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WRONGS OF IGNORANCE AND AMBIGUITY:
Lawyer Responsibility for Collective Misconduct

William H. Simon*

Deliberate ignorance and calculated ambiguity are key recurring themes in modern scandals from Watergate to Enron. Actors, especially lawyers, seek to limit responsibility by avoiding knowledge and clear articulation. This essay considers this phenomenon from the point of view of both business organization and legal doctrine. Evasive ignorance and ambiguity seem endemic to a particular organizational model and to a traditional model of legal responsibility. Developments in both law and business, however, suggest that these models are being superceded. Many of the most dynamic businesses now emphasize practices of “transparency” designed to inhibit evasive ignorance and calculated ambiguity. A major trend in recent legal doctrine, strikingly exemplified by the Sarbanes-Oxley Act, is to strengthen duties of inquiry and clear articulation. The legal profession, however, has strongly resisted these trends with respect to its own regulation. The essay argues that the bar’s opposition to many of the lawyer regulation initiatives under Sarbanes-Oxley reflects a misguided attachment to the privileges of non-accountability associated with deliberate ignorance and calculated ambiguity.

A distinctive set of ethical and regulatory issues arises where harmful conduct is ambiguous or the actors profess ignorance of its effects. Such ambiguity or ignorance

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sometimes indicates inadvertence and blamelessness. But because both law and social opinion hesitate to condemn ambiguous or ignorant conduct, actors are tempted to affect calculated ambiguity or deliberate ignorance in order to diminish accountability.

We are familiar with these practices from literature and history. Shakespeare illustrates deliberate ignorance in Antony and Cleopatra. When Menas asks Pompey for permission to kill Pompey's rivals for the chief magistracy of Rome, Pompey reproaches him:

Ah, this thou shouldst have done
And not spoken on't....
... Being done unknown,
I should have found it afterwards well done,
But must condemn it now.¹

Henry II employed calculated ambiguity when he cried out, "Will no one rid me of this turbulent priest?", simultaneously prompting his knights to murder Thomas Becket and permitting Henry to deny that he intended such an extreme response.²

Both tropes recur in Hollywood portrayals of corrupt politics and organized crime. Think of two of the best known moments in these films -- Captain Renault's claim in Casablanca to be "shocked – shocked!" that gambling is going on at Rick's café (deliberate ignorance), and Vito Corleone's statement in The Godfather about making "an offer he can't refuse" to the movie producer who resists giving a key role to Johnny Fontane (calculated ambiguity).

Issues of ignorance and ambiguity are prominent in some recent financial scandals, notably Enron. Some of the most important provisions of the Enron-inspired Sarbanes-Oxley Act

¹ II, 7, 77-84

² Simon Schama, A History of Britain: At the Edge of the World 3500 B.C.- 1603 A.D. 141-42 (2000). I quote the language of legend. Schama says that Henry actually said something closer to, "What miserable drones and traitors have I nourished and brought up in my household who allow their lord to be treated with such shameful contempt by a low-born cleric!".

on corporate governance are addressed to such issues. Sarbanes-Oxley culminates an important trend toward norms that narrow the range for excuses based on ignorance and ambiguity by encouraging or requiring inquiry and articulation. Traditional ethics and liability norms left a broad range for such excuses, but the traditional approaches seem increasingly anachronistic, especially as applied to organized political and business conduct.

Most significantly, business management styles have evolved in the past three decades to emphasize broad inquiry and clear articulation and to condemn ignorance and ambiguity as symptoms, not just of potential public irresponsibility, but of poor business performance. Regulatory efforts that seek to enhance accountability by encouraging inquiry and articulation resonate with these business developments.

Nevertheless, these regulatory trends have not been uniformly welcomed by those subject to them, and there has been one pocket of especially fierce and successful resistance – the legal profession. The profession's reaction to the regulation of lawyers mandated by Sarbanes-Oxley shows a reluctance to accept the kind of accountability the statute promotes and an apparent attachment to the privileges of ignorance and ambiguity.

Part I of this essay further illustrates deliberate ignorance and calculated ambiguity by recalling that they were emblematic of the wrongdoing in Watergate and then exploring their role in two major episodes of lawyer conduct in Enron.

The next two parts consider the relation between these pathologies and organizational style and structure. Part II reviews some accounts of modern corporate life that suggest that deliberate ignorance and calculated ambiguity are encouraged by a particular model of organization that I call Ambivalent Bureaucracy. Enron seems to have been an example of Ambivalent Bureaucracy, and the key weaknesses of this form of organization seem to have played a major role in its collapse. Part III surveys recent trends that seem to be

eroding the prevalence of the Ambivalent Bureaucracy and promoting types of transparency and accountability that constrain ignorance and ambiguity.

Part IV reviews a trend in legal regulation that parallels the evolution of business style and structure toward transparency and accountability. The trend has strengthened and elaborated duties of inquiry and articulation. Sarbanes-Oxley stands as a striking confirmation of the trend.

Finally, Part V shows that, compared to business managers and accountants, the legal profession remains an outlier in both the virulence and the success of its resistance to pressures to preclude deliberate ignorance and calculated ambiguity and the immunity from accountability they facilitate. Nevertheless, some aspects of the recent regulatory initiatives of the Securities and Exchange Commission have the potential to push the bar along the same path on which its corporate clients are traveling.

I. Ignorance and Ambiguity in Watergate and Enron

The behavior that offends us in public scandals is sometimes blatantly illegal. On the other hand, it sometimes takes the form of socially obnoxious but inadvertently unregulated behavior – the exploitation of loopholes. Deliberate ignorance and calculated ambiguity are recurring behaviors that cut across both categories. They are efforts to escape accountability either to the law or to social opinion for consequences that the actor should know are socially harmful. Such efforts were among the most salient and unattractive features of the wrongdoing in Watergate, and in more diluted form, they seem central to questions of lawyer conduct in Enron.

A. Watergate

The most salient theme in the unsavory moral world of the Watergate participants is, not amorality or ruthlessness, but rather aversion to accountability. The participants show intense faith in the immunizing power of deliberate ignorance and calculated ambiguity.

When Hugh Sloan, treasurer of the Committee to Re-Elect the President (CREEP), asked campaign finance chairman Maurice Stans why Gordon Liddy had asked for \$83,000, Stans replied "I do not want to know and you do not want to know".³ (Liddy was planning the burglary of the Democratic National Committee headquarters.) When Liddy's accomplice Howard Hunt phoned presidential advisor Chuck Colson after the burglary, Colson "repeatedly insisted that he knew nothing about Watergate and wanted to keep it that way."⁴ At about the same time, Liddy approached Attorney General Richard Kleindienst on a golf course and said, "you've got to get my men out of jail. Kleindienst said, "You get the hell out of here kid. Whatever you have to say, just say to someone else."⁵ When asked much later about charges that the Greek military dictatorship made secret contributions to Watergate-related activities, CIA Director Richard Helms replied, "Even if somebody suggests they would like to do it, I would insist that they don't tell me about it because that is dynamite."⁶

Ambiguity is an equally salient theme in Watergate discourse. In his introduction to the tapes, R. W. Apple wrote, "The record is ... so full of ambiguities and contradictions and elliptical language – a kind of White House code -- that definitive judgments will be difficult."⁷ Some of the ambiguity may be inadvertent or unconscious, reflecting anxiety or

³ Stanley I. Kutler, The Wars of Watergate: The Last Crisis of Richard Nixon 355 (1990) [hereinafter Wars].

⁴ Id. at 249.

⁵ As reported by John Dean to Nixon. New York Times, The White House Transcripts 142 (1974).

⁶ Kutler, cited in note 3, at 206.

⁷ New York Times, cited in note 5, at 4.

indecision. In the very long discussion between Nixon and Dean about payment of hush money to the burglars, Nixon veers back and forth between approval and disapproval of the payments, leaving no impression of how the thought he had left the matter.⁸

But the participants often emphasize that ambiguity can be used deliberately to minimize accountability. Did CREEP Chairman John Mitchell authorize the Watergate break-in? Nixon doubted that he would have done so in any way for which he could be held accountable: "Hell, [Mitchell] may have said, don't tell me about it, but you go ahead and do what you want. But that doesn't take the rap you know."⁹ Did Chief of Staff Bob Haldeman? John Dean had a similar doubt: "I think he knew there was a capacity to do this but he was not given specific direction."¹⁰ What about Colson? Dean reports that, when Liddy and Hunt came to Colson to complain that CREEP chair Jeb Magruder was reluctant to approve their efforts, Colson called Magruder and said, "You all either fish or cut bait. This is absurd to have these guys over there and not using them." Dean assumed that Colson expected Magruder to interpret this as endorsement of the Liddy's and Hunt's burglary plan, but he also expected that Colson would deny it and "would probably get away with denying it."¹¹

B. Deliberate Ignorance in Enron: The Vinson & Elkins Letter

After CEO Kenneth Lay received Sherron Watkins August 15, 2001, letter suggesting improper accounting and self-dealing, Enron's general counsel asked its principal outside counsel, Vinson & Elkins, to investigate. Since Vinson & Elkins had played a major role in some of the relevant

⁸ New York Times, cited in noe5, at 132-80 (March 21, 1973).

⁹ Abuse of Power: The New Nixon Tapes 55 (Stanley Kutler ed. 1997).

¹⁰ New York Times, cited in note 4, at 140.

¹¹ Id. at 137.

transactions, it had a conflict and should not have undertaken the assignment.¹² For whatever reason, the investigation the firm conducted was notably circumspect. As a board committee formed after the collapse concluded, "The result of the V & E review was largely predetermined by the scope and nature of the investigation and process employed."¹³ V & E's circumscription was especially notable in two broad areas.

First, the lawyers decided that they would not reconsider, or "second guess", Arthur Andersen's accounting judgments, nor would they seek independent accounting advice.¹⁴ In effect, the lawyers acted as if the Andersen accountants had sole responsibility for accounting judgments and their own responsibilities were limited to assuring that material facts were presented to the accountants. This limitation was remarkable for at least two reasons.

One reason was that, under the relevant accounting standard, the most important determinant of accounting treatment was the extent to which Enron had retained control of rights and financial interests in the partnerships' assets. This was, as the accounting standard explicitly recognized, a legal question.¹⁵ Moreover, V & E had already given quite a bit of

¹² See Roger Cramton, "Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues," 58 The Business Lawyer 143, 163-67 (2002). Watkins in her letter had presciently warned Lay "can't use V & E due to conflict." Destruction of Enron Related Documents by Andersen Personnel, Hearing Before the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce of the House of Representatives, 107th Congress, 2d Sess., Jan. 24, 2002, at 39, 43. [hereinafter Hearing].

¹³ William Powers, Jr., et al., "Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp.," (Feb. 1, 2002), at 176 (on file with author).

¹⁴ Letter from Vinson & Elkins LLP, to James Derrick, Oct. 15, 2001, in id., at 46, 47.

¹⁵ Financial Accounting Standards Board, "Accounting for Transfers and Services of Financial Assets, and Extinguishments of Liabilities," Statement of Financial Accounting Standards No. 125 (1996), at par. 23 (proper treatment depends on specified "factors pertinent under applicable law.") A revised standard governed the later Enron transactions, but the

advice and assistance in matters related to these issues. According to the Powers report, “management and the board relied heavily on the perceived approval by V & E of the structure and disclosure of the transactions.”¹⁶ Vinson & Elkins had given legal opinions in connection with similar transactions for the purposes of supporting the accounting treatment Enron sought.¹⁷ And it had given advice with respect to whether some of the transactions required elaboration in the “Management Discussion and Analysis” section of Enron’s securities filings.¹⁸

A further problem with V & E's deference to the accountants is that V & E's letter shows that its lawyers understood the accounting concerns raised by Watkins and later vindicated by the Powers report and many other critics. In a concluding section entitled "Bad Cosmetics", it noted key objections to the accounting treatment, including the arguable facts that the special purpose entities were not truly independent and that they were insolvent, implying that the obligations from them that Enron showed on its books were valueless.¹⁹ The letter suggested that disclosure of further information might lead to lawsuits or bad publicity. The letter clearly implies that,

basic determinants were unchanged. Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 140: “Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities” (Sept. 2000).

¹⁶ William Powers, Jr., et al., cited in note 13, at 26. The fullest account of the lawyers’ activity is in *In re Enron Corp*, No. 01-16034 (AJG) (Bkrpt. Ct. S.D.N.Y.), “Final Report of Neal Batson, Court-Appointed Examiner,” Appendix C (2003).

¹⁷ Enron declined to give an opinion with respect to whether the special purpose entity transactions were “true sales”, which was the legal issue central to accounting treatment. It gave “true issuance” opinions with respect to some of the transactions. These opinions were technically correct, but they did not support Enron’s accounting treatment. It appears that Vinson & Elkins gave the opinions knowing that Enron and the accountants wanted them for the purpose of supporting their preferred treatment. *Id.* at 28-48.

¹⁸ *Id.* at 48-52, 86-90.

¹⁹ Hearing, cited in note , at 53.

as long as the accountants "were comfortable" with these matters, such concerns were a matter of prudence within the discretion of the board, rather than legal duty.

But the securities laws do not recognize any distinction between information that merely "looks" bad and information that really bears on performance. The issue under these laws is whether information is the type that a "reasonable investor" would be influenced by. A reasonable investor cares about information that would be likely to cause price movements.²⁰ Thus, one might argue that "Bad Cosmetics" was by definition a violation of the securities law materiality standard. At the least, this was a legal question that a business lawyer should have considered. Yet, V & E failed to do so.

The other area of V & E's self-imposed ignorance concerned allegations of improper self-dealing. With regard to these issues, the Powers Committee faulted the lawyers for speaking only to ten, mostly senior, people at Enron and Andersen, "who, with a few exceptions, had professional and personal stakes in the matters under review."²¹ The Committee suggested that more junior employees or former employees might have provided more disinterested information.

Although the report does not charge V & E with it, another striking omission appears there. Just as they took

²⁰ See TSC Industries v. Northway, 426 U.S. 438, 449 (1976) (materiality standard is what "reasonable investor" would consider significant); Basic v. Levinson, 485 U.S. 224 (1988) (investors can be assumed to rely on soundness of public market prices). There may be a paradox here because the principle implies that a reasonable investor would be interested in matters of concern to unreasonable investors to the extent that the decisions of the latter affected prices. But the securities laws seem comfortable with this position.

Although sparse and dated, the relevant authority indicated that compliance with Generally Accepted Accounting Principles would not exonerate an otherwise misleading statement. See United States v. Simon, 425 F.2d 796, 805-07 (2d Cir. 1969) (Friendly, J.); Thomas L. Hazen, Securities Regulation 610-11 (4th ed. 2002).

²¹ Powers et al, cited in note 15, at 177.

approval of financial statements by the accountants as conclusive and sought only to ascertain if the accountants were aware of the facts, so they took approval of the LJM transactions by the board as conclusive and sought only to ascertain compliance with approval processes. At the times it approved the LJM structures, the Board recognized the deals would require a waiver of Enron's ethics code and it conditioned the waiver on review and approval of each deal by the chief accounting and risk officers and an annual review of completed deals by the board's audit, finance, and compensation committees. The chief accounting and risk officers were both subordinate to Fastow; so their approval could not have been expected to be a strong check. The Audit Committee review was thus of central importance. In its letter, V & E concluded that "it appears" that the mandated review had occurred at the end of the two annual periods since the LJMs were established.²²

In fact, the Powers report found that board committee review was cursory and based on mistaken assumptions. The board vastly overestimated the degree of scrutiny that the chief accounting and risk officers were giving to the deals and wrongly thought that CEO Jeffrey Skilling was approving them. Important information on the substance of the transactions was withheld from the board. Most important,

the annual reviews of LJM transactions by the Audit and Compliance Committee (and later also the Finance Committee) appear to have involved only brief presentations by Management (with Andersen present at the Audit Committee) and did not involve any meaningful examination of the terms of the transactions. Moreover, even though the Board Committee-mandated procedures required a review by the Compensation Committee of Fastow's compensation from the

²² Hearing, cited in note 12, at 50.

partnerships, neither the Board nor Senior Management asked Fastow for the amount of his LJM-related compensation until October 2001, after media reports focused on Fastow's role in LJM.²³

V & E's failure to recognize the weakness of the board's review seems to arise from a decision to assess the board's efforts on the basis of documents. V & E decided not to interview Board members on the extent of their efforts or understanding. (After V & E concluded its report, it gave a verbal summary of its conclusions to the Audit Committee, but this meeting seems to have involved re-assurance, rather than probing.)

V & E's failure to interview board members responsible for reviewing the transactions surely rivals the firm's more prominently condemned misjudgments. Given the pervasiveness of managerial conflicts, board committee review was a critical safeguard, and the board itself seemed to have so deemed it at the time it authorized dealings with the partnerships. It was not plausible to think that the quality of this review could be assessed on the basis of documentary records.

No doubt lawyers do not casually seek to interview members of the board of a major corporate client, but V & E itself recognized that the stakes in this matter were extraordinarily high, and it should have recognized that the board's role was critical. Thus, the question arises whether its efforts might have been inhibited by a desire to avoid receiving or giving information. Perhaps Lay or the lawyers themselves did not want to take the risk of learning that the board's consideration had been inadequate, since such knowledge might have intensified their own responsibilities. Perhaps the lawyers sense that, if the board knew little about the transactions, it was because its members preferred it that way, and they did not

²³ Powers, cited in note 12, at 11.

want to take the risk of burdening them with unwanted knowledge.

C. Calculated Ambiguity in Enron: The Temple Memo

On October 12, 2001, knowing that an SEC investigation of the Enron audits was likely in the near future, Nancy Temple sent an e-mail to Michael Odom. The text read:

Mike –

It might be useful to consider reminding the engagement team of our documentation and retention policy. It will be helpful to make sure that we have complied with the policy. Let me know if you have any questions.

Nancy

It concluded with the URL of the Andersen policy on its web site.²⁴

Temple was a lawyer in the legal office of Andersen's Chicago headquarters. Odom was director of Andersen's Houston office. Odom promptly forwarded the message to David Duncan, the "engagement partner" on the Enron account. A few days later Duncan organized the shredding of more 3,500 pounds of Enron-related documents. Duncan subsequently pleaded guilty to obstruction of justice in connection with the shredding, and he testified at Andersen's criminal trial that his decision to shred had been influenced by the Temple memo.

Temple denies that her memo was calculated to encourage destruction. She testified to a Congressional panel that she intended simply that Odom and Duncan follow the policy. According to her, it was Duncan's responsibility as engagement

²⁴ Hearing, cited in note 12, at 45.

partner, to interpret the policy and to make inquiries if he had any difficulty doing so.²⁵

Temple's account was incredible as a description either of the relative responsibilities of lawyer and client in this situation or of Temple's motives. Lawyers are trained and paid to be advisors, not archivists. Their job is to tell clients what the rules require them to do, not simply to pass them along. Moreover, the Andersen policy was, as the firm itself later conceded, "not a model of lucidity".²⁶ It was 10 pages long, turgidly written, and ambiguous in key respects. It stated that audit work papers should be preserved for six years and that, "In case of threatened litigation, no related information will be destroyed." On the other hand, it also stated that "drafts and preliminary versions of information should be destroyed," that personnel should "eliminate or destroy [client information] when no longer needed," and that "only essential information to support or conclusions should be retained." It did not specify the priority of these competing injunctions.²⁷ Thus, it was at least risky to leave interpretation to a lay person. And what was almost certainly the most prudent advice for a lawyer to give on October 12 – preserve all Enron-related materials until further notice – was not very difficult to formulate.

There are two possible interpretations of the ambiguity of Temple's memo. Many believe that she intended to encourage tacitly destruction of Enron documents.²⁸ There is much to be said for this interpretation. Andersen had suffered large losses in several recent lawsuits, and an attitude of bitterness and

²⁵ For Temple's Congressional testimony, see Hearing, cited in note 12, at 118-68; see especially 137-38.; on Duncan's trial testimony, see Jonathan Weil and Alexei Barrionuevo, "In the Balance: As Trial Nears End, Andersen Proves Surprisingly Tough," Wall Street Journal (June 4, 2002), at A1.

²⁶ Prepared Statement of C.E. Andrews, Global Managing Partner, Arthur Andersen, in Hearing, cited in note 12, at 33.

²⁷ The policy appears in Hearing, cited in note 12, at 79-105.

²⁸ This was the prosecutors' argument in the Andersen criminal trial. See Weil and Barrionuevo, cited in note 25.

wariness toward litigation appears to have been pervasive. Odom had explicitly urged destruction of documents in anticipation of litigation a couple of days before Temple wrote (although there's no indication that Temple was aware of this).²⁹

But another equally plausible interpretation is that Temple was uncertain about aspects of the policy or about what advice she should give. Temple's testimony to Congress suggested that she was not sure even by that point what Andersen's duties were.³⁰ She also pointed out that the policy explicitly gave the engagement partner the duty to interpret and apply it. A simple warning not to destroy Enron-related documents might prompt detailed inquiries about specific documents that would have been difficult to answer. Moreover, Temple might have worried that even clear and accurate advice would have been unwelcome. Such advice sometimes limits the recipient's later ability to claim excusable mistake.

Regardless of which interpretation we accept, there remains the further question of why Andersen's policy was itself ambiguous. Casual or amateurish drafting is certainly one explanation. On the other hand, the bad litigation experiences that led Andersen to focus on the document retention issue might have been expected to induce careful thinking about the matter. A more likely explanation lies in the tensions inherent in document destruction strategy generally. These tensions create strong pressures against clarity.

The drafter of a corporate policy faces the following problem: After she has specified which documents the company

²⁹ Id.

³⁰ Rep. Markey: Is it your legal opinion that Andersen is free to shred documents relating to its work for Enron until such time as it actually receives a subpoena from the SEC, or formally named as a defendant in a class action lawsuit by Enron's employees or other investors?

Ms. Temple: I have not reached that legal question.

Rep. Markey: What was your view at the time?

Ms. Temple: I was not asked ... to reach a legal opinion at any particular time

Hearing, cited in note 12, at 150.

is legally obliged to retain – e.g., documents likely be sought in imminent litigation – she needs to indicate which of the remaining documents should be retained and which destroyed. In principle, she would like to retain helpful documents and destroy harmful ones. But it is impossible to fully anticipate in advance which documents will fall into these categories or to effectively express her expectations in precise rules. Thus, she is pushed to leave discretion for ad hoc decision-making under an open-ended standard that prescribes destruction when the document is likely to be harmful. Ad hoc decision-making, however, has especially severe disadvantages in this context. For one thing, it means that local decision-makers will have to make difficult judgments for which they will not always be qualified. For another, evidence law provides that, when a party has destroyed documents pertinent to a claim, the trier may infer that the documents would have supported the adverse party's position.³¹ Ad hoc decisions under a harmfulness standard are more likely to encourage such inferences, since such decisions will suggest that the decisionmaker specifically determined that the document was harmful.

In this situation, the policy-maker may be inclined to ambiguity for two distinct reasons that parallel the interpretations of the Temple memo. First, an ambiguous policy might seem likely to produce the most litigation advantage. It leaves discretion to local decisionmakers. If they understand tacitly that the goal is to eliminate harmful material, they will exercise their discretion accordingly, but the absence of an explicit standard will make it easier to portray the destruction as motivated by something other than a sense of culpability.

Second, an ambiguous policy might seem to allow the policymaker to avoid sticking her neck out in a situation where there are large risks. A clear rule-based policy runs large risks of over-inclusion (documents that turn out to be desperately

³¹ See 2 Wigmore on Evidence sec. 291 (James Chadbourn rev. 1979).

needed get destroyed) or under-inclusion (documents that turn out to be smoking guns are preserved). A clear standards-based policy risks embarrassing adverse inferences from destruction. A policymaker might fear that, should some extreme version of these bad outcomes occur, hindsight bias or opportunism might cause others to blame her. An ambiguous policy has the same risks, but it has the compensating advantage that it increases the policy-maker's chance to claim that she did not intend or foresee the bad consequence and to blame the local decisionmakers for it.

D. Liability

Clearly in Watergate and apparently in Enron, key participants sought immunity through ignorance and ambiguity. In Watergate, they were largely unsuccessful. The two Enron episodes described here have not been fully resolved, but the participants have already suffered reputational damage and face prospects of liability.

In the Andersen criminal prosecution, the government argued that Temple's letter was intended to encourage document destruction and hence an act of obstruction of justice. Although some jurors may have agreed, the jury as a whole did not. Its conviction was based on another episode involving Ms. Temple.³² It remains possible that Temple will face individual criminal charges. It is also arguable that her advice, if not obstruction of justice, was malpractice. Such a claim seems unlikely as a practical matter, but in different circumstances, she

³² According to the special verdict form, the conviction was based on an episode in which Temple advised Duncan to alter a memorandum of a conference with an Enron manager to remove indications that Duncan had advised against making a certain statement and that Temple had received the memo. See Jonathan Weil, Alexei Barrionuevo, and Cassell Bryan-Low, "Auditor's Ruling: Andersen Case Lifts U.S. Enron Case," Wall Street Journal (June 17, 2002), at A1.

might have been faced with a negligence claim from the client (or its successor).

The pending civil damage action against Vinson & Elkins alleges that the letter to Derrick amounted to fraud, as an effort to cover-up the deceptions in the original transactions.³³ The bankruptcy examiner suggested that evidence concerning the firm's conduct of the Watkins investigation would support a malpractice claim.³⁴

Thus, in both Watergate and Enron, it is not clear that the pre-existing liability rules failed to adequately address the conduct in question. Nevertheless, a natural response has been to tighten prohibitions and increase sanctions. And as with Watergate, another response has been exhortation against the misconduct. To the extent that misconduct is not a matter simply of rational calculation but of acculturated instinct, exhortation may be responsive. Thus, it is pertinent to consider the relative influences of strategy and culture.

II. Organizational Pressures: Ambivalent Bureaucracy

Many accounts of the structure of business organization take notice of deliberate ignorance and calculated ambiguity and attribute these phenomena to distinctive organizational pressures. In some accounts, these pressures are endemic to a style and structure of business organization that was dominant until recently and was evident in Enron and Arthur Andersen.

Ambivalent Bureaucracy is my name for the most salient model in the academic literature on American business organization of the last century. This model asserts that there is a strong and inevitable gulf in large organizations between two regimes of order – a formal one and an informal one. The formal one is a bureaucracy of the sort described by Max Weber – a hierarchical organization of narrowly specialized roles

³³ Newby v. Enron Corporation, 2002 WL 31973134, at 64-66 (S.D.Tex. 2002) (describing complaint).

³⁴ Appendix C, cited in note , at 185-87.

governed by rules. The behavior of rank-and-file agents is controlled through rules promulgated by top managers. The informal order is made up of tacit norms and personal relationships. The informal order arises because the formal one is insufficient. A major problem is that the top managers lack the information about the production process necessary to promulgate and update rules of adequate specificity for rank-and-file agents, and they lack the information about the behavior of the agents needed to monitor their compliance.³⁵ How the informal rules respond to these deficiencies varies among accounts, but many accounts suggest an important role for deliberate ignorance and calculated ambiguity. In particular, they suggest both a cultural account and a strategic account of these phenomena.

A. Culture

By some accounts, the informal order of the Ambivalently Bureaucratic business organization is characterized by hierarchical networks of personal deference and loyalty. A participant's most fundamental obligation is to serve his immediate superior, and this means, not necessarily compliance with the organization's express rules or even the superior's express commands, but catering to her unspoken desires.³⁶ These relations are fluid because people typically move from job to job within them. The identity of one's superiors changes. Thus, one has to be fairly adept at shifting allegiances and at reading the unspoken concerns of different people.

Ignorance and ambiguity have important uses in such a culture. A participant needs to avoid certain types of

³⁵ See, e.g., Alvin Gouldner, Patterns of Industrial Bureaucracy (1954); Chester Bernard, The Functions of the Executive (1938).

³⁶ The locus classicus of this view is William H. Whyte, Jr., The Organization Man (1956). The themes with which this paper is concerned are best developed in Robert Jackall, Moral Mazes: The World of Corporate Managers 101-61(1988).

knowledge because it triggers responsibilities under the explicit rules that would conflict with the unspoken desires of a superior. Knowledge of wrongdoing by the superior or knowledge that might reflect adversely on the superior that would trigger reporting obligations are the most serious examples. Information about risks and uncertainties about which it appears that there is little that can be done is sometimes another. Just as the participant avoids knowledge that is unhelpful to her, so she refrains from transmitting information to the superior that the superior does not want to hear, information that would trigger unwelcome duties or induce anxieties on the part of the superior.

In these accounts, managers would prefer not to take responsibility for decisions involving risk or uncertainty. They tend to tacitly delegate such matters downward, forcing subordinates to resolve them without explicit guidance. Subordinates perceive that managers do not want information that would force them to confront such matters directly.³⁷ In addition,

most bosses simply do not want to hear bad news. Bad news either requires action, always open to multiple and perhaps pejorative interpretations, or it upsets pre-established plans of action, scattering ducks already set in a row. Besides one can only criticize something when one has the resources to solve it in a clear and decisive way. Otherwise, one should keep one's skepticism to oneself and get "on board."³⁸

Ambiguity is a critical tool of flexibility. The participant wants to keep his commitments tacit so he can modify and shift them as circumstances and relationships change. He prefers to speak imprecisely and off-the-record so as not to limit his

³⁷ W. Morris, Decentralization in Management Systems 53 (1968).

³⁸ Jackall, cited in note 36, at 118.

freedom to re-characterize his commitments in retrospect and or to change them prospectively.³⁹ "Within the corporation, subordinates often have to protect their bosses' 'deniability' by concealing the specific dimensions of a problem in abstract, empty terms, maximizing the number of possible subsequent interpretations."⁴⁰

There are a variety of functional explanations for this culture. It makes possible a limited kind of mutual recognition and support where deeper kinds are not possible. It allays the anxiety that is naturally associated with uncertainty. Its practices strike individuals as strategies for material success. However, part of what we mean in calling this explanation cultural is that people engage in these practices more or less unreflectively. They may initially adopt and periodically re-affirm the practices on instrumental grounds – as means to material reward – but the practices do not remain a matter of ongoing calculation. Often the practices become habitual and persist even after the environmental contingencies that made them strategically plausible have changed. If the culture fails to adapt to such change, the practices become dysfunctional. Thus, on this cultural view, it is no surprise that people sometimes behave in ways that depart from rational assessment of their material interests. Either they have sacrificed these interests to the emotional needs served by the practices, or the culture has blinded them to the environmental changes that have decreased the strategic effectiveness of the practices.

Although Watergate took place in the context of a political organization rather than a business one, this cultural

³⁹ Jackall writes of one of his subjects, who came to grief by flouting the norms of this culture:

He tried to fix responsibility for action, a tactic certain to shatter the trust required to maintain a kind of cooperative nonaccountability. He put things into writing in a world that, apart from ritual nods to the importance of documentation, actually fosters ambiguity by its reliance on talk as the basic mode of negotiation and command. *Id.* at 118

⁴⁰ *Id.* at 136.

interpretation fits it quite well. Personal loyalty is clearly the most basic norm for the Watergate participants. The tapes show Nixon's preoccupation with retaliation against those who are disloyal to him. The participants repeatedly conflate virtue with sensitivity and commitment to the needs of Nixon and his close advisors. They describe their goal as the protection of "the Presidency", but they conflate the interests of the institution with those of its incumbent. The idea that exposure of White House wrongdoing might hurt only Nixon, and not his office, invariably eludes them.⁴¹

The tapes also illustrate the fluidity of this ethos. As the collaborators perceive that some will have to be sacrificed, and as some defect and offer testimony against the White House, loyalties shift drastically. Former team players become casualties or traitors, who no longer show or can expect loyalty.

We don't know enough about Enron and Arthur Andersen to assess the pertinence of this cultural explanation, but there are some indications that it may prove helpful. In contrast to the strategic explanation we consider next, cultural explanations have some ability to account for behavior that seems against the actor's self-interest. At least some of the conduct in Enron seems of this kind. In particular, Nancy Temple's conduct is hard to account for in rational strategic terms. She knew that inquiry was likely and that her e-mail advice would almost certainly be discovered in the event the inquiry became at all extensive. It seems very doubtful that whatever personal stake she might have thought she was protecting by sending the e-mail could have been of a magnitude to warrant the risk she ran. Thus, in our present state of knowledge, it seems plausible to see this as the kind of unreflective, self-protective ambiguity encouraged by the corporate culture of amoral personalism.

B. Strategy

⁴¹ See Kutler, intro to Abuse of Power

Criminal or tort liability for intentional wrongdoing typically requires proof of an element of intent and an element of conduct. In the organizational context, the conduct is often a statement. In the case of fraud, a false statement; or in the case of other wrongs, a statement instructing or authorizing a subordinate to engage in some further wrongful act. Intent is often an inference from knowledge. With fraud, if the person knows facts that make the statement fraudulent, the intent to deceive can be inferred. With acts committed by subordinates, intent can be inferred from knowledge of facts that make it likely that the subordinate will respond to the statement by doing the wrongful act.

In the organizational context, a perennial strategy of those in control for avoiding this type of liability is to encourage subordinates to engage in wrongful conduct only indirectly or ambiguously and to avoid receiving information about it. The controllers can do this by structuring the organization in a way that creates tacit pressures for such behavior. The key elements of such a strategy are decentralization coupled with selective incentives. The subordinate receives rewards or penalties based on evidence of a narrow range of performance – for example, sales volume or profits, but has wide discretion with respect to other aspects of his performance. Discretion does not have to be explicit. It can arise from the silence of the organization's rules or from their selective enforcement. Thus, the controllers can promulgate rules forbidding illegal conduct – say, bribery or pollution – but tacitly nullify the rules by failing to monitor compliance or sanction violations.

A liability regime predicated on evidence of direct knowledge and explicit encouragement will have difficulty imposing sanctions against the organization as a whole or the controllers in such a situation. In fact, the knowledge and conduct requirements for liability have not been so strict as to preclude liability in this situation. Nevertheless, managers can sometimes reduce their risk of individual liability by a strategy

of tacit encouragement and enforced ignorance (though, as we will shortly acknowledge, the potential gain has been considerably eroded in recent years⁴²).

Of course, in this scenario, the subordinates will be fully chargeable with knowledge and explicit misconduct. The implicit bargain between them and the controllers will be plausible only if the latter anticipate compensation for the greater risks they assume. However, the fact that they are likely to be poor relative to the controllers facilitates agreement. The relative poverty of the subordinates means, first, that they have less wealth to lose in the event of failure, and perhaps second, that the marginal value of prospective material gain is higher to them (that is, they will demand less compensation than the more wealthy controllers for running a given amount of risk).

The relatively low status of the Watergate burglars and of John Dean, the White House lawyer who negotiated for their silence, seems consistent with this strategy. Their low status seems to have made them attractive both because it facilitated denial of knowledge by their superiors and because it was likely to motivate them to take the necessary risks.⁴³ Of course, Watergate also illustrates the central weakness of the strategy: Since the controllers, in order to preserve their claim of ignorance and non-authorization must limit monitoring, they run an increased risk that the subordinates will perform incompetently or take excessive risks.

Some elements of corporate scandals also resonate this perspective. In his 1977 survey of the subject, Jack Coffee looked at the spate of then recent scandals involving illegal payments to foreign government officials and an earlier group involving price fixing. Among the recurring characteristics he found are those that make our strategy. The active wrongdoers were generally middle or lower-level managers. Corporate policies were either silent about the practices or they were

⁴² See text at notes below.

⁴³ See Abuse of Power, at 54 (Haldeman referring to Liddy as "some little lawyer trying to make a name for himself"); NYT cite re Dean

unenforced. Monitoring was lax, and there were sometimes informal sanctions for reporting lower-level misconduct outside the chain of command. The actors were compensated or evaluated on the basis of indicators such as sales or profits that would be moved in their favor by the practices.⁴⁴

At Enron, we find a chief financial officer – Fastow -- given extraordinary discretion and high-powered incentives contingent on a fairly narrow set of indicators, coupled with disinclination on the part of his superiors to monitor that, given the subordinate's incentives and the corporate stakes, would seem amazing from any perspective other than the one we are considering.

Andersen also seems to have had a remarkable degree of decentralization. Duncan and his engagement team in Houston were bound to Enron by strong incentive compensation. It appears that central oversight at Andersen was so weak that when an internal audit partner from Chicago headquarters warned of problems with the Enron accounting, the Houston team was able to have him removed.⁴⁵ And Andersen had no procedures for central monitoring its auditors' compliance with its document retention policies. It left such matters up to the engagement partner.⁴⁶

Moreover, the effort by Enron's senior executives and Vinson & Elkins to shift ostensible responsibility for the critical accounting judgments to Andersen seems consistent with the pattern. As we have seen, the key judgments involved legal matters that the lawyers should have been competent to assess. As among the executives and professionals involved, the accountants were the least compensated, least prestigious, and

⁴⁴ John C. Coffee, Jr., "Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response," 63 Michigan Law Review 1099, 1104-09, 1125-32 (1977).

⁴⁵ Robert Manor & Jon Yates, "Faceless Andersen Partner in Spotlight's Glare: David Duncan Vital to Federal Probe After Plea," Chicago Tribune (April 14, 2002), at C1.

⁴⁶ Hearing, cited in note , at 134, 138 (testimony of Nancy Temple).

least credentialed.⁴⁷ On any functional view, assigning them responsibility to make the most difficult reporting judgments unilaterally would make little sense. But their relative poverty made them best qualified to run the risks of public sanction for misconduct.

C. Culture and Strategy: Professional Duty to Organizations

Problems of ambiguity and ignorance take on a different cast in the context of the dealings between professionals and their clients. Both as a matter of tort liability and as a matter of professional discipline, lawyers owe their clients duties of care and loyalty. These duties impose affirmative burdens both to communicate clearly to the client and to acquire information. Unlike the situation with arm's length dealings, the lawyer cannot satisfy these duties by remaining silent. She generally cannot blame the client for the client's predictable misunderstanding of the lawyer's literally accurate but knowingly misleading statement. And she must undertake reasonable research to develop information needed to make her advice effective.

Clearly these doctrines are intended to obviate the problems of ambiguity and ignorance. Nevertheless, when the client is an organization, ambiguity recurs from a different angle. The problem now arises from the difficulty of identifying the client. An organization is an abstraction; lawyers can deal with organizations only through their individual constituents. They need norms to tell them how to identify from among the various actors who purport to speak for the corporation those on whom they should bestow the care and loyalty due a client.

⁴⁷ cites

This is not the place for a full account of these issues,⁴⁸ but we can readily note the most salient ambiguity in the bar's response. On the one hand, lawyers tend to identify the organizational client with the managers with whom they deal personally. This tendency resonates strongly with both the cultural and strategic considerations we considered above. Lawyers take the same psychological satisfactions in personal loyalty and deference as business executives. And lawyers have a clear strategic interest in pleasing the executives with whom they deal, since these executives will most likely make decisions about the lawyers' future retention. As a matter of substantive law, this tendency seems justifiable in the most common situations where managers purport to speak for the organization and there is no reason to doubt their authority.

But identifying the organization with its managers is not appropriate where managers are violating the corporation's own norms or knowingly harming the interests of its constituents. In such situations the tendency of recent doctrine is to point to the board. The board has broad strategic and oversight responsibility for the enterprise. Thus, when managers are acting *ultra vires*, the lawyer can serve the organizational client by going to the board.

However, as a practical matter, this course is often costly to the lawyer, especially where she has no strong prior relation with the board. The lawyer who goes over the head of the misbehaving manager is likely to ruin his relation with her and risk her future employment prospects with the firm. The latter risk seems particularly severe if we recall the lesson of organizational scholarship that the board may not be grateful for the lawyer's intervention. Informing the board may trigger responsibilities that the board might prefer not to have.

In addition, we need to consider the situation where the board knows of the wrongdoing and, whether because of

⁴⁸ For a fuller treatment, see William H. Simon, "Whom (or What) Does the Organization's Lawyer Represent?," 91 *California Law Review* 57 (2003).

incompetence or complicity, acquiesces in or encourages it. At this point, it becomes implausible, as a matter of principle, to identify the client with its board. On the other hand, as a practical matter, the alternatives – going to constituents (shareholders) or an agency charged with protecting them, such as the SEC, seem awkward and radical. In a private corporation, shareholders might be contacted discretely, but in a public corporation, communicating with shareholders would involve public disclosure.

Surely there are situations where such public disclosure is the best way for the lawyer to protect the interests of the organizational client, but lawyers are deeply uncomfortable with such a course. As a cultural matter, lawyers are so viscerally habituated to thinking of clients in terms of personal relations and to thinking of confidentiality as the core ethical obligation that it is hard for them to appreciate the logic of the notion that loyalty to the client might require going public. As a strategic matter, going public will antagonize anyone in the organization with any power to allocate legal business and will send a signal to managers of other enterprises who might employ the lawyer that they cannot count on the lawyer's loyalty to them individually.

So the issues of organizational loyalty are difficult as matters of principle, culture, and strategy. On the one hand, it is untenable to assert that the organizational lawyer should always serve management. On the other hand, duties to go beyond management require difficult judgments and involve personal costs for the lawyer. In this situation, the bar's response has been to acknowledge the principle that the organization to which lawyers owe loyalty is something different from its managers, but to keep ambiguous the scope of duty to constituents other than managers.

We see this preference for ambiguity in the bar's principal response to these issues – Model Rule of Professional

Responsibility 1.13, first promulgated in 1983.⁴⁹ Prior to this rule, although lawyers had always represented organizations and public corporate work had been a major component of the law practice for more than a century, there was virtually no doctrine at all on the distinctive duties of counsel to an organization. In terms of clarifying lawyer duty, the Rule was not much of an improvement. It started by asserting plausibly that the lawyer represents the organization "acting through its duly authorized agents", but then it meandered into evasiveness when it came to the critical situations in which agents are acting ultra vires. In cases of wrongdoing, it prescribed, superfluously, that the lawyer act "in the best interests of the organization", indicating that this "may" involve going to the "highest authority that can act on behalf of the organization." It provided no guidance as to when the lawyer should climb the ladder. The "highest authority" was undefined, so it was unclear whether it might ever include shareholders. The rule could be interpreted to forbid reporting wrongdoing outside the organization, but it was ambiguous on this point as well.

For twenty years, there was virtually no official effort to clarify these ambiguities. The ABA amended the rule in August 2003 only after Congress and the SEC had intervened with the attorney conduct provisions of the Sarbanes-Oxley Act and implementing regulations.⁵⁰ And its revisions were the minimum (or perhaps less than the minimum⁵¹) needed to avoid

⁴⁹ ABA Model Rule of Professional Conduct 1.13 in Stephen Gillers and Roy Simon, Regulation of Lawyers: Statutes and Standards 2001 163-64.

⁵⁰ ABA Model Rule of Professional Conduct 1.13, as amended, August, 2003, available at www.abanet.org/cpr/mrpc/new_rule_1.13.pdf. 15 U.S.C. 7202, 7245, 7262 (attorney conduct provisions of the Sarbanes-Oxley Act of 1992); 17 C.F.R. 205.3

⁵¹ The Sarbanes-Oxley "up-the-ladder" provision seems broader and stricter than the amended rule. The new rule mandates reporting only when the lawyer "knows" both that illegal conduct has or will occur and that it is likely to inflict harm on the organization. Sarbanes-Oxley mandates reporting whenever the lawyer "becomes aware of evidence" of a material

pre-emption by the Sarbanes-Oxley rules. Like Sarbanes-Oxley, the new rule makes going up-the-ladder to the “highest authority” mandatory in certain circumstances, and it permits outside disclosure of wrongdoing to prevent future harm to the corporation. But all the ambiguities that had not been independently clarified by Sarbanes-Oxley were retained. The “highest authority” remains undefined. The lawyer’s responsibilities with respect to past wrongdoing is unspecified. There is still no indication as to how the lawyer is to exercise her discretion to disclose to avoid future harm.

III. The Changing Influence of Corporate Structure: Self-Conscious Bureaucracy

In his 1977 article on corporate wrongdoing, Jack Coffee took account of the observations of organization theory about the limited information and control of senior managers over corporate agents and the consequent strategic and cultural effects inhibiting compliance with public norms. He argued, further, that the problems of limited information and control inherent in any large bureaucratic structure were intensified by the multidivisional form that the large corporation assumed during the first half of the twentieth century.

In this structure, the corporation's activities were divided into product groups, each housed in a separate division with operating autonomy. Division managers controlled operations. Central managers, including the board, were responsible for strategy. They monitored the performance of the divisions and sanctioned or rewarded them, in particular, by allocating capital toward or away from them. This structure further distanced senior managers from front-line operations. By causing them to specialize in financial monitoring across a broad range of

securities law violation or breach of fiduciary duty. 28 C.F.R. 205.3(b). Moreover, the duty to report under the new 1.13 does not apply if the lawyer “reasonably believes that it is not necessary in the best interests of the organization.” Sarbanes-Oxley contains no such qualification.

products, it reduced the importance of expertise in and knowledge of operations. At the same time, it intensified the conflict of interest between lower and upper management by drawing a clear line between central and divisional management.⁵²

Coffee's response to the problems of managerial ambiguity and ignorance was to modify this structure to introduce bridges between central and divisional management. Thus, he proposed "mini-boards" – divisional committees composed of central board members and operating managers that reported to the board and transmitted its policies.

In the years since Coffee's analysis, however, both the self-image and the structure of American business organizations have changed. Developments have altered the features he saw as reinforcing pressures toward ambiguity and ignorance and created countervailing pressures toward inquiry and articulation. The change seems to have been prompted by intensified product competition and by advances in communications and information technology. Product competition has required firms' operations to become more flexible and dynamic. Technology has facilitated new forms of decentralization. Both as norm and description, Ambivalent Bureaucracy has been challenged by a new model, which might be called Self-Conscious Bureaucracy.⁵³

To begin with, the multidivisional firm is no longer in fashion. Neither is the preeminence of finance over operations. Firms are encouraged to focus on "core competences," and senior managers are expected to act less like bankers, and more like entrepreneurs. There is a tendency for hierarchy to be compressed and for lines of authority to cross horizontally. Product development and production occur through shifting

⁵² Id. at 1132-36.

⁵³ See, e.g., Peter Senge, The Fifth Discipline: The Art and Science of the Learning Organization (1994); Richard B. Chase, F. Robert Jacobs, Nicholas J. Aquilano, Operations Management for Competitive Advantage (10th ed. 2004).

collaborations across specialties both within the firm, and as firms outsource more and collaborate more intensely with their suppliers and customers, across firms. In such circumstances, coordination is achieved less by command-and-control authority structures and more by "shared vision." Firms that have gone furthest along these lines see themselves as "learning organizations" engaged in continuous innovation.

Senior managers in such organizations are expected to take a "systems approach." This means they are alert to the myriad shifting influences on and elements of the firm's activities. New information technologies make collection, retrieval, and analysis of a far broader range of data than previously. Data recorded by lower-tier workers can be accessed and analyzed instantly by people physically and organizationally remote from these workers.

In this new context, personal relations of deference and loyalties independent of the firm's articulated goals are more difficult to maintain. Relationships now shift so rapidly that they do not have time to gel even provisionally. In any given collaboration, it is likely to be more difficult to determine who is senior to whom. Moreover, key monitoring and even evaluation functions are more likely to be performed by people who have no strong personal contact with the person monitored or evaluated. And monitoring is likely to be at once more pervasive and more intensive.

Some of the strongest pressures of this organization approach are toward articulation and inquiry.

Articulation. Clear and explicit policy becomes important in these circumstances for many reasons. "Say what you do, and do what you say," is a basic maxim.⁵⁴ Pervasive

⁵⁴ The ISO 14000 Handbook 196 (Joseph Cascio ed. 1996). ISO 14000 designates a series of environmental management standards promulgated by the International Organization for Standards, and ISO 9000, cited in the next note, refers to the organization's product quality management standards. The standards are commonly used as internal guidelines, and hundreds of companies require their suppliers to certify their compliance with them.

documentation of policy and practice is prescribed in order to obviate the ambiguity and inconsistency of oral communication. Part of the idea is to eliminate dependence on informal relations. "The objective is to make the operational process substantially independent of individuals, so that any appropriately experienced and trained individual could make the system work."⁵⁵

In the Self-Conscious Bureaucracy, policy, rather than being promulgated from above or evolving informally, is negotiated explicitly at many levels. In the absence of stable linear authority, people find more need of explicit policy for guidance. Communication across positions, disciplines, and firms puts a premium on explication. People have to be prepared to work with others they have never met before and who do not share a common educational background or professional orientation. They cannot appeal to the body of tacit understanding and commitments that members of the same profession might share.⁵⁶ They thus have to be explicit to be understood.

In addition, forcing people to state their premises explicitly is a basic heuristic strategy of the "learning organization." It forces people to examine and to expose to criticism by others assumptions they might otherwise have taken for granted. Moreover, explicit description of practices facilitates learning across positions and firms. People look for "best practices" developed by leading performers in the field, but these practices can only be adopted by outsiders if they have been intelligibly described.

Evasion of issues or risk and uncertainty is viewed as pathological. "Risk management" is a key function in the Self-Conscious Bureaucracy. Managers are expected to identify

⁵⁵ The ISO 9000 Handbook 304 (3d ed., Robert Peach ed., 1997).

⁵⁶ See, e.g., id. at 200: "A typical auditor's question, 'What would happen if X, Y, or Z left your company tomorrow?' indicates the importance of maintaining written procedures and directions for work."

risks, formulate strategies for limiting them, and update the strategies in the light of experience.⁵⁷

Inquiry. In the Ambivalent Bureaucracy, the key formal function of management is to issue policy. Monitoring sometimes comes as an afterthought. The formal model of the organization encourages a naïve tendency to see policy as self-implementing and hence monitoring as superfluous. To the extent that the practical reality of the corporation takes the form of informal hierarchies of personal deference and loyalty, monitoring is difficult because informal practices are opaque to the monitors. In the new style, the commitment to "say what you do and do what you say" mitigates these problems.

Moreover, in the new organization, monitoring is critical, not merely as means to insure compliance with settled policy, but as part of the process of continuous re-assessment and revision. The new organizational style collapses the distinction between policy-making and monitoring. Implementation of policy generates experience and information that can be used to improve it. Senior managers have to stay in touch with rank-and-file actors (and involve them in the process of revision) in order to capture the benefits of these lessons.

Policy tends to take a different form in the new style. Formal policy in the Ambivalent Bureaucracy is characteristically binary; it specifies thresholds that must be met unconditionally, and when met, constitute unconditional compliance. Rules of this kind continue to play a role in the new style, but they co-exist with different kinds of norms implied by the ideal of continuous improvement: moving targets and scaled measurements. The policies specify targets and require actors to demonstrate progress toward them. The targets are revised as progress is made. Satisfactory progress is often measured by comparison to the performance of comparable plants or firms. This latter type of norm requires senior

⁵⁷ See, e.g., Thomas Barton, William Shenkir, and Paul Walker, Making Enterprise Risk Management Pay Off (2002).

managers to take a greater interest in monitoring. Performance under such norms cannot be meaningfully summarized by a conclusory judgment of compliance. It is critical to know where on the scale the actors are performing.

Finally, monitoring tends to be very broad in the new style of organization. The strategy of deliberate selective ignorance, in which senior managers watch matters such as sales and revenues that are important to them but overlook performance with respect to matters of public interest, is not a real option for these organizations. This is partly a function of changes in legal rules we shall shortly consider. For corporations sensitive to adverse publicity, it is a function of public relations. But more fundamentally, it arises from the fact that management cannot reliably determine which aspects of the corporation's performance are irrelevant even to its narrow selfish goals.⁵⁸

In a dynamic business environment, the critical indicators of effective performance are not stable. In choosing strategic ignorance, management takes risks that the information it dispenses with will turn out to be important to its goals. If, for example, management cannot tell whether high sales figures reflect bribery of purchasing agents or customer satisfaction with its product, it cuts itself off from important product development information. If it cannot tell whether the lower costs of a particular plan represent more efficient processes or more lax compliance with environmental norms, it impairs its ability to make key investment decisions. In a more stable business environment, the strategic benefits of such

⁵⁸ The pressures to monitor in the new model are countered by liability concerns. A harsh and erratic liability system will make even law-abiding firms hesitate to make their operations transparent. These counter-pressures can be reduced by reforms that mitigate liability when the defendant makes monitoring and disclosure efforts. See Jennifer Arlen and Reinier Kraakman, "Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes," 72 *New York University Law Review* 687 (1997).

ignorance might have been worth the price, but the premise of the new industrial organization is that organizations can no longer afford it.

The Self-Conscious Bureaucracy model remains so far simply a tendency in some quarters of business, and it may not be plausible for some fields of enterprise. Although Enron portrayed itself as an embodiment of the most progressive and innovative tendencies in business organization, it more strongly resembled older models in its visceral and strategic tolerance of ignorance and ambiguity.⁵⁹

IV. The Trend Toward Legal Duties of Inquiry and Articulation

The trend in business practices toward transparency has been paralleled and reinforced by contemporaneous legal developments that have prescribed duties of inquiry and articulation.

A. Duties of Inquiry.

In 1963, the Delaware Supreme Court held in Graham v. Allis Chalmers that directors had no duty to initiate monitoring or compliance procedures in the absence of specific evidence of managerial wrongdoing.⁶⁰ The case arose out of price fixing in

⁵⁹ In a pioneering article Robert Eli Rosen portrays Enron as an example of the “redesigned corporation,” his name for some of the same tendencies I summarize under the rubric of Self-Conscious Bureaucracy. “Risk Management and Corporate Governance: The Case of Enron,” 35 Conn. L. Rev. 157 (2003). Although I learned a lot from it, I think he is wrong to associate Enron with the new model. He treats decentralization as a novel feature of the new model, when in fact, the literature cited in notes 35 and 36 above shows that it was a central, albeit tacit, feature of the old one. Second, he underestimates the importance in the new model of the features of transparency that Enron so strikingly lacked.

⁶⁰ As the Court tendentiously put it, “[A]bsent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists.” Graham v. Allis-Chalmers Corporation, 188 A2d 125, 130 (1963).

violation of the antitrust laws. The corporation had been held liable in public and private enforcement actions, and shareholders brought a derivative suit against directors seeking reimbursement for the corporation's loss. The misconduct in question involved the violation of laws intended to protect the corporation's customers, rather than its shareholders. It seems likely that the court would have been more sympathetic to a claim based on shareholder protection norms, such as constraints on managerial self-dealing. Nevertheless, the court's language was harsh and categorical, and the case stood for decades for a basically reactive conception of director duty that did not require affirmative efforts to elicit information.

In 1996, Delaware Chancellor William Allen suggested in a widely noted opinion that, although never explicitly repudiated, the Allis-Chalmers case was no longer good law. He argued that the directors' duties embraced some responsibility to determine "that the corporation's information and reporting systems are in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner."⁶¹ Allen's dictum reflects a steady trend toward the recognition of duties of inquiry. Examples include these:

-- A longstanding doctrine of Anglo-American jurisprudence holds that for some purposes "willful blindness" or "conscious avoidance" can be treated as knowledge of the facts ignored.⁶² In recent decades, the federal courts have invigorated this principle in criminal fraud prosecutions under a variety of statutes.⁶³ Where the defendants are lawyers or

⁶¹ In Re Caremark International, Inc., Derivative Litigation, 698 A.2d 959, (Del.Ch.1996).

⁶² See David Luban, "Contrived Ignorance," 87 Georgetown Law Journal 957 (1999), which is useful both for its survey of doctrine and its acute discussion of the moral blameworthiness of deliberate ignorance.

⁶³ U.S. v. Jewell, 532 F.2d 697, 704 (9th Cir. 1976); U.S. v. Nicholson, 677 F.2d 706, 710 (9th Cir. 1982); U.S. v. Cronin, 39 F.3d 1299, 1310 (5th Cir. 1994). The cases say that "(1) subjective awareness of a high probability of illegal conduct [by an associate or agent] and (2) purposeful

accountants, the cases suggest that their failure to use modes of inquiry that are customary within the profession can be taken as deliberate, and hence culpable ignorance. Thus, United States v. Benjamin sustained the conviction of an accountant for securities fraud despite his uncontradicted claim that he had merely incorporated information provided by the client in the statements he prepared and had no specific reason to know they were false. The court held that the accountant's failure to adhere to verification practices recognized within the profession sufficed to establish scienter.⁶⁴

-- Perhaps most influential has been the Federal Sentencing Guidelines for corporate defendants enacted in 1991. These guidelines provide a presumptive penalty for corporate criminal liability of a fine of several times the amount

contrivance to avoid learning of the illegal conduct" establishes scienter. Nicholson, 677 F.2d at 710. This does not seem quite right. Subjective awareness alone amounts to knowledge if the probability is high enough. What these cases imply is that proof of a lower probability is sufficient where the defendant ignored customary or readily available means of inquiry.

A related line of authority in the securities field holds that "recklessness" can establish scienter for civil liability purposes. See Hazen, cited in note , at 592-94.

Some statutes and cases impose liability on corporations and even their managers without regard to knowledge. They are designed to induce monitoring, but unlike the "deliberate ignorance" doctrine, they penalize ignorance without regard to its blameworthiness. Such practices seem dubious in the criminal sphere, where blameworthy conduct and a culpable mental state traditionally have been pre-requisites for liability. Some would suggest that even many of the "deliberate ignorance" scenarios are inappropriate for criminal treatment. For a seminal discussion of these matters, see John C. Coffee, Jr., "Does Unlawful Mean Criminal?: Reflections on the Disappearing Tort/Crime Distinction," 71 Boston University Law Review 193 (1991). It is no part of my argument to defend strict liability for blameless ignorance, nor to defend any preference for criminal over civil sanctioning of deliberate ignorance. My point is merely that deliberate ignorance is increasingly and appropriately regarded as both blameworthy and a basis for some form of liability.

⁶⁴ 328 F. 2d 854 (1964).

of harm done by the violation. They then prescribe mitigating factors that can reduce substantially the presumptive penalty, including "an effective program to prevent and detect violations of law."⁶⁵

-- Delaware Supreme Court cases on director duty of care since the 1980s have re-strengthened the duty of care in substantial part by emphasizing the board's duty to demand and consider information in connection with major strategic decisions. Cases like Smith v. Van Gorkom suggest that the board deference traditionally mandated by the "business judgment" rule is conditioned on the board's adequately informing itself in connection with the decision at issue. People sometimes now speak of the board's "duty to become informed" as a distinct element of the fiduciary duty of care.⁶⁶

-- Several states have created "environmental audit" privileges that immunize firms from liability for violations that the firms discover, promptly report, and correct. The Environmental Protection Agency has an announced presumption against prosecution in such circumstances.⁶⁷

-- In widely noted decisions applying the employment discrimination provisions of the Civil Rights Act to sexual harassment, the Supreme Court indicated that employer liability for harassing conduct by its agents would depend in substantial part on the extent to which the employer had "exercised reasonable care to avoid harassment and eliminate it where it might occur." The court mentioned reporting and monitoring procedures as elements of such care.⁶⁸

⁶⁵ U.S. Sentencing Guidelines Manual, sec. 8C2.5(f).

⁶⁶ Smith v. Van Gorkom, 488 A.2d 858 (Del.1985); Jeffrey Bauman, Elliott J. Weiss, and Alan R. Palmiter, Corporations: Law and Policy 652 (5th ed. 2003).

⁶⁷ See Arlen and Kraakman, cited in note 58, at 742-52 and sources cited therein at notes 7-8.

⁶⁸ Faragher v. City of Boca Raton, 524 U.S. 775, 805 (1998); Burlington Industries v. Ellerth, 524 U.S. 742, 764 (1998).

-- Several statutes and regulations have required firms in various industries to perform "risk analysis", requiring inquiry and explicit planning with respect to various kinds of hazards.⁶⁹

B. Duties of Clarity.

Two types of doctrinal evolution have implicitly intensified the responsibility of people for the foreseeable harm of ambiguity in statements or conduct with which they are associated.

First, there is the law of fraud. There appears to have been a gradual tendency in misrepresentation doctrine to shift responsibility for ambiguity from the addressee, who bore it traditionally under notions such as "caveat emptor", to the speaker. The new position is set out in the Restatement (Second) of Torts which classifies as actionable misrepresentation, not only false statements, but ambiguous statements that are foreseeably misleading. Under section 527, a statement susceptible to both a true interpretation and a false interpretation is fraudulent if the speaker expects the addressee to understand it in the false sense. Indeed, it is sufficient for liability that the speaker shows "reckless indifference" as to how the addressee will understand it. Thus, a used car dealer who describes a car as a "Rolls", knowing that is a low-value Rolls Royce but expecting the customer to understand that it is a high value Rolls Royce, is liable. The Restatement also explicitly creates liability for misleadingly incomplete statements (statements that are misleading because of the "omission to state additional or qualifying matter").⁷⁰

The second development that bears on ambiguity is the growth of secondary liability doctrine – aiding-and-abetting and conspiracy. These doctrines are specifically addressed to

⁶⁹ Bao Q. Tran and Jonathan P. Tomes, "Risk Analysis: Your Key to Compliance," ACC Docket (November-December 2003), at 38-54 (identifying about 25 laws requiring some form of "risk analysis").

⁷⁰ Restatement (2d) of Torts, sec.s 527, 529. The securities law fraud standard is at least as broad. Louis Loss and Joel Seligman, VII Securities Regulation 3419-27 (3d ed. 2003).

conduct that, viewed in isolation, is innocent or ambiguous, but seems wrongful when viewed in conjunction with other activities. In a common scenario, a professional provides services – for example, brokering or the preparation of financial statements – for a transaction in which she knows that one party is making fraudulent representations to the other. If her own conduct does not involve explicit misrepresentation but knowingly assists the fraud of another, she is likely to be secondarily liable. There has been a marked growth in this type of secondary liability in recent decades.⁷¹

C. Sarbanes-Oxley.

The most pervasive themes of the corporate control provisions of the Sarbanes-Oxley Act of 2002 -- Congress's response to Enron and related scandals -- concern ignorance and ambiguity.

The 1933 and 1934 securities acts were primarily concerned to mandate disclosure by managers to investors. Key Sarbanes-Oxley provisions are concerned with inducing disclosures within management. The older provisions appear to have assumed that obligations of external reporting would induce the firms to arrange adequate internal information flows. Sarbanes-Oxley represents a recognition that strategies of deliberate ignorance may impede effective information management.

The key provisions mandate "internal controls." The CEO and CFO are required to sign annual and warrant that they are not misleading "based on the officer's knowledge." The statute then proceeds to give these officers the responsibility for designing "internal controls to ensure that material information relating to the issuer ... is made known to such officers by others within these entities."⁷² As the Fried Frank firm puts it in

⁷¹ E.g., Granewich v. Harding, 985 P.2d 788 (Or. 1999); U.S. v. Cueto, 151 F.3d 620 (7th Cir. 1998); Loser v. Superior Court, 177 P.2d 320 (Cal. App. 1947); U.S. v. Teitler, 802 F.2d 606 (2d Cir. 1986).

⁷² Sec. 302(a)(4)(B); 15 U.S.C. 7241. As Lawrence Cunningham points out, most of these provisions are, in a strict legal sense, redundant of pre-

a client memo, this "makes it more difficult for [officers] to disclaim knowledge of their company's disclosure."⁷³

This basic provision is supplemented by four other ones designed to induce corporate agents to provide information to senior managers. First, the general whistle-blowing provision requires the audit committee to establish procedures for receiving and responding to complaints, including confidential and anonymous ones from employees, regarding auditing and accounting matters.⁷⁴

Second, there is the "up-the-ladder" reporting provision for lawyers. Under this provision, a lawyer for an issuer who encounters evidence of a securities law or fiduciary duty violation by an agent of the client must report it to the chief executive officer or chief legal officer, and if the officer in question fails to "respond appropriately," to a board committee with only independent directors.⁷⁵

Third, the statute obliges auditors to report to the audit committee "all critical accounting policies and practices to be used," the possible alternatives, and the ramifications of the different approaches.⁷⁶

Fourth, the auditors must involve the Audit Committee in decisions about "critical accounting policies." They have to inform the Committee where decisions among alternative treatments involve large stakes and of communications from managers on these issues.⁷⁷

existing law. Their primary effect is rhetorical and hortatory, although as Cunningham also points out, that doesn't mean they won't have substantial effect. Lawrence A. Cunningham, "The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Might Just Work)," 35 Connecticut Law Review 915 (2003).

⁷³ Dixie Johnson and Karl Groskaufmanis, "FFHSJ Client Memorandum: The Post-Enron Corporate Governance Environment," 1366 PLI/Corp 907, 923 (Westlaw 2003).

⁷⁴ Sec. 301(m)(5); 15 U.S.C. 78j(5), retaliation cite

⁷⁵ Sec. 307, 15 U.S.C. 7245.

⁷⁶ Sec. 108(k); 15 U.S.C. 77s(k).

⁷⁷ Sec. 204; 15 U.S.C. 78j-l.

The statute thus gives protections to the whistle-blowers, and it creates a duty for the lawyers and accountants. Its main thrust, however, is to require the board to encourage the communication of and to receive information it might otherwise not want to be exposed to. Firms have always been free to establish whistle-blower policies and to demand reporting from their lawyers and accountants. They have not consistently done so. Now they must.

Sarbanes-Oxley also makes a distinctive response to the problem of calculated ambiguity. It requires the firm and its auditors to consider and identify the limitations of their own disclosures. Annual reports must now include an "internal control report" that assesses the "effectiveness of the internal control structure and procedures of the issuer for financial reporting".⁷⁸ They are specifically to identify "all significant deficiencies in the design or operation of internal controls which could adversely affect" financial reporting.⁷⁹

These demands to explicitly identify ambiguities and weakness may represent a new stage in the evolution of disclosure law, one that resonates with the evolution of the modern business structure toward hyper-articulateness. To some extent, they seem redundant. As the Restatement makes clear, the basic fraud standard already required that ambiguities and weaknesses be identified where there would otherwise be a strong risk of misunderstanding. But the new standards seem more exigent in two ways. First, they appear to lower the threshold at which explication is required. Ambiguities that might not have amounted to a substantial risk of misunderstanding in the past may have to be explicated. Second and most important, they seem designed to foster the kind of continuous revision in disclosure practice that the new industrial organization encourages in other matters. By forcing greater articulation of premises, the new provisions facilitate

⁷⁸ Sec. 404(a), 15 U.S.C. 7262.

⁷⁹ Sec. 302(a)(5); 15 U.S.C. 7241(a)(5).

comparison of practices across firms by both investors and the firms themselves. By observing their peers, the firms can get more insight into different disclosure possibilities and their effects.

V. Sarbanes-Oxley Section 307 and the Bar's Resistance to Accountability

There are two competing intuitions as to how the trend toward transparency in business organization might affect lawyers. On the one hand, one might expect lawyers to adopt their clients' perspectives. Clearly, they must take account of their clients' views to provide them satisfactory service, and the natural tendency to identify with clients might encourage the absorption of the clients' ideas and attitudes. Thus, one might expect those segments of the bar that work for clients in the industries in which the new trends are most developed to adapt their own firms to these trends.

On the other hand, lawyers have some autonomy from their clients by virtue of their independent organizational base and their expert knowledge of technical matters. One might expect them to use this independence to resist the trend toward transparency. Transparency measures are designed to enforce kinds of accountability that can be threatening. Moreover, the bar has a traditional ideological commitment, and perhaps an economic stake, in confidentiality norms that are in tension with some transparency measures.

The intuition that ideology and/or self-interest might incline the bar to resist the trend toward transparency receives support from the bar's reaction to section 307 of Sarbanes-Oxley, which concerns the regulation of lawyers. This section authorizes and instructs the SEC to promulgate regulations "setting forth minimum standards of professional conduct for attorneys" in federal securities practice. These standards must include "up-the-ladder" reporting for corporate counsel. Where attorneys encounter "evidence of a material violation of the

securities law or breach of fiduciary duty," they must report it to the CEO or chief legal officer. If the officer does not "appropriately respond", the attorney must go to the audit committee or another committee of independent directors.⁸⁰

In November, 2002, the SEC proposed rules implementing the "up-the-ladder" requirement and adding a requirement of "noisy withdrawal". The latter would prescribe that, in situations where the board failed to respond appropriately to an "up-the-ladder" report, the attorney must withdraw and give notice to the SEC that she had withdrawn "for professional reasons."⁸¹ The SEC subsequently withdrew the proposal that the attorney give notice to the SEC and proposed instead that the company give the notice. (The revised proposal parallels the duties of a company when an auditor resigns.)⁸²

Section 307 has the information-forcing and articulation-forcing characteristics that we have noted as central themes of Sarbanes-Oxley corporate governance regulation. From the board's perspective, the main effect of "up-the-ladder" reporting is to force information on the directors that they always had a right to demand but might have preferred not to receive. From the lawyer's perspective, the main effect is reduce the ambiguity about the relevant duties that prior doctrine failed to resolve, and in fact, actively cultivated.

The bar's truculent response to the SEC's implementing efforts reflects its longstanding resistance to outside regulation generally. It also shows a visceral clinging to the prerogatives of ignorance and ambiguity. The corporate sector of the profession seems unable to reconcile its own image and activities with the principles that now undeniably govern its clients.

⁸⁰ 15 U.S.C. 7245

⁸¹ Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys, Release Nos. 33-8186, 34-47282; available at sec.gov/rules/proposed/33-8186.htm

⁸² 17 C.F.R. § 229.304.

The issue of deliberate ignorance was implicitly at stake in the debate over the cognitive threshold that would trigger duties to report "up-the-ladder". The statute refers to "evidence" of a violation, which suggests something considerably short of certainty that a violation is occurring. The SEC's initial proposal triggered reporting duties when a lawyer "reasonably believe[d]" that a violation had occurred, was occurring, or will occur; the final rule defines the trigger as circumstances in which "it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that" a violation has occurred, is occurring or will occur. Both phrases are awkward, and the latter is an affront to English style, but the general thrust of both seems recognizable. Each suggests an "objective" standard under which mere lack of knowledge would not exonerate unless the lawyer had behaved reasonably, and in particular, had made the inquiries that a reasonable lawyer would undertake.⁸³

Many segments of the bar, however, protested strenuously against any "objective standard." In particular, they urged the SEC to adopt the standard of the Model Rules provisions regarding misrepresentation. The Model Rules forbid "knowing" misrepresentation and the define "know" to mean "actual knowledge" – a subjective standard that seems to deny any duty to inquire.⁸⁴ Lawyers pressed the SEC to incorporate this standard arguing, first, that it would promote desirable uniformity with state standards, and second, that it would spare

⁸³ While her frustration at the contorted language is understandable, I think Susan Koniak is wrong to predict that the standard will be interpreted as closer to a subjective one. Susan P. Koniak, "When the Hurlyburly's Done: The Bar's Struggle With the SEC," 103 *Columbia Law Review* 1236, 1274-76 (2003).

⁸⁴ Model Rules of Professional Conduct 3.3, 4.1 (forbidding knowing misrepresentation); "Terminology" (definition of "knows"). Koniak argues that the "actual knowledge" standard reflects that, "In the bar's normative universe, lawyers never know." Cited in note 82, at 1247.

lawyers the difficulties of having to determine the meaning in particular situations of an objective standard.⁸⁵

These were arguments of desperation. An objective cognitive standard resembling both the proposed and final one already governed some professional duties under the Model Rules, and it defined the lawyer's duty of care to clients under the common law duty of care.⁸⁶ Organizational clients are subject to standards of reasonable knowledge (and hence inquiry) under the negligence norms of myriad regulatory regimes. Lawyers advise clients on the application of such standards routinely. If taken seriously, the lawyers' professed inability to apply such standards to their own conduct would be a confession of astonishing incompetence. In fact, however, it was a plea to retain the privileges of deliberate ignorance as a defense against accountability.

Calculated ambiguity was a tacit theme in the bar's push to limit the intrusion of the SEC rules on state disciplinary rules. The bar had long opposed SEC regulation of lawyers on the ground that it would displace the traditional regulatory authority of the states.⁸⁷ Once 307 was enacted, it had to live with federally-mandated "up-the-ladder" reporting, since the statute was specific on that point. But it vehemently opposed "noisy

⁸⁵ See, e.g., Comments of Alfred P. Carlton, Jr., President, American Bar Association, (December 18, 2003), at www.sec.gov/rules/proposed/s74502/apcalrtonhtm.

⁸⁶ ABA Model Rules of Professional Conduct, "Terminology", (defining reasonably should know" to include what a lawyer "of reasonable competence and prudence would ascertain"); 2.3(a) (duty to explain to corporate constituent that lawyer represents entity when lawyer "reasonably should know" constituent's interests are adverse to entity); 2.4 (duty to get clients consent for distribution of opinion when lawyer "reasonably should know" addressee intends further distribution); 3.6 (duties with respect to trial statements that lawyer "reasonably should know" will be publicly disseminated); 4.4b (duty to return privileged document that lawyer "reasonably should know" was inadvertently sent by opposing counsel). For recognition that the "should know" standard is implicit in the common law duty of care, see, e.g.,

⁸⁷ See Koniak, cited in note 82, at 1248-60,

withdrawal" arguing that Congress could not have intended such an extension abrogation of deference to state lawyer regulation.⁸⁸ The extent to which the tradition of state lawyer regulation is entitled to respect in any circumstances is open to debate. Arguably, the state processes have dominated by lawyers acting from narrowly selfish motives. Even if we assume they have some general legitimacy, it would be extremely implausible for the SEC to defer to them in a matter it deemed integral to the securities laws. The securities laws are plainly intended to create a national system with a federally-defined floor of practice standards uniform across states.

But for our purposes, the key point is to recognize the connection between the appeal to state regulation and the preference for ambiguity. One source of ambiguity is the choice-of-law issue involved in state regulation of multistate transactions. The ABA codes had no choice-of-law rule until 1993.⁸⁹ The new rule, which looks for most non-litigation situations to the rules of the state that has licensed the lawyer, is controversial and has not been universally adopted.⁹⁰ Even where it is adopted and settles the issue for individual lawyers, it leaves potential problems of predictability and coordination where lawyers from more than one state collaborate, as commonly occurs in securities matters.⁹¹

Much more fundamental, however, is the fact that ambiguity was the dominant characteristic of the ABA's rule on

⁸⁸ See e.g., Carleton, cited in note ; Comments of the Association of the Bar of the City of New York (April 7, 2003), at www.sec.gov/rules/proposed/s74502/abcny040703.htm; Comments of Professor Joseph Grundfest and various Silicon Valley lawyers (December 23, 2002), at www.sec.gov/rules/proposed/s74502/jagrundfest.htm.

⁸⁹ Model Rule 8.5c. See the ABA Committee Report excerpted in Stephen Gillers and Roy Simon, Regulation of Lawyers: Statutes and Standards 448-49 (2002).

⁹⁰ See id. at 450-52.

⁹¹ For example, while "up-the-ladder" reporting has been permissive under Model Rule 1.13 as adopted in most states, it has been mandatory in four. Id. at

corporate representation and the variations adopted by most states until the threat of Sarbanes-Oxley pre-emption forced some clarification in 2003. Before then, the rule gave no guidance as to when the lawyer should go to the board, and was unclear as to whether she was even allowed to go beyond it. And while the rule has clearly never required “noisy withdrawal,” it remains unclear whether it permits it. To prefer the state regime is to treat ambiguity as a virtue.

The bar failed in its efforts on behalf of an objective standard and strong deference to state rules (although it has so far fended off the strongest of the proposed departures from state norms – “noisy withdrawal”). However, one provision of the SEC's final rule under section 307 does seem unfortunately responsive to the bar's pleas. In general, when board reports evidence of illegal conduct to the CEO or chief legal officer, she must determine that their response is “appropriate”. This would be satisfied where the response gave the lawyer reason to believe either that there has been no misconduct or that effective remedial steps have been taken. Otherwise, she must proceed to the board or a committee of independent directors. However, the final rule creates an exception. The lawyer need not proceed further if, after reporting to the CEO or chief legal officer, she is informed that the board approved retention of another lawyer to look into the matter and the other lawyer has determined that he can ethically “assert a colorable defense on behalf of the issuer ... in any investigation or judicial or administrative proceeding relating to the reported evidence of a material violation.”

Although it remains to be seen what the influence of this provision will be, it seems unfortunately conducive to pathologies of deliberate ignorance and calculated ambiguity. The effect of the provision is to authorize two types of ignorance. When the second lawyer gives the requisite opinion, the lawyer is excused from going to the board. So the board does not have to be confronted with his information. (This effect is mitigated by the requirement that the board itself have

approved retaining the second lawyer, but that fact raises the question of what point there is in excusing the first lawyer's report.)

Moreover, it appears that the first lawyer has no duty to assess the qualifications of the second lawyer or the quality of his investigation. In the normal duty-of-care situation, a lawyer would not be justified in relying on a second lawyer's opinion about what should be done without plausibly determining that the opinion was well supported (and even it were, would often have a responsibility to make her own assessment of the merits). Without such a responsibility on the part of the first lawyer, there is no check on the ability of a board in bad faith from shopping for a compliant second lawyer.

And the "second opinion" exception contains a salient ambiguity. The "colorable issue" language and the reference to proceedings suggests that threshold of plausibility required for counsel to present a claim to a tribunal. This standard requires no more than that the claim be more than "frivolous."⁹² Since this standard regulates positions that the client will take publicly, the only concern competing with the client's interests is the danger of wasting the tribunal's time. However, it would trivialize the "up-the-ladder" rule to apply this standard to situations where no proceeding was pending and whether the matter becomes public may depend on what the attorneys do under the rule. The fact that some lawyer has been found who thinks the client has a non-frivolous defense to claims of wrongdoing is of small moment if the effect of the judgment is that the client's conduct will remain unknown and the claim will never be made.

It is possible that the SEC meant the rule to apply only where claims have been made publicly or are about to be made, but the rule is phrased much more broadly. It is also possible that the SEC intended to create a transparently low standard and

⁹² See Model Rule of Professional Conduct 1.3.

just drafted it badly.⁹³ But so far, the effect of its efforts has been to preserve a substantial measure of space for the kind of ignorance and ambiguity in which the bar has traditionally taken refuge from pressures of accountability.

VI. Conclusion

Deliberate ignorance and calculated ambiguity are key themes in major scandals from Watergate to Enron. Until recently, these practices were encouraged by both legal doctrine and organizational structure. Recent trends in both law and organization have narrowed the space for them by enlarging duties of inquiry and articulation.

Enron seems to be a watershed in this evolution. Although it advertised itself as a highly advanced business organization, in its aversion to transparency and accountability, it resembled the Ambivalent Bureaucracy model of past years more than the newer model I call Self-Conscious Bureaucracy. The inquiry- and articulation forcing features of Sarbanes-Oxley, while simply an intensification of prior trends, appropriately increase legal pressures for organizations to move toward the newer model.

It remains to be seen, however, how these pressures will affect lawyers. The bar continues to resist some responsibilities of sort that are being imposed on its clients, and its own norms continue to both reflect and encourage deliberate ignorance and calculated ambiguity.

⁹³ Koniak believes that the rule was intended to be applied broadly as a concession to the bar. Cited in note 82, at 1275-78. The attempt to import the "colorable defense" standard to the sphere of disclosure regulation was a major (and highly dubious) tactic of the defenders of the Kaye Scholer firm against the misconduct charges arising out of its representation of Charles Keating and Lincoln Savings and Loan. See William H. Simon, "The Kaye Scholer Affair: The Lawyer's Duty of Candor and the Bar's Temptations of Evasion and Apology," 23 Law & Social Inquiry 243, 270-73 (2003).