the lawyers involved were, if anything, likely to have been dominated by the constituents, rather than the other way round.

Yet, the disconnect between the question and the actual scandals may not be such a problem. After all, if the lawyers working with Richard Nixon or Ken Lay embraced a professional role in which the lawyer was both a loyal agent and a "gatekeeper" with duties to the public, the scandals might never have happened. We might imagine that a lawyer possessing such a professional self-conception is able to save simultaneously both his soul and his hide. In fact, the real problem with the conventional question is not its imperfect fit with the scandals; rather, the real problem is that the professional self-conception implied by the question is unattainable, practically, if not conceptually.²³

22. See, e.g., *In the Matter of Kaye, Scholer, Fierman, Hays & Handler: A Symposium on Government Regulation, Lawyers' Ethics, and the Rule of Law*, 66 S. CAL. L. REV. 977 (1993) (describing the saga of the Kaye Scholer law firm, the lawyers for Lincoln Savings and Loan, in which the firm faced a \$275 million claim filed by the Office of Thrift Supervision). For the fate of the Watergate lawyers, see Pack, *supra* note 9.

23. See James A. Cohen, *Lawyer Role, Agency Law, and the Characterization*, "Officer of the Court," 48 BUFF. L. REV. 349, 408 (2000) (analyzing the lawyer's role in the litigation context and concluding that the idea of the lawyer as an "officer of the court" is "conceptually empty"). For a differing view, see Russell G. Pearce, *What Does It Mean to Practice Law "In the Interests of Justice" in the Twenty-First Century?*, 70 FORDHAM L. REV. 1805 (2002).

Consider first the realities of contemporary practice. Lawyers think of themselves, and the state's law treats them, as agents for their clients/principals. As such, lawyers owe a duty of loyalty to the client. This "loyalty" necessarily connotes putting the client's interests ahead of the interests of others. Thus, lawyers often assist the client in ways that diminish the position and interests of others. A tax lawyer helps the client pay as little taxes as possible; the environmental lawyer helps the manufacturer fully exploit the legal capacity to pollute. The criminal defense lawyer seeks liberty for his client without regard to the question of innocence or recidivism, and so on.

On the other hand, it is simply empirically false to suppose that practicing lawyers know no bounds in their pursuit of the client's interests other than the formal bounds of the state's law. In the initial decision of engagement, lawyers choose, on grounds of personal values and morality, to devote their services to some clients and not to others.²⁴ Once engaged, lawyers may seek to dissuade a client on moral grounds from taking an advantage when, for example, the gain to the client is small compared to the cost to others.²⁵ Lawyers may be tough-minded partisans but few of them are moral monsters operating with no actual regard whatever for the consequences of their work. Still, most practicing lawyers understand themselves as essentially loyal agents rather than a hybrid of agent and public guardian.

All of this, of course, does not answer the normative question of whether we should adopt a different understanding of our practice. Certainly lawyers in different cultures possess different understandings of their role.²⁶ The difficulty in imagining any significant change in our professional self-conception, at least any change driven by the lawyers themselves, arises when one considers the deeply rooted quality of that conception.

The bar, like any community, has stories that help it understand its nature and destiny. The nineteenth century historical narrative of Lord Brougham's defense of Queen Caroline in a royal divorce proceeding contains perhaps the most famous expression of the lawyer's professional duty and is a story that often surfaces in the bar's discourse.²⁷ Brougham's defense was controversial especially because of its tabloid quality with the royals as central characters and charges of

24. Monroe Freedman, a strong advocate of "zealous representation," emphasizes the moral accountability in choosing one's clients. See FREEDMAN & SMITH, *supra* note 18, at 80-84. Freedman also acknowledges the "need to earn a living" that complicates the choice. *Id.* at 84.

25. Thomas Shaffer is a strong proponent of such "moral discourse" between lawyers and clients. See SHAFFER & COCHRAN, *supra* note 15.

26. See, e.g., CHARLES R. EPP, *THE RIGHTS REVOLUTION: LAWYERS, ACTIVISTS, AND SUPREME COURTS IN COMPARATIVE PERSPECTIVE* (1998); *LAWYERS IN SOCIETY: COMPARATIVE THEORIES* (Richard L. Abel & Philip S. C. Lewis eds., 1989).

27. 2 TRIAL OF QUEEN CAROLINE 3 (1879), *discussed in* Hazard, *The Future of Legal Ethics*, *supra* note 16, at 1244.

adultery running in each direction. Brougham nonetheless plunged ahead and explained his actions in the following terms:

[A]n advocate, in the discharge of his duty, knows but one person in all the world, and that person is his client. To save that client by all means and expedients, and at all hazards and costs to other persons, and, among them, to himself, is his first and only duty; and in performing this duty he must not regard the alarm, the torments, the destruction which he may bring upon others.²⁸

Within our own history, a commonly invoked narrative arises from the mid-eighteenth century trial of the newspaper publisher, John Peter Zenger, by the colonial government of New York.²⁹ The colonial government put Zenger on trial for seditious libel as a result of articles published in his newspaper that were critical of the colonial regime. The Governor's hand-picked judge disbarred Zenger's first set of lawyers. Andrew Hamilton, a prominent Pennsylvania lawyer, assumed the publisher's defense. In defiance of the judge's orders, Hamilton argued the truthfulness of the newspaper's criticisms. The jury acquitted Zenger, and the narrative became another of the bar's epic tales.

In these epic stories, the lawyer stands between the client and the awesome power of the state. These stories teach us that the lawyer must proceed, like Lord Brougham, knowing but one person in the world, the client, and heedless to the harm to others. This idea of the lawyer as loyal and fearless champion of his client has always resonated within the profession.³⁰ Thus, the idea of the lawyer as a "gate-keeper," putting the interests of third parties ahead of the client's interest, runs against both the bar's sacred stories and the essential nature of law practice as lived by lawyers across the various practice domains.³¹

Moreover, the conception of the lawyer as loyal partisan possesses real force and resonance. Who among us would want our lawyer to be less than fully committed to us, especially when we must face the imposing resources of the state? It seems right, as a general principle, that a lawyer should place his client's interests ahead of others. Thus, the suggestion that the lawyer should see himself as concerned with the public interest rather than his client's interests collides with a deeply rooted professional self-conception that has an intrinsic sense.

28. *Id.*

29. See Paul Finkelman, *The Zenger Case: Prototype of a Political Trial*, in *AMERICAN POLITICAL TRIALS* 21 (Michal R. Belknap ed., 1981).

30. See Thomas Ross, *Knowing No Other Duty: Privy, the Myth of Elitism, and the Transformation of the Legal Profession*, 32 *WAKE FOREST L. REV.* 819, 830-32 (1997).

31. See Susan P. Koniak, *The Law Between the Bar and the State*, 70 *N.C. L. REV.* 1389 (1992) (providing an analysis of the "bar's sacred stories," focusing on the Zenger saga).

In the past thirty years, in the wake of Watergate and Wasserstrom's challenge to the profession, legal philosophers have offered much thoughtful analysis on the conventional question. At the same time, little, if anything, has changed. From Watergate through the savings and loan crash of the 1980s and into Enron, the pattern has persisted. Human constituents violate their duties to the entity, commit massive fraud and other illegality, all with the lawyers along for the ride. Again and again.

III. A BETTER QUESTION

A change of perspective may do little to alter the persistent pattern of lawyer complicity in fraud. In fact, I am not optimistic that any perspective on this problem will be sufficient to cut through the web of laws, cultural understandings, incentive structures, and human nature that presumably account for these debacles. Still, it should be at least interesting to change the focus a bit. Instead of seeing the Enron lawyers as simply greedy crooks or as conflicted lawyers stuck in complex circumstances, we shall consider them as perhaps just incompetent at their essential task.

The "stars" of the Enron media spotlight were generally the executives, the accountants, and even a few government men.³² The lawyers enjoyed a relative obscurity, although the firm of Vinson & Elkins, Enron's lawyers, received some publicity.³³ When the spotlight drifted on occasion to the lawyers, the lawyers responded with the assertion that their representation was consistent with their professional norms, stressing confidentiality as a central obligation.³⁴

Yet, the great glaring weakness in the argument that the Enron lawyers were simply too devoted to the client and bound in any event by the strictures of confidentiality is the central fact that the entity, Enron, was the client and not Ken Lay or Andy Fastow or any of the other human constituents. The lawyers owed their loyalty to the entity and not to the constituents. In essence, their task as lawyers was to help the entity become as successful as it could, while making sure that they and their client stayed on the right side of the state's law. In

32. The "government men" included most prominently Eliot Spitzer, the New York Attorney General, and Harvey Pitt, the ultimately deposed head of the SEC. See John Cassidy, *The Investigation: How Eliot Spitzer Humbled Wall Street*, NEW YORKER, Apr. 7, 2003, at 54. See also Jeffrey H. Birnbaum, *It's Time for Him to Go: The Securities and Exchange Commission Is Desperate for Strong Leadership — and Harvey Pitt Isn't Providing It*, FORTUNE, Oct. 28, 2002, at 99.

33. Anthony Lin, *Kirkland Protected by Silence in Enron Unlike Vinson & Elkins, Firm Made No Disclosures*, N.Y. L.J., Dec. 30, 2002, at 1; James V. Grimaldi, *Jamail Goes on the Offensive in Defense of Vinson & Elkins*, WASH. POST, Feb. 25, 2002, at E01; David Streitfeld, *Vinson & Elkins' Turn in the Enron Spotlight*, L.A. TIMES, Mar. 14, 2002, at 1.

34. See Riva D. Atlas, *A Law Firm's 2 Roles Risk Suit by Enron, Experts Say*, N.Y. TIMES, Jan. 29, 2002, at C-1 (quoting a firm "spokesperson").

this task, the Enron lawyers were a colossal failure. The human constituents rode Enron into the ground, while violating the state's law in ways that would be attributed to the entity, as well as themselves individually.

Thus, the question emerges: How do law firms of national standing and reputation allow the human constituents of their entity client to ravage the company and trample across the state's law? We cannot know, literally, the answer to this question. Each case is unique. A standard part of the explanation is the idea that lawyers seek not to know bad news, thus allowing them to carry on even in the face of signals that all is not well. The psychology of the lawyer who manages to "see no evil" has been extensively explored and surely is part of the explanation.³⁵

Yet, whatever the intricacies of the lawyer-client relationships in the scandals, we can be reasonably sure that the lawyers and law firms will respond to the financial incentive structures. Law firms, more than anything else, are profit-making enterprises, and quite sensibly so. Faced with a "demanding" CEO wanting to push the envelope and then some, firms must confront several significant realities. Law firms operate in a competitive market in which, according to standard lore, there are always other firms ready to be more aggressive to get the business. The limiting factor, in theory, is the penalty suffered by firms when they go too far. Put another way, an aggressive, profit-driven firm would probably find a way to discern bad news if failing to see it was truly and significantly costly.

Thus, the perspective of the "better question" begins by emphasizing the fact that the entity is the client. The story becomes one of lawyers allowing themselves to be manipulated by other agents of the client, rather than a story of lawyers torn between obligations to the client and conflicting obligations to the public. If we wish to reduce the incidence of such inadequate lawyering, we need to re-examine the legal disincentives for such lawyering. Rather than imagining that the profession will embrace the paradoxical conception of "green lawyering," we imagine instead that tough-minded lawyers would respond to tough and sure penalties for compliant lawyering on behalf of a fraud-doing constituent.³⁶ The new SEC rules seem directed to precisely that end. What remains to be seen is whether the rules hold out the hope for real change.

35. See Sargent, *supra* note 5, at 30-36. See also Donald C. Langevoort, *Where Were the Lawyers? A Behavioral Inquiry into Lawyers' Responsibility for Clients' Fraud*, 46 *VAND. L. REV.* 75, 95-111 (1993).

36. "[I]f we are unsatisfied with the perceived incidence of attorney complicity in client fraud, then some tinkering with legal incentives is necessary." Langevoort, *supra* note 35, at 115.

IV. SEC AND THE LAWYERS

In section 307 of the Sarbanes-Oxley Act, Congress directed the SEC to develop rules of professional conduct for securities lawyers.³⁷ Specifically, the statute contemplated internal, “up the ladder” reporting requirements that would compel a lawyer to report evidence of the violation of securities laws to the CEO, general counsel, or, if necessary, the board of directors. The SEC’s proposed rules, published in November of 2002, contained both an “up the ladder” reporting requirement and, even more controversially, a “noisy withdrawal” rule requiring resignation and notice to the SEC in the event that the lawyer did not receive a satisfactory response from the corporate constituents.

The proposed rules prompted an avalanche of commentary.³⁸ The bar was generally very unhappy with the “up the ladder” reporting requirements and was emphatically hostile to the whistle-blowing “noisy withdrawal” idea. The SEC final rules incorporated a version of the “up the ladder” reporting requirement but deferred the resolution of the “noisy withdrawal” rule.³⁹ Yet, with or without the “noisy withdrawal” requirement, good reason exists to doubt the efficacy of the SEC’s answer to the problem of the Enron lawyers.

Two basic problems arise when we contemplate the SEC’s potential to regulate the securities bar. First, the general problem of “capture” arises.⁴⁰ In this theoretical understanding, powerful and well-organized interest groups, for example the securities bar, may exercise undue influence with the regulators such as the SEC staff. This influence may be a product of various factors, e.g., a “revolving door” hiring pattern in which members of the securities bar join the SEC staff and then cycle back into private practice. We may suppose that the presence of experienced securities lawyers in the regulatory role lends itself to a more empathetic response from the regulator. The extent to which such “capture” might limit the SEC’s construction, interpretation, and enforcement of its rules in this case remains to be seen.

The second and less well understood problem is the bar’s special capacity to resist the state’s attempts at regulation. Susan Koniak has thoughtfully explored this issue in the important article, “The Law Between the Bar and the State.”⁴¹ Building on the work of Robert

37. Pub. L. No. 107-204, 116 Stat. 784 (codified at 15 U.S.C. § 7245).

38. The commentary is available at <http://www.sec.gov/rules/proposed/s74502.shtml>.

39. See Final Rule: Implementation of Standards of Professional Conduct for Attorneys, Exchange Act Release Nos. 33-8185, 34-47276, IC-25919 (Jan. 29, 2003), 68 Fed. Reg. 6296 (Feb. 6, 2003), available at <http://www.sec.gov/rules/final/33-8185.htm>.

40. See David Dana & Susan P. Koniak, *Bargaining in the Shadow of Democracy*, 148 U. PA. L. REV. 473, 497 (1999); Thomas Merrill, *Capture Theory and the Courts: 1967-1983*, 72 CHI.-KENT L. REV. 1039, 1043 (1997).

41. Koniak, *supra* note 31.

Cover, Koniak shows that the bar has its own understanding of the law governing lawyers.⁴² The conventional understanding of ethics law is that it is simply an additional body of law that applies to lawyers. Within this understanding, ethics law begins where the rest of the state's law leaves off. Thus, ethics law could not conflict with other parts of the state's law. Yet, this understanding does not mirror reality. The bar talks and acts in ways that project its understanding that its law, most especially the rule of confidentiality, controls even in the face of conflicting obligations under other forms of the state's law.

The bar's response to a provision of the Tax Reform Act of 1984, which required taxpayers to report cash payments of \$10,000 or more, provides a vivid example of the bar's insistence on the primacy of its law.⁴³ In response to this federal law, criminal defense attorneys, who received such cash payments from clients, filled out IRS forms that omitted client identity and the amount of the payment. The attorneys explained that the omitted information was protected by the attorney-client privilege. The only problem was that the privilege generally does not protect client identity and fee information.⁴⁴ The government brought suit, and the federal courts ruled for the government, reminding the lawyers of the well-settled principle of evidence law that client identity and fee are not privileged. Still, throughout the process, and even after the Second Circuit ruled against the lawyers, various units of the organized bar continued to counsel their members to resist the state's demand for the information.⁴⁵

Talk of the bar's own "law," and of resistance, may sound odd, especially when speaking of the bar. Among other things, how does a loosely affiliated group of professionals stand up to the state? Admittedly, the bar recognizes what Cover calls the state's "imperfect monopoly on violence." Because the state possesses an array of force that may be deployed to compel obedience, the bar will say that the lawyer *may* disclose confidences, but only when the choice is to speak or go to jail.⁴⁶ Yet, the state will often save the lawyer from such a stark choice.

Part of what makes it possible for the bar to maintain and advance its own vision of the law governing lawyers is that the state

42. Koniak's primary source for Cover's vision is the path-breaking article, Robert M. Cover, *Nomos and Narrative*, 97 HARV. L. REV. 4 (1983).

43. Koniak, *supra* note 31, at 1405-07.

44. See 1 GEOFFREY C. HAZARD, JR. & W. WILLIAM HODES, *THE LAW OF LAWYERING* § 9.11 (3d ed. Supp. 2003).

45. "After this decision, when asked what advice he would give to lawyers in the circuit, the head of the National Association of Criminal Defense Lawyers' '8300 Task Force' commented: 'I would say many people subscribe to the notion that you don't violate a confidence until you are ordered to do so by a court.' From the context it is obvious he meant *personally* ordered." Koniak, *supra* note 31, at 1407 (emphasis added).

46. See *id.* at 1483-85.

often shows what Koniak calls a “weak commitment” to its law.⁴⁷ Interestingly, an example of such weak commitment, and a case that figures prominently in Koniak’s analysis, is the *National Student Marketing* case, which was a prominent securities fraud case of the 1970s.⁴⁸

National Student Marketing Corporation (NSM), a vendor of products for college and high school students, was one of the market’s darlings in the late 1960s. In 1969 NSM acquired Interstate National Corporation (Interstate), an insurance holding company, in a stock-for-stock transaction. Unfortunately, NSM had provided materially false financial statements to Interstate, overstating the financial health of NSM. Interstate’s shareholders presumably relied on these financial statements in voting to approve the merger. Making matters worse, at least for the lawyers involved, the false nature of the financials became known to Interstate and its lawyers at the closing. Nonetheless, the Interstate principals decided to proceed with the closing and the lawyers acquiesced. No one informed the Interstate shareholders, now NSM shareholders, of the misrepresentations in the NSM financials. Within months, NSM was in financial ruin, and the lawsuits commenced.

In addition to the private litigation, the SEC brought enforcement actions against the two companies, their principals and their lawyers, charging securities fraud and seeking injunctive and declaratory relief. The case was simple. The NSM financials were materially false; the lawyers and principals knew this, and they nonetheless closed the merger. The NSM principals and lawyers settled with the SEC. Surprisingly, the Interstate defendants went to trial. Judge Parker’s opinion expresses the obvious conclusion - a clear case of the lawyers aiding and abetting securities fraud. But the remedy analysis is the interesting part. Judge Parker denied the SEC’s requested injunctive relief, relying on the fact that the defendants were “attorneys and officers of the court.” Thus, concluded Judge Parker, “[t]he Court is confident that they will take appropriate steps to ensure that their professional conduct in the future comports with the law.”⁴⁹

In *National Student Marketing*, the court said that the lawyers had aided and abetted securities law violations but declined to deploy any force to back that interpretation. Most strikingly, the court deferred precisely because the defendants were lawyers. In this way, the state

47. *See id.* at 1460-78.

48. *SEC v. Nat’l Student Mktg. Corp.*, 457 F. Supp. 682 (D.D.C. 1978).

49. *Id.* at 717. The judge’s faith was misplaced. Within the year, the firm was again charged with violating the securities laws and paid a \$24 million settlement. *See Koniak, supra* note 31, at 1467-68 n.341.

ceded normative space to the bar and showed a weakened commitment to its own interpretation of the state's law.

In the *National Student Marketing* case, as with all of the important struggles between the bar and the state, the bar's position revolves around the commitment to confidentiality. This is because confidentiality is the bar's "constitutional norm." Koniak clarified that concept:

[b]y "constitutional norm," I mean a norm so central to group definition . . . that the group perceives threats to the norm as threats against the group itself - against the group's very existence; that the group sees proposals to change the norm as proposals to change the essence/character/function of the group itself; and consequently that the group feels extreme action in defense of the norm is justified.⁵⁰

Thus, the current SEC rules, especially to the extent they may seek to incorporate a "whistle blowing" disclosure requirement, will collide with the bar's constitutional norm of confidentiality. It is hardly surprising, and no accident, that the SEC blinked on the "noisy withdrawal" piece of its proposed rules. It will be interesting to see how the SEC ultimately decides this deferred question, although history suggests that the SEC will ultimately cede this normative space to the bar.

This would be the end of this brief review of the struggle between the bar and the state except for something that happened in August of 2003 as I composed this essay. The ABA House of Delegates adopted an amendment to Model Rule 1.6 that would permit the lawyer, in certain limited circumstances, to disclose confidential information in the context of client fraud.⁵¹ The rule has several qualifying provisions that, depending upon their interpretation, may significantly limit the rule's scope, e.g., is the harm "reasonably certain to result"? Also, the ABA amendment is a less dramatic development than it appears because a number of jurisdictions have already provided for permissive disclosure in the context of client fraud.⁵² Still, it is a remarkable event in light of the fact that the bar has vigorously resisted precisely this move for many years.⁵³

While we cannot know for sure what, if anything, will follow from this amendment to the Model Rules, we can be reasonably sure that it will not solve the Enron problem. First, the amendment changes no law anywhere; it is a *Model* Rule. Moreover, the new rule only per-

50. Koniak, *supra* note 31, at 1427.

51. See James Podgers, *Corporate Watchdogs: ABA House OKs Rule That Would Allow Lawyers to Report Financial Wrongdoing*, ABA J. E-REPORT, Aug. 15, 2003, available at <http://www.abanet.org/journal/ereport/au15house.html>.

52. See JOHN S. DZIENKOWSKI, PROFESSIONAL RESPONSIBILITY - STANDARDS, RULES, AND STATUTES 157-63 (abr. ed. 2003).

53. See Ted Schneyer, *Professionalism as Bar Politics: The Making of the Model Rules of Professional Conduct*, 14 LAW & SOC. INQUIRY 677 (1989).

mits disclosures in certain limited circumstances. Most importantly, so long as the culture of the profession remains one in which confidentiality is a constitutional norm, the *permission* to disclose client confidences will make little difference. As a permissive provision, the amendment by itself creates no incentive for disclosure. That is, no lawyer risks professional discipline under this provision for choosing not to disclose the confidences.

V. WHERE FROM HERE

The SEC's new rules have an unknowable destiny. Much may depend on the SEC's resolution of the deferred question of "whistle blowing" disclosures. Still more depends on how the SEC chooses to enforce the rules it finally adopts. Tough sounding rules applied with weak commitment will probably change nothing. Moreover, even if the SEC deploys the rules with real commitment, it is not clear that the penalties for non-compliance will be a sufficient disincentive to alter significantly the historical pattern of lawyer complicity in financial scandals.

Worse yet, the SEC rules, as well as the recent ABA amendment of Model Rule 1.6, while carrying the seeds of change, may function as the sleight-of-hand effect that facilitates the perpetuation of the status quo. As the Enron scandals recede in time, public attention will go elsewhere, especially if it appears as though something has been done. It may be that ten years hence, the *Washburn Law Journal* will publish a symposium on the then-current financial scandals, and the papers will each bemoan the failures of the reform efforts we discuss today.

In the aftermath of Enron, some things have changed. The SEC has imposed new rules on securities lawyers. The ABA has amended its rule on confidentiality. The academic bar has taken notice. Unfortunately, it is unlikely that these efforts will change the essential ingredients of lawyer complicity in securities fraud. The culture of the profession continues to embrace a near-absolute sense of confidentiality; whistle blowing remains a pariah. Lawyers continue to believe, probably with good reason, that if they are too nosy and picky with their corporate constituents, the business will simply go down the street to a law firm that knows how to keep the CEO happy. If change is going to come anytime soon, it will require an overhaul of liability rules that makes "seeing no evil" much more costly to the lawyers. Such a development is not on the horizon.

