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Recommended Citation

Miller, Geoffrey P., "From Club to Market: The Evolving Role of Business Lawyers" (2005). *New York University Law and Economics Working Papers*. Paper 33.

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From Club to Market: The Evolving Role of Business Lawyers

Geoffrey Miller*

Abstract: The traditional protection against undesirable legal representation is the attorney's independence from the client backed by the threat of withdrawal. That protection, however, has eroded over time due to two large-scale economic developments: the evolution of the legal services market from club to competitive forms of organization and the share market bubble of 1995-2000. This paper argues that the failure of the attorney "gatekeeper" function, as potentially manifested in recent scandals - Enron, WorldCom, Adelphia, and HealthSouth being prime examples - was largely a function of these underlying economic conditions. After identifying the transition from club to competitive organization and the bubble economy as two principal economic developments that impacted attorney independence, this paper addresses several proposals

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for reform: up-the-ladder reporting, noisy withdrawal, enhanced permission to reveal client confidences, and changes in the self-identity of the profession. An awareness of the background economic developments provides helpful insights into the policy arguments for and against these proposals.

* * *

The Enron fiasco, along with other major corporate frauds and scandals of the past few years—WorldCom, Adelphia, Global Crossing, and HealthSouth come to mind—raises in dramatic fashion a longstanding issue about the role of business lawyers. To what extent can (or should) attorneys act as the "conscience" of their clients, guiding them away from decisions which, while perhaps legally defensible, are nevertheless close enough to the line to raise questions about their propriety? In theory, the answer to this question has long been clear-cut, at least at the level of abstraction. The goal of representing a client "zealously" while remaining within the "bounds of the law" was well enough understood by the framers of the American Bar Association's ("ABA's") Model Code of Professional Conduct to be enshrined as one of the basic canons of lawyer's ethics.¹ How to carry out that obligation has been reasonably well-understood at a more operational level as well. For example, the following

¹ Model Code of Prof'l Responsibility Canon 7 (2001).

propositions appear to enjoy consensus as descriptions of the attorney's professional responsibility (although some would advocate reforms to alter this basic pattern):²

- The attorney's responsibility is to provide the client, on request, with information about the probable legal consequences of potential actions, and to do so with a reasonable degree of professional competence.
- Unless the parties agree otherwise, the attorney is not responsible for advising the client as to business (as opposed to legal) considerations.
- If requested by the client, the attorney can recommend legally appropriate means for structuring transactions in order to serve the client's legitimate objectives (which can include minimizing regulatory burdens, reducing taxes, or enhancing the client's public image).
- An attorney may assist a client in carrying out a course of action that skirts the edge of the permissible, so long as the attorney believes in good faith that the

² See, e.g., William Simon, Ethical Discretion in Lawyering, 101 Harv. L.R. 1083 (1988)(recommending that in representing clients, attorneys exercise discretion to promote justice even when doing so is in tension with the client's wishes or interests).

action is, in fact, legally valid and that the client has adequate awareness of the legal risks.

- An attorney may not counsel or advise a client to commit fraud or other illegal actions, and may not assist the client in perpetuating a fraud or other violation of law.
- When the client is an institution (such as a corporation), the attorney's obligations run to the institution as a whole, as embodied in its board of directors, and not to its senior managers in their personal capacities.

These basic principles do not resolve all the problems lawyers face in reconciling their fiduciary duties of loyalty to the client with their responsibilities as officers of the court and custodians of the legal system. In general, however, the principles listed above provide a framework that has proven relatively durable over time, and that—so far at least—has withstood the firestorm of criticism generated by Enron and like cases. Even the Securities and Exchange Commission ("SEC"), an agency at the center of the maelstrom and the subject of withering criticism for alleged regulatory laxness, has backed off its attempt, in the "noisy withdrawal" provisions

implementing of the Sarbanes-Oxley Act,³ to insert the attorney into a complex, quasi-adversary role towards a client that the attorney believes has violated federal securities laws. It's probable that when the dust of the current wave of scandals settles, the ethical requirements under which business lawyers operate will not be radically different from those that applied heretofore. This does not mean, however, that constructive reforms cannot be devised to correct for shortcomings in the regulatory system. But before such reforms are implemented, it is important that we gain as clear an understanding as possible as to the nature of the problem and the dynamic forces that may have contributed to bringing it about.

This paper first attempts to shed some light on why the gatekeeper function—that is, the role of independent attorneys in protecting the public against corporate malfeasance—seems to have broken down in several recent cases. The cause was not a sudden degeneration in the personal morality of business lawyers. Instead, the problems that have come to light over the past few years—to the extent that they are exceptional in light of historical experience—are the product of large-scale economic

³ Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, 29 U.S.C.).

developments that these professionals did not cause, but that profoundly influenced the environment within which they practiced. The paper focuses on two developments: (1) a far-reaching change in the economic organization of the legal profession from what I term a "club" system to a competitive one; and (2) the unusual macroeconomic environment of the mid and late 1990s that is epitomized in the stock market bubble which peaked at the beginning of the current century. These developments pressured attorneys to push the envelope of propriety when requested to do so by their clients. In light of these pressures, what is surprising is not that so many attorneys crossed the line, but that so few did so.

Moving from descriptive to normative analysis, this paper asks whether, in light of this economic analysis, the system regulating the activities of attorneys and other gatekeepers should be revised to combat the risk of inappropriate behavior. To the extent that the problems were due to the stock market bubble and related phenomena, no particular action needs to be undertaken because these unusual and unpredictable economic conditions are unlikely to recur anytime soon. Indeed, "reforms" may already have taken place in the form of basic changes in the norms of legal practice. Additional actions could be counterproductive if they impose too many constraints

on the conduct of attorneys in the absence of the economic conditions that generated the problematic behaviors.

On the other hand, to the extent that the observed problems were due to the move from club to competitive organization in the legal services sector, the issue of reform remains salient because this shift in organization is a durable rather than a transient phenomenon. I would certainly not recommend a return to the club system with all its coziness, exclusivity and inefficiency. Like it or not, professional service providers operate in a competitive environment and will continue to do so. I do believe, however, that reforms might provide a useful corrective to the risk of inappropriate behavior that the move to a more competitive environment has created. I discuss several of these suggestions in the final section of this article.

I. The Social Role of Business Lawyers

Ronald Gilson's influential paper, Value Creation by Business Lawyers: Legal Skills and Asset Pricing, outlines an optimistic theory of the role of attorneys as transaction cost engineers.⁴ In this view, business attorneys enhance the wealth

⁴ Ronald J. Gilson, Value Creation by Business Lawyers: Legal Skills and Asset Pricing, 94 Yale L.J. 239 (1984).

of the society as a whole when they serve the economic interests of their clients. They accomplish this by identifying arrangements that maximize the value of the transaction.⁵ For example, suppose that in a contract for sale the question arises as to who should bear the risk of loss between contract and closing. A traditional way of understanding this problem, from the standpoint of legal representation, is that the attorney either allowed the clients to negotiate the terms and embodied the agreement in legal form—the "scrivener" function—or negotiated for the client by attempting to win every deal point—thus often ruining the whole transaction. Gilson argues, however, that when attorneys negotiate a matter, they can perform a third, more valuable function. They can assist clients in allocating the costs and benefits of a transaction to the parties who can make the best economic use of them, thus creating a surplus that can be shared among all the parties.⁶ The attorneys in the above example might conclude, for example, that the seller's existing insurance policy can cover the risk of loss most cheaply for all concerned, and thus agree to impose the risk of loss on the seller with an appropriate adjustment of the sales price to reflect this allocation.

⁵ See id. at 249-56.

⁶ See id. at 255.

Gilson's picture of the social value of business lawyers has its greatest cogency in the context of negotiations in a simple two-party transaction among individuals with relatively equal bargaining power and sophistication. The picture has less force, however, when these conditions are relaxed. Two settings are especially problematic.

Negotiations with the Government. Suppose the transaction in question is not between two individuals, but between (let's say) a person and the public as a whole. For example, in the absence of environmental regulation, companies would be tempted to discharge pollutants into the air or water, knowing that others will have to pay the cleanup costs. Attorneys who help a company engage in such pollution (for example, by negotiating the purchase of plant and equipment for the polluting facility) are not adding to the welfare of society by minimizing transaction costs; instead, they are reducing social welfare by taking advantage of the high transaction costs which allow the factory to pollute in the first place. Gilson's transaction cost engineer model of business lawyers has little relevance in this setting.

However, we do not simply allow businesses to pollute. We have environmental laws and agencies to counteract their incentive to spoil the environment in order to increase profits. Once laws and agencies with enforcement powers enter the

picture, Gilson's model has more force than when the transaction is between corporate managers and a disorganized group such as shareholders or the public at large.

But Gilson's theory is still an unsatisfactory description of the behavior of attorneys in this setting even when legal regulation is included in the model. The dynamics and underlying premises of these actions are different than the one-on-one private bargaining for mutual advantage that forms the centerpiece of Gilson's theory. Among the most salient differences are the following.

First, while in a private bargaining situation everything is subject to negotiation (at least in theory), in the context of legal compliance, the baseline of applicable law is fixed in the short to medium term. The government agency is required to enforce the law, even if the agency's personnel believe that the requirement is unwise or impractical. If Congress tells the Environmental Protection Agency ("EPA") that it must meet environmental goals by a date certain, the EPA must attempt to achieve that objective even if doing so imposes onerous burdens on the economy or creates collateral environmental harms. Conversely, the government may be powerless against parties whose conduct constitutes a clear breach of the spirit of a law so long as technical compliance is present. It's true that constructive violations can be tracked down and punished under

doctrines designed to deter egregious conduct (e.g., the step transaction and business purpose rules in tax law).⁷ But these filters are never wholly effective as countermeasures against socially undesirable behaviors that are in technical compliance with written law.

The incentives of government agents also differ in important respects from those influencing private parties. In the case of the private party dealing with the government, the financial incentives of its agents can be expected to be aligned to some substantial extent with the interests of the organization itself. This is not to say that the alignment is perfect; as I discuss below, much of the economic theory of corporate law deals with failures of alignment in the form of agency costs. But from a financial point of view, the alignment of interests between agent and organization is likely to be better in the private sphere than in the government sector, where agents work on a salary, enjoy substantial job security, and rarely receive a direct financial benefit (or penalty) for performance. Government agents, of course, may act as effective representatives of their offices, but they typically do so for reasons other than financial gain: pride in work or belief in the agency's mission may substitute for a desire to accumulate

⁷ See, e.g., Gregory v. Helvering, 293 U.S. 465 (1935).

wealth. It is clear, however, that the incentive structure for government agents is different than that which dominates the private sector, and that this difference may influence the dynamics and outcomes of bargaining between government and private agents.

A third difference between government enforcement and private bargaining is that governments usually lack the resources to negotiate each transaction individually. A great deal of enforcement is voluntary, in the sense that citizens are asked to comply with the law without facing particularized scrutiny of their performance. Only a small percentage of tax returns get audited. The EPA doesn't have the ability to send inspectors to every factory and job site to check emissions levels. In these and many other settings, citizens can (and sometimes do) break the law with little fear of detection. On the other hand, while the government's resources are stretched thinner, it does have a more effective arsenal of enforcement techniques to punish noncompliance. Private parties do not have the ability to impose fines on defaulting counterparties—indeed, liquidated damages clauses will be invalidated if found to constitute a penalty. Jail time is not a consequence of private breach, even when fraud is present.

Agency Costs of Management. The simple version of Gilson's model of attorneys as transaction cost engineers also does not

take account of the agency cost problem within firms. Business lawyers typically do not represent individuals in a formal sense. Most often they represent organizations that have a fictional legal personality. Yet they are hired by and report to human representatives of these fictional persons, their clients. These employees are not necessarily good agents of the companies they serve. Like everyone else, corporate executives might prefer to serve their own interests (including their desire to maximize their own compensation at shareholder expense). Even if the attorney knows or suspects that corporate officers are acting in a self-serving way, he or she may elect to ignore this inconvenient fact. Because the basic executive decisions—including the decisions to hire and fire counsel—are usually made by corporate managers, the attorney will not necessarily abide by the admonition that his or her duties run to the organization rather than its officers. If business lawyers respond atavistically to the demands of corporate executives, they will not necessarily serve the best interests of their clients and the public at large. On the contrary, they could exacerbate agency problems, increase rather than decrease transactions costs, raise the firm's cost of capital, and facilitate business decisions by the firm that are not consonant with social welfare.

* * *

As a result of these and other problems, the role of the business lawyer in the compliance and fiduciary duty settings is not as likely to result in value creation through transaction costs engineering as it is in the case of bilateral contract negotiations between sophisticated parties. Lawyers representing private clients in relations with the government or with corporate shareholders may engage in any or all of the following types of behavior, only some of which appears to be socially beneficial.

1. The lawyer can find a way to conserve the client's resources while still fully complying with the letter and spirit of a efficient law. In such cases, the value creation function is similar to that which Gilson posits for lawyers in the private sphere.
2. The lawyer can facilitate avoidance by the client of either the letter or spirit of the law, but the law itself is economically inefficient. Here, the lawyer has contributed (arguably) to value creation in Gilson's

sense, but does so at the cost of subverting other values (e.g. respect for and compliance with laws) which we are likely to view as important.

3. The lawyer can facilitate avoidance by the client of either the letter or spirit of the law, and the law is economically efficient. Here, the lawyer's services have been used to advance the client's interests, but at the expense of society as a whole. Even from an economic point of view, the lawyer has engaged in value destruction rather than value creation. Some of the behavior by attorneys in recent corporate scandals may fall in this category.
4. The lawyer can serve the interests of corporate managers, but do so in a way that is detrimental to the long-range best interests of the corporation. Here, again, the attorney has engaged in value destruction rather than value creation. Some of the conduct by corporate attorneys in recent corporate scandals also appears to fall in this category.

II. The Changing Conditions of Corporate Practice

The analysis so far suggests that attorneys representing clients in the contexts of corporate governance and legal compliance will not always be subject to an effective check, and that, in consequence, the society is at risk that the lawyer's

services will be value-destroying rather than value-creating. How should this risk be handled? A traditional answer is that lawyer independence will substitute for the lack of private controls. While the lawyer must be a faithful agent and zealous advocate, he or she is always required to exercise independence of judgment and action. The attorney's autonomy goes beyond merely recommending the best way to achieve the client's goals. The attorney must also preserve a professional distance from the client and eschew actions that cross over the line. To avoid even the "appearance of impropriety"⁹ the attorney may remonstrate with a client bent on questionable conduct, or, if the client persists, may (and in some cases must) withdraw from the representation.¹⁰ If all attorneys in fact exercised this degree of independence, the problems identified above would be mitigated. Clients who wanted to cross the line would encounter the independent attorney obstinately blocking the path. And although they could dispense with that attorney, doing so would be costly and any other qualified attorney they might retain would also exercise ethical lawyer action.

⁹ See Model Code of Prof'l Responsibility Canon 9 (2001) (entitled "A Lawyer Should Avoid Even the Appearance of Professional Impropriety").

¹⁰ See Model Rules of Prof'l Conduct R. 1.16 (2002).

Lawyer independence, however, is effective at checking client misconduct only if lawyers actually act in the prescribed manner. Underlying much of the contemporary misgivings, both among lawyers and in popular consciousness, is the concern that obligations of independence are too often honored in the breach. However much attorneys may tout their independence, in this view, at the end of the day money talks. Associated with this cynical view of attorney ethics is the nostalgic view that the problem of attorney venality is worse today than in times past. At one time, according to this view, the norms of the profession had a real impact on lawyer behavior. But those traditions no longer protect against attorneys who are all too willing to compromise their integrity in order to curry favor with major accounts.

To what extent is this perception of degradation in attorney independence justified? It is commonplace for individuals, as they grow older, to bemoan a perceived breakdown in standards. It is easy to forget that attorneys in the past have not always been paragons of virtue. Recall, in recent history, the Operation Greylord investigation in Chicago that disclosed massive corruption in the Cook County, Illinois court system, or the Watergate scandal in which many villains were also members of the bar. Attorneys have been in bad odor with the public for hundreds of years, and have often been seen as

distressingly ready to sacrifice principle for avarice. But it is also possible that the conditions have changed secularly in a way that makes independent lawyer behavior less likely today. This section explores that question.

A. From Club to Competition

If lawyers are less independent today than heretofore, part of the reason may lie in a fundamental change in the organization of the service professions. Gradually and fitfully, but unmistakably, these industries have moved from a "club" style of organization to one dominated by competitive forces—a "free market" paradigm. As in the case of any broad thesis about economic history, this one requires qualification at the outset. "Club organization" and "competitive organization" are not exclusive characteristics. At any given time, a profession will display both club and competitive features. Competition was present in the bar even when club organization formed the dominant mode of operation, and many features of club organization persist today even in an environment characterized by competition among service providers. I am speaking here of general styles or characteristics rather than universal attributes that define all aspects of a profession at any given moment.

The club form of professional organization displays the following general features. First, the profession is exclusive,

with significant barriers to entry into membership. Second, members often maintain associations with one another and with clients outside the context of their roles as professional service providers. Third, competition among service providers, when it occurs, is constrained by norms of politeness and courtesy. Fourth, there is little lateral mobility within the profession: people join firms and remain there absent unusual circumstances. Finally, relations between service providers and clients tend to be stable and long-lasting, and are based on institutional history rather than the personal relationships of dominant individuals.

If we imagine the legal profession circa 1950, it is easy to see features of club organization.¹¹ Membership in the bar required (in general) graduation from college and law school, passage of the bar examination, and approval by the relevant committee on character and fitness. Family connections were often a ticket into a good college, and graduation from a good college was a significant factor improving chances for admission

¹¹ For sociological accounts of one important bar including historical discussion, see John P. Heinz & Edward O. Laumann, *Chicago Lawyers: The Social Structure of the Bar* (1982); John P. Heinz et al., The Changing Character of Lawyers' Work: Chicago in 1975 and 1995, 32 *Law & Soc'y Rev.* 751 (1998).

to a top law school. To get set up in a firm, it paid to know someone who could introduce you; and to obtain clients, it was desirable to have personal connections. Lawyers in a community would be members of the same country clubs and civic organizations as the business leaders, and would socialize with them and with one another in all sorts of different settings. Almost all elite attorneys (and almost all senior managers of corporate clients) were men of European backgrounds.¹² Jews could and did practice law but tended to do so in firms characterized by ethnicity; "white shoe" firms had few Jews, no women and no African-Americans.

In the world of practice, competition, while inevitably present, was not emphasized as a professional value. On the contrary, it was generally disapproved, at least as a guiding principle for action. Lawyers who were too competitive would be stigmatized. Stealing another lawyer's clients violated strong norms of professional courtesy, and any lawyer who developed a reputation for poaching faced sanction from colleagues.

¹² See Richard L. Abel, *American Lawyers* 99 (1989). Even as late as 1989, a survey of large law firms found that over 90% of the partners were men and more than 98% were white. Rita Henley Jensen, Minorities Didn't Share in Firm Growth, *Nat'l L.J.*, Feb. 19, 1990, at 1.

Solicitation or advertising of any sort was prohibited. In the case of services to individuals and small firms, the constraints on competition were even more overt. Many bar associations imposed "minimum fee schedules," which were nothing other than cartel prices backed by the threat of penalties for undercutting the prescribed tariff.

The club style of organization was characterized, also, by limitations on job mobility. An attorney who joined a large corporate firm would generally expect—or at least, hope—to spend his entire professional life there. Movement by senior attorneys between firms was unexpected, even remarkable, and, perhaps, a source of concern about that attorney's stability or reliability. Junior attorneys who joined as associates would not be assured of becoming partners, but the expectation was that if someone performed well partnership would be the reward. Those deemed unworthy of elevation were also protected. Someone passed over for partnership could remain at the firm while seeking a new position, and could sometimes swallow his pride and accept a role as "permanent associate" doing Blue Sky or other work. Unsuccessful partner candidates would be out-placed, frequently into the offices of the in-house counsel of major clients.

Associated with this lack of mobility among attorneys was a stable structure of attorney-client relationships. Major

corporations would keep one law firm as their outside counsel for years. The relationship between the corporation and the law firm was cemented by personal bonds between senior managers and partners; and those bonds were reinforced over time as junior executives and associate attorneys came to know one another in their subordinate capacities and eventually were promoted to positions of authority in their respective organizations. Sometimes, the law firm would take office space in the client's headquarters. Senior lawyers from the firm might serve on the client's board of directors. The firm would do personal legal work as an accommodation for senior executives of major clients. Some attorney client relationships during this period were legendary: Shearman & Sterling, for example, was strongly identified in the public eye as Citibank's outside counsel.

The features of the club form of organization tend to be self-reinforcing. Social connections among attorneys, and between attorneys and clients, perpetuated exclusivity in the bar, while the profits which such exclusivity protected made pursuit of such social connections a desirable priority for any ambitious attorney. Norms against advertising, solicitation and client poaching gave durability to firms because once a reputation and client base were established, others had difficulty in competing for these benefits. Low lateral mobility of attorneys at elite firms tended to solidify

longstanding firm-client relationships because attorneys would not leave and take the client with them. At the same time, long-standing relationships tended to discourage mobility because no one attorney was likely to "own" a major account. Outplacement of failed partnership candidates at corporate counsel's office reinforced connections with clients, as did concessionary provision of personal legal services. Barriers to entry in the bar facilitated anti-competitive rules such as minimum fee schedules and norms against client poaching, while the presence of such practices made barriers to entry valuable assets which attorneys wished to maintain. Long-standing relationships between attorney and client also tended to be self-reinforcing: the mere fact that a relationship had been in place for so long enhanced its stability, since a breach of relations between a firm and a client would raise serious questions about both and also be painful to the individuals involved. These self-reinforcing qualities help explain the club form's durability and far-reaching effects.¹³

¹³ Although outside the scope of this paper, I believe that other professions, and to some extent industry generally, exhibited features of club organization during this time. For example, the securities industry operated with fixed brokerage commissions until 1975. Real estate brokers maintained fixed

If we compare the characteristics of elite legal representation in the 1950s to the situation today, we observe a

commissions as well. Professional organizations other than the organized bar promoted norms of professional courtesy and discouraged advertising, solicitation and poaching. Even outside the professional service industries, horror of "ruinous competition" pervaded American industry. Cartels, price matching in oligopolistic markets, and government restraints on price competition were common. Insurance operated with explicit cartels until 1945, see Jonathan R. Macey & Geoffrey P. Miller, *Costly Policies: State Regulation and Antitrust Exemption in Insurance Markets* (jump-cite?) (1993), while banks long enlisted the government to prohibit price competition for deposits. See Kenneth E. Scott, The Dual Banking System: A Model of Competition in Regulation, 30 *Stan. L. Rev.* 1 (1977). The existence of the club form of organization in other industries also reinforced the overall system: if clients were characterized by club organization, they would also display features such as low mobility of personnel that could give durability to relationships with service providers. Thus, the phenomenon of club organization appears to be a relatively far-reaching feature of economic organization during the period in question.

dramatic contrast in nearly all of the elements that we have identified. The practice of law has evolved from a club form of organization to a competitive form. In consequence, law has increasingly become a "buyer's market" in which clients call the shots.¹⁴

Consider the question of barriers to entry. It remains true that to gain admission to a bar, a candidate must ordinarily graduate from college and law school, pass the bar examination, and be approved by the character and fitness committee. These constraints, however, appear less binding than they were in the past. Law schools have proliferated and existing law schools have increased enrollments, spewing tens of thousands of additional attorney candidates into the bar admission system each year.¹⁵ Character and fitness review, never very significant except as a filter to screen out undesirable characters such as communists and felons, has become little more than a ritual of initiation in which the chance of failure is about as high as that facing a bar mitzvah boy. The bar examination continues to operate as a screen, but if a

¹⁴ Davis, supra note 15, at 148.

¹⁵ See F. Leary Davis, Back to the Future: The Buyer's Market and the Need for Law Firm Leadership, Creativity and Innovation, 16 Campbell L. Rev. 147, 152 (1994).

person is persistent, he or she is likely to pass eventually, and if they don't succeed in one state, they can always move somewhere with a higher passage rate. The result, overall, is that barriers to entry into legal practice have become less significant over time.

The reduced barriers to entry are reflected in bar admission statistics.¹⁶ After a brief rise following World War II, the rate of new admissions to the bar remained stable at 8,000 to 10,000 a year until the mid-1960s. Yearly admissions then began to rise modestly, reaching just over 15,000 in 1971. A sharp rise occurred in 1972 when admissions climbed to over 20,000. Thereafter, new admissions increased yearly, exceeding 30,000 in 1979. During the 1980s, new admissions averaged about 30,000 a year, but because the cohorts of young attorneys entering the profession were larger than the cohorts that were leaving, the attorney population continued to rise. Thus, the number of attorneys in the economy has soared, both in absolute terms and as a percentage of the population.¹⁷ Increases in the

¹⁶ The following information is from American Bar Foundation: The Lawyer Statistical Report.

¹⁷ As illustrated in the following table:

U.S. Lawyer Population and Population/Lawyer Ratio in Selected
Years

number of attorneys may translate into enhanced competition in the bar.¹⁸

Year	No. of Lawyers	Lawyer/ Population Ratio
1951	221,605	1/695
1960	285,933	1/627
1971	355,242	1/527
1980	542,205	1/418
1985	655,191	1/360
1988	723,189	1/340
1991	805,872	1/313
1995	857,931	1/303
2000	1,066,328	1/264

Source for 1951-1995: American Bar Foundation, The Lawyer Statistical Report: The U.S. Legal Profession in 1995 by Clara Carlson; source of 2000: American Bar Foundation: The Lawyer Statistical Report: The Legal Profession in 2000.

¹⁸ The demand side must be considered along with the supply side to establish this relationship with certainty. While the number of attorneys has grown both in absolute terms and relative to population, so has the demand for legal services. Government regulation has increased for many business sectors. There is also a perception that plaintiffs' attorneys have

These increases in the attorney population tell only part of the story. Attorney ability to maintain the exclusivity of

become more active, better financed, and more sophisticated, and that trial lawyers have exercised political influence to obtain changes in liability regimes that generate increases in litigation exposure for large corporations. Whatever the cause, the data do substantiate significant increases in demand. Robert L. Nelson reports that "[b]etween 1977 and 1989, revenues devoted to legal services increased by . . . 480%"—a rate of expansion more than twice that of gross national product (which expanded by 260%), and greater even than health care (which grew by 370%). Robert L. Nelson, The Futures of American Lawyers: A Demographic Profile of a Changing Profession in a Changing Society, 44 Case W. Res. L. Rev. 345, 345 (1994). While the supply of attorneys is not going to shrink over the medium term, however, the demand for attorney services could easily do so as a result of fluctuations in market conditions or the business cycle.

²⁰ See Herbert M. Kritzer, The Future Role of "Law Workers": Rethinking the Forms of Legal Practice and the Scope of Legal Education, 44 Ariz. L. Rev. 917 (2002); Herbert M. Kritzer, The Professions Are Dead, Long Live the Professions: Legal Practice in a Post-Professional World, 33 Law & Soc'y Rev. 713 (1999).

the franchise through enforcement of unauthorized practice restrictions is also increasingly suspect. Non-attorneys are performing tasks previously monopolized by lawyers; and even computers can do some of the work.²⁰ The prospect of multi-disciplinary practice groups also poses a threat—as evidenced by the ABA's repudiation of the concept as a general model for American legal practice.²¹

Demographic changes have also dramatically altered the practice of law. Women now represent close to half of all new attorneys;²⁴ and as time passes, their representation in the bar

²¹ See generally Charles W. Wolfram, Comparative Multi-Disciplinary Practice of Law: Paths Taken and Not Taken, 52 Case W. Res. L. Rev. 961 (2002).

²⁴ See Ronit Dinovitzer, After the JD: First Results of a National Study of Legal Careers 19 (American Bar Foundation 2004) (survey finding that 46% of new attorneys are women).

as a whole should also grow to about 50%. African-American and Latino/Latina attorneys are entering the bar in substantial numbers.²⁵ Even though new lawyers still tend to come from relatively privileged backgrounds,²⁶ the era of the old-boy network, the country club connection, and the white shoe firm, if not eclipsed, is certainly fading.²⁷ The personal connections that once maintained the club system have given way to a varied, shifting, multi-featured pattern of relationships. Connections as a means for entry, acceptance and advancement are not gone, of course, and probably will never disappear; but the exclusivity of the old system has been supplanted by a different, more flexible, and more open environment.

Legal constraints on competition in the market for legal services have also eroded. The old system of minimum fee schedules received its quietus in 1975 when the Supreme Court declared that such arrangements (if not required by state action) amounted to price fixing in violation of the Sherman

²⁵ See *id.* (17% of new lawyers in survey were non-White).

²⁶ See *id.* at 20 (finding that 69% of new lawyers' fathers were managers or professionals, as compared with 20% in the general workforce).

²⁷ See *id.* at 20 (reporting that Protestants no longer dominate the practice of corporate law as they once did).

Act.²⁸ The Court also took on restraints on attorney marketing. Restrictions on truthful attorney advertising are today generally outlawed as violations of the First Amendment if they significantly restrict commercial speech.²⁹ Even direct solicitation of clients is permitted if done for ideological rather than commercial purposes.³⁰ These changes in legal

²⁸ See Goldfarb v. Va. State Bar, 421 U.S. 773 (1975).

²⁹ See, e.g., Peel v. Attorney Registration & Disciplinary Comm'n, 496 U.S. 91 (1990) (plurality opinion); Shapero v. Ky. Bar Ass'n, 486 U.S. 466 (1988); Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626 (1985); In re R.M.J., 455 U.S. 191 (1982); Bates v. State Bar of Az., 433 U.S. 350 (1977). But see Fla. Bar v. Went For It, Inc., 515 U.S. 618 (1995) (upholding a Florida Bar rule that prohibited personal injury lawyers from sending direct-mail solicitations targeted to victims and their relatives within thirty days of an accident).

³⁰ See In re Primus, 436 U.S. 412 (1978); Edenfield v. Fane, 507 U.S. 761 (1993) (permitting in-person solicitation by accountants). But see Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447 (1978) (state could sanction attorney's "ambulance chasing" solicitation of vulnerable clients for financial gain).

doctrine are likely to have the effect of increasing competition in the market for legal services, at least in the long run.³¹

Associated with these developments are perceived changes in the internal norms of the profession. The rule against poaching clients appears moribund today; any large firm is willing to offer its services to a desirable account even if the client is known to be currently represented by another law firm. In the view of many, professional courtesy has deteriorated in other respects as well. The bar, it is said, is plagued by an epidemic of incivility. Attorneys wait only for the judge to leave the courtroom before launching verbal assaults at one another or at the opposing counsel's client,³² and litigation tactics appear calculated as much to impose inconvenience on the adversary as to advance the client's legal position in court.

Restraints on mobility have also become less binding. These days, it is not uncommon for attorneys to move from firm

³¹ See Abel, supra note 12, at 121-22 (concluding that the legal changes did not reduce the price of legal services).

³² See, e.g., In re the Discipline of Benjamin J. Eicher, 661 N.W.2d 354, 358 (S.D. 2003) (opposing client labeled "despicable" and "shockingly greedy").

to firm several times during a career.³³ Often when attorneys move, they take significant clients with them. Indeed, client portability is usually the reason such moves are feasible. And because bringing the client along is often the sine qua non, it is not unusual to find whole practice groups jumping ship. Often, too, the mobility takes the form of a whole-firm merger in which established firms are swallowed up by leviathans such as Skadden Arps or Baker & McKenzie in the United States, or Freshfields or Lovells in the UK. Sometimes mobility is the product of a firm's demise. Brobeck Phleger & Harrison's closure in 2003, and the ensuing exodus of Brobeck attorneys to other firms, was only a recent example of a series of similar events in the past few years.

Loyalty between law firms and their longstanding clients has also begun to fade. Whereas major clients would once have been content to use a single law firm for all important legal matters, today they tend to diversify their portfolio of service providers. Most major companies have significant in-house legal

³³ For example, approximately a third of the attorneys who graduated from law school in 2000 had changed jobs at least once within four years. See Ronit Dinovitzer, *After the JD: First Results of a National Study of Legal Careers* 53 (American Bar Foundation 2004).

offices, which attempt to control costs and monitor the quality of services performed, and which can also perform sophisticated work on their own. When outside counsel is used, a large client is likely to diversify by using different firms for specialized services (e.g., regulatory work, tax planning, and litigation).³⁴ Large clients, moreover, have become more price-sensitive and may not hesitate to question bills or negotiate favorable retainer agreements. Contingency fees have become, if not common, at least an accepted part of commercial representation;³⁵ such fees facilitate competitive bidding for legal work because they are clearly defined by outcomes, and therefore require less of a background of trust between lawyer and client.

Developments in the client's industries also affect attorney-client relations. It seems safe to say that American business has itself become more competitive over the past half century. Globalization and competition by foreign suppliers have been important factors. But in addition, legal changes

³⁴ See Davis, supra note 15, at 164 (in-house counsel increasingly seeks transactional rather than general assistance from outside law firms).

³⁵ See, e.g., Brobeck, Phleger & Harrison v. Telex Corp., 602 F.2d 866 (9th Cir. 1979), cert. denied, 444 U.S. 981 (1979) (\$1 million contingent fee in a commercial case).

have influenced markets other than the legal services industry. The elimination of fixed commissions for securities brokers, deregulation of the airline, trucking and telecommunications industries, and the dismantling of legal restraints on commercial banking have enhanced competition in those industries. Firms facing price competition are likely to look to cost centers where they may save money, including payments to their professional service providers. Since the 1970s, moreover, waves of mergers and divestitures have altered the identities of many corporations.³⁶ Even if a corporation were not inclined to switch lawyers under ordinary circumstances, a merger may necessitate such a change because it creates conflicts of interest or because the merger partner wishes to use its own counsel. And companies are no longer squeamish about changing lawyers, even in the absence of structural changes: although they may not switch law firms as often as advertising agencies, even long-standing client relationships are no longer sacrosanct.

Increases in mobility have altered the internal structure of law firms as well. Compensation systems are one area of change. The "Cravath" strategy of lockstep partner compensation

³⁶ See generally Neil Fligstein, *The Transformation of Corporate Control* 336 (1990).

has given way nearly everywhere to "performance-based" pay. And because attorneys these days can leave and take the client with them, control over billings has become the most important factor in divvying up the profits in performance-based systems. The "eat-what-you-kill" approach is commonplace. Some law firms have become little more than franchisors offering office space and secretarial services to practice groups.

Firm demographics have also changed. Firms providing representation to big corporations have grown much larger, in general, and have taken on legions of younger associates. The growth in size of major corporate firms has been due, in part, to the economics of partner compensation.³⁷ Mark Galanter and Thomas Paley, in their influential book Tournament of Lawyers, document and attempt to explain this trend.³⁸ Partners earn much

³⁷ See Ronald J. Gilson & Robert H. Mnookin, Coming of Age in a Corporate Law Firm: The Economics of Associate Career Patterns, 41 Stan. L. Rev. 567 (1989); Ronald J. Gilson & Robert H. Mnookin, Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits, 37 Stan. L. Rev. 313 (1985).

³⁸ Marc Galanter & Thomas Palay, Tournament of Lawyers: The Transformation of the Big Law Firm (1991); see also Richard H. Sander & E. Douglass Williams, Why Are There So Many Lawyers?

of their compensation by billing out associates at rates higher than what the associate costs internally. To increase profits, partners maintain a high partner-associate ratio. However, as the ratio increases, partners face problems of monitoring associates for quality and ensuring that they work hard. Galanter and Palay's "tournament" model explains how the tension between monitoring and profitability is maintained. The idea is that some associates—those who work very hard and produce excellent work—will "win" the tournament by being promoted to partner and thus obtaining the financial rewards associated with that status. Because associates want to win the tournament, they are willing to work hard and strive to do the best possible job even with relatively light supervision. Whether or not the tournament model accurately captures the dynamic forces at work, it is clear that only a fraction of associates at many large corporate firms can hope to be made partners; most move on within five to seven years. Thus lateral job mobility at corporate law firms is as high or higher among associates as it is among partners.

Perspectives on a Turbulent Market, 14 Law & Soc. Inquiry 431 (1989); Robert L. Nelson, *Partners with Power: The Social Transformation of the Large Law Firm* (1988).

Lawyers also face increasing costs. Overhead costs include office space rental and costs of technology (data processing, storage and retrieval). Big law firms also carry big payrolls. Costs of associates have been high because salaries skyrocketed during the period of greatest growth, in the late 1980s to early 2000s.³⁹ Although associates usually are hired on an at-will basis, downsizing for a large firm can be costly, not only because of the need to buy out redundant employees, but also because of the signal that layoffs send to the market. Many firms would probably prefer to wait out a down time, even at a loss, rather than incur the costs of cutting back.⁴⁰ Moreover, firms often finance these costs with borrowed money, adding the costs of debt service into the mix. Lenders demand to be

³⁹ See Bruce M. Price, *New Institutions of the Knowledge Economy: A Sociological Study of Equity Billing by Law Firms in Silicon Valley in 1998-1999* 75-90 (2005) (unpublished doctoral dissertation on file with the author).

⁴⁰ Firms can cover themselves to some extent against the risk of a downturn by using temporary workers to cover peak demand, but temporary workers have costs of their own (they have to be brought up to speed and carefully supervised, and may not be as capable as regular employees).

repaid, and if law firms default, the partners are likely to face personal liability to make good the shortfall.

B. The Share Market Bubble

If the tectonics of the legal profession has been the slow drift from club to competitive organization, its meteorology was the share market bubble which impacted American financial markets between 1995 and 2000. The bubble and its painful aftermath affected elite legal services in ways which, if perhaps not significant in the long term, have had substantial short-term effects.

Just as the share market bubble was more pronounced in the high-tech sector than in the rest of the economy, so law firms serving high tech clients were most profoundly affected. The stratospheric trajectory of many high-tech initial public offerings during this period created opportunities for firms working for fledgling high-tech clients to take an equity interest in the firms that they represented, in hopes that the expected increase in share price after the IPO would more than compensate them for the lack of cash compensation at the time the services were rendered.⁴¹ Wilson Sonsini was the best known—

⁴¹ For an interesting study of the phenomenon of equity investments by attorneys in dot.com clients, see Bruce M. Price, *New Institutions of the Knowledge Economy: A Sociological Study*

but not the only firm—to adopt this strategy. But because the bubble turned out to be market-wide, and not just restricted to tech stocks, the effect of the bubble economy was felt in the practices of many law firms.. Any firm with clients in the financial sector stood to profit from the bubble economy as a result of increases in frequency of transactions and the profits that financial market clients were earning during this period. Law firms in financial centers, notably New York, profited as well because of the effects of the financial market bubble on the economies of these areas.

The bubble economy disguised but did nothing to rectify developing weaknesses in the underlying market for legal services. Law firms could get by on the profits they were making from financial markets-related work. When the boom ended, in 2000 and 2001, the bottom dropped out of this market. Firms that were heavily involved in the financial sector or in representing high-tech clients found themselves in free-fall. A few—most notably Brobeck Phleger & Harrison—were unable to recover. Despite being one of the leading firms in the country

of Equity Billing by Law Firms in Silicon Valley in 1998-1999 (2005) (unpublished doctoral dissertation on file with the author).

in profits-per-partner in 2000, Brobeck shut its doors permanently in 2003.⁴²

The bubble economy had important effects on law firm clients as well—effects that influenced the demands clients made on their attorneys. It is in the nature of a stock market bubble that underlying conditions in the real economy can, for a time, be disguised in the apparent prosperity of the equity price run-up. As participants in the market began to believe that share price increases would continue, it became possible for firms to finance themselves with equity—or even with warrants that could not be exercised until the stock reached even greater heights. Firms could become their own bankers: rather than turning to lenders for financing, they could simply issue stock to fund their acquisitions. Accounting measures of profitability became subject to manipulation because poor results from operations could be offset by sales of appreciated assets. It became nearly a fetish during this period for firms to show steadily increasing profits. Managers of firms

⁴² See Ann Grimes, *Brobeck Law Firm Could Dissolve As Merger Folds*, *Wall St. J.*, Jan. 31, 2003, at B2; Brenda Sandburg, *Brobeck to End Turmoil by Going Out of Business*, *Nat'l. L.J.*, Feb. 3, 2003, at A15, Col. 1.

naturally turned to their lawyers to help them realize these objectives.

Executive compensation also played a role. Part of the problem was tax-driven. In 1994, Congress, in a perhaps ill-considered bow to populist resentment, restricted the deductibility of executive salaries over \$1 million per year in publicly traded companies.⁴³ One result was to increase the desirability of stock options as forms of managerial compensation, since options did not cost the company anything out of pocket when issued, yet provided real value to managers (options did, of course, potentially dilute the interests of the company's shareholders). From the managers' point of view, options became desirable as well when share prices began their steep climb. As the bubble economy took hold, it looked like nearly any option could quickly be in the money. Furthermore, the use of options appeared to jibe with the ideology of free markets. By enhancing managers' equity interests in the

⁴³ See I.R.C § 162(m), codified at 26 USC § 162 (2000) (denying deductibility to CEO and top officer pay in excess of \$1 million annually unless the excess consists of options or is based upon the achievement of performance goals that have been established by a compensation committee composed solely of independent outside directors).

companies they served, options appeared well designed to align the incentives of managers with those of shareholders, and thus promised to reduce the agency costs of management. Accordingly, companies engaged in massive issuance of options to their senior officers during the 1990s.⁴⁴

Another effect of the bubble economy was psychological. As belief in the inevitability of share price increases grew, people lost hold of ordinary caution about economic realities. They began to believe that things really were different, that the laws of gravity had been repealed when it came to share prices, and that old-fashioned warning signals such as price-earnings ratios did not have to be heeded on the information superhighway. The mood of the entire market became euphoric. It is possible that some attorneys came to share that effervescence, and accordingly found it possible to participate in actions designed to create, in the public mind, a relentlessly upbeat picture of corporate performance even when a sober assessment would bespeak caution.

⁴⁴ See Kenneth A. Bertsch, Rachel Leahey, and Hawie Haun, Board Practices: The Structure and Compensation of Boards of Directors at S&P Super 1500 Companies 19 (Investor Responsibility Research Center 1998) (81 percent of S&P 500 firms awarded directors stock or options in 1997).

III. Changing Incentives and Attorney Independence

So far, this Article has illustrated how Professor Gilson's model of value creation does not fully apply to legal compliance and corporate governance activities by private attorneys, and has identified both the bubble economy of 1995-2000 and the deeper evolution from club to competitive organization as salient factors affecting the incentives facing attorneys in elite law practices. We are now in a position to address the question posed at the outset of this article: how have changing economic conditions affected the propensity of lawyers to display independence in their professional representation of business clients? My thesis is that these developments significantly altered the cost-benefit calculation facing attorneys when confronted with the question whether to exercise independence.

For one thing, attorneys operating under competitive organization have lower incentives and ability to monitor one another to detect and deter misconduct. Because attorneys receive compensation today based partly on their own performance, their financial interests are not as closely tied to the actions of their partners as in years past. They have less reason to expend energy to ensure that their partners are serving other clients well. Further, maintaining the firm's

reputation may not be as important in competitive organization as it was in the club system. What matters to an attorney who is being compensated under an "eat-what-you-kill" system is whether a client came to him or her personally (or to his or her practice group). If the client came in because of the reputation of the firm as a whole, the attorney is unlikely to receive as large a percentage of the revenues from that client even if he or she ends up as the billing partner. Because attorneys are likely to be less concerned with overall firm reputation, they have less incentive to check up on how other attorneys are conducting their practices. Further reducing the attorney's bond with the long-range interests of the law firm is the probability that the attorney will move. An attorney who knows that he or she is likely to leave a firm has a lower incentive to monitor other attorneys in order to maintain the firm's reputation.

Attorneys not only have reduced incentives to monitor their partners; they also have reasons to avoid exposing their own work to monitoring by others. In an "eat-what-you-kill" compensation environment, attorneys may avoid sharing details of their practices with others in the firm out of fear that weaknesses in their performance will lead to reduced compensation or that other attorneys in the firm may poach their clients.

Increases in firm size also affect monitoring incentives. When a firm is relatively small, each attorney is likely to feel responsibility for others in the firm. But when a firm grows large, the sense of corporate obligation dissipates. Responsibility for monitoring attorneys becomes the job of the executive committee. And even executive committees may lack the ability to effectively monitor attorneys in mega-firms. Such monitoring as occurs may take the form of reviewing billings and profitability—not the sort of scrutiny that is calculated to enhance ethical behavior by lawyers.

The transition from club to competitive organization has also adversely affected the ability of lawyers to monitor their clients. To be an effective overseer of another person's activities, a party must have knowledge of the party's conduct, the ability to influence his actions, and the proper incentives to influence the actions in the right way. The club system arguably accomplished all three of these objections with respect to the relationship between outside counsel and corporate clients. Under the club system, the longstanding relationship between lawyer and client often gave the lawyer a comprehensive understanding of the client's situation—knowledge based not only on extensive involvement over time with the client's legal problems, but also on a long history of personal interactions with the client's senior managers. The rich network of

relationships that existed under the club system also provided attorneys with a nuanced and effective palette of resources to employ in order to encourage the client to avoid testing legal limits. A word spoken on the golf course could sometimes accomplish as much as a formal memorandum to the board of directors. Further, the pattern of interactions between lawyers and client management made conflicts with the attorney costly to the client because valued friendships and personal business relationships might be jeopardized (although, because the attorneys would incur similar costs, the risk of a breach might also deter counsel from threatening to sever the relationship).

Attorneys operating within the club system also had good incentives to use their knowledge and influence in a constructive way. As a result of the longstanding relationship, lawyers identified emotionally with the client's long-range institutional interests. Counsel also had economic interests in the client—in the form of an anticipated income stream—that promoted a long-range perspective on the client's affairs. Attorneys under the club system were not likely to be swayed by the prospects for a quick fix of the company's financial statements if the result was only to put off even more serious problems until another day.

These advantages of the club system at encouraging effective monitoring of clients are largely dissipated under

competitive organization. Because relationships between attorney and client are more transitory, and based typically on a thin data set of work on formal legal matters, without the deeper understanding that comes from personal interactions, attorneys under the competitive system are likely to operate with less knowledge of the client's affairs and institutional processes. The client may also be less willing to share information with the attorney because the two are operating at arms length on matters of compensation and retention and because the client may not want to provide the attorney with facts that could complicate matters if the client wishes to change counsel. The attorney's influence with the client is also less substantial under the competitive system. Without extensive interpersonal bonds, the attorney may not know how to manage the political forces within the client in order to achieve legal compliance and avoid questionable activities.

Attorneys under the competitive system, moreover, do not have the same alignment of interests with the long-range best interests of the client. Lawyers today are less likely to identify emotionally with the client as an institution, and more likely to perceive their interests as tied to the particular officers who have the power to allocate legal work—individuals who themselves may not have interests that are fully aligned with those of the institution as a whole. Moreover, because

under competitive organization the law firm does not have confidence that it will be retained indefinitely, its perspective is foreshortened: the lawyers will discount their expectation of receiving a future income stream by the probability of being replaced by other counsel, and thus will tend to focus more on the client's short run results than on its performance over the long term. All these factors suggest that attorneys under competitive organization are likely, other things equal, to be less effective monitors than they were under club organization.

Competitive organization also increases the bargaining power of clients vis-à-vis attorneys. Most importantly, clients these days possess a realistic ability to switch counsel even when they have a longstanding relationship with a firm. The elaborate network of contacts, loyalties and obligations that bonded law firm and corporate client together under club organization has largely disappeared. In today's competitive environment, there are always plenty of firms eager to bid for the client's business. Thus, as the market for legal services has grown more competitive, the social conditions that allow lawyers (if they would chose to do so) to act independently as a "conscience" for their business clients have dissipated. When it comes to relationships between law firms and their corporate clients, no-fault divorce is now the standard.

The threat of client defection can be a powerful antidote to attorney independence in an "eat-what-you-kill" environment. Each attorney's welfare in such a system is tied to billings from a few clients. The risk of losing a client is not diversified for that attorney as it would be under a lockstep system in which client losses (and gains) are spread among all the partners. Thus, losing a major client can be personally devastating. Clients, knowing this fact, can exercise leverage over the attorney by threatening to leave the firm—or even (and perhaps worse) by requesting reassignment to a different partner within the firm.

The fear of losing a client applies also to firms as a whole. It's true that under the "eat-what-you-kill" system each attorney is less exposed to losses of clients by other attorneys, and also true that as law firms grow in size, they become better diversified against such losses. Nevertheless, no firm wants to lose a major client, both because the reduction in billings will affect compensation of all attorneys to some extent and also because defection of a big account can be demoralizing within the firm and damaging to its reputation outside. Moreover, even when firms become very large, major clients can still represent a significant share of their billings.

The financial structure of law firms under a competitive environment also reduces a firm's bargaining leverage vis-à-vis clients. The huge base of associate attorneys at large firms creates a payroll obligation which, as noted above, is not particularly flexible in the short run. Firms also face other financial commitments including office leases and debt service. The need to satisfy these obligations generates an imperative to maintain billings. Further, the "tournament of lawyers" works only if there in fact is a tournament. Even if they have some flexibility at the margin to cull out weaker candidates in tough economic times, law firms must continue to promote associates. Unless the firm is in the position to echo Cravath's boast that it turns away more work than it accepts, the threat of the loss of a significant source of billings carries with it the possibility of financial repercussions. These considerations make it dangerous for a law firm to exercise independence in representing a client if doing so risks a possible loss of business.

Moreover, even if a law firm did attempt to exercise independence, the exercise might be futile. Clients can easily find other firms willing to do their work, and if they look hard enough, they can probably find one more willing to test the edges of the permissible. By exercising independence, the first firm may find itself simply losing billings without deterring

the client's wrongful conduct. If the first law firm perceives that resistance to the client's demands would only be self-defeating, it may be less likely to attempt the exercise in the first place. And if clients understand that they have little to fear from changing counsel, they may be more inclined to push for actions that approach the line of what is legally permissible.⁴⁵

Even if attorneys have experienced a significant reduction in their bargaining leverage vis-à-vis clients over matters of legal compliance, this fact alone would not necessarily be problematic so long as clients did not want attorneys to assist them in questionable actions. However, evidence from Enron and other cases indicates that at least some clients do want their attorneys to push the envelope. Such client pressure can be understood, in part, as a product of the same economic conditions that we have been discussing throughout this paper. Just as the legal business has become more competitive, so has the business of many clients. Pressed to make profits in a

⁴⁵ The analysis of whether attorney withdrawal is in fact relatively painless for the client is complicated, however, by the question of the signal that such withdrawal might communicate to others—a matter discussed in the final section of this paper.

competitive environment, clients may pressure attorneys to test or bend the law.

The bubble economy also played a role. The boom years tended to select for advancement within companies people who were relentless optimists and risk-takers, and who sometimes had a deaf ear for cautionary signals. The natural risk-preference and capacity for denial displayed by these individuals was further accentuated when stock options became important aspects of executive pay. Managers holding large portfolios of options benefited from increasing the volatility of their firms. Thus managers with significant option compensation were encouraged to take inappropriate risks—a feature of option-based compensation that was perhaps noted but little appreciated during the heyday of the bubble. Even more troubling, these individuals found it to be in their interests to manipulate public perceptions of the performance of their companies in order to enhance the value of their options and to reinforce the perception that all was well in their firms. The temptation to use any means fair or foul to achieve this result sometimes proved irresistible.

The manipulability of financial statements in a bubble economy also generated imperatives for managers to present ever-improving financial statements to the investing public. While some degree of earnings smoothing may be legitimate in order to avoid misleading the market, the process of adjusting earnings

is too easy to turn into deception. "Smoothing" becomes a euphemism for fraud. The pressure to present positive financial results every quarter led officers of some public companies to go over that line. And to achieve such desired results they needed to enlist the services of lawyers.

Finally, the intoxicating gas that inflated the share market bubble also may have played a role. It is possible that some attorneys were so caught up in the euphoria of soaring stock prices that they were able to persuade themselves that their participation in questionable activities would never come to light, or that if discovered, it would be understood as justified by the spirit of the times.

Overall, the analysis in this section suggests that far-reaching economic developments—the evolution from club to competitive organization in the legal services industry and, during the late 1990s, the share market boom—had more to do with causing the problems at Enron and other companies than any erosion in the private ethics of corporate lawyers.⁴⁶ Given the enormous pressures that these developments created, it is not surprising that some lawyers failed to exhibit the degree of

⁴⁶ Whether attorneys at Enron or other fraud-ridden companies in fact went over the line of permissible legal representation will presumably be determined in the legal process.

independence that we would wish for counsel in such important positions. What is perhaps noteworthy is that more attorneys did not fall into the trap. Nevertheless, it is unfortunate that any went over the line. It would serve the public interest to deter such conduct if it is possible to do so without creating greater costs than the harms being prevented. The next section of this paper offers tentative and preliminary thoughts about possible reform strategies.

IV. Recommendations for Reform

If it is true that changing economic conditions have reduced the ability of business lawyers to display independence when representing corporate clients, the question becomes whether the regulatory system should undertake any actions in response. Should business lawyers be placed under obligations to protect the public interest even at some cost to their undivided loyalty to clients?

A natural but facile response argument against such reform efforts is to revert to a visceral defense of zealous advocacy. An advocate, Lord Brougham famously observed, "knows but one person in all the world, and that person is his client."⁴⁷ Under this strong form of the ideal of undivided loyalty, the attorney

⁴⁷ 2 Trial of Queen Caroline 8 (J. Nightengale ed., 1821).

is bound to defend the client with every legitimate means at his disposal. In the criminal context, this means attempting to raise doubts of guilt even by sophistry, innuendo, and deception short of falsehood. Even in the civil context, the lawyer can and should use all available means to advance the client's interests. The ideal of pure and energetic loyalty resonates with a long tradition at the bar.

However appealing these images might be, they are misplaced in the contexts we have been considering. In the case that generated Lord Brougham's famous encomium, Queen Caroline was accused of cuckolding the King of England; she faced the resources of the Crown in his divorce suit against her and needed all the help she could get.⁴⁸ The lawyer's undivided loyalty to the client was a means of leveling (to some extent) the playing field in which the adversarial contest occurred. Similarly, we accept some level of sophistry as appropriate for criminal defense counsel because of the perceived imbalance between the resources of the state and those available to the defendant and because the sanctions for conviction are so high. But this is not the setting of recent corporate frauds. When attorneys represent corporate clients in compliance matters or

⁴⁸ See generally Roger Fulford, *The Trial of Queen Caroline* (1967).

in corporate cases where the agency costs of management are high, the imbalance is reversed. The risk in these settings is that the attorney's skills will be employed to take inappropriate advantage of the public at large or of disorganized and unrepresented shareholders. Strong norms of loyalty to clients may not be necessary to protect the public interest in these settings.

How, then, should the incentives of attorneys be adjusted to achieve optimum behavior from a social point of view? Ideally, we would want to employ strategies that align the attorney's interests with those of the public. If we can accomplish this task perfectly, then we do not need to worry about enforcement. The attorney's own self-interest will take care of the public's interest as well. However, it is difficult to achieve this alignment. The "public interest" is notoriously difficult to identify. We would not readily conclude, moreover, that the public interest, whatever it is, would be served if attorneys ensured that their clients never tested the limits. We do not put a fence around the law to avoid close encounters with the impermissible. "[T]he very meaning of a line in the law," Justice Holmes observed, "is that you intentionally may go

as close to it as you can if you do not pass it.”⁴⁹ And because the law is not always clear, even good legal representation will result from time to time in clients going too far. If lawyers always dissuaded their clients from even approaching the line we would have over-deterrence because the lawmaker sets the legal standard with the assumption that people are allowed to take advantage of all permissible actions. Lawyers who too zealously guard the law’s outer boundaries will often be “deal-killers” who harm rather than help the public interest.

One could imagine an attempt to set up an incentive-compatible compensation system for lawyers that would at least align their interests with the long-range best interests of their corporate clients. Such a system might help deal with some of the problems if the expected income stream from the client was sufficiently extended in time. For example, attorneys (and other professional service providers, such as auditors or management compensation consultants) might be paid in the form of options with strike dates spread out over a period of years, or might receive vested rights to receive treasury stock at periodic intervals. Because the compensation would be tied to the performance of the company over time, the

⁴⁹ Superior Oil Co. v. Mississippi, 280 U.S. 390, 395-96 (1930) (citation omitted).

recipient would have the incentive to take the company's long-range best interests into account in formulating his or her advice or service. Service providers in such a case might be less willing to assist managers in conduct that is harmful to shareholders, or to facilitate corporate action that deceives financial markets in the short run but that harms the company's welfare in the long run. Such compensation systems might be worth exploring, although it is not clear they would be feasible.⁵⁰ Moreover, even if we could devise a compensation system that aligned the incentives of service providers with the long-range best interests of their clients, this would not necessarily equate with service to the public interest because their clients' long range interests might differ from those of the public.

An alternative approach is to formulate concrete behavioral rules governing attorney conduct. Such rules hold some promise for addressing the perceived deficit in attorney independence. They must, however, be designed cautiously. For example, we have noted that some of the recent problems seem to have been

⁵⁰ Among other problems, they would be costly to the client because the service provider would have to be compensated for the significant loss of liquidity and increase in undiversified risk.

influenced by the share price bubble of 1995-2000. This phenomenon should not provide a justification for reforms. While the bubble's effects were no doubt profound, they were also limited in time. It is unlikely that a similar share price boom will occur for a considerable period. Reforms that might be appropriate in a boom setting are unlikely to be desirable in normal times. Reforms should not be so onerous as to detract from the value that lawyers provide to clients and the legal system. It would be a mistake to overreact to the events of the bubble economy by adopting structural reforms whose long-range costs may exceed their benefits.

The transition from club to competitive organization, however, does provide a potential basis for structural reform, since the development is profound, long-standing, and unlikely to change. The question is whether and to what extent this development warrants structural changes in the rules governing legal representation of corporate clients. I will briefly address four such changes, each of which has been put forward as a possible policy response to the problems that manifested themselves in Enron and other disasters. The goal is not to comprehensively analyze each of these four proposals, but rather to draw out implications for these proposals of the evolution from club to competitive organization discussed in the first sections of this paper.

A. Up-the-Ladder Reporting

One such reform is the adoption of express instructions to attorneys to engage in "up the ladder" reporting of client misconduct. Such a requirement has recently been imposed for lawyers representing clients before the Securities and Exchange Commission. The SEC's final rule implementing § 307 of the Sarbanes-Oxley Act⁵¹ requires that lawyers who become aware of "evidence of a material violation" must report their discovery to successively higher levels of authority within the client under certain circumstances.⁵² An attorney who discovers such

⁵¹ See Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 8185, Exchange Act Release No. 47,276, Investment Company Act Release No. 25,919, (need Federal Register info), (Aug. 5, 2003) [hereinafter "Adopting Release"], available at <http://www.sec.gov/rules/final/33-8185.htm>.

⁵² As used in the rule, "evidence" means "credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur." Adopting Release § 205.2(e). A "material violation" means "a material violation of an applicable United States federal or state

evidence may report the evidence to the company's Chief Legal Officer (CLO) and if appropriate the company's CEO. Upon receiving such a report, the CLO is required either to investigate the report or refer the evidence to the company's Qualified Legal Compliance Committee (QLCC), if such a committee exists. If the CLO investigates and concludes that there is an ongoing material violation, he or she must notify the reporting attorney and take all reasonable steps to cause the company to adopt an appropriate response. If the CLO refers the matter to the QLCC, it is then the committee's job to take the appropriate action. If the reporting attorney receives an appropriate response from the CLO, no further action is required. If, however, the reporting attorney does not receive an appropriate response, he or she must go up the corporate ladder by reporting the matter to the audit committee, a different committee of independent directors, or the full board. If the reporting attorney reasonably believes that it would be futile to report evidence of a material violation lower in the corporate

securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law." Id. § 205.2(i).

hierarchy, he or she may report the matter directly to the QLCC or the board.

These rules apply only to attorneys who practice before the SEC. The generally-applicable ethics rules do not presently require up-the-ladder reporting, but do not rule it out either. Under ABA Model Rule 1.13(b), if an attorney for an organization knows that a corporate officer is engaged in (or intends to engage in) a violation of a legal obligation to the company or an illegal action that might be imputed to the company, and the conduct in question is likely to result in substantial injury to the organization, the attorney shall "proceed as is reasonably necessary in the best interest of the organization." Unless the lawyer reasonably believes it is not necessary in the best interest of the organization to do so, he or she is required to refer the matter "to higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization as determined by applicable law."⁵³

Up-the-ladder reporting can be a constructive reform in light of the trend from club to competitive organization documented earlier in this paper. As we have seen, under competitive organization, law firms have less bargaining

⁵³ Model Rules of Prof'l Conduct R. 1.13(b) (2003).

leverage with clients than under club organization. Clients that wish to test legal limits can select law firms that are willing to overlook problems. And because law firms need clients, they will face competitive pressures to offer lax supervision.⁵⁴ One means for testing the limits is for the client's board of directors not to know what is going on. Senior executives who have the most to gain can keep the information to themselves. If up-the-ladder reporting is not mandatory, law firms that want to assist clients in limit-

⁵⁴ This is not to say that all law firms would give in to these pressures. In fact, law firms that do not bend to a client's wishes can develop valuable reputations as rigorous monitors. By employing these law firms, clients can signal to regulators, the investment community and other interested parties that they are willing to subject themselves to a form of independent legal audit. However, only a limited number of law firms can occupy this market niche. Among other things, such a law firm needs to be able to demonstrate that it is selective about work. When a law firm boasts that it turns away clients, it signals that it can afford to be a rigorous monitor because it can withdraw from any of its accounts without incurring unacceptable financial costs. But not many law firms are in this position.

testing will not report. But mandatory up-the-ladder reporting disrupts the equilibrium because all firms have the obligation to inform higher authority. Although some law firms might elect to ignore this obligation, they face sanctions if their failure to report is subsequently revealed (as it would be, for example, if the client declares bankruptcy or otherwise falls into the hands of new management). Thus, the general idea of mandatory up-the-ladder reporting appears to be a sensible means for enhancing the bargaining leverage of firms that provide legal services to corporate clients in compliance and fiduciary duty matters.⁵⁵

⁵⁵ Much depends, of course, on the specific definitions and text of the requirement. For example, the SEC's rule is considerably more stringent than the ABA's. Under the ABA rule, attorneys have an "out" if they conclude that a referral would not be in the best interests of the organization, a feature that is lacking under the SEC approach. See Model Rules of Prof'l Conduct R. 1.13(b). The ABA rule, moreover, applies only when an attorney "knows" of an actual or intended violation. The SEC rule does not require knowledge of facts or conclusions of law, but only "evidence of a material violation." Adopting Release § 205.2(e). Thus, the general up-the-ladder reporting requirement under ABA Rule 1.13 is weaker than the corresponding SEC rule.

B. Noisy Withdrawal

Another family of reform measures are proposals for "noisy withdrawal" in situations where the client fails to take remedial action after the attorney brings a problem to the attention of suitably placed persons within the organization. The metaphor of "noise" in this phrase is used for two somewhat conflicting purposes. On the one hand, noise commands attention. The idea suggests that the attorney's action conveys a signal to regulators that all is not right with the client's legal compliance. On the other hand, noise interferes with communication by crowding out meaningful information with signals that are not meaningful. The term thus conveys the idea that the signal conveyed by the withdrawal disguises whatever attorney-client confidences may have precipitated the lawyer's decision.

The SEC proposed a noisy withdrawal obligation as part of its regulations implementing § 307 of the Sarbanes-Oxley Act,⁵⁶

This difference may be justified because the ABA rule applies across the board to many different forms of legal representation, whereas the SEC rule applies in a special context that has proved to be problematic in recent years.

⁵⁶ Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release 8150, Exchange Act Release No.

but omitted the concept from its final rule.⁵⁷ However, contemporaneously with issuing the final rule, the SEC extended its request for comments on the noisy withdrawal proposal.⁵⁸ Under the proposed rule, when an issuer's outside counsel has complied with the obligations of the up-the-ladder reporting requirement and has not received a satisfactory response, and the attorney reasonably believes that a material violation is ongoing or is about to occur and is likely to result in substantial injury to the financial interests or property of the issuer or of investors, the attorney would be required to withdraw from the representation with the indication that the withdrawal is based on "professional considerations." Within one business day, the attorney would be required to give written

46,868, Investment Company Act Release No. 25,829, 67 Fed. Reg. 71670-01 (Dec. 2, 2002).

⁵⁷ See Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release 8185, Exchange Act Release No. 47,276, Investment Company Act Release No. 25,919, 68 Fed. Reg. 6296-01 (Feb. 6, 2003).

⁵⁸ See Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 8186, Exchange Act Release No. 47,282, Investment Company Act Release No. 25,920, 68 Fed. Reg. 6324-01 (Feb. 6, 2003).

notice of the withdrawal to the SEC, again stating that the action was based on "professional considerations." The attorney would also be required promptly to disaffirm to the SEC any opinion or other writing that the attorney had prepared or assisted in preparing and that the attorney reasonably believes is or may be materially false or misleading.

Versions of noisy withdrawal have also been proposed at the state level. California experimented with one, but the idea was rejected by the state Supreme Court as inconsistent with statutory requirements.⁵⁹ The recent amendments to ABA Model Rule 1.13 also contain what might be termed a "muted" form of noisy withdrawal. If an attorney is discharged or withdraws in a situation where the attorney knows or has reason to know of a legal violation by a person associated with the client (as more specifically defined in the rule), the attorney "shall proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal."⁶⁰ This provision is muted because the attorney is only required to make noise internally: she must

⁵⁹ See John W. Amberg & Jon L. Rewinski, Ethics Roundup: Issues of Loyalty and Confidentiality Continue to Dominate Developments in Legal Ethics, 26 L.A. Law. 31, April 2003.

⁶⁰ Model Rules of Prof'l Conduct R. 1.13(e) (2003).

make sure that the highest authority in the client is informed of the problem, but need not inform any external agency.

Noisy withdrawal proposals can be understood (in part) in the context of the secular trend from club to competitive organization discussed earlier in this paper. First, for the same reasons as those pertaining to up-the-ladder reporting, it is important that the noisy withdrawal provision be mandatory rather than permissive. If the noisy withdrawal provision is permissive, the effect might only be to cause clients to seek out law firms that are willing to provide assurance that they will not report them. Two perverse consequences would follow: permissive withdrawal would tend to reward law firms that are willing to assist clients to evade legal compliance or engage in arguable breaches of fiduciary, and would also reduce rather than increase the constraints on the conduct of the very parties whose behavior we wish to control—risk-preferring managers who want to test the limits of the law. Under competitive organization some law firms will be compelled to assume the role of assisting clients in questionable behavior, because clients have sufficient bargaining leverage to pressure them to do so. Thus, in light of the competitive pressures under which attorneys operate today, noisy withdrawal rules should be mandatory.

The question remains whether such rules should be implemented at all. Although noisy withdrawal is debated today as something new, in fact it is a variation of ordinary withdrawal, an option that has always been available, and sometimes required, when attorneys confront the tension between loyalty to the client and the obligations incident to being an officer of the court. Ordinary (as opposed to noisy) withdrawal is an important structural element of the existing rules of professional responsibility. Withdrawal is permitted or required in many circumstances.⁶¹ Most importantly for present purposes, it is the traditional solution for cases in which the client demands that the attorney pursue a course of conduct which the attorney considers to be illegal, imprudent or unwise.⁶²

⁶¹ See Model Rules of Prof'l Conduct R. 1.16 (2002).

⁶² See id. at R. 1.16(a)(1) (mandatory withdrawal when "the representation will result in violation of the rules of professional conduct or other law"); id. at R. 1.16(b)(2) (permissive withdrawal when "the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent"); id. at R. 1.16(b)(4) (permissive withdrawal when "the client insists upon

While the legal consequences of ordinary withdrawal are only that the attorney no longer represents the client, it has other effects. Withdrawal is expensive for both the attorney and the client: the attorney loses a profitable source of billings, and the client loses an attorney with whom the client has developed a relationship and who is familiar with the client's affairs. Withdrawal also conveys a signal to third parties. That an attorney no longer represents a client is not something that can easily be hidden. People who observe the severing of ties will draw inferences about the reasons. In some cases, they will not be able to tell the reason for the split. The law firm and client may agree to a bland explanation and may adhere to that agreement. Even if third parties cannot ascertain the reason for the split, however, they are likely to conclude that the event itself does not speak well for either party. Moreover, some information about the reasons for the disassociation is likely to come out. A split between an attorney and a significant client is often the subject of gossip. Whichever party considers itself to be in the "right" is particularly likely to disclose reasons for the breakup in order to deflect adverse public perceptions onto the other

taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement").

party. If the attorney has been fired for incompetence or questionable billing practices, for example, the client is likely to make that fact known. Similarly, although attorneys must take care to avoid disclosing privileged information, they may find ways to suggest that the severing of relations was due to some fault in the client. Thus, when an attorney withdraws because a client insists on actions that are close to or over what the attorney considers the line of permissible behavior, that fact may become generally known or believed. Withdrawal is thus costly both to attorney and client. Because these costs are shared, withdrawal can be understood as a self-regulating mechanism that attempts to optimize between the attorney's role as gatekeeper and his or her function as zealous advocate and preserver of client confidences.

The practical effects of withdrawal have changed, however, as the legal professional has evolved from club to competitive organization. Under the club system, withdrawal by outside counsel conveyed a particularly powerful signal to third parties. Because law firms represented clients on a long-term basis, and because lawyers were connected with client management in all sorts of ways, withdrawal conveyed high costs on both parties. Persons who observed the severing of relationships would know that something significant had occurred. Moreover,

because withdrawal was uncommon, when it did occur it would be a focus of intense interest.

Under competitive organization, in contrast, the practical consequences of withdrawal are different. Although withdrawal remains costly for both parties, it is less burdensome for clients than in times past because clients are not as firmly tied to any particular firm. To the extent that the costs of withdrawal are lower for clients, the attorney loses the ability to influence the client by credibly threatening to withdraw. And when the parties do part ways, the effects of the signal to third parties may not be as detrimental to clients. Because clients and law firms part ways frequently under competitive organization, withdrawal by an attorney will not necessarily provoke intense interest. It is no longer "news" when an attorney and a client part ways. For the same reason, a parting of the ways does not necessarily indicate that something fundamental has occurred. Many separations between attorney and client occur for reasons that do not reflect adversely on either party. Moreover, we have observed that under competitive organization the client has gained bargaining leverage vis-à-vis the attorney. Because a separation is more costly for attorney than for the client, a third party who observes a severing of relations would tend to infer that the impetus for the change came from the client. On the other hand if the reason for the

separation came out, and that reason turned out to be that the attorney had withdrawn rather than been discharged, the adverse inferences about the client might be stronger: because attorneys incur a high cost from severing relations with a client, the fact a split has occurred at the attorney's insistence may lead an observer to conclude that there is something wrong with the client. Overall, however, it appears that the signal conveyed by a separation between attorney and client is less detrimental to the client under competitive organization than under the club system.

If this analysis is accurate, it could provide a reason to enhance the effect of withdrawal. The rules of ethics have relied on withdrawal as a counterpoise to the danger of client overreaching. But if withdrawal has become less of a sanction as a result of changes in economic organization, then the client malfeasance may become more of a concern. To address the problem, the regulatory system might wish to enhance the "sting" of withdrawal for the client. Noisy withdrawal has this effect because it magnifies the signal and also directs it to the party who is in the best position to impose a sanction on the client. Noisy withdrawal, in this sense, can be seen as a corrective for the reduction in attorney independence caused by the evolution from club to competitive organization in the service professions.

Much depends, of course, on how strong the enhancement of the signal is. The mantra of "professional considerations" found in the SEC's proposed rule threatens to be a powerful signal indeed. The words "professional considerations," in themselves, sound innocuous, but when contained in a written communiqué to the SEC pursuant to § 307 of the Sarbanes-Oxley Act, they attain magical potency. Because that form of words is mandated by the proposed rule, we can be sure they will not be used except in contexts contemplated under the rule. Accordingly, the SEC's proposal essentially requires a lawyer who practices before the agency to inform it of probable legal violations by a client. While the SEC may be left guessing about what those violations might be, there is nothing to stop it from commencing an investigation based on the attorney's report in order to ferret out the problem. This is "noisy" indeed. Whether the noise is too great in light of the risks is a question that the regulatory system will need to address and resolve over the coming years.

C. Disclosure of Client Confidences

The ABA also recently adopted important changes to the rules on confidentiality. Revised Rule 1.13(c) provides that if the attorney fulfills his or her responsibility of up-the-ladder reporting and the organization's highest legal authority fails to take appropriate action, and if the lawyer reasonably

believes that the violation is reasonably certain to result in substantial injury to the organization, then the lawyer may reveal information relating to the representation, but only and to the extent that the lawyer reasonably believes necessary to prevent substantial injury to the organization.⁶³ The information can be revealed even if it would otherwise be protected under the basic confidentiality provisions of ABA Model Rule 1.6.⁶⁴

⁶³ Model Rules of Prof'l Conduct R. 1.13(c) (2003).

⁶⁴ New Rule 1.6 permits (but does not require) an attorney to reveal information relating to the representation of a client to the extent the lawyer reasonable believes it necessary "to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services" or "to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services." Model Rules of Prof'l Conduct R. 1.6(b) (2003).

The analysis in this paper suggests a reason for concern about this rule. As we have noted, the bar has moved from club to competitive systems as the dominant form of economic organization. As a result, attorneys have less bargaining power vis-à-vis corporate clients than they had at one time. I argued above that in light of this development, reforms such as up-the-ladder reporting and noisy withdrawal, to be effective, must be mandatory. Otherwise they could have the perverse effect of exacerbating the situation because managers of firms who wish to test the limits will deliberately seek out attorneys who will exercise only minimal control. Similar concerns are present in the context of disclosure of client confidences. If senior management in a client wishes to test the limits, they will want assurances that their lawyers will not disclose their conduct to the authorities in the event that the lawyer becomes squeamish about the risks. If the rules on confidentiality permit (but not require) such disclosures, managers of those firms that we most wish to control—i.e., individuals with a taste for risk and a well-developed ability to deny inconvenient facts—will be especially careful to seek out attorneys who they can rely on not to divulge their confidences. Permissive disclosure can, ironically, reward attorneys whose independence is low. If such attorneys can reliably signal to clients that they will not “rat them out,” they can potentially develop a profitable market

niche among the clients whose conduct we most want to control. And even reputable law firms may find it hard to resist the pressures to remain mum. Few law firms would want to take up the invitation of Rule 1.13 to disclose client confidences, because if they do so, they will gain a reputation as a firm that cannot be relied on in a pinch. In short, under competitive organization, permissive disclosure under Rule 1.13 could do more harm than good. We could, of course, make such disclosure mandatory, thus solving the problem of creating an equilibrium in which firms are rewarded for their lack of independence. But the costs of a mandatory disclosure rule, in terms of creating distrust and lack of communication between attorneys and clients, would potentially exceed any perceived benefits. An analysis of the underlying economic trends in the industry suggests reasons for concern about the utility of Model Rule 1.13 insofar as it allows, but does not require, attorneys to disclose client misconduct when up-the-ladder reporting has proved ineffective at rectifying the problem.

D. Changes in Professional Identity

A final potential reform is to attempt to influence business lawyers' sense of professional identity. The means for implementing such reforms would presumably include, for example, changes in legal education to stress the value of independence; changes in training programs for younger attorneys in practice;

enhanced emphasis on professional independence in continuing legal education programs; and perhaps displays of public commitment to the concept of attorney independence by influential bodies such as the American Bar Association.

The idea of changing the professional self-identity of attorneys is appealing because, if successful, it is self-policing. When people have internalized a particular sense of identity, it no longer is crucial to control them from without. The control occurs internally because people experience uncomfortable feelings when asked to do something that is in conflict with their self-concept.⁶⁵

Should the organized bar attempt to influence professional identity formation in order to enhance ethical lawyer action? Efforts to enhance a sense of the value of independence among corporate lawyers probably would not hurt but can only be expected to have a modest impact. Efforts by the government or other organized interests to change professional identities are not always successful. Indeed, the organized bar has already attempted the exercise. After the Watergate scandal, the ABA

⁶⁵ For extended discussion of the role of identity as a form of social control, see Geoffrey P. Miller, *The Legal Function of Ritual*, 80 *Chicago-Kent Law Review* 1181 (2005)

required that law schools provide instruction in the history and norms of the legal profession. The purposes of this reform were to promote more ethical conduct among attorneys and to counteract the negative public image of attorneys that the scandal had triggered. It is not clear that the reform had any lasting effect on lawyer behavior beyond forcing thousands of law students to take upper-level mandatory courses in legal ethics, thus giving many of them a decidedly negative view of the whole subject. It's likely that all of the attorneys involved in the most recent spate of corporate scandals were instructed in legal ethic and passed the professional responsibility section of the bar examination. This and other examples suggests the need for caution about what can be accomplished when the government or organized bar seeks to shape professional identities.

At the same time, some of the work at altering professional identities may already have been accomplished—not by the government or the bar associations, but by events. Enron and other scandals may result in devastating liabilities for law firms. Some firms associated with the scandals have already suffered losses of clients and defections of partners and associates. The mistakes that may have been made by attorneys in these cases stand as object lessons for all lawyers in business law practice—lessons that probably will do more to

shape behaviors than any number of hours of continuing legal education. At the same time, clients also have learned from the recent fiascos. It is unlikely that attorneys and other professionals will face the sorts of pressures to manage financial statements or cover up questionable conduct that they faced during the bubble economy years. While these lessons cannot be expected to last forever, they at least promise to operate, for a substantial period of time, as inoculations against behavior that tacks too close to the wind. Circumstances have already accomplished much of the work.

Conclusion

In this paper, I argue that corporate lawyers do not always engage in value creation when they represent clients in compliance matters or in decisions implicating the fiduciary duties of management. The traditional protection against socially undesirable representation is the attorney's independence from the client backed by the threat of withdrawal. That protection, however, has eroded as the legal services market evolved from club to competitive forms of organization. The problems of reduced lawyer independence have come to the fore as a result of the share market bubble of 1995-2000 and corporate scandals that to one degree or another were related to the bubble economy: Enron, WorldCom, Adelphia, and HealthSouth

being prime examples. Although we do not yet know the full facts in those cases, it is possible that if counsel had exercised a higher degree of independence some of the harms might have been mitigated. Having identified the transition from club to competitive organization and the bubble economy as two principal economic developments that have impacted attorney independence, this paper addressed several proposals for reform: up-the-ladder reporting, noisy withdrawal, enhanced permission to reveal client confidences, and changes in the self-identity of the profession. An awareness of the background economic developments provides helpful insights into the policy arguments for and against these proposed changes.