

CORPORATE FRAUD: SEE, LAWYERS

SUSAN P. KONIAK*

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I. INTRODUCTION

The accounting profession must bear a good deal of responsibility for the current wave of corporate scandals, as must those CEOs whose watchword was greed, lackadaisical directors, projections-for-hire investment analysts, banks selling methods designed to deceive, and institutional investors asleep at the switch. One set of villains, however, have managed thus far to float beneath the radar screen and thus escape the lion-sized portion of blame that should rightly be laid at their door: lawyers.

The hidden dirty secret of corporate scandals is that without lawyers, few corporate scandals would exist and fewer still would succeed long enough to cause any significant damage. No reform directed at other groups or institutions that is enacted by Congress, the SEC, or any other body, private or public, will accomplish its intended result as long as lawyers are allowed to roam in a law-free zone where legal fees know no bounds and the bankruptcy of one firm's corporate client only provides more legal fees to another firm. Some racket: The client disintegrates with its lawyers' assistance and the lawyers need to pay back (at most) a token amount of the huge fees they reaped assisting the fraud that brought the client down. Even better: The lawyers get hired by a client, that some other law firm has helped bring down, to fight the SEC, the Justice Department, or

* Professor of Law, Boston University. A sketch of some of the ideas discussed here and portions of the language used here were originally presented in Susan P. Koniak, *Who Gave Lawyers a Pass?*, FORBES, Aug. 19, 2002, at 58. I appreciate the cooperation of *Forbes* on this project.

creditors in bankruptcy. Perhaps they are hired by institutions victimized by another firm's client, as counsel, for example, to a creditors committee in a bankruptcy proceeding. Even more shocking: Lawyers can do all this with virtually no risk. There is no real prospect of criminal prosecution, SEC enforcement actions or discipline, or state bar sanctions. And best of all: This almost-to-good-to-be-true world that lawyers inhabit is all but impervious to change. As for everybody else? Well, they just have to live with the consequences, however painful those may be.

II. LAWYERS, LIES AND MARKET-GATE

To take my assertions one at a time: Am I right that lawyers are responsible for much of the present travail? Take Enron. Vinson & Elkins, a prestigious Texas-based law firm, and other law firms representing Enron blessed many of the related-party transactions that played such a large role in Enron's demise.¹ I am certain that many of these transactions were fraudulent—meaning they violated civil and criminal law.

Kirkland & Ellis, a prestigious Chicago-based firm, represented numerous Enron-related partnerships—entities with names like Raptor and Condor, names that all but screamed out, "Fraud is going on here."² They too blessed related-party transactions that I believe to

1. For an extensive discussion of Vinson & Elkins's role in the collapse of Enron, see Ellen Joan Pollock, *Lawyers for Enron Faulted Its Deals, Didn't Force Issue*, WALL ST. J., May 22, 2002, at A1; Michael France *What About the Lawyers?*, BUSINESSWEEK, Dec. 23, 2002, at 58. Vinson & Elkins, as well as Kirkland & Ellis, see *infra* note 3 and accompanying text, were sued, *inter alia*, for securities fraud by Enron investors. On Dec. 20, 2002, the court denied Vinson & Elkins' motion to dismiss, but did dismiss the complaint against Kirkland & Ellis. *In re Enron Corp. Securities, Derivative & ERISA Litigation*, 235 F. Supp. 2d 549 (S.D. Tex. 549 2002). For a discussion of the involvement of these two firms' in Enron's shady transactions, as alleged by the plaintiffs, see *id.* at *656-674, 704-706.

2. See Consolidated Complaint for Violation of the Securities Laws at ¶¶ 857-96, *In re Enron Corporate Sec. Litig.*, (S.D. Tex. filed Apr. 8, 2002) (No. H-01-3624) (University of California Regents' class action complaint detailing Kirkland & Ellis's alleged role in Enron's violations of securities law). See *id.* at *305-317, 413-415. In dismissing the complaint against Kirkland & Ellis, the court said:

While the allegations against Kirkland & Ellis may indicate that it acted with significant conflicts of interest and breached professional ethical standards, unlike its claim against Vinson & Elkins, Lead Plaintiff has not alleged that Kirkland & Ellis exceeded activities [that] would be protected by an attorney client relationship . . . because [the firm] never made any material misrepresentations or omissions to investors or the public generally that might make it liable [for securities fraud as a primary violator]. Any documents it drafted were for private transactions between Enron and the SPEs and the partnerships and were not included in or drafted for [the public or shareholders of Enron]. Any opinion letters that the firm wrote are not alleged to have reached the plaintiffs nor been drafted for the benefit of the plaintiffs. It was not Enron's counsel for either its securities filings or its SEC filings.

be fraudulent. Kirkland & Ellis was surely not the only law firm to sign off on behalf of the entities and their big-time investors. Merrill Lynch, for example, marketed those partnerships to big-time investors based on documents that intimated the partnerships were great investments because partners would be privy to inside information concerning Enron.³ Some set of lawyers and one or more firms had to have approved those marketing documents. To wit, representatives of Citigroup and J.P. Morgan, banks that also appear to have assisted Enron in its hell-bent quest to cook its books, testified before Congress that the shady and, again in my opinion, illegal transactions between the banks and Enron were approved by Citigroup's, J.P. Morgan's, and Enron's lawyers.⁴ Further, the First Interim Report of Neal Batson (the court-appointed examiner for the Enron bankruptcy proceedings) makes clear that the accountants sought out and relied on the guidance of lawyers when trying to determine if certain transactions should be booked as sales or something else.⁵ In fact, Enron had to provide Andersen with two legal opinions from its outside counsel in order for Andersen's accountants to sign off on the accounting treatment of the transactions.⁶ This clearly suggests that these were not situations where, as many have claimed, lawyers were merely following the advice of the accountants, but rather it was the lawyers who made the accountants feel comfortable about the way some of the Enron transactions were to be booked.

Before we go any further, a few definitions are in order. Fraud is, in plain English, lying to someone to get them to give you their stuff.

In re Enron, 235 F. Supp. 2d at 706. As the court explained at great length at the start of its opinion, there is no private cause of action for aiding and abetting securities fraud. The involvement of the firm thus had to be substantial enough to make it liable as a primary violator. On the facts available to the plaintiffs and alleged by them, the court found that Kirkland & Ellis could not be sued as a primary violator of the law. Those facts as described by the court would, in my opinion, have been more than sufficient to sustain a claim for aiding and abetting fraud were it not for the fact that Congress tacitly affirmed the Supreme Court's holding in *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994), when it enacted the Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b)(3)(A), thus eliminating private causes of action for mere aiding of securities fraud.

3. See generally *The Role of the Financial Institutions in Enron's Collapse: Hearings Before the Permanent Subcomm. on Investigations of the Senate Governmental Affairs Comm.*, 107th Cong. (2002), 2002 WL 1722723 (F.D.C.H.) and 2002 WL 1767468 (F.D.C.H.) [hereinafter *Financial Institutions Hearings*] (detailing the role of Merrill Lynch and other investment banks' in Enron's transactions).

4. See *id.*

5. See First Interim Report of Neal Batson, Court Appointed Examiner at 38 n.98, *In re Enron Corp.*, 274 B.R. 327 (Bankr. S.D.N.Y. Dec. 2, 2001) (No. 01-16034).

6. *Id.*

Sometimes the lie is expressed out loud. Other times it is told by speaking and leaving out important information that the person with the “stuff” would certainly have wanted to consider before parting with that stuff. Consider the statement, “I have \$40,000 in the bank,” when spoken to a prospective lender. If you have written a check to another for \$40,000 post-dated for the next day, you have lied by omitting important information.

Not all untruths are lies. A lie is an untruth spoken when one knows it is an untruth or when one asserts something as true when one has no idea whether the statement is true or not. Consider the statement, “I did not eat a salad last Wednesday.” I have no idea what I ate last Wednesday. So, the assertion is a lie, at least if it turns out later that I did eat a salad and maybe whether or not I ate a salad. Finally, an often over-looked point, one need not know what is true to know what is false. Consider the statement, “I ate chicken last Wednesday.” I know that is false because I never eat chicken. It is irrelevant that I have not a clue what I did eat last Wednesday.

I said I was certain that many of Enron’s related party transactions were fraudulent. Why? The partnerships were buying assets from Enron and making trades with Enron that Enron was financing. This made it seem as if Enron was generating profits that it was not (a lie). This also made it seem as if Enron had protected itself from potential losses from risky assets and trades (another lie)—risks it was not transferring to the related-entities, given because Enron was promising the investors in those entities a profit, no matter what happened. These lies were told to get people to buy Enron’s stock at inflated values—values driven by financial statements that included these lies, thus projecting an intentionally false picture of Enron’s financial condition. They were, in other words, lies to get people to give up their stuff.

Moreover, some, if not all of the so-called “related entities,” did not qualify to buy anything from Enron because they did not meet the requirements that would have made it legitimate to book these transactions as sales between Enron and an arms-length trading partner, which is how Enron booked them. Some of the related party transactions seemed to have failed the base requirement that at least three percent of the investment made by the “special purpose entity” (“SPE”) be from sources other than Enron. Furthermore, most, if not all, of the SPEs that arguably met the three-percent minimum were nonetheless obviously not engaging in “arms length trades” with Enron—the trades that a truly independent party would entertain. The

SPEs were controlled by Enron's CFO, who "supervised" the agents who were supposed to be negotiating on Enron's behalf with the SPEs, entities in which their boss had a huge financial stake. In short, it was Enron CFO Andrew Fastow's will (used in service of his interests) that was manifest on both sides of the "negotiation." All in all, these transactions were more like an eyelash-length, than an arms-length, negotiation. Thus, not only were those buying Enron's stock "defrauded" by Enron, Fastow's partnerships, and knowledgeable principals of both, some of the investors in the related-entities were defrauded too (i.e., told a lie that the entities were qualified to trade with Enron, when many, if not all, were not).

Marketing the partnerships as investments, Merrill Lynch emphasized to would-be investors in these partnerships that the major investor and controlling partner was Enron's CFO, a person uniquely situated to make would-be investors in these partnerships (set up to trade with Enron) sure, steady, and substantial profits. This was a selling point because as Enron's CFO, Fastow had a front-row seat at Enron's planning sessions and understood the company's strategy and financial state as only a person with access to all of Enron's inside information would. Trading on inside information is both a civil and criminal wrong. Again, the lawyers approving Merrill Lynch's marketing strategy seemed not to notice or care about this none-too-subtle suggestion that inside information would be the key to the partnerships' future success.

J.P. Morgan, Citigroup and other major banks engaged in what they call "structured financing" with Enron. It worked like this: The banks would enter into contracts to buy a commodity from entity A at X price some time in the future, say within the next year or two. Entity A (and each bank had its own A) would contract to buy that commodity from Enron for X price (or X plus some take for entity A) within the same period of time. Enron, in turn, would agree to buy the commodity from the banks for X + Y price within that period of time. Y was some percentage of X that turns out to be what one might

7. Of course, any of the investors who knew that their investment was not at risk because Enron had guaranteed debt were not defraudees, but, in my opinion, defrauders.

8. See *Financial Institutions Hearing*, *supra* note 3, at 1-3 (testimony of Robert Roach, Chief Investigator, Permanent Subcomm. on Investigations) available at http://www.senate.gov/~gov_affairs/072302roach.pdf. See also *id.* app. at A-1-A-8 (testimony of Robert Roach, laying out Enron's prepay scheme) available at http://www.senate.gov/~gov_affairs/072302roach_a.pdf. Citigroup and J.P. Morgan were not the only banks engaged in "trading" with Enron aimed at helping Enron hide its debt. See Richard Oppel Jr., *Senate Hearing Set on Enron's Bankers*, N.Y. TIMES, July 22, 2002, at C6.

expect the interest rate to be, if Enron were borrowing X from the banks.

Notice the circle. The commodity in Enron's possession at the start is (at least on paper) to be transferred to A, which in turn will "deliver" the commodity to its sponsoring bank. Then the bank will "deliver" the commodity back to Enron. In the end, the commodity ends up where it started, with Enron. Indeed, the commodity never has to leave Enron's possession except on paper. In the meantime, the money, which is the bank's money at the beginning, moved from the bank to A (ostensibly as a "prepayment" for the commodity) and from A to Enron (again ostensibly as a "prepayment" for Enron's promise to deliver the commodity when A demanded it). Then the money plus the add-on that looks like interest for the use of the bank's money was to be paid back to the bank by Enron, supposedly for the commodity that Enron already had and which it was promising to re-purchase for itself at a greater cost in the future. So, the money ended where it started—with the bank, except that it returned with the interest-like add-on.

Enron booked the money coming in (from the banks via A) as trading "revenue" and booked its promise to "prepay" the banks (later, and for a commodity it already owned) as a trading liability. As a "trading liability" Enron's promise to repay, excuse me I mean "prepay," the banks could be offset not just by the "revenue" it had just booked, but also by other so-called "trades."

The problem is that none of this qualifies as a "trade." As Enron's accounting firm, Arthur Andersen, told Enron (this time correctly), these types of "trades" must be booked as loans from the banks, unless four conditions are met. As should be plain, however, Enron had no intention of booking these transactions as loans, four conditions or not. The point was to get "financing" from the banks that did not show up on the books as loans. If these "trades" had been booked as loans, it would have been clear to investors that Enron was much more heavily in debt than Enron wanted its investors to know. So here again Enron was lying to get people's stuff, and the banks were necessary for these lies and may well have lied themselves in doing these deals.

Among the four conditions that these "trades" could not meet were that each A had to be "independent" from its respective bank. Citigroup's and J.P. Morgan's entities were, however, created by their

respective banks, funded by them, and, as a practical matter, under the complete control of their sponsoring banks.⁹ Another condition that these “trades” failed to meet was that each of the three “trading” partners (the banks, the A entities, and Enron) had to have a legitimate business purpose for entering into the deal. The banks’ witnesses who appeared before a Senate subcommittee could identify no such purpose.¹⁰ Apparently, the purpose was to allow Enron to book financing as liabilities related to ongoing business instead of as loans. Unless cooking one’s books counts as a legitimate business purpose, the transactions failed on this criterion as well. The third condition that these transactions failed to meet was that the “buying” by the banks and their A entities had to be unrelated to the “selling” by the banks to Enron. In short, the transactions could not be linked. As the bank witnesses admitted to the Senate subcommittee, the transactions between themselves, their “As,” Enron, and the banks again, were connected. No party to these transactions had any interest in fulfilling its leg, apart from the other two parties fulfilling their legs. Okay, no need to beat a dead horse. We will stop here.

For the reasons just given, these transactions were loans, not trades. And the banks’ cooperation (setting up As, calling their extension of money “prepayments” instead of loans etc.) was necessary for Enron’s lies to succeed in duping anyone. The banks needed to back up Enron’s lies with lies of their own, which they seemed all too willing to do and seem still to be doing by insisting that they were “prepaying” Enron instead of lending it money. Fraud does not require that the lie-teller keep or ever get the defrauded party’s stuff. Lying to get people to give their stuff to one’s cousin or to a business contact whom one knows will be grateful for the help (here in terms of future deals) suffices.

What was the role of lawyers in all of this? Take the banks’ lawyers first: A law firm set up, ran, and served as a trustee for J.P.

9. The documents produced by the Senate’s Governmental Affairs Committee’s Subcommittee on Investigations, showing the complete control that Citibank and J.P. Morgan exercised over their respective banks, was devastating to the stories being told (under oath) by bank witnesses, i.e., that each bank’s A was “independent” and that decision making for each A was handled by that A’s Board of Directors. *See generally Financial Institutions Hearings, supra* note 3. I encourage anyone interested in the culpability and credibility of these two major financial institutions to get a video tape of this hearing from C-SPAN, if available, because a written transcript cannot possibly convey the melting of the bank’s witnesses as the hearing progresses. If a video is not available, the written transcript will give you all the information you need, although minus the amazing “color” of the spectacle. I play the video for friends; it is just that amazing.

10. *See generally Financial Institutions Hearings, supra* note 3.

Morgan's entity A, Mahonia.¹¹ Mahonia had no assets of its own. It needed none, since it just passed through to Enron the "payments" from J.P. Morgan (ostensibly for assets Mahonia was supposed to "buy" from Enron and "deliver" to J.P. Morgan). Mahonia's sole *raison d'être* was to act as a pass-through to mask the fact that J.P. Morgan was loaning Enron money that Enron was to pay back with interest.¹² To make all that worse, the offshore based trustee-lawyer for Mahonia also served on Mahonia's Board of Directors (its supposed decision-making body), served as Mahonia's counsel, and identified himself as J.P. Morgan's lawyer when he set up Mahonia. Thus, this lawyer-agent of J.P. Morgan in a position to make decisions for Mahonia was nonetheless comfortable participating in the charade that Mahonia was independent.

Second, J.P. Morgan personnel testified under oath before a Senate committee that lawyers (not the Mahonia lawyer referred to above but presumably either or both J.P. Morgan's in-house legal team or lawyers from one or more major New York firms) assured them that Mahonia was legally "independent" from its puppet-master, J.P. Morgan. In fact, Mahonia was not independent, as explained above. The lawyers were thus assuring J.P. Morgan of something that was not true. If they had no idea whether it was true or not, the lawyers had no business assuring anyone of anything.¹³ Similarly, Citigroup personnel testified under oath before the same Senate committee that they had two legal opinions, one from Milbank, Tweed, Hadley & McCloy, Citigroup's lawyers, and the other from Vinson & Elkins, Enron's lawyers, assuring Citigroup, in one way or the other, that its round-and-round deals with Enron were legitimate.¹⁴ If Enron's lawyers, Vinson & Elkins, were telling Citigroup that the deal qualified as a trade, not a loan, one can be sure they were telling Enron officials the same thing.

Over at Merrill Lynch, lawyers seemed to have been fulfilling a similar role. Merrill Lynch agreed to "buy" some barges from Enron.¹⁵ Enron promised Merrill Lynch that within six months of

11. *See id.* app. at C-5 (testimony of Robert Roach, laying out J.P. Morgan's involvement with Enron) available at http://www.senate.gov/~gov_affairs/072302roach_c.pdf.

12. *See id.* app. at C-1-C-4.

13. *See generally id.*, 2002 WL 1722723 (F.D.C.H.) (testimony of Jeffrey W. Dellapina, Managing Director, J.P. Morgan Chase Bank). Mr. Dellapina testified that he could not remember which lawyers told him that Mahonia was "legally" independent.

14. *See generally id.*, 2002 WL 1722723 (F.D.C.H.) (testimony of Richard Caplan, Managing Director & Co-Head, Credit Derivatives Group, Salomon Smith Barney/Citigroup).

15. *See generally id.* (discussing these transactions extensively).

Merrill's purchase Enron would find some entity to "buy" the barges back from Merrill. Further, Enron assured Merrill that it would receive a handsome fifteen percent "profit" from the to-be-arranged (by Enron) "purchase." Merrill set up a SPE named E-Barge to hold the barges. E-Barge was, at least on paper, to send Merrill funds flowing from the commercial use of these barges. That never happened, and Merrill never bothered about it (because, it seems obvious to me, the entire "purchase" was a sham). E-Barge, supposedly an SPE of Merrill's, had its expenses paid by Enron, the previous "owner" of the barges that were now supposedly assets of Merrill's (through E-Barge). Having failed to find any truly independent buyer interested in purchasing these loser-barges from Merrill, Enron apparently fulfilled its promise to Merrill by arranging for one of Fastow's partnerships to buy the barges back from Merrill at a "price" that included the "profit" that Merrill had been promised *ab initio*. In what alternate universe would anyone call this Enron device for parking a loser-asset off its balance sheet, a "sale?"

Enron's counsel and Merrill's counsel apparently endorsed the reporting of this device as a "sale."¹⁶ I find it impossible to imagine Enron and Merrill engaging in this bogus "sale" without lawyers telling them they could get away with it. Lawyers were, however, there to oblige. Did any lawyer not understand that all this funny business had to have had as its purpose lying to investors to get them to give up their stuff (by buying or holding Enron shares)?

Internal Merrill Lynch documents show that its personnel considered the barge deal to be a courtesy *loan* to Enron—a loan that Enron could book as revenue from the sale of an asset, the barges. In other words, they understood it was a fraud even if they did not know that is what the law calls this type of machination. Merrill personnel worried that the parking of the barges at Merrill might cause others to accuse Merrill of "aiding and abetting" Enron's manipulation of its financial statements. Yet, Merrill's lawyers were apparently not similarly worried. They should have been. These barge deals figure prominently in the Justice Department's papers charging Enron's CFO, Fastow, with criminal conduct, and, although Merrill Lynch is

16. In the July 30, 2002 Permanent Investigations Subcommittee hearing for the Senate Committee on Governmental Affairs, Kelly Martin, Senior Vice President and President of International Clients for Merrill Lynch, testified that "the transactions were subject to Merrill Lynch's internal approval process, and included review with business, legal, and other personnel who had no stake in the outcome." See *id.* at 1 (statement of Merrill Lynch & Co., Inc.) available at http://www.senate.gov/~gov_affairs/073002merrillLynch.htm.

not mentioned by name, its participation is described as that of an unindicted co-conspirator.¹⁷ Why were Merrill's lawyers not telling its other agents that they could not engage in conduct that might expose Merrill to criminal charges?

The plot thickens. Merrill knew a good deal about LJM2, the entity that took the barges off Merrill's books and handed Merrill a handsome "profit" that looks precisely like interest on a short-term loan. Merrill had (on behalf of Fastow) marketed investments in LJM2 to institutional investors and others. Merrill told investors that LJM2 was an entity set up to make deals with Enron. This is true. Merrill also told prospective investors that LJM2 was a good investment because Fastow, Enron's CFO, would be at LJM2's helm—also true. The problem is, as I suggested earlier, that the reason Fastow's captaincy made LJM2 a good bet was that Fastow had an intimate familiarity with Enron's strategies. Most important, Fastow had access to other Enron "proprietary information," as he put it, while convincing Merrill Lynch to handle getting investors for LJM2. How could LJM2 fail? It not only had Fastow with his unique knowledge and important Enron position, it also had two other Enron managers (both supervised by Fastow at Enron) to give it and its investors a unique leg-up.

In sum, Fastow convinced Merrill Lynch to handle LJM2's quest for investors by none-too-subtly alluding to his ability to use Enron information (its property) to make money for others, the LJM2 investors. Merrill, in turn, sold LJM2 to prospective investors with the same pitch. It is fraud for an agent to appropriate the property of his principal for his own gain or for the gain of others absent the principal's consent to such use.¹⁸ The Enron Board of Directors had waived Enron's conflict of interest provisions to allow Fastow to form partnerships like LJM2, but it did not (at least not so far as the evidence amassed thus far shows) give Fastow permission to

17. See Complaint at 9, SEC v. Fastow, (S.D. Tex. filed Oct. 2, 2002) (No. H-02-3666).

18. See generally *Carpenter v. United States*, 484 U.S. 19, 27 (1987). Let me explain why this is fraud in terms of the plain English definition of fraud I gave earlier, *supra* p. 2. The lie is this: "I, your agent, will use your information and all of your property only in the service of your interests, unless you give me permission to use it for personal gain or for the gain of others." An agent need never speak those words; they are implicit in the role of agent by virtue of the law of agency. When an agent uses the principal's information or property for personal gain or the gain of others without the principal's permission, the statement every agent is deemed by law to have spoken is rendered a lie. The principal entrusts his stuff to the agent believing that the implicit statement is true. When the agent acts in a manner as to render the statement a lie, he has gotten the principal to give up his stuff (information or other property) by lying, which is fraud.

appropriate Enron information for the benefit of himself or others.¹⁹ No private placement memorandum is issued without being vetted by lawyers. That means some lawyer approved Merrill's sales pitch, at least the one in the memorandum, that alluded to Fastow's too-good-to-be-legal ability to benefit LJM2 investors via his position at Enron. Merrill's lawyers apparently did not inform Merrill that this method of marketing might get Merrill charged with a crime or sued for mega-damages. Merrill's lawyers were not the only ones failing here. Probably most, if not all, of the institutions that invested in LJM2 and other similarly-pitched Fastow business ventures checked with their lawyers on the legality of this very incestuous relationship between the partnerships, Fastow, and Enron. Apparently none of the lawyers for those who ended up investing in the partnerships were concerned about this pitch or the way LJM2 was to make its money; none of them managed to convince her client to forego investing and blow the whistle on Fastow, LJM2, Enron, or Merrill Lynch. Instead, it seems clear to me that some lawyers for potential investors were telling clients with questions that they could go ahead and get on LJM2's gravy train.

Finally, Citigroup witnesses testified that Citigroup transferred the risk that Enron might not complete the last leg of its circular deals, i.e., would default on its loan obligation. Citigroup's investment bank side, Salomon Smith Barney, marketed and sold securities, which were put together by Citigroup, but which investors were told was backed exclusively by Enron's credit. Notice that this convoluted setup boils down to an Enron bond, but not one that Enron has to acknowledge issuing on its books because it is issued by another entity—ever-helpful Citigroup.

Citigroup knew that Enron's books were not models of honest bookkeeping and as far from transparent as financial statements can get. Citigroup knew that Enron was busy getting "financing" through "trades" that did not show up as debt on Enron's books. It had to know this. After all, it was busy helping Enron turn loans into "trades."

Indeed, when the Salomon team sought approval to sell the Enron-

19. Note that I do not mean to suggest that Enron's board could legally have granted Fastow permission to use Enron property for the gain of himself and his LJM2 partners. After all, Board members are not principals, nor is the Board itself. The principal is the corporation Enron, which can only act through agents. Yet that does not mean that anything and everything authorized by the highest ranking Enron agent serves to immunize all acts of agents further down the chain.

backed securities that were designed to transfer Citigroup's risk to others, from the high-level Citigroup committee that deals with such matters, the committee withheld its approval pending a report from the team designed to reassure the committee that even if one counted as debt all the debt Enron was hiding as "trades," Enron was still an investment grade company. The Salomon team facing a short deadline for the report did a quick and dirty calculation, resulting, according to testimony before a Senate subcommittee, in overstating just how much "debt" Enron was carrying that was not clearly labeled debt on its balance sheets. Even with this overstatement, Enron still passed the investment grade test, so the Citigroup committee approved the sale of the Enron-backed securities.

The material given prospective investors did, as I have said, clearly disclose that it was Enron's credit, not Citigroup's, which was backing these securities. The problem is that the Citigroup sales documents simply referred potential investors to Enron's books for information on Enron's creditworthiness—books that Citigroup's own committee refused to rely upon. The fact that Citigroup's committee wanted the real scoop on Enron's debt load before making a decision—wanting information either absent from Enron's financial statements or so deeply buried in footnotes to those documents that Citigroup's committee needed a report to get even a roughly accurate sense of how much debt Enron was carrying—means, in my opinion, that Citigroup was withholding material information from those it was asking to give up their stuff by simply referring investors to Enron's shrouded financial statements.

Citigroup defended its decision to say nothing to investors about the debt that was hidden or absent from Enron's financial statements by suggesting that its lawyers had vetted the information provided to investors in these Enron-backed securities. This is simply another instance of lawyers telling a client just what it wants to hear. Citigroup also said that to give out the overstated debt estimate Salomon had prepared—or any more refined estimate of Enron's real debt load—would have been legally problematic. This is true enough. Salomon could have been liable, at least to Enron, for asserting as fact debt-load numbers in which it had little or no confidence. The problem is that it is also legally problematic to invite institutions or individuals to rely on financial statements in which Citigroup had no confidence, as demonstrated by the actions of Citigroup's own

committee. Did none of Citigroup's high-priced counsel get that point?²⁰

And we must not forget the accountants. They had lawyers too. Some set of lawyers wrote Arthur Andersen's document "retention" policy. One need only read it to know that it is the product of a lawyer's hand. That policy called for the destruction of documents even when destruction could be obstruction of justice, a felony.

Knowing that the SEC had begun an informal investigation of Enron's books, an in-house lawyer at Arthur Andersen, Nancy Temple, instructed David Duncan, the Andersen partner in charge of the Enron account, to pay attention to Andersen's "retention" policy.²¹ Duncan did just that. His reading of the policy apparently mirrored my own: The policy condoned destruction of many Enron documents even though an informal investigation of Enron was underway. Unfortunately for poor Duncan, who later pled guilty to the felony of obstruction of justice, the law prohibits such destruction and prohibits him from encouraging his staff to destroy documents in order to keep them from the SEC.

Duncan ordered the shredding to begin shortly after Temple reminded him to consult Andersen's "retention" policy. A little over a month later, after literally tons of documents had been destroyed, Temple told Duncan and everyone else at Andersen to stop shredding: She wrote clear instructions to preserve all Enron documents.²² Why? She did this because Andersen had received a subpoena from the SEC. Destroying documents after the receipt of a subpoena is a

20. As to J.P. Morgan, it tried to transfer the risk that Enron would default on its "trading" obligations by buying insurance. However, collecting on that insurance has proved a minefield. The bank sued the insurance companies for breach of contract, and the insurance companies defended on the ground that J.P. Morgan either procured insurance for something the law does not permit to be insured (the payments I am calling "debt") and/or lied to the insurance companies to get the insurance, i.e., committed fraud. See Kurt Eichenwald, *Chase Counters Accusers In Disguised-Loan Case*, N.Y. TIMES, July 2, 2002, at C2. The suit settled with J.P. Morgan getting about 50 cents on the dollar. Peter Bahr *J.P. Morgan, Insurers settle Enron Dispute: Bank to be Paid About Half Its Loan Guarantees for Failed Energy Trades*, WASH. POST, Jan. 3, 2003, at E1. Again, I presume that lawyers for J.P. Morgan told it that applying for insurance for Enron's future obligation to "buy" goods from J.P. Morgan as part of a circular transaction was just fine.

21. See *Destruction of Enron-Related Documents by Andersen Personnel: Hearing Before the Subcomm. on Oversight and Investigations of the House Comm. on Energy and Commerce*, 107th Cong. 45 (2002) (E-mail from Nancy Temple to Michael C. Odom Partner, Arthur Andersen forwarded to David Duncan). See also Arthur Andersen, Practice Administration: Client Engagement Information—Organization, Retention and Destruction, Statement No. 760, (2000) (on file with the Harvard Journal of Law and Public Policy).

22. For the policy, see Arthur Andersen, Practice Administration: Client Engagement Information—Organization, Retention and Destruction, Statement No. 760 *supra* note 21.

felony, but so is destroying documents before a subpoena is received but during an “informal” SEC investigation, at least, if that destruction is done to keep the material from the SEC. I believe the evidence collected against Andersen clearly demonstrates that Duncan’s destruction of documents and Temple’s reference to the company’s policy were actions undertaken with the intent to keep information from the SEC investigators.²³

Temple knew how to write a memo saying, “Preserve all Enron documents.” She wrote just such a memo after the subpoena was received. A month earlier, however, when the law called for her to write that memo, she decided instead to write a memo that she had to know would produce the opposite effect: shredding and lots of it.²⁴

When an Enron manager named Sherron Watkins wrote a memo to Enron’s CEO, Kenneth Lay, stating that she thought Enron would collapse in a wave of accounting scandals and providing significant details on Enron activities that were, put it mildly, over the line,²⁵

23. A jury convicted Andersen of obstruction of justice, although it seems the jurors were not unanimous on the reasons for their verdict. Apparently not all jurors agreed that Duncan, who pled guilty to obstructing justice, or Temple, who asserted her Fifth Amendment rights at Andersen’s trial, urged others to destroy documents to keep them from the SEC. I have no doubt that both did precisely that. However, the one theory all jurors endorsed was that Temple had encouraged another to alter potential evidence with the aim of keeping that evidence from the government by telling others to eliminate from a document the conclusion that an Enron announcement was misleading and to take her name off the memo to minimize the risk that she would be called as a witness. According to Temple, she wanted her name and references to Andersen’s legal office omitted because it would invite some party in some later suit to call her or other Andersen lawyers as witnesses, which she said might adversely affect Andersen’s attorney-client privilege. Andersen either had a valid attorney-client privilege to assert as to each Temple communication with other Andersen agents or it did not, i.e., because of the crime-fraud exception to the privilege. If it had a valid privilege claim, which it chose to assert, calling Temple would not change that. See Jeff Leeds, *The Andersen Verdict: Andersen Found Guilty of Obstruction*, L.A. TIMES, June 16, 2002, A1. However puzzling I and others might find the jury’s lack of unanimity on the illegality of Temple and Duncan encouraging others to shred tons of Andersen documents, the jury got this much right: A lawyer was at the heart of Andersen’s obstruction. It just failed to appreciate just how many ways she had helped her client violate the law.

Professor Gillers wrote an op-ed for the New York Times, asserting that most, if not all, lawyer activities cannot serve as the *actus reus* for obstruction of justice. See Stephen Gillers, *The Flaw in the Andersen Verdict*, N.Y. TIMES, June 18, 2002, at A23. In my opinion, his reading of the statute is untenable.

24. Andersen had outside counsel on the scene when Temple wrote her invitation to shred, another prestigious firm: Davis, Polk & Wardell. Temple consulted Davis Polk days after she referred Duncan and others to Andersen’s “retention” policy. See *Destruction of Enron-Related Documents*, *supra* note 21 at 118-127. I do not know what the outside firm told her, but whatever it was, it was insufficient to get her or Andersen to withdraw her initial instructions and issue the “preserve everything” memo that would have kept Andersen on the right side of the law. Later, Davis Polk played a key role in investigating the shredding at Andersen. Was the firm supposed to criticize its own lackadaisical approach to all of this?

25. See *Text of Letter [by Sherron Watkins] to Enron’s Chairman After Departure of Chief Executive*, N.Y. TIMES, Jan. 16, 2002, at C6.

Vinson & Elkins, the law firm that had approved some of Enron's shady transactions, was assigned to conduct a so-called "preliminary investigation" into Watkins's allegations. They were given this assignment by another lawyer, Enron's in-house general counsel, James Derrick, who had been a partner at Vinson before joining Enron's management.²⁶

Vinson should not have accepted this assignment. To say that the matters raised by Watkins were serious problems that warranted a full-fledged, all-out, independent investigation of potential wrongdoing related to Enron's financial shenanigans would have required it to criticize its own previous advice to the company and to open itself up to lawsuits and further scrutiny. The idea is ridiculous that an investigation conducted by Vinson, under these circumstances, would count to establish that Enron's management had fulfilled its fiduciary duty to investigate allegations of wrongdoing by the company and its agents made by a credible employee. Derrick should not have asked Vinson to take on this assignment and Vinson should never have accepted it. Having taken it on, Vinson should not have done such a slipshod, once-over-lightly "investigation" of Watkins's allegations. It should not have accepted Andersen's word that all its advice to Enron had been correct. It should have looked into any new information gleaned in the minimal investigation it conducted that suggested that Enron's agents were engaged in other wrongful conduct or, at a minimum, it should have advised Enron that it needed to follow-up with dispatch and different counsel on any such new information.²⁷ Vinson did stumble across such new information. For example, it happened across information suggesting that Enron was demanding that its banks assist it in questionable deals designed to hide debt or they would risk losing future Enron business. Vinson did not follow up on this information or advise Enron that it do so immediately. Vinson & Elkins ultimately delivered a report to Enron's management, telling it that no further investigation into Watkins's allegations was necessary, so much for "preliminary."²⁸

While all the above examples are connected to Enron, there is unfortunately nothing new or unique about lawyers assisting with fraud and aiding in concealing damaging corporate information.

26. See THE SPECIAL INVESTIGATIVE COMM. OF THE BOARD OF DIRECTORS OF ENRON CORP., REPORT OF INVESTIGATION 173 (2002) (widely known as the "Powers Report").

27. See *id.* at 176-77.

28. See *id.* at 176.

Those with doubts should see the court's opinion in the *National Student Marketing* case, especially the portion describing the activities of White & Case lawyer Marion J. Epley, III.²⁹ They might also want to look at the reports on Singer, Hutner's assistance of OPM's fraud in the 1980s,³⁰ and the opinion denying Jones Day's motion for summary judgment in the suits brought against it for helping Charles Keating and Lincoln Savings and Loan commit fraud, obstruct justice, and engage in other wrongful conduct.³¹ Finally, they should read *Klein v. Boyd*, detailing a Drinker Biddle & Reath partner's assistance of client fraud.³²

For another quite recent example, see the *Los Angeles Times* report on the "investigation" conducted by Simpson, Thatcher & Bartlett, another prestigious firm, for its client Global Crossing, which asked Simpson to look into allegations of company wrongdoing made by a senior Global Crossing manager in a memo similar to the Sherron Watkins memo at Enron.³³ Simpson Thatcher conducted a "preliminary" investigation on behalf of Global Crossing that was so superficial that it makes Vinson's investigation into the Watkins memo look good. Apparently, Simpson neither interviewed Global Crossing's outside accountants nor the author of the memo that raised concerns about Global Crossing's disclosures to investors about its finances.³⁴ Nonetheless, Simpson told managers at Global Crossing that no further investigation into these allegations or action in response to them was necessary.³⁵

Let me put this as plainly as I can: The only reason company managers ask law firms to conduct such once-over-lightly "investigations"—investigations that end up regurgitating management's position that everything is hunky-dory—is to buy some cover for their own or their company's wrongdoing.³⁶ They are buying the right to say, "Our lawyers gave us a clean bill of health."

29. SEC v. Nat'l Student Mktg. Corp., 457 F. Supp. 682 (D.D.C. 1978).

30. See GEOFFREY C. HAZARD, JR., SUSAN P. KONIAK, & ROGER C. CRAMPTON, *THE LAW AND ETHICS OF LAWYERING* 304-10 (3d ed. 1999).

31. See *id.* at 748-59.

32. See *Klein v. Boyd*, [1996-1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,352 (E.D. Pa. Nov. 18, 1996). See also HAZARD, KONIAK & CRAMPTON, *supra* note 30, at 289-98.

33. Joseph Menn, *Global Crossing Case Figure Not Questioned*, L.A. TIMES, Feb. 22, 2002, at C1.

34. See *id.*

35. See *id.*

36. Unrectified fraud is an ongoing crime and civil wrong until it is detected by the defrauded party.

What could any law firm asked to conduct one of these blindfolded, hands-tied, conclusion-foregone “investigations” be thinking? Could any experienced lawyer have any doubt that she was being paid to allow some ongoing illegality to continue or to delay anyone, including the company’s board of directors, finding out about past misdeeds by management?

Simpson’s story, a common one, is apparently that it asked senior management if the memo contained anything that the company’s accountants did not know (or had not approved) or anything that the board had not approved.³⁷ Management said the accountants knew all the facts contained in the “whistleblower” memo and had nonetheless given Global Crossing the all-clear and that the board knew everything as well.³⁸ Simpson’s story is that given that management confirmed those sign-offs, its barely existent investigation was proper.³⁹ Here is the problem: No accountant and no board of directors is privileged to commit fraud. Assuming the management was not lying to Simpson about who knew what, if the books were cooked in some way, Global Crossing could have been committing ongoing securities, mail, and wire fraud. And, assuming the board had approved everything and that some of what it approved was illegal, the board might not have understood that it had broken the law. That is what the lawyers are for.

One does not need a lawyer to ask management if accountants or the board has approved something. A cab driver could do that job just as well and a lot cheaper. A lawyer is necessary to figure out what additional facts a board or accountants should have been told. But the quick and dirty “investigations” conducted by Vinson and Simpson were simply not deep enough to discover what more, if anything, the accountants or the board should have been told before their sign-offs were secured. No, these lawyers are being hired for something else. Managers want to be able to say they did something in response to a “whistleblower memo,” because “something must be done”—just not anything of any use to anyone, and certainly nothing that gets at the truth.

III. THE LAW-FREE ZONE

Three avenues for regulating lawyers exist: state authorities, federal

37. See Menn, *supra* note 33.

38. See *id.*

39. See *id.*

authorities, and private lawsuits against lawyers. Each of those three can in turn be broken into two major subcategories. The states have bar disciplinary authorities and attorneys general. The federal government has the Securities and Exchange Commission and the Justice Department. Private lawsuits can be initiated by third parties and by client corporations against lawyers for malpractice or aiding other of the client in breaching their fiduciary duties.⁴⁰ None of these avenues now work.

State disciplinary authorities are charged with enforcing state ethics rules, not the ABA rules, but state rules that are based on the ABA's rules (although most state rules diverge sharply in critical areas, most notably in the area of confidentiality, from the ABA's *Model Rules of Professional Conduct*). State ethics rules are law, although in the hierarchy of law, state ethics rules are trumped in almost every instance by other law (state or federal) with which they conflict.⁴¹ I will return to that point later. For present purposes, we may put the hierarchy issue aside.

There are ethics rules that speak to a lawyer's obligations when a client is intent on committing fraud or otherwise violating the law and seeks to use the lawyer's services to accomplish that end. Every state's ethics rules prohibit assisting client fraud or illegal conduct and demand that a lawyer resign when she "knows" that her client intends to use the lawyer's services to perpetuate the fraud or other illegality.⁴² These rules are, however, ineffective for a number of reasons.

First, lawyers never "know" their clients are committing fraud because that is what the lawyers say. That is, at least, what lawyers say. True, as Geoffrey Hazard has written, a radical epistemologist might maintain that no one ever "knows" anything, at least not about what another intends and whether that actually violates something as subject to interpretation as a legal norm.⁴³ But as Hazard also

40. See generally David B. Wilkins, *Who Should Regulate Lawyers?*, 105 HARV. L. REV. 799 (1992) (A deeper discussion of the avenues available for regulating lawyers, especially Part II-A).

41. See generally Susan P. Koniak, *The Law Between the Bar and the State*, 70 N.C. L. REV. 1389 (1992) (A deeper discussion of the relationship between state law and the legal profession's ethics).

42. See MODEL RULES OF PROF'L CONDUCT R. 1.2(d), 16(a) (1991). Model Rules 1.2(d) and 1.16(a) are included virtually unchanged in almost all state-adopted ethics codes and those states with different versions of these rules have rules that include the points I have described in the text.

43. Hazard noted:

Of course, speaking in terms of radical epistemology, it is true that a lawyer cannot

explained, however, that lawyers are paid to operate in the real world and to provide practical advice on the law, not to ponder such imponderables as whether falling trees make noise when no one is there or whether anyone can ever “know” anything about others or the law.⁴⁴

Consider that lawyers can, of course, spot fraud that others are trying to perpetrate against their clients, so long as those others are not members of the client’s senior management team, whom lawyers treat as their clients even though they are not. This ability to discern wrongdoing is shut down when a lawyer looks at her own client or the senior management team she imagines as her client. This is a product of the litigation mentality.

A litigator’s mindset is to press any argument with even a patina of legal plausibility to justify conduct that has been called into question by an adversary. Once the adversarial system is in play, the litigator’s mindset is justifiable. Licensing lawyers to offer every possible legal justification when there is another side whose job it is to present every possible legal objection to the very same conduct is a route to truth, at least that is the premise underlying our judicial system. I accept that premise to the extent the clash of arguments about facts and law produces “court truth,” which is to be distinguished from actual truth, but is nonetheless of value. Court truth diverges from actual truth for good reason. Our legal system is committed not just to producing truth, but to maintaining other values as well—values that, in my opinion, have a good claim to being important enough to justify sacrificing discovery of the “whole truth and nothing but the truth.” Those values include privacy, limited government, the sanctity of marriage, the sanctity of the confessional, and even the right to get sound legal advice. Such values should be distinguished from using a lawyer to commit crimes or frauds (an intent that destroys the attorney-client privilege because it is inimical to the public good).

Whatever justification the adversarial process provides for

“know” what a client-or anyone else-intends. In these terms it is impossible for a lawyer to “know” anything. Yet the practice of law is based on practical knowledge, that is, practical assessments leading to empirical conclusions, which form the basis for irrevocable action. Lawyers certainly possess such practical knowledge. If a lawyer can have practical knowledge of how the purposes of others may affect his client, he can have the same knowledge of how his client’s purposes may affect others. It is in that sense that the lawyer can “know” when a client’s purpose is illegal. The question, therefore, is what degree of certainty imposes legal obligations on one who “knows”?

Geoffrey C. Hazard, Jr., *How Far May a Lawyer Go in Assisting a Client in Legally Wrongful Conduct?*, 35 U. MIAMI L. REV. 669, 672 (1981).

44. *See id.*

litigators, pushing the limits of law to justify client conduct that is contemplated or ongoing is another matter altogether. When passing on the legality of contemplated or ongoing client conduct, there is no adversary present to challenge stretched legal interpretations, and there is no umpire available to judge between competing visions of what the law allows. Most talented lawyers can weave an interpretation to justify anything, as long as no adversary is present to challenge it and no umpire around to throw out the bizarre interpretation. Now, we reach the crux of the matter. Who frees corporate clients from the law that would constrain them? Their lawyers do.

Lawyers thus can know what their clients (or more accurately in the present context, their clients' agents) are doing and we should insist that they take responsibility for knowing, unless we are willing to accept a world in which law does not constrain what their business clients do. As we proceed with the survey of the failed avenues for lawyer regulation, however, it will become apparent that we do not insist that lawyers know. Indeed, we do not insist that big-time transaction lawyers conform to any set of norms. We allow them to inhabit a law-free zone that they can then extend to their corporate clients in the manner I have just outlined.

As I said, state disciplinary authorities are charged with enforcing states' rules of ethics. I have described the rules that prohibit lawyers from assisting fraud that they "know" a client is perpetrating and that demand that lawyers resign, if the client persists in that conduct, despite the efforts of the lawyers to dissuade the client from breaking the law. Those are the only rules that *require* anything of corporate transaction lawyers whose clients are using them to commit fraud, crimes, or intentional torts. There are other rules that bear on this situation, but they merely present the lawyer with options on how to proceed. There are two such option-rules I have in mind. First, the rule that allows lawyers for corporate clients to report management illegality up the corporate ladder, all the way to the board of directors, if necessary.⁴⁵ Second, many states now allow lawyers to disclose to the government or injured parties' illegal client conduct in which the lawyers' services were used to cause serious economic harm, despite the ABA's continuing rejection of such a provision. Rules that allow action at a lawyer's discretion, however, do not operate as restraints.

45. *See, e.g.*, MODEL RULES OF PROF'L CONDUCT R. 1.13 (1991) (which all adopting states have left virtually unchanged from the ABA version).

But why aren't the rules prohibiting "knowing" assistance enforced? Establishing what a lawyer actually "knew" is a formidable task, even for well-funded agencies with expertise.⁴⁶ It is fanciful to imagine state bar authorities, notoriously under-funded and under-staffed, succeeding in establishing assistance of fraud by a big-time corporate law firm. Moreover, even if state ethics' rules prohibited "reckless" assistance of client fraud, even if the option-rules were changed to insist on certain actions when a lawyer had reason to suspect client fraud (such as advising management that an independent investigation be conducted and reporting to the company's board that such advice had been given), state bar authorities would not be able to regulate the corporate bar.

State bar authorities are not just under-funded and under-staffed; they lack the expertise in securities law and complicated financial transactions to handle a disciplinary hearing against a lawyer for assisting securities fraud or mail or wire fraud embedded in a complex corporate deal. Even if they could afford to hire experts in such cases, competent securities law experts (including professors) would be loathe to take on lawyers from prestigious firms on behalf of institutions with low prestige, such as bar counsel's offices. Increasing the funding for bar counsel's offices is simply not a viable plan because bringing even a single case or disciplinary proceeding against a big-time corporate law firm would be too difficult and would quickly eat up whatever extra money the state had added to the bar counsel's budget. It is also true that bar counsel's offices now have all the work they can handle chasing down lawyers who steal client funds.

In all my years of research into the law governing lawyers, I have come across no case in which a state bar authority has successfully challenged the conduct of a big-time securities or corporate lawyer. I have not even come across a case in which a state bar authority has initiated charges against such a lawyer for assisting client fraud or failing to resign to prevent her services from being used to perpetrate a fraud. If a lawyer were to be convicted of aiding securities fraud in a state or federal proceeding, state bar rules would kick in to mete out automatic penalties for lawyers convicted of crimes involving dishonesty. That, however, is a big "if," which brings us to other state regulatory possibilities.

46. See *infra* note 82 (Congress's change requiring SEC to show knowing participation in fraud by lawyers).

Helping a corporate client cheat others or destroy evidence is criminal activity. As I need not remind members of the Federalist Society, criminal law is primarily a matter of state law. State prosecutors do not prosecute lawyers from prestigious firms. Indeed, it is rare that state authorities prosecute any lawyer for criminal conduct engaged in as part of “representing” a client. Elsewhere I have written about the reasons for this lack of prosecutorial zeal,⁴⁷ but due to space limitations here, I will forego that discussion and merely assert what I know to be true: State prosecutors do not and will not begin prosecuting corporate lawyers from powerful firms for assisting client crimes.

This is not a problem peculiar to the states, which brings us to the first of the two regulatory routes available at the federal level: prosecution. Historically federal prosecutors have shown no greater appetite for prosecuting big-firm corporate lawyers than their state counterparts, and thus far it does not appear that the current wave of heavily-lawyered corporate scandals has changed anything.

Consider that federal prosecutors acted swiftly to indict David Duncan, an accountant, for encouraging his team to destroy evidence. On the other hand, Nancy Temple, the Andersen in-house lawyer whose lead Duncan says he was following and whose belated instructions to preserve evidence caused Duncan to stop shredding, has not been indicted and, as I write this article months after the Andersen trial, it does not appear that she will be.⁴⁸ In the *National Student Marketing* scandal, accountant Anthony Natelli was convicted for aiding the fraud.⁴⁹ Read the description of White & Case attorney Marion Epley’s activities in connection with that fraud laid out by the

47. HAZARD, KONIAK, & CRAMTON, *supra* note 30, at 59.

48. *But see* Richard A. Oppel, Jr., *Inquiry on Andersen Lawyer is Urged by House Committee*, N.Y. TIMES, Dec. 18, 2002 at C7 (reporting the Committee wants the Justice Department to consider perjury charges against Temple related to her House testimony); *cf.* Jonathan D. Glater, *Lawyer Caught In Tyco Tangle Leaves Friends Wondering*, N.Y. TIMES, September 24, 2002, at C1. The conduct that forms the heart of the government’s case against Belnick is self-dealing connected to loans and compensation packages that he and Tyco’s CEO created for Belnick, allegedly as rewards for Belnick helping the CEO defraud the company. What if Belnick had not engaged, as alleged, in blatant self-dealing, but just helped the CEO or other managers commit crimes? I have been arguing that that is the more common phenomenon, and I am highly doubtful that the federal or state authorities would have prosecuted Belnick or will prosecute any outside or in-house lawyer involved in any of the corporate scandals that have recently come to light unless that self-dealing component exists. That means lawyers who commit crimes for payment at their normal hourly rate or normal high in-house counsel salary, i.e., without themselves directly involving themselves in the funds misappropriated by others corporate actors, as I am suggesting Temple and many other lawyers have done, will continue to escape prosecution by federal and state authorities, as they have in the past.

49. SEC v. Nat’l Student Mktg. Corp., 457 F. Supp. 682, 687 n.2 (D.D.C. 1978).

district court in a civil proceeding against other lawyers.⁵⁰ Epley was not prosecuted. Read the description of the conduct of some Jones Day lawyers (another prestigious law firm) laid out by a district court in Arizona in denying a summary judgment motion in a civil suit brought by private parties against the firm.⁵¹ Relying largely on evidence from the firm's own files and testimony, the court describes activities that are not just civil wrongs, but could have been the basis of criminal charges. None were brought. I could go on, but you get the point. Federal prosecution of lawyers for crimes has not been used to rein in lawyers, and there is no reason to believe that that is about to change.

That brings us to the SEC. Twice upon a time, the SEC got serious about regulating the bar, first in the early 1970s and once more in the early 1980s. In the 1970s, it brought an enforcement action in court, charging lawyers with having aided and abetted the fraud perpetrated by National Student Marketing Corporation and its merger partner Interstate.⁵² The gravamen of the SEC's complaint was that the lawyers failed to point out clearly and forcefully to company management and directors that the merger they were about to close would constitute a fraud because shareholders had been told the acquiring company had a profit, despite management and some directors knowing that was untrue.⁵³ The SEC's complaint argued that the lawyers had to speak out, tell the management and directors present that closing the deal in these circumstances was illegal, and, if the actors insisted on going ahead, the lawyers had to inform the SEC.⁵⁴ The lawyers' client was the company, not management or directors, and when criminal activity was about to jeopardize the company's future and thus the fortunes of its shareholder-owners, lawyers had to act to protect the client by telling management and directors to cease or notify the authorities. To fail in any of this, according to the SEC, was to aid and abet securities fraud.

The SEC's vision of lawyer responsibility was not made up by the agency; it precisely echoed what the ethics rules adopted in every state said at the time. A lawyer who knew a client was engaged in fraud had to tell the client to stop and rectify, and if the client did not,

50. *Id.*

51. *In re Am. Continental Corp./Lincoln Sav. and Loan Sec. Litig.*, 794 F. Supp. 1424, 1450-52 (D. Ariz. 1992).

52. *See Nat'l Student Mktg. Corp.*, 457 F. Supp. at 682.

53. *Id.* at 700.

54. *Id.* at 700-01.

then the lawyer had to inform the defrauded parties.⁵⁵ That ethics rule, however, had never been enforced against prestigious corporate law firms, for reasons I explained above.⁵⁶

What was the bar's reaction to the SEC's action in *National Student Marketing*? It declared war. It used all its muscle to beat the SEC back. It bellowed on about our "King George" government trying to turn the bar into informants, refusing to concede even a duty to insist that the law be obeyed within the corporation itself.⁵⁷ The ABA amended its "model" ethics rule, upon which the SEC was relying—the rule that was extant law in every state. That action did not change the extant law, but it was the start of the ABA's campaign to purge from state ethics rules the notion that a lawyer must insist that her client refrain from using her services to commit fraud, rectify any fraud so perpetrated, and disclose the fraud to those wronged, unless the client stops and rectifies on its own. The ABA's campaign still goes on today.

The court in *National Student Marketing* was keenly aware of the bar's fury over the SEC's attempt to enforce what was technically the ethical duty of every lawyer. The court ducked. It held that the lawyers had aided the fraud by sitting around passively while the managers and directors engaged in blatant violations of the securities laws that any securities lawyer should have recognized.⁵⁸ The court got fuzzy, however, when it came to explaining precisely what the lawyers should have done to avoid aiding and abetting the fraud. The court said "at the least" the lawyers had to speak up, presumably pointing out to management that proceeding with the deal would be against the law.⁵⁹ Would that suffice if the clients' agents persisted? The court, mentioning the bar's vigorous resistance to the notion that lawyers should ever disclose fraud to the SEC, refused to say. Much more troubling, the court, having held the lawyers did aid securities fraud, refused the SEC's request for an injunction prohibiting the lawyers from doing so again.⁶⁰ The court said no remedy was warranted.⁶¹ After all, the defendants were lawyers, people who need

55. See HAZARD, KONIAK & CRAMTON, *supra* note 30, at 121, 282-84.

56. The lawyers involved with the merger were from White & Case and Lord, Bissell & Brook. See *Nat'l Student Mktg. Corp.*, 457 F. Supp. at 687.

57. See generally HAZARD, KONIAK & CRAMTON, *supra* note 30, at 282-88.

58. See *Nat'l Student Mktg. Corp.*, 457 F. Supp. at 712-13.

59. See *id.* at 713.

60. See *id.* at 717.

61. See *id.*

no further incentive to follow the law than a gentle reminder by the court of what the law requires of them. How naive or disingenuous could the judge have been?⁶²

The SEC, having suffered quite a beating for its efforts in the above case, retreated from the battlefield for about a decade. Then in the early 1980s it tried again. This time it attempted to discipline two lawyers for sitting by passively while a CEO committed fraud.⁶³ This time the SEC dropped the “if all fails, tell us” part of its position and insisted only that a lawyer in these circumstances had to insist that management abide by the law, had to tell the board of directors if management was intransigent, and had to resign if the client’s agents (even assuming those agents were the members of the board) persisted in illegal conduct despite the lawyer’s efforts.

The administrative law judge said that the lawyers, who had done none of those things, warranted discipline by the SEC. Again, the bar would have none of that. Lo and behold, the SEC reversed the judge.⁶⁴ The SEC said discipline was not justified because securities lawyers had no fair warning of what conduct would be deemed a disciplinary violation by the SEC,⁶⁵ nevermind that the *National Student Marketing* court had said such conduct constituted aiding and abetting securities fraud a decade before. According to the bar and now the SEC, it was somehow unforeseeable or unclear that aiding securities fraud warranted disciplinary action by the SEC.

The SEC apparently thought that it could appease the bar by not disciplining the two lawyers in question and announcing a rule only to be applied prospectively. After all, that would not only let off the two lawyers in question, but it would also relieve all the other securities lawyers who had been busy ignoring the holding in *National Student Marketing*. Naive SEC. The SEC put its proposed rule (go up the corporate ladder to stop fraud and resign, if necessary) out for notice and comment.⁶⁶ After lawyers got finished commenting, the rule was never heard of again. The SEC abandoned its proposed rule, and with it, its efforts to regulate the bar.⁶⁷

When Enron exploded, forty law professors, myself included, wrote to Chairman Pitt to urge the SEC to revive its “tell the board

62. See HAZARD, KONIAK & CRAMTON, *supra* note 30 at 117.

63. *See id.* at 739-41.

64. *See id.* at 740.

65. *See id.*

66. *See* Sec. Act Release No. 6344, Sec. Exchange Act Release No. 18106 (Sept. 21, 1981).

67. *See* HAZARD, KONIAK & CRAMTON, *supra* note 30 at 741-42.

and/or resign” rule that it had abandoned in the 1980s.⁶⁸ We received a response from David Becker, then the SEC’s General Counsel, saying that the SEC had given up trying to regulate lawyers in the early 1980s.⁶⁹ Of course it did, that is why we wrote. It said that the bar was against such a role for the SEC. No kidding. It said that traditionally bar regulation was a matter left to state authorities and that is where the matter belonged. As I have explained,⁷⁰ leaving it to state disciplinary authorities means no regulation at all.

Before Congress included language in its corporate reform legislation demanding the SEC get back in the lawyer-regulation business,⁷¹ Chairman Pitt talked a good deal about accountants, but was mute on lawyer responsibility for corporate wrongdoing. Indeed, when Senator John Edwards, following up on the professors’ letter to the SEC, wrote to Chairman Pitt, asking for his help in crafting legislation to strengthen the SEC’s hand against lawyers, he got no reply at all.⁷²

Senator Edwards, joined by Senators Enzi and Corzine, went ahead without Pitt. They co-sponsored an amendment to the Sarbanes bill, providing that when lawyers encounter evidence of material violations of laws relevant to the SEC’s jurisdiction in the course of representing a client, they must report the existence of such evidence up the corporate ladder to the board of directors, and if necessary to get the evidence investigated and any wrongdoing corrected.⁷³ The amendment also requires the SEC to issue regulations to implement the amendment’s mandate that the SEC discipline securities lawyers for helping corporate wrongdoing. This amendment to the Sarbanes bill passed the Senate 97-0.

The ABA was not pleased. It wrote to the conferees urging them to omit the Edwards’ amendment and to clarify other language in the bill

68. See Letter from Law Professors to Harvey Pitt, Chairman, Securities and Exchange Commission (March 7, 2002) (on file with author).

69. See Letter from David M. Becker, General Counsel, Securities and Exchange Commission, to Law Professors (March 28, 2002) (on file with author).

70. It should be noted that just as this article was going to print, Harvey Pitt resigned as Chairman of the SEC.

71. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 307, 116 Stat. 745, 7245 (2002).

72. See Letter from Senator John Edwards to Harvey Pitt, Chairman, Securities and Exchange Commission (June 18, 2002) (on file with author). Becker’s reply to the Professors’ letter suggested that the SEC would not move again to use its existing power to discipline lawyers under Rule 102(e) without instructions from Congress. It is to that portion of Becker’s reply that Senator Edwards referred to in asking Chairman Pitt to help him craft legislation to bolster the SEC’s regulatory authority over lawyers.

73. See 148 CONG. REC. S6580 (daily ed. July 10, 2002) (amendment of Sen. Edwards to SA 4187).

that might suggest that the federal government, through any of its arms, should be regulating securities lawyers.⁷⁴ The ABA trotted out all its standard arguments with particular emphasis on the lawyer-discipline-is-for-the-states refrain.⁷⁵ That argument ignores the fact that patent lawyers, bankruptcy lawyers, and tax lawyers all are regulated at the federal level, given their practices in areas of federal concern. Indeed, securities lawyers are the odd group out. They practice in an area of unquestioned federal supremacy, yet are not subject to a meaningful federal regulatory regime (or, as I am arguing, any other form of meaningful regulation).⁷⁶

The conferees resisted the ABA's lobbying and left in the Edwards amendment. The President signed the law. Now, we wait to see whether the reluctant SEC takes up this Congressional mandate with energy and purpose. I wish I could tell you I am hopeful. I am not.

The final avenue of ineffective lawyer regulation is private litigation. In 1994, the Supreme Court suddenly announced that private causes of action for aiding and abetting securities fraud were not authorized by law.⁷⁷ For decades, courts had held that the securities laws included an "implied" cause of action for aiding and abetting securities fraud. The current Court, not inclined to "imply" causes of action when the relevant statute does not explicitly create them, was not persuaded by Congress's longstanding, if tacit, acquiescence to the "implied" cause of action theory, and thus put an end to private suits against lawyers (and others) for aiding securities fraud. The following year, Congress undertook a substantial revision of the securities laws and had every opportunity to write in explicit language authorizing private aiding and abetting suits, thereby restoring the legal landscape that the Supreme Court had disturbed.

74. See Letter from Robert D. Evans, Director, Governmental Affairs Office, American Bar Association to Senator Paul S. Sarbanes (July 19, 2002) available at <http://www.abanet.org/poladv/letters/107th/business071902.html>.

75. See *id.*

76. That is not to say that the lawyers practicing in other federal areas are adequately regulated. At least as to bankruptcy lawyers I am convinced they are not. Rather, it is to say that the fight for exclusive state regulation of those lawyers has been over for a long, long time.

77. *Cent. Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 177-78 (1994). This case states that,

As in earlier cases considering conduct prohibited by § 10(b), we again conclude that the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act (citations omitted). The proscription does not include giving aid to a person who commits a manipulative or deceptive act. We cannot amend the statute to create liability for acts that are not themselves manipulative or deceptive within the meaning of the statute.

Id. (citations omitted).

Congress, however, chose not to do so.

Securities fraud is not just an intentional tort; it is also a serious crime. The idea that criminal aiding and abetting is not an actionable civil wrong from which individuals damaged by the fraud can seek redress from our courts is, in my opinion, an outrage. The justification given for this outrage is that class action plaintiffs' lawyers will abuse the system by filing frivolous suits. I am no fan of the class action plaintiffs' bar. Indeed, for almost ten years now I have been writing article after article on the urgent need to establish meaningful regulation of class action lawyers.⁷⁸ But the idea that an unscrupulous plaintiffs' class action bar justifies denying redress in the courts to persons wronged by those who aid and abet fraud is unjust and dangerous. The injustice is plain, for this punishes defrauded persons for the actions of lawyers who they may never have met, no less retained. As to the danger, it removes an otherwise powerful method of deterring future misconduct on the part of corporate counsel—a group that is otherwise virtually impervious to penalties for the damage they cause. The answer to class action abuse is not to foreclose meritorious actions for aiding and abetting against lawyers or others, thereby further wronging institutional and individual investors who have already been wronged. It is class action lawyers who abuse the system that should be punished, not their clients.

The elimination of private suits for aiding and abetting dismantled one of the only working methods of regulating corporate lawyers and deterring bad conduct by members of this elite and powerful section of the bar. Lawyers can still be sued as primary violators of the

78. See, e.g., Susan P. Koniak & George M. Cohen, *In Hell There Will Be Lawyers Without Clients or Law*, 30 HOFSTRA L. REV. 129 (2001) (discussing the relative strength of the ethics rules that speak to corporate lawyers as compared to those that speak to the conduct of class counsel); Susan P. Koniak & George M. Cohen, *Under Cloak of Settlement*, 82 VA. L. REV. 1051 (1996) (arguing that class action lawyers be liable for malpractice, fraud and antitrust violations committed in the course of bringing or settling class suits and discussing examples of class action settlements in which conduct allegedly engaged in by class and defense counsel constituted a civil wrong or a criminal act under state or federal law, and arguing that the findings made by state and federal courts in blessing these settlements should not immunize the conduct from the reach of state tort law, consumer protection law, criminal law, or antitrust suits); Susan P. Koniak, *Feasting While the Widow Weeps: Georgine v. Amchem Products, Inc.*, 80 CORNELL L. REV. 1045 (1995) (describing the numerous ethical and legal failings of class counsel in this suit, which reached the Supreme Court as *Amchem Prods. v. Windsor*, 521 U.S. 591(1997)). I also testified before the House Judiciary Committee on the abuse of class action lawyers. See *Hearings on Class Action Abuse before the Courts and Intellectual Property Subcomm. of the Judiciary Committee of the House of Representatives* 105th Cong. (1998). Previously, I aided then Senator Cohen, from Maine, in drafting legislation to curb some abuses by class action lawyers—legislation still not passed but, which is introduced each year, by Senators Kohl and Grassley. See, e.g., *Class Action Fairness Act of 2001*, S. 1712, 107th Cong. (2001).

securities laws, but that case is very difficult to make. In plain language, what lawyers can do wrong is help others break the law. In law that is called “aiding and abetting.” To force plaintiffs to sue under some strained and not precisely applicable theory (i.e., that lawyers are primary violators of the law) seriously weakens their chances of success, thereby making the settlement value of such suits quite low. This, in turn, virtually wipes out the power of the law to deter the “helping” conduct that I have been arguing is so central to the success of corporate fraud. Proving that the lawyers were so central to the fraud that they qualify as primary actors is possible, but very difficult. The deterrent value of the law has thus been undermined. The law Congress passed in 1995, however, does not stop there. It further undermines the deterrent value of suits against lawyers by eliminating joint and several liability for all (including law firms) and establishing tough new pleading requirements for plaintiffs.⁷⁹

Most cases settle, but suits against law firms settle at an even higher rate. Lawyers do not want to risk court decisions that articulate precisely what they have done wrong and what they better not do again. Settlements avoid that risk. Cheap settlements allow lawyers to avoid that risk and keep the lion’s share of the oversized fees big-time lawyers charge for “lawyering” fraudulent transactions. In short, the so-called “reform act” gave a license to go all out to a profession that was already prone to turn a blind-eye to evidence of fraud and to offer a helping hand to their clients’ schemes. The result is that we are now so knee-deep in corporate corruption in institutions so central to our nation’s economy, such as Citigroup and J.P. Morgan, that I am uncertain whether we can actually afford to punish the wrongs that seem to have been perpetrated on so many or to examine just how perverse the regular business practices of our financial institutions have become.

We need to look back for a moment to the SEC. I described two instances of the SEC attempting to get tough with the bar. Something I did not state explicitly above is that the SEC employed two different methods. In the 1970s case, the SEC brought an enforcement action against lawyers in court, alleging the lawyers had aided and abetted. In the 1980s, the SEC used its rarely used power to discipline lawyers who practice before it. The Edwards amendment seeks to bolster the

79. See Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995).

latter method. What of the SEC's other route, enforcement actions against lawyers brought in court alleging aiding and abetting securities law violations?

When the Supreme Court eliminated private causes of action for aiding and abetting, it did not specifically address whether the SEC could still bring such suits. The reasoning of the opinion, however, seemed to apply to any action for aiding and abetting, whether brought by a private person or the SEC. Congress clarified that. In the 1995 Securities Reform Act, it specifically affirmed the SEC's power to bring aiding and abetting actions.⁸⁰ So far, so good. But what Congress gave with one hand, it took away with the other. It legislated that, from then on, the SEC would have to show that the assistance was "knowing" and not just "reckless."⁸¹ Recklessly assisting fraud had defined aiding and abetting liability for decades. Congress got rid of all that old law. As I explained above, showing that a lawyer "knew" something was illegal is a very difficult task.

This reining in of the SEC would have been comical if it were not so indicative of the government's cowardice in the face of the bar. The SEC was dormant, already a paper tiger. It gave-up on aiding and abetting suits against lawyers a long time ago. The SEC needed no new excuses to leave lawyers alone. Nonetheless the bar persuaded Congress to provide one.

One last avenue is left to explore—suits brought by the clients themselves for malpractice committed by attorneys that carelessly allow corporate managers to commit crimes. These are relatively easy cases to bring, and deterring negligence (carelessness) by lawyers in the face of corporate fraud would, by definition, take care of all the reckless lawyer conduct as well. All of that assumes, however, that the corporate client's senior management team and its board would be willing to sue the lawyers who helped management break the law. They are not. The lawyers know all about those agents' many hidden skeletons. After the savings and loan debacle, commercial institutions sued the lawyers who had not objected when senior management looted those banks. The suits happened only because the banks' federally appointed receivers had no personal interest in covering up the misdeeds of former management. In contrast, Enron has not sued its lawyers; there are still too many old hands running the show. The same goes for Global Crossing and Andersen.

80. *See id.* at § 104.

81. *See id.*

As I have described above, there is no state regulation, no federal regulation, and no major threat from private suits. That is a law-free zone, and it has to end. The Edwards amendment to the Sarbanes bill is a step in the right direction, but it will not work without a commitment of will by the SEC. That commitment of will will not occur unless responsible business leaders, Republican politicians, institutional investors, and the press insist that. Will that happen? Nothing thus far suggests it will. The silence on lawyer involvement is still breathtaking.

Even if it does happen, and with increased funding, the SEC simply has too much to do to be the sole method of regulating the securities bar. Private causes of action for aiding and abetting, joint and several liability, and the recklessness standard must all be restored, at least for lawyers. Senator Shelby had an amendment that did the first and last of those three, an excellent beginning.⁸² It went nowhere fast. In sum, as things now stand, the law-free zone for lawyers is as large and impenetrable as ever.

IV. LIES OR CONSEQUENCES

Norms maintained by private means (morality, ethics, religious principles) do not exist in a vacuum. They coexist, affect, and are affected by the norms of law.⁸³ The difference between privately maintained norms and publicly maintained norms (what most people call law) is not the conduct that they address. There is at least as much conduct addressed by both normative systems (private and public) as there is conduct addressed by only one. Indeed, the area of overlap is probably a lot greater than the area in which only one system operates. The greatest difference between the two normative systems is in the manner in which commitment to the norms is expressed. Private groups express commitment to their norms by ostracizing those who defy important norms, shaming them, denying them community prestige, and other signs of approval that the community has the power to bestow—positions of influence, monetary rewards, and similar signs of honor and acceptance.

The State, on the other hand, expresses its commitment to its norms by employing its important, albeit imperfect, monopoly on the use of

82. See 148 CONG. REC. S6584 (daily ed. July 10, 2002) (amendment of Sen. Shelby to SA 4197).

83. See Susan P. Koniak, *The Law Between the Bar and the State*, 70 N.C. L. REV. 1389, 1409-27 (1992) (discussing the hierarchy of norms).

force. All law is the exercise of State force, even civil sanctions, which are backed by the power of the State to seize one who defies those sanctions and throw her in jail. So, civil sanctions are properly read this way: pay these damages or lose your liberty; follow this injunction or lose your liberty; disgorge ill-gotten gains or lose your liberty. You get the point.

Any norm, public or private, which exists without commitment, is all but useless as a means of guiding conduct. A norm that no one intends be realized today in action is something less than a norm, something less than law. The State's norms on lawyer behavior are something less than law. The private norms that take their place, the bar's norms, diverge from the impotent State norms and indeed dictate conduct that the State's laws ostensibly forbid or would forbid, if anyone was prepared to insist that the laws be followed.

The bar's norms are evident from the status of the lawyers and firms that aid corporate wrongdoing and just how many lawyers and law firms are involved. The law firms involved in aiding major corporate fraud are not outlier firms, renegades practicing some perversion of what the pillars of the bar would tolerate; they are the pillars of the bar—the community's elders and norm generators. They are not concentrated in one area of the country; the norms they live by are nationwide. A lawyer who does not have it in her to follow these norms, who is not tough enough to stretch every law until its form and purpose are destroyed, will not make it to the top. It is just that simple. The bar's private norms are that strong.

This is so because the State's norms, which reflect not just the bar's narrow perspective and self-interest, but the interests of the larger community (most notably the investing public and institutions) have lost any claim to the name of law through a failure of State enforcement (commitment to state law). The bar is not challenged to rethink its norms since it incurs no costs or consequences for ignoring state law. But the lawyer who ignores bar norms, who refuses to assist a client's fraud and lies, that lawyer is likely to pay a price. When every lawyer knows that refusing to help a client break the law is a futile gesture because the lawyer down the street will be happy to take the fees you lose by your desire to follow state law that not even the State takes seriously, what result would one expect to see? Plenty of lawyers are willing to assist client fraud and to relieve their clients from the constraints of law. It is the rest of us who bear the consequences.

The State needs to take its norms seriously or no one else will.

V. CONCLUSION

I began by asserting that lawyers were central to corporate wrongdoing. Few, if any, corporate frauds could exist without lawyers; and fewer still could be maintained long enough to do any substantial harm. The examples I provided of lawyer involvement in the current wave of corporate scandals were used to demonstrate that point, but let me be more direct. No major corporate transaction goes forward without a lawyer's okay; no securities documents get filed without a lawyer's review; and no private placement memoranda are issued without a lawyer's input, if not a lawyer's drafting them herself.

We had laws on the books that prohibited most and maybe all of the damaging conduct engaged in by companies like Enron. But it takes lawyers to bring that law to bear on transactions and corporate activities, as they are being planned and implemented. When lawyers use their skills instead to circumvent those laws, we end up here. Unless we rein in the lawyers, what use is it to write new laws or to enact reforms? As long as lawyers stand ready to interpret our laws out of existence to serve management's goals, our new laws will be as ineffective as our old ones. Take away the lawyer's law-free zone and the law-free zones lawyers build for others will shrink too.

The law, lawyers used to say, is a jealous mistress. No mistress, jealous or not, would tolerate the total disregard that pillars of the bar now demonstrate toward the law. We are supposed to be the law's servants. It is not supposed to be the other way around. When we treat law this way, we dishonor ourselves. When the law gives lawyers license to ignore its dictates, it sows the seeds of its own destruction. This is your wake up call.

POSTSCRIPT: JANUARY 26, 2003

As this article was going to print, the SEC, as mandated by the Edwards amendment to the Sarbanes-Oxley legislation, adopted an up-the-ladder reporting rule for lawyers.⁸⁴ The final text of the rule was not available at the time this postscript was due. Nonetheless, a few preliminary observations are possible.

The rule originally proposed by the SEC in November of 2002 provided that a lawyer would have to withdraw, disaffirm any

84. Press Release 2003-13, Securities and Exchange Commission, SEC Adopts Attorney Conduct Rule Under Sarbanes-Oxley Act (January 23, 2003) (available at <http://www.sec.gov/news/press/2003-13.htm>).

fraudulent or misleading documents she had filed with the SEC and inform the SEC of the fact of withdrawal, if the board of directors of a company refused to take appropriate action to investigate evidence of fraud brought to its attention by the lawyer or failed to rectify company fraud to which the lawyer had alerted it. This was known as the “noisy withdrawal” provision of the proposed rule, and it received the most press attention with lawyers and the organized bar complaining loud and hard that this provision was inconsistent with the professional responsibilities of lawyers.⁸⁵ The SEC punted, deferring further consideration of this controversial provision to allow more time for comment. In the meantime, the SEC proposed an alternative to the noisy withdrawal provision that would shift the responsibility for reporting the fact that a lawyer had withdrawn because of an inadequate response to an up-the-ladder report (required by the rule as adopted) to the company, relieving the lawyer from the “noise” part of the “withdrawal” requirement.

Investors will be as protected by a company’s reporting that its lawyer had to withdraw after an unacceptable company response to an up-the-ladder report of wrongdoing as they would be by the lawyer herself making such a report to the SEC. I thus am not troubled by the alternative to lawyer-noisy-withdrawal proposed by the SEC. But that does not mean all is well.

The entire noisy withdrawal controversy was overblown by the media and the bar, and unfortunately that masked the much more important battleground: What should trigger a lawyer’s duty to report evidence of fraud to a company’s CEO or Chief Legal Officer (CLO) and when should a lawyer have a further duty to report that evidence up-the-ladder to a company’s board or a committee of the board? Whether anything changes about lawyer behavior in the face of evidence of corporate fraud depends on how that trigger is defined, or more appropriately how “those triggers” are defined in that there are at least two steps here: an obligation to report to the CEO or CLO and an obligation to report to the full board or a board committee, and maybe a third: the obligation of company (or lawyer) to report to the SEC an inadequate company response to a report to the board.

Along with Professors George Cohen and Roger Cramton, I wrote extensive comments to the SEC on its original proposal, comments that were endorsed by some 50 other securities and law governing

85. The SEC was inundated by comments from lawyers and bar groups. Those comments were posted by the SEC at <http://www.sec.gov/rules/proposed/s74502.shtml>.

lawyers' professors.⁸⁶ Our comments endorsed the original noisy withdrawal proposal, pointing out that noisy withdrawal was allowed by the ethics rules of almost every state and already required in certain instances by the newest Comments to the ABA's Model Rules. Thus, to describe the SEC's proposal as groundbreaking, outrageous, or destructive of the attorney-client relationship as currently understood was the worst form of hyperbole and just plain false, particularly given that any company could completely avoid their lawyers' having to make noisy withdrawal, under the SEC's proposal, by creating a qualified legal compliance committee. More important, our comments emphasized that the most important issue were the triggers for lawyer reporting within the company, not noisy withdrawal. After all, had the SEC adopted its own noisy withdrawal proposal, it's operation would depend on when the first and second reports (to the CEO/CLO and the board) would be required. We thus concentrated our comments on the all-important triggers.

Our position was that the SEC's proposed triggers were a mess: too high to accomplish the kind of reporting intended by the Edwards amendment and, as troubling, confused and confusing. The bar, for its part, carried on publicly about noisy withdrawal but spent at least as much time as we did in the many comments submitted by groups of law firms, official bar groups, bar insurers and individual lawyers, arguing that the triggers proposed by the SEC should be made even higher. Many of the comments submitted by the bar argued that lawyers should only have to report evidence of fraud to CEOs or boards of directors that was strong enough to allow a lawyer to "know" that fraud was in fact occurring. As I discussed earlier in that article, that standard, integral to the structure of bar-written ethics rules, is useless and would only perpetuate the unredeemed status quo.

In contrast, the professors proposed that first level reporting (to the CEO or CLO) occur when a reasonable and prudent lawyer would conclude that credible evidence available to her constituted probable cause to believe a material violation of law had, was or would occur. If, after that report and any response from the company's management, the lawyer learned nothing to alter that judgment, she would be required to report to the board. As for making noisy withdrawal to the SEC, we proposed a higher standard, adding that the evidence be both credible and substantial and that it be evidence

86. *Id.* Those comments are on file with the author and were posted on the SEC's website.

of a violation of law that was likely to cause substantial financial injury to investors or the company.

The SEC's final rules, as I said, are not yet published, but its press release states that it has revised its triggering standard:

The revised definition confirms that the Commission intends an objective, rather than a subjective, triggering standard, involving credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing or is about to occur.⁸⁷

There's a reason double negatives are considered poor grammar. They require the mind to do flips to understand what is being said. The press was quick to lambaste the SEC for its workmanship:

A lawyer who reasonably believes his client is a crook can keep quiet [under the new definition], so long as it would not be unreasonable for someone else to fail to conclude he was right. Using the double negative⁸⁸ made it a lot harder for the SEC to prove a violation later.

I listened to the SEC's live webcast of the meeting at which it adopted its rule. I was disturbed not just by the convoluted triggering definition but other statements made by the staff and the Commissioner about the new rule that the agency was adopting—statements that suggested that the rule may have been narrowed in its scope in various ways that would weaken its effectiveness. Time will tell.

For now, I am prepared to say this. The SEC's tortured triggering standard and its refusal to mandate without further delay that a company, as opposed to its lawyer, notify the agency when its lawyer is forced to withdraw over potential company fraud say something important about the power of the bar to fend off reform. Unfortunately for the American public, and to the everlasting disgrace of the bar, the freedom to remain complacent in the face of client fraud appears to be one of the bar's most cherished prerogatives. It is not apparent that the SEC has the strength or will to insist that that change.

87. Press Release, SEC, SEC Adopts Attorney Conduct Rule Under Sarbanes-Oxley Act (Jan. 23, 2003) (available at <http://www.sec.gov/news/press/2003-13.htm>).

88. Floyd Norris, *No Positives in This Double Negative*, NEW YORK TIMES, January 24, 2003 at C1. See also Jonathan B. Glater, *SEC Adopts New Rules for Lawyers and Funds*, NEW YORK TIMES, January 24, 2003 at C1.