How Corporate Lawyers Escaped Sarbanes-Oxley: Disparate Treatment in the Legislative Process

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HOW CORPORATE LAWYERS ESCAPED SARBANES-OXLEY: DISPARATE TREATMENT IN THE LEGISLATIVE PROCESS

BRENT J. HORTON*

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"The government of democracy is favorable to the political power of lawyers; for when the wealthy, the noble, and the prince are excluded from the government, the lawyers take possession of it . . . ."1

I. INTRODUCTION

No law better illustrates the political power of lawyers than the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley or the Act).2 Sarbanes-Oxley was Congress’s legislative response to the 2001 Enron scandal.3 Enron, with the help of its lawyers, used a series of off-balance-sheet transactions to hide billions of dollars of losses from investors and thus artificially inflated its earnings and, it followed, its stock price.4 When the losses were finally discovered—and disclosed—Enron’s stock price plummeted as investors attempted to sell their overvalued shares.5 In the end, investors lost billions of dollars.6

Corporate lawyers played a central role in helping Enron engineer the off-balance-sheet transactions.7 Part II of this Article describes that role in detail.

4. See, e.g., R.T. McNamar, Lawyers as Corporate Monitors, in AFTER ENRON: LESSONS FOR PUBLIC POLICY 171, 183 (William A. Niskanen ed., 2005) ("Approximately $13 billion [of the off-balance-sheet debt] was incurred through structured finance transactions involving the use of SPEs. Hence the role of the lawyers was key to the financial structure that Enron developed."); Mike France, Close the Lawyer Loophole, BUS. WK., Feb. 2, 2004, at 70, 70 [hereinafter France, Lawyer Loophole] ("Critical elements of many of Enron Corp.’s most deceptive balance-sheet maneuvers were approved by big law firms . . . ."); Mike France, What About the Lawyers?, BUS. WK., Dec. 23, 2002, at 58 [hereinafter France, What About the Lawyers?] ("[T]here’s no way that Enron’s left hand could have sold so many assets to its right hand without creative input from both inside and outside counsel.").
7. See, e.g., France, Lawyer Loophole, supra note 4 (noting the role of the lawyers in creating Enron’s financial structure); Mike France, One Big Client, One Big Hassle, BUS. WK., Jan. 28, 2002, at 38, 38 [hereinafter France, One Big Client] (stating that Enron’s lawyers “played a creative role in structuring and managing some of the company’s controversial ‘special purpose’
However, Sarbanes-Oxley does nothing to prevent lawyers from assisting in corporate fraud in the future. How could Sarbanes-Oxley, a law that purports to prevent repetitive corporate fraud, fail to tackle the very group that aided and abetted the fraud? My explanation, in short, is that lawyers’ substantial influence on politicians, both in terms of monetary contributions and less tangible social and professional connections, meant that lawyers could defeat—albeit covertly—legislation designed to prevent corporate lawyers from doing the same in the future. In support of the above proposition, Part II of this Article describes how corporate lawyers helped devise and structure transactions with the sole purpose of hiding Enron’s debt. Part III explores the historical absence of legal punishments for corporate lawyers who aid and abet such schemes. Part IV describes how corporate lawyers were able to use their considerable influence to defeat legislation designed to impose new legal punishments on corporate lawyers; that is to say, at least in part, corporate lawyers escaped Sarbanes-Oxley because they were able to curry favor with the politicians that controlled the substantive content of the Act.

But corporate lawyers’ influence is only part of the story. Although lawyers were able to avoid new legal punishments under Sarbanes-Oxley, politicians still needed to give the public the impression—and do so quickly—that Congress was being tough on corporate malfeasance. Politicians needed to publicly punish some group, or some scapegoat, for the financial scandals of 2001 to 2002.

Part V expands on the previous question: how did corporate lawyers escape Sarbanes-Oxley while corporate officers and accountants faced greater regulation? The sad truth is that corporate officers and accountants made easier legislative targets than corporate lawyers. Part V describes how the business press failed to cover the lawyers’ complicity in Enron; to the contrary, the business press’s focus was almost solely on the officers’ and the accountants’ roles in the Enron scandal—corporate officers and accountants were in no position to oppose legislation in the spring of 2002. In short, the business press’s coverage encouraged politicians to turn a blind eye to lawyers at the expense of officers and accountants.

partnerships”); France, What About the Lawyers?, supra note 4, at 60 (noting that Enron’s deceptive transactions were “cooked up by cross-disciplinary teams of lawyers, accountants, and investment bankers”).

8. Roberta Romano, The Sarbanes-Oxley Act and the Making of Quack Corporate Governance, 114 YALE L.J. 1521, 1525 (2005) (“It was widely perceived in the media that members of Congress were motivated by reelection concerns when a statute was hurriedly enacted in the summer prior to the midterm elections... following heightened attention on corporate malfeasance as the WorldCom scandal erupted post-Enron.”).

9. See, e.g., id. at 1526 (“The suggestion from the media was that the priority of members of Congress was to enact something, with the specific content of less concern and importance.”).
Part VI considers and rejects the counterargument that the favorable treatment of lawyers can be explained solely by competing policy arguments. Instead, the existence of policy arguments on both sides of the debate—arguments for and against regulating lawyers and regulating officers—supports the contention that more than policy considerations were at play in the formulation of Sarbanes-Oxley's operative provisions. Policy arguments cannot explain the different treatment.

II. A BRIEF HISTORY OF ENRON: PLACING THE LAWYERS’ ROLE IN PERSPECTIVE

Between 1999 and 2001, the business press "cooperated in an intensification of Enron's good news and in a progressive suspension of good sense and judgment."\textsuperscript{10} The following quotes are by no means exhaustive but are certainly representative of the business press's coverage of Enron:

[The] big winner was Enron, which returned nearly forty percent because of the strength of its energy-trading and energy-services operations . . . .\textsuperscript{11}

They're making some pretty megainvestments, and you're seeing that pay off.\textsuperscript{12}

The real story isn't the earnings . . . . It's what lies ahead. This isn't your father's natural-gas company.\textsuperscript{13}

It's absolutely astounding . . . .\textsuperscript{14}

No company illustrates the transformative power of innovation more dramatically than Enron. Over the past decade Enron's commitment to the invention—and later domination—of new business categories has

\textsuperscript{10} Paul H. Weaver, \textit{The Business Press as a Corporate Monitor: How the Wall Street Journal and Fortune Covered Enron}, in \textit{AFTER ENRON: LESSONS FOR PUBLIC POLICY}, supra note 4, at 147, 163.


\textsuperscript{12} Kruti Trivedi, \textit{Enron Posts Rise of 29% in Profit for Second Period}, WALL ST. J., July 14, 1999, at B5 (quoting Michael Barbis, analyst at Warburg Dillon Read) (emphasis added) (internal quotation marks omitted).

\textsuperscript{13} Rebecca Smith, \textit{Enron Net Nearly Tripled in 1st Period, Beating Estimate, as Revenue Rose 72%}, WALL ST. J., Apr. 13, 2000, at A4 (quoting David Fleisher, utilities analyst at Goldman Sachs Group, Inc.) (internal quotation marks omitted).

\textsuperscript{14} Id. (quoting Jeffrey Skilling, Enron President) (internal quotation marks omitted).
taken it from a $200 million old-economy pipeline operator to a $40 billion new-economy trading powerhouse.\textsuperscript{15}

With constant glowing reports from the press, Enron’s share price more than quadrupled in value from $20 in 1998 to $90 in the first half of 2001.\textsuperscript{16} However, with the benefit of hindsight, we know that Enron’s financial strength was an illusion, a house of cards;\textsuperscript{17} in reality, Enron was buckling under the pressure of over $25 billion of unreported, hidden debt.\textsuperscript{18} Enron collapsed and declared bankruptcy just months later.\textsuperscript{19}

Upon Enron’s collapse, the business press simplistically concluded that the scandal was caused by Enron’s officers—Kenneth Lay as chief executive officer (CEO), Jeffrey Skilling as chief operating officer (COO), and Andrew Fastow as chief financial officer (CFO).\textsuperscript{20} Certainly, Enron’s officers were eyeball deep in the scandal, but the business press largely failed to reveal that Enron’s lawyers aided and abetted the schemes that allowed Enron to hide $25 billion in debt.\textsuperscript{21} Part II.B discusses the extent of that assistance in full.

The President and Congress trumpeted the conclusion that the scandal was the result of a few rogue corporate officers. On March 7, 2002, President Bush

\begin{itemize}
\item \textsuperscript{15} Nicholas Stein, \textit{The World’s Most Admired Companies: How Do You Make the Most Admired List?}, \textit{FORTUNE}, Oct. 2, 2000, at 183, 184.
\item \textsuperscript{17} R.T. McNamar, \textit{Bankers as Corporate Monitors}, in \textit{AFTER ENRON: LESSONS FOR PUBLIC POLICY}, supra note 4, at 198, 209.
\item \textsuperscript{18} Id. at 205.
\item \textsuperscript{19} William A. Niskanen, \textit{A Crisis of Trust}, in \textit{AFTER ENRON: LESSONS FOR PUBLIC POLICY}, supra note 4, at 1, 2.
\item \textsuperscript{20} See, e.g., France, \textit{What About the Lawyers?}, supra note 4, at 58 (“[O]ne group of professionals has so far escaped the inquisition: the energy giant’s lawyers.”).
\item \textsuperscript{21} There were, of course, exceptions to this broad failure of the business press. Mike France at \textit{BusinessWeek} provided excellent coverage. See, e.g., France, \textit{Lawyer Loophole}, supra note 4 (reporting on lawyers’ approval of deceptive balance-sheet maneuvers); Mike France, \textit{One Big Client}, supra note 7 at 38 (reporting on lawyers’ involvement in helping Enron structure questionable deals); France, \textit{What About the Lawyers?}, supra note 4 (questioning lawyers’ supposed innocence in Enron). Dan Ackman at \textit{Forbes} also provided excellent coverage. See, e.g., Dan Ackman, \textit{Enron’s Lawyers: Eyes Wide Shut?}, \textit{FORBES.COM}, Jan. 28, 2002, http://www.forbes.com/2002/01/28/0128vconron_print.html [hereinafter Ackman, \textit{Enron’s Lawyers}] (reporting on lawyers’ role in Enron debacle); Dan Ackman, \textit{It’s the Lawyers’ Turn to Answer for Enron}, \textit{FORBES.COM}, Mar. 14, 2002, http://www.forbes.com/2002/03/14/0314topnews_print.html [hereinafter Ackman, \textit{It’s the Lawyers’ Turn}] (reporting on House Commerce Committee’s investigation into lawyers’ role in Enron debacle). However, the business press focused an overwhelming majority of its coverage on Enron’s officers and accountants. See, e.g., France, \textit{What About the Lawyers?}, supra note 4, at 58 (noting that Enron’s attorneys escaped scrutiny while its accountants and bankers underwent investigation).
\end{itemize}
stated that “[r]eform should begin with accountability, and reform should start at the top. The chief executive officer has a daily duty to oversee the entire enterprise, the entire firm, and therefore, bears a unique responsibility.”

While the foregoing is certainly true, there was no mention by President Bush of corporate lawyers. Likewise, during the congressional hearings that followed Enron, the Judiciary Committee placed the blame squarely on corporate officers “whose actions led to Enron’s failure.” Congress lamented the “[c]orporate officers [who] performed poorly (to say the least) at Enron,” and between the wailing and gnashing of teeth, Congress concluded that “[h]olding corporate officers responsible for their actions [must be] a big part of the foundation of [Sarbanes-Oxley].”

A. The Officers: The “Smartest” Guys in the Room

Knowing what we know now, it is easy to forget that Enron was once a successful, well-run company. The COO of Enron in the early to mid-1990s, Rich Kinder, “ran a famously tight and disciplined ship, presciently favoring a hard-asset strategy.” Hard assets are “those things that you can touch and feel.” Kinder grew Enron on the back of hard assets—tens of thousands of miles of interstate natural gas pipeline—together with power plants and water utilities. Then, in 1997, Enron changed direction when Jeffrey Skilling

29. See, e.g., Niskanen, supra note 19, at 3 (stating that part of Enron’s “traditional ‘asset rich’ business model... was to invest in the infrastructure of the energy, water, and telecommunications industries”); Douglas G. Baird & Robert K. Rasmussen, Four (or Five) Easy Lessons from Enron, 55 VAND. L. REV. 1787, 1793 (2002) (describing how “Enron began in the mid-1980s as a gas pipeline company owning the largest gas pipeline in the United States”); Harry Hurt III, Power Players: Enron Has Shaken Up the Sleepy Gas Pipeline and Power Businesses by Aggressively Embracing Risk and Continually Remaking Itself. So What’s Not to Like?. FORTUNE, Aug. 15, 1996, at 94 (reporting that in 1996, Enron “operat[ed] 37,000 miles of interstate pipeline that transport[ed] nearly 20% of the nation’s natural gas”). Building a company on hard assets did not necessarily mean complacency—Enron was the first to tout natural gas as a substitute for coal as an electricity generator, and to prove it, built its own natural gas generator in Texas, “showing
became COO—a Harvard MBA and allegedly “the most intellectually brilliant executive in the natural gas business.” Skilling was focused less on hard assets—pipes and energy plants—and more on turning Enron into an asset light company. Enron began to shed its hard assets in favor of energy trading. Ken Lay, Enron’s CEO, touted the plan in a 1997 interview:

Historically it was thought that natural gas was natural gas was natural gas. But you also have a lot of risk management or contract issues. Do customers want to buy short-term or long-term? Do they want to hedge their risk? Or do they want to go with the market index? Now everybody can have the kind of portfolio they want, the kind of risk they want to take, and the kind of exposure they want to price swings.


30. Hurt, supra note 29.
31. See, e.g., Niskanen, supra note 19, at 3 (“The . . . innovative ‘asset light’ model [was] developed for Enron by Jeffrey Skilling.”); Tom Fowler, The Fall of Enron: A Year Ago, Enron’s Crumbling Foundation Was Revealed to all when the Company Reported Its Disastrous Third-Quarter Numbers, HOUS. CHRON., Oct. 20, 2002, at A1 (discussing the asset light mantra—a company that owns few hard assets and makes all its money off of trading and services—that Skillings preached); Dan Piller, Enron Did EOG a Favor by Selling It, FORT-WORTH STAR TELEGRAM, Jan. 29, 2006 (reporting how the company unloaded so-called hard assets such as energy production and pipelines); Jennifer Wells, U.S. Courts Reserve the Big Fire for Those at the Top, TORONTO STAR, Oct. 24, 2006, at D1 (discussing the transformation of Enron from a hard asset pipeline company to an “asset light” energy trader).
32. Lynn J. Cook, Lessons Learned, HOUS. CHRON., May 30, 2006, at D1. Ironically, not only did Kinder take his hard asset mentality with him, he actually took the hard assets. Id. His current company Kinder Morgan “was birthed from one of Enron’s cast-off ‘hard assets’ that Kinder’s replacement, Jeff Skilling, so despised.” Id.
34. Id.
to the narrative of the Enron scandal because asset light companies find it easier to hide debt.\textsuperscript{35} Simply put, the value of hard assets are difficult to fudge—the value of an energy plant's equipment and receivables can be precisely calculated; on the other hand, futures and commodities can become "tools of fiscal concealment and manipulation."\textsuperscript{36}

However, even prior to the shift from a hard asset corporation to an asset light corporation, many of Enron's officers had a reputation for being cowboys—taking risks and using aggressive accounting.\textsuperscript{37} Kinder's leaving and Skilling's transforming of Enron greatly exacerbated this propensity.\textsuperscript{38} As such, a perfect storm was brewing. At the same time that Enron's shift to light assets was making fiscal concealment and manipulation easier, Enron was facing higher and higher earnings expectations—Enron was "a captive of its own success."\textsuperscript{39} Enron was not alone. In the late 1990s, investors gave all attention to whether a company was meeting analysts' earnings expectations.\textsuperscript{40} Companies that missed expectations by as little as a penny found themselves losing as much as 6\% of their stock value.\textsuperscript{41} The Securities and Exchange Commission (SEC) Chairman, Arthur Levitt, stated,

This is the pattern earnings management creates: companies try to meet or beat Wall Street earnings projections in order to grow market capitalization and increase the value of stock options. Their ability to do this depends on achieving the earnings expectations of analysts. And analysts seek constant guidance from companies to frame those expectations. Auditors, who want to retain their clients, are under pressure not to stand in the way.\textsuperscript{42}

\textsuperscript{36} Id.
\textsuperscript{37} Hurt, supra note 29.
\textsuperscript{38} See Hiltzik, supra note 35 ("[D]erivatives allowed Enron to inflate the value of its assets and transactions while understating their risks and obscuring their real nature.").
\textsuperscript{39} Joseph Fuller & Michael C. Jensen, \textit{Just Say No to Wall Street: Putting a Stop to the Earnings Game}, 14 J. APPLIED CORP. FIN. 41, 43 (2002).
\textsuperscript{41} Id., discussed in Leonard G. Weld et al., \textit{Anatomy of a Financial Fraud}, CPA J., Oct. 2004, available at http://www.nysscpa.org/cpajournal/2004/1004/essentials/p44.htm ("The pressure to meet revenue expectations is particularly intense and may be the primary catalyst leading managers to engage in earnings management practices that result in questionable, improper, or fraudulent revenue-recognition practices.").
\textsuperscript{42} Levitt, supra note 40.
Within this earnings focused environment, Enron’s officers began to focus “almost exclusively on increasing the level of reported earnings.”43 “Enron was ‘laser focused’ on shareholder value” and even “had televisions in its elevators to allow employees to monitor stock prices at all times.”44 The problem was, some of Enron’s investments were losing money45—a fact that was highly inconvenient to meeting constantly increasing earnings expectations. Enter the lawyers.

B. The Lawyers’ Role

Every lawyer works at the behest of his client, and the client is entitled to zealous representation—the most aggressive business structure that the law supports.46 Indeed, “[t]he ethical obligation to vigorously represent one’s client marches right up to the very brink of what is legal, although it does not go beyond it.”47 The problem is that many corporate lawyers cross that line. They become “linguistic Houdinis who specialize in hypertechnical arguments as to

43. Niskanen, supra note 19, at 3. Asked at his trial whether there was intense pressure to hit earnings targets, Mr. Skilling said, “Every company tries to hit their earnings targets. I would hope we would push. If we weren’t pushing then we weren’t doing the best job for our shareholders.” Brian Hanney, Enron Trial: Day 42, Accountancymagazine.com, Apr. 19, 2006, http://www.accountancymagazine.com (follow “News Archive” hyperlink; then follow “All News” hyperlink; then follow “April 2006” hyperlink).


46. See, e.g., William H. Simon, After Confidentiality: Rethinking the Professional Responsibilities of the Business Lawyer, 75 FORDHAM L. REV. 1453, 1457 (2006) (“Stephen Gillers of New York University Law School said, ‘the job of a lawyer is to figure out how to accomplish the client’s objective within the law, and if that can only be done through a technicality, that is not the lawyers fault.’” (citing Patti Waldmeir, Inside Track: Don’t Blame the Lawyers for Enron, FIN. TIMES, Feb. 21, 2001, at 14)); Ackman, It’s the Lawyers’ Turn, supra note 21 (“[Attorneys argue] they are only helping the client do what it wants to do as long as it’s within the law.”).

why their client’s rat poison meets the five-part test for being apple pie.”48 Here, Enron’s lawyers tried to pass off Enron’s rat poison—debt—as apple pie by “play[ing] a creative role in structuring and managing some of the company’s controversial ‘special purpose’ partnerships”49 and, in the process, all but “ignore[d] the spirit of . . . securities laws.”50

Though not present at the planning meetings where the schemes to hide Enron’s debt were devised—likely involving Enron’s key officers, lawyers, accountants, and bankers—one can imagine a scenario where Enron’s officers turned to Enron’s lawyers for solutions and queried, “Any idea how to move some of this debt off our books? How do we make it work?”51 Whether or not Enron’s lawyers were the primary driving force,52 the lawyers “played a creative role in structuring and managing” some of Enron’s Special Purpose Entities (SPEs).53 In short, it is hard to deny that Enron’s lawyers were intimately involved in deciding to use SPEs to buy poorly performing assets—loss assets—from Enron.54

48. France, Lawyer Loophole, supra note 4, at 71; see also France, What About the Lawyers?, supra note 4, at 59 (“It is still part of the mythology of the profession that lawyers serve as brakes on bad conduct . . . . What we have seen in the past 20 years is that client pressures have turned them into more of a gas pedal.”) (internal quotation marks omitted) (quoting Stephen Gillers, professor of legal ethics at New York University School of Law).

49. France, One Big Client, supra note 7; see also France, What About the Lawyers?, supra note 4, at 58 (“[T]here’s no way Enron’s left hand could have sold so many assets to its right hand without creative input from both inside and outside counsel.”).

50. France, Lawyer Loophole, supra note 4, at 71.

51. See France, One Big Client, supra note 7, at 38 (“One former [Enron] executive . . . says employees would approach [Enron’s] lawyers ‘and say, “this thing needs to work. How do we make it work?””

52. For arguments that the lawyers were the primary driving force, see McNamar, supra note 4, at 184 (“It was not an occasional transaction that might be misunderstood out of context . . . .”); Ackman, It’s the Lawyers’ Turn, supra note 21 (noting that Enron’s lawyers were “intimately involved in structuring [Enron’s] transactions”); France, What About the Lawyers?, supra note 4 (“Enron . . . manipulate[d] its balance sheet . . . with] cross-disciplinary teams of lawyers, accountants, and investment bankers.”); James Kimberly, States Want Liability Extended for Firms with Links to Enron, HOUS. CHRON., June 11, 2002, at D3 (“These defendants didn’t just sit back. . . . They themselves were personally aware of what was happening. . . . They participated in what was happening. In fact, the fraud couldn’t have happened without the help of these defendants.”); John Schwartz, Enron’s Many Strands: The Lawyers; Troubling Questions Ahead for Enron’s Law Firm, N.Y. TIMES, Mar. 12, 2002, at C1 (“[Enron] couldn’t get past the conceptual planning stage without calling in the legal architects.”). But see McNamar, supra note 4, at 171 (“From a public policy perspective, one of the most vexing challenges is to understand the role of the corporate lawyer in the Enron collapse.”).

53. France, What About the Lawyers?, supra note 4, at 60.

54. See, e.g., McNamar, supra note 17, at 206 (“Enron’s SPE transactions all had true sales opinions from the law firms of Vinson & Elkins or Andrews & Kurth.”); France, What About the Lawyers?, supra note 4, at 58 (noting that Enron’s lawyers did “‘most of the heavy lifting’
Using SPEs to hide debt was a four-step process. First, Enron’s lawyers formed the SPE. Second, a major bank financed the SPE with a loan. Then, the SPE used the cash from the loan to purchase loss assets from Enron. Enron’s lawyers structured a perfect win-win situation for Enron—Enron got cash and divested itself of the loss asset.

Next, and important for illustrating the role of Enron’s lawyers, in order for the transferred loss assets not to be consolidated onto Enron’s books, Enron’s lawyers drafted “true sale” opinions stating that Enron and the SPE were separate entities engaged in an arm’s-length deal. In short, Enron’s lawyers protected the SPE deals from scrutiny by vouching for their legal status.

However, the above described transaction is not really a true sale. In order for there to be a true sale, after the transfer the assets “must be ‘isolated’ or ‘remote’ from the [selling entity, Enron].” That is to say, the selling entity cannot be responsible for the debts of the buying entity. But Enron, having guaranteed the debt in order to entice the bank to make the loan to the SPE, was ultimately responsible for the SPE’s debt. Likewise, the selling entity cannot implementing the SPEs). A second scheme cooked up for Enron by their lawyers was fraudulent prepay transactions:

Say, for example, that Enron needed to borrow $1 billion from a bank to meet its expenses or buy a steel mill in Thailand. Enron could simply borrow the money from a lender, but this debt [would appear on its financial reports]. To avoid this outcome, Enron would offer to sell to major financial institutions energy futures for $1 billion. At the same time, Enron would offer to buy back the same energy futures in one year for, say, $1.2 billion. The bank would agree to this proposal because for all intents and purposes the proposed transaction was a loan: the bank would provide Enron $1 billion for one year, and in return would receive the principal back plus $200 million in interest once the term of the loan was over.

Kroger, supra note 3, at 73 (internal citations omitted). Enron recorded the $1 billion it borrowed as “cash flow” and the $1.2 billion it owed as a “price risk management liability” which, to simplify for our purposes, was not recorded as debt. Id. at 74 (citing Second Interim Report of Neal Batson, Court-Appointed Examiner at 42–43, In re Enron Corp., No. 01-16034 (AIG) (Bankr. S.D.N.Y. Jan. 21, 2003), available at http://www.enron.com/media/2nd_Examiners_Report.pdf [hereinafter Batson Second Report]). In the above example, $1 billion in debt disappeared off the books. Id.

55. France, What About the Lawyers?, supra note 4.
56. McNamar, supra note 17, at 206.
57. Id. at 207. A modification of these “sham sales” [was] where the buyers simultaneously or after a prearranged delay sold back to Enron the same or similar assets at close to the prices they ‘paid.’ These dealings wrongly allowed Enron to report profits on the sales.” GEORGE BENSTON ET AL., FOLLOWING THE MONEY: THE ENRON FAILURE AND THE STATE OF CORPORATE DISCLOSURE 27 (2003).
58. See McNamar, supra note 17, at 207.
59. Id. at 206.
60. See id.
61. Id. at 204.
62. Id.
63. Id. at 206.
retain a beneficial stake in the assets sold, but in the case of Enron’s SPEs, Enron entered into a “total return swap,” which meant that Enron was entitled to the profits of the SPEs. In short, the transfer from Enron to its SPEs was without economic substance; it was an illusion designed to hide debt. There was no sale, and Enron’s lawyers never should have drafted the true sale opinions.

To place specifics on the general framework described above, consider Enron’s SPE “Whitewing.” Through asset sales to Whitewing, Enron removed the debt from its books as follows:

Enron raised money for its Whitewing fund by secretly promising that Enron itself would repay the raised funds at a future date. Enron then “sold” assets of limited or decreasing value to the Whitewing fund. Enron was, in practice, both the buyer and the seller in the deals, and it remained the true equitable owner of the “warehoused” assets. However, it treated the transactions as sales. This allowed Enron to move valueless assets off its books while hiding substantial debt. The size of these “sales” was ultimately staggering. According to the bankruptcy examiner, Enron ultimately “sold” some $1.6 billion in underperforming assets to its own Whitewing fund.

64. Id.
65. See id.
66. Kroger, supra note 3, at 80. Enron also created “Raptor,” another SPE, “so that illiquid investments that managers expected to decline in value could be removed from the company’s financial statements.” Simon, supra note 46, at 1455. Eventually, Enron transferred assets on a “watch” or “troubled” list to the Raptor vehicles. Claire Poole, Skilling Pleads Ignorance, DAILY DEAL, Apr. 19, 2006, http://www.thedeal.com (subscription required for archived articles). Specifically,

The Raptors were set up in late 2000 as hedges against the declining value of investments in other companies. For example, in 1998 Enron invested $28 million in Rhythms NetConnections. When the Internet service provider’s stock went up, it was worth more than $500 million to Enron. The company then recorded the increase as revenue even though it didn’t sell the stock. Since mark-to-market accounting would require Enron to report a decrease in Rhythms’ share price as a loss, Enron put the stock into one of the Raptors as a hedge against such a drop. But Enron used its own stock as its contribution to the partnership, assuming that its own share price would not fall. When both stocks fell at the same time, the Raptor went bankrupt.


Enron transferred $1.6 billion to Whitewing alone, all told Enron hid $14 billion in debt in SPEs. Enron’s lawyers conceived, structured, and carried out the deals—"[b]y definition, the attorneys have to know the terms of the deal inside out." Any contention that Enron’s lawyers were just following orders is at best naive and at worst disingenuous.

C. The Accountants

Consider that Enron’s lawyers reviewed each disclosure document prepared by Enron’s accountants to make sure that the statements properly incorporated—or rather, did not incorporate—the losses transferred to the SPEs. In a way, the accountants were mere scriveners—albeit reckless ones—incorporating the fraudulent schemes into the disclosure documents to be filed with the SEC. Those disclosure documents are “referred to by investors and securities lawyers as ‘10-Qs’ and ‘10-Ks,’ [and] inform investors about a company through two different mechanisms.” The disclosure documents are prepared as follows:

First, companies provide a narrative description of their operations and new initiatives during the relevant reporting period in a “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” or “MD&A.” Second, the company supports this narrative by disclosing hard financial data covering basic performance metrics, such as the amount of the company’s debt, revenue, and cash flow. Companies are required to report information accurately and in compliance with “generally accepted accounting principles,” or “GAAP.” They are also required to report any additional “material” information needed to ensure that their disclosures in the MD&A or metric sections are not misleading. The materiality requirement means, in practice, that companies must disclose all major developments, both

68. Kroger, supra note 3, at 82 (citing Batson Second Report, supra note 54).
69. McNamar, supra note 17, at 205.
70. France, What About the Lawyers?, supra note 4, at 60.
71. In re Enron, 235 F. Supp. 2d at 616. The accountants worked with the lawyers to reach the result insisted upon by Enron’s directors; the accountants would look at the legal documents prepared by the lawyers and say, “Under those circumstances, we can’t reach the accounting result we would like to reach.” . . . [T]he two sides would go back and forth in a collaborative process driven by ‘what the [directors] wanted at the end of the day—for example, to take an asset off the balance sheet.’ ” France, What About the Lawyers?, supra note 4, at 61.
72. See Kroger, supra note 3, at 70–71.
73. Id. at 69.
good and bad. The importance of these publicly filed financial statements to equity and debt markets cannot be overestimated.\footnote{74}{\textit{Id.} at 69–71 (internal citations omitted).}

Enron was able to defeat the mandatory securities reporting system established by the Securities Exchange Act of 1934 by drafting the narrative portion of the reports in such a way that negative financial information—massive obligations to lenders—was included in footnotes that were incomplete and “virtually incomprehensible.”\footnote{75}{Batson Second Report, supra note 54, at 55–56.} More importantly, the hard financial data portion of the report—the part that one imagines would be exceedingly difficult to fudge—did not reflect the debt because of the above described sham transactions Enron’s corporate lawyers structured.\footnote{76}{Kroger, supra note 3, at 71.} At the end of the day, “investors were not aware that Enron was heavily in debt and losing money fast for a very simple reason: Enron did not tell them.”\footnote{77}{\textit{Id.} at 69. This was readily apparent during congressional hearings into the collapse of Enron: As we have heard over the past several weeks, if the numbers on the financial reports are meaningless, or if there is widespread gimmickry in use to conceal true financial status of an enterprise, then we are in deep trouble. If investors cannot rely upon the information available to them, then the equities markets devolve into little more than games of chance, where smoke and mirrors prevail over reason and rational decision-making.\textit{Lessons Learned from Enron’s Collapse: Auditing the Accounting Industry: Hearing Before the H. Comm. on Energy and Commerce, 107th Cong. 67 (2002) (prepared statement of Rep. Tom Davis).}} Enron did not tell the investors about the debt because Enron’s lawyers found a way to hide it.\footnote{78}{See supra text accompanying notes 52–65.}

Further, while it may be intuitively obvious why Enron’s activity—hiding losses from investors—was morally reprehensible, it may not be as obvious why the activity violated federal securities laws. As discussed in greater detail in Part III.B, the Securities Exchange Act of 1934 section 10(b) allows a wronged investor to bring an action for damages arising from a misrepresentation or omission of material fact in connection with the offer or sale of a security.\footnote{79}{15 U.S.C. § 78j(b) (2000); see also In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1417 (3d Cir. 1997) ("The first step for a Rule 10b-5 plaintiff is to establish that defendant made a materially false or misleading statement or omitted to state a material fact necessary to make a statement not misleading. Next, plaintiff must establish that defendant acted with scienter and that plaintiff’s reliance on defendant’s misstatement cause him or her injury.").} That such an action can be brought against Enron, the corporate entity, is not debated; however, whether an action can be brought against lawyers that aided and abetted the fraud pursuant to section 10(b) will be discussed in greater detail below at Part III.B. Section 10(b) states,
It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe. . . .

In turn, the SEC promulgated the following rule:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

To establish a violation of section 10(b), a plaintiff must show that the defendant acted with scienter in making the misrepresentation and that the plaintiff relied on the defendant’s misstatement. In the case of Enron, the misrepresentation was the failure, apparently intentional, to disclose losses. Indeed, hiding losses to keep stock prices artificially high is the classic case that implicates section 10(b) of the Securities Exchange Act of 1934.

82. In re Burlington Coat Factory, 114 F.3d. at 1417. Additionally, in certain similar circumstances, liability can arise in the absence of scienter or reliance. See, e.g., 15 U.S.C. § 77k(a) (2000) (allowing recovery of purchase price where there is an untrue or misleading or omission of material fact in the registration statement).
83. See supra text accompanying notes 52–65.
84. See, e.g., In re Burlington Coat Factory, 114 F.3d. at 1419–20 (stating defendant had manipulated financial statements through improper and misleading accounting practices in violation of GAAP in order to achieve their goal of inflating the company’s stock price).
III. REGULATORY AND LIABILITY REGIME FOR LAWYERS PRIOR TO ENRON

A. State and Federal Regulation and Administrative Action

What liability or punishment could have been exacted on Enron’s lawyers for their central role in the scandal? Historically, when a publicly traded corporation filed false reports with the SEC, lawyers that assisted in the preparation of the false reports could face sanctions if they violated state ethics laws—or be barred from the practice of law altogether.\textsuperscript{85} Most state bar associations have adopted the language of the Model Rules of Professional Conduct:\textsuperscript{86}

If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, the lawyer shall proceed as is reasonably necessary in the best interest of the organization. . . . Such measures may include among others:

. . . referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law.\textsuperscript{87}

However, even if the above Rule is violated, lawyers are self-regulated.\textsuperscript{88} Lawyers decide the sanctions, if any, for their peers’ misconduct.\textsuperscript{89} The reality is, few, if any, lawyers face serious repercussions from their state’s bar for aiding and abetting securities fraud because of the limited resources available to the state’s bar coupled with the expense and complexity of a securities fraud


\textsuperscript{87} Model Rules of Prof’l Conduct R. 1.13(b).

\textsuperscript{88} McNamar, supra note 4, at 172 (“[Attorneys] are regulated by the state bar association, which is managed by the attorneys who are members of the state bar association.”).

\textsuperscript{89} Id.
investigation. As one commentator noted, "[bar associations] would much rather hound paralegals selling cheap wills in strip malls." Further, at the law firm level, the transition of law firms from general partnerships to limited liability partnerships reduces the incentive for lawyers to make sure that others in their firm are not engaging in questionable activity because the lawyers are only responsible for their own misconduct. In addition, lawyers may actually benefit from the misconduct of their peers. In 2000 one of Enron's law firms billed the corporation between $27 million and $30 million, which the firm distributed to its partners in accordance with the firm's partnership agreement.

While lawyer disbarment is exclusively the purview of the states' bars, at the federal level, the SEC can bar lawyers that assisted in the preparation of the false report from appearing or practicing before the SEC. This is extremely rare. Even if the SEC barred a lawyer, he could still prepare the documents for signature by another lawyer at his firm. Thus, there is no serious threat of administrative punishment.

B. State and Federal Civil Liability

An alternative deterrent for lawyers who help corporations hide debt is civil liability. However, as explained below, like disbarment, civil liability is rare. Civil liability at the state level is based on the common law notion of negligent misrepresentation. A lawyer's liability to a third party for damages arising from a misstatement while the parties are not in privity can only arise where the relationship is so close as to approach that of privity. "Such a requirement is necessary in order to provide fair and manageable bounds to what otherwise could be limitless liability." The New York Court of Appeals has stated,

90. See id. at 173.
91. France, Lawyer Loophole, supra note 4, at 70.
92. See McNamar, supra note 4, at 172.
93. See Ackman, Enron's Lawyers, supra note 21; McNamar, supra note 4, at 70. For a contrary view, that there are reputational repercussions, see Adam C. Pritchard, Should Congress Repeal Securities Class Action Reform?, in AFTER ENRON: LESSONS FOR PUBLIC POLICY, supra note 4, at 125, 131–32.
94. 17 C.F.R. § 201.102(e) (2008); see also McNamar, supra note 4, at 173 ("The SEC, on occasion, has barred individual attorneys from SEC work for securities law violations.").
95. McNamar, supra note 4, at 173.
96. Id.
98. Id.
99. Id.
100. Id.
[A]ttorneys, like other professionals, may be held liable for economic injury arising from negligent representation. Although the defendants in many of the prior cases addressing this issue have been accountants, there is no reason to arbitrarily limit the potentially liable defendants to that class of professionals... [I]n the right circumstances pecuniary recovery might be had from lawyers. We now conclude that in circumstances such as these, a theoretical basis for liability against legal professionals can be presented.  

Prudential involved a case where a law firm—for its client’s debt refinancing and for the benefit of its client’s creditor—wrote an opinion letter assuring the creditor of the enforceability of the creditor’s security interest after the restructuring. It turned out the opinion was wrong. The court emphasized that “the negligent acts, i.e., the creation of an opinion letter and the transmission of that letter directly to a third party for the party’s own use, were carried out by the lawyer at the client’s express direction.” The law firm’s opinion letter was for the benefit of the creditor. As such, the relationship between the lawyer and the third party was so close as to approach that of privity, which created a duty running from the attorney to the third party relying on the opinion letter.

However, the court refused to find a breach of duty because of the cautious terms used in the opinion letter, stating that the factual predicates were not “independently established” and expressing an “opinion” only that state laws would not prevent the third party from collecting its debt. According to the court, the use of cautious terms and qualifications was enough to meet the duty of due care; that is to say, “neither procedural nor substantive misrepresentations were made.”

At the federal level, pursuant to the securities laws (prior to Enron as well as today) a lawyer could face liability to a private party—a harmed investor—where the lawyer committed a primary violation of section 10(b) of the Securities Exchange Act of 1934; however, there is no liability to a private

101. Id.
102. Id. at 319.
103. Id.
104. Id. at 320.
105. See id.
106. Id. at 322.
107. Id. at 323 (emphasis omitted).
108. Id.
109. Id.
110. 15 U.S.C. § 78j(b) (2006); see also 17 C.F.R. § 240.10b-5 (“It shall be unlawful for any person... to employ any device, scheme, or artifice to defraud...”) (emphasis added).
party for aiding and abetting securities fraud. The primary case that defined the availability of aiding and abetting liability prior to Enron was Central Bank of Denver v. First Interstate Bank of Denver. In Central Bank, the Court decided "whether private civil liability under § 10(b) extends . . . to those who do not engage in the manipulative or deceptive practice, but who aid and abet the violation." The secondary actor in question, Central Bank, was an indenture trustee for bonds issued by the Colorado Springs–Stetson Hills Public Building Authority. Central Bank learned from its in-house appraiser that the "appraisal [on the land] appeared optimistic considering the local real estate market." As such, Central Bank knew that the bonds themselves were being offered to the public at an artificially high price. Central Bank decided to have the land reappraised but delayed independent review of the appraisal until after the bonds were issued.

The Court found that the purchaser of the bonds could not maintain an action for aiding and abetting against Central Bank. "[T]he statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act. The proscription does not include giving aid to a person who commits a manipulative or deceptive act." The Court concluded, "[w]e cannot amend the statute to create liability for acts that are not themselves manipulative or deceptive within the meaning of the statute.

However, under Central Bank, a court could find secondary actors, like lawyers, liable if their acts rise above mere aiding and abetting—where

111. See 15 U.S.C. § 78t(e) (2006). While there is no private civil cause of action for aiding and abetting securities fraud under § 78t(e), "[K]nowingly aiding and abetting securities fraud is . . . a civil wrong that may be pursued by the SEC." Letter from George M. Cohen, Susan P. Koniak, David A. Dana & Thomas Ross (endorsed by named academics), to Office of the Comptroller of the Currency (June 2, 2006). available at http://www.sec.gov/comments/s7-08-06/s70806-1.pdf. Further, there is criminal liability, but prosecuting lawyers for aiding and abetting is extremely difficult because the prosecutor must demonstrate each element beyond a reasonable doubt—and it is virtually impossible to prove that a lawyer "kn[e]w[ ]" anything. See 15 U.S.C. § 78t(e).


113. 511 U.S. at 167.

114. Id. Central Bank was not the issuer of the bonds and made no direct statements to the public about the value of the land securing the bonds. See id. at 168.

115. Id. at 167.

116. See id.

117. Id. at 168.

118. Id. at 175–78.

119. Id. at 177 (citations omitted).

120. Id. at 177–78.
secondary actors commit a primary violation of section 10(b).\footnote{121} In other words, “Central Bank only excludes liability when secondary defendants have made no false statement [to the injured party] themselves.”\footnote{122} The Court in Central Bank left an opening in the secondary actor’s shield against aiding and abetting liability, stating,

Because the text of § 10(b) does not prohibit aiding and abetting, we hold that a private plaintiff may not maintain an aiding and abetting suit under § 10(b). The absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b–5, assuming all of the requirements for primary liability under Rule 10b–5 are met.\footnote{123}

While there is a possibility of a secondary actor facing liability when it commits a primary violation, section 10(b), coupled with the Court’s decision in Central Bank, make it very difficult for a private party wronged by securities fraud to bring an action against a secondary actor, and no action exists for mere aiding and abetting.\footnote{124} While the Central Bank defendant was a bank, the

\footnote{121} See id. at 177.
\footnote{122} Pritchard, supra note 93, at 140. However, even then, the liability is only proportional. The Private Securities Litigation Reform Act of 1995 (PSLRA) “limited the liability of ‘peripheral’ defendants or ‘secondary actors’ to proportional liability when they lack knowledge of fraud; that is, the attorneys are only liable for the incremental harm caused by their participation in the fraud.” McNamar, supra note 4, at 174.
\footnote{123} Cent. Bank, 511 U.S. at 191.
\footnote{124} In 2002 Judge Melinda Harmon issued an opinion in In re Enron Corp. Sec., Derivative & ERISA Litig., which made use of the opening left by Central Bank to find that Enron’s lawyers could be liable for aiding and abetting where they engaged in a primary violation. 235 F. Supp. 2d 549, 590–91 (S.D. Tex. 1992). The following synopsis comes from Anthony Sebok’s excellent summary of the decision.

The motion that prompted the opinion was filed by the . . . “secondary” defendants, . . . alleged to have committed securities fraud . . . . The motion asked the judge to dismiss the claims against the secondary defendants, [Enron’s lawyers]. . . . [Judge Harmon] . . . allowed the plaintiffs to maintain their federal securities fraud claims against . . . [Enron’s lawyers]. . . . Under the case law, professionals such as law firms and accountants need not always be [aiders and abettors]; they can sometimes be primary actors, too. [Judge Harmon’s] reasoning was that Central Bank may have properly excluded actors who may have conspired to defraud others, but that there is a difference between helping another commit fraud and “making” a fraud, even if one makes the fraud (by necessity) by working with others who are also making the fraud . . . [Enron’s lawyers were] essentially “a participant making material
holding is directly applicable to lawyers, who often aid and abet a primary actor, usually the offeror of the securities. Accordingly, “since 1994 attorneys have been citing the Central Bank case as the controlling precedent for why they should have no civil liability under section 10(b) of the Securities Exchange Act of 1934.” Among those attorneys using the foregoing defense were the corporate lawyers in In re Enron. 

IV. SARBANES-OXLEY RETAINED THE STATUS QUO FOR LAWYERS

Central Bank was an absolute coup for corporate attorneys—it became virtually impossible to recover a civil judgment from attorneys pursuant to section 10(b), even where, as in the case of Enron, they cooked up SPEs for the express purpose of absorbing loss assets which allowed Enron to take those bad investments off its books. As discussed in Part IV.C, Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc. recently confirmed Central Bank’s prohibition against aiding and abetting liability.

A. Show Me the Money: The Death of House Bill 3818—Aiding and Abetting Liability

It’s almost impossible to compete with the effect that money has on these congressmen.

In response to the corporate lawyers’ role in Enron, Representative John J. LaFalce introduced House Bill 3818 on February 28, 2002. It aimed to revive
aiding and abetting liability for lawyers by amending § 20 of the Securities Exchange Act of 1934 and statutorily overruling Central Bank.131 The bill provided,

For purposes of . . . an express or implied private right of action under this title, any person who knowingly or recklessly provides substantial assistance to another person in the violation of a provision of this title, or of any rule or regulation thereunder, shall be deemed to violate such provision and shall be liable to the same extent as the person to whom such assistance is provided.132

Representative LaFalce explained that House Bill 3818 would restore aiding and abetting liability and “would provide a private right of action against anyone (auditors, lawyers, and other outside professionals) who knowingly or recklessly provides substantial assistance to another person in violation of the securities laws.”133

House Bill 3818 was referred to the House Committee on Financial Services (Financial Services Committee), where it was to be marked up by those representatives with expertise in the subject matter and then returned to the entire House for an up or down vote.134 However, the thirty-seven Republicans that formed the majority on the Financial Services Committee received over $1.2 million from corporate lawyers during that election cycle—ten times the amount contributed by business associations, which represent the interests of corporate officers (approximately $100,000). Those contributions were significantly more than accountants (approximately $800,000).135 Not

131. Id. § 14(a).

132. Id. § 14(b). The bill also provided an affirmative defense: “No person shall be liable under this subsection based on an omission or failure to act unless such omission or failure constituted a breach of a duty owed by such person.” Id. Because the bill never became law, there is no judicial interpretation of the troublesome language. A plain reading is that the language would have shielded a lawyer from liability when the lawyer’s actions were reasonable.


135. Part IV infra discusses why accountants’ significant contributions were less effective than lawyers’ contributions in gaining access to the politicians’ ear. See generally Lawyers/Law Firms Industry Profile 2002, http://www.opensecrets.org (follow “Influence & Lobbying” hyperlink; then follow “Lobbying” hyperlink; then follow “Industries” hyperlink; then follow “Alphabetical Listing of Industries” hyperlink; then follow “Lawyers/Law Firms” hyperlink; then follow “2002” hyperlink) (last visited Oct. 29, 2008) (statistics compiled by and on file with the author). For a similar compilation of corporate lawyers’ campaign contributions to the relevant
surprisingly, the Financial Services Committee appears to have protected lawyers by not acting on the bill. They wielded their "blocking power"—if committee members disfavor the bill for any reason, they can do nothing and allow the bill to languish in committee. Commentators have observed that to the extent campaign contributions can affect legislation, it often happens at the committee level where it is less observable. This appears to be exactly what happened to House Bill 3818.

The only way that Representative LaFalce could revive House Bill 3818 was via a seldom used procedural move—a discharge petition. The discharge petition is a "mechanism by which any majority can force the floor to consider legislation without approval from the committee of jurisdiction" thereby discharging the committee from its duty. On July 10, 2002, Representative conference committee, see infra note 148 and accompanying text. Looking only at contributions given to Republicans prevents artificially inflating the corporate lawyer contribution figure by including plaintiffs' bar contributions. That the trial lobby was for the renewal of aiding and abetting liability is well documented: "Earlier this year, the trial lawyers mounted a full-court press on Capitol Hill to revise the PSLRA, working through the Association of Trial Lawyers of America and the National Association of Securities and Commercial Law Attorneys, the trade group for law firms that specialize in litigating class-action securities fraud suits." Shawn Zeller, Holding the Line on Investor Lawsuits, NAT'L J., July 27, 2002, at 2255, 2256. "It is plausible to assume that of those funds [lawyers] contributed, the Democrats received contributions principally from the plaintiffs' bar while corporate law firms' contributions went to Republicans." Roberta Romano, The Sarbanes-Oxley Act and the Making of Quack Corporate Governance 197 (YALE UNIV. INT'L CTR. FOR FIN., Working Paper No. 04-37, 2004), available at http://ssrn.com/abstract=596101 [hereinafter Romano, Working Paper]. This contention is supported by the Center for Responsive Politics, which states that overwhelmingly "corporate lawyers (corporate law firms) . . . give to Republicans." Id. at 194 n.384. As to why lawyers (as a group) gave a far greater amount than higher earning corporate executives, one can only posit that the number of lawyers in the United States far outweighs the number of corporate executives.


137. Id.


139. Id. at 3. As Rule 15 of the Rules of the House of Representatives sets forth:

(b)(1) A Member may present to the Clerk a motion in writing to discharge—

(A) a committee from consideration of a public bill or public resolution that has been referred to it for 30 legislative days; or

(B) the Committee on Rules from consideration of a resolution that has been referred to it for seven legislative days and that proposes a special order of business for the consideration of a public bill or public resolution that has been reported by a standing committee or has been referred to a standing committee for 30 legislative days.

(2) Only one motion may be presented for a bill or resolution. . . .
LaFalce and Representative Carson filed a motion to discharge the Committee from consideration of House Bill 3818.\textsuperscript{140} The petition received only 161 of the required 218 signatures,\textsuperscript{141} and not surprisingly, no committee member who received contributions from corporate lawyers signed the petition.\textsuperscript{142} Representative LaFalce knew the score—the opposition was “too strong, too powerful, too influential.”\textsuperscript{143} That is the “governmental process as it really works, as opposed to you know how it is supposed to work.”\textsuperscript{144}

(c) . . . When a majority of the total membership of the House [218 Members] shall have signed the motion, it shall be entered on the Journal, published with the signatures thereto in the Record, and referred to the Calendar of Motions to Discharge Committees.

. . . .

d) When a motion to discharge is called up, the bill or resolution to which it relates shall be read by title only. The motion is debatable for 20 minutes, one-half in favor of the motion and one-half in opposition thereto.

e) If a motion prevails to discharge the Committee on Rules from consideration of a resolution, the House shall immediately consider the resolution, pending which the Speaker may entertain one motion that the House adjourn. After the result of such a motion to adjourn is announced, the Speaker may not entertain any other dilatory motion until the resolution has been disposed of. If the resolution is adopted, the House shall immediately proceed to its execution.


141. \textit{See} H.R. 479.

142. \textit{Compare} Motion to Discharge a Committee from the Consideration of a Resolution, H.R. PETITION NO. 107-09, at 1 (2002) (listing House of Representatives members who signed the petition), \textit{with} House Financial Services Committee, Archived Committee Membership, http://financialservices.house.gov/archive_membership.html, \textit{(follow “Members from the 107th Congress” hyperlink)} (listing members of the House Financial Services Committee from the 107th Congress), \textit{and} Chart of Campaign Contributions (Nov. 2008) (on file with author) \textit{(compiling list of campaign contributions to members of the House Financial Services Committee)}.


A cloture vote prevented the amendment from being considered. \textit{See, e.g.,} Otis Bilodeau, \textit{Senate Fires out Proposals that Target Lawyers,} \textit{RECORDER} (San Francisco), July 15, 2002, at 1 \textit{ (“A cloture vote on [Senate Amendment 4261] on Friday appeared to lessen Shelby’s chances of}
Roberta Romano of Yale Law School seconded the above explanation: “It is possible that Congress’[s] more accommodating attitude toward the regulation of the legal, compared to the accounting, profession was affected by its larger contributions to committee members.”

Professor Romano’s careful words betray the fact that it cannot be directly proven that a particular contribution buys any action or nonaction on the part of a lawmaker. On the other hand, “[c]ontributions are widely understood as providing donors with access (the ‘politician’s ear’)” even if “there is little consensus on whether they purchase anything else.”

$s1 million from one group surely would affect a lawmaker’s decisions.  

succeeding. The parliamentary maneuver restricts the Senate from taking up amendments deemed not germane to the underlying bill.”

144. Hearing on H.R. 3763, supra note 143.

145. Romano, Working paper, supra note 135, at 198. Professor Romano was looking at the issue of contribution influence on Sarbanes-Oxley generally, and she focused on the conference committee that reconciled the House and Senate Bill. Id. at 185–86. Though Professor Romano believes “we can . . . only consider campaign contributions in a qualitative analysis, in relation to committee actions with regard to SOX,” her findings are analogous to the consideration of House Bill 3818. Id. at 186. She found that corporate lawyers gave $790,947 to Republicans on the conference committee. Id. at tbl.8 That is seven times as much as given by business associations and twice as much as given by accountants. See id. (noting that Republicans on the House Committee received $119,963 from business associations and $439,222 from accountants).

146. See Romano, Working paper, supra note 135, at 185.

147. Id. at 185 (“The connection, if any, between campaign contributions and legislative decision making is a matter of considerable controversy in the political science literature.”).

According to Romano,

[D]ifferences in conclusions regarding the impact of contributions on votes depend on whether in the model tested the campaign contributions variable is significant after controlling for economic interests. If the policy views of contributors match those of the legislators’ voting constituents, then the effect of campaign contributions is not of any particular importance politically.

Id. at 186 n.368. For a further discussion of the relationship between legislative decisionmaking and campaign contributions, see SAMUEL KERNELL AND GARY C. JACOBSON, THE LOGIC OF AMERICAN POLITICS 421 (2d ed. 2003); SHEPSLE AND BONCHEK, supra note 136, at 338.

148. This does not even take into account the lobbying power of lawyers separate and apart from contributions, which is concentrated in the American Bar Association (the ABA), and its powerful lobbying arm, the Governmental Affairs Office (the GAO). See American Bar Association, Governmental Affairs Office Homepage, http://www.abanet.org/poladv [hereinafter GAO Homepage] (last visited Sept. 29, 2008). “The GAO coordinates the Association’s Washington activities, and all representation on behalf of the ABA before governmental entities or officials must be coordinated with and through the GAO.” GAO Homepage About Us, http://www.abanet.org/poladv/about.html. The GAO opened its doors in Washington, D.C. in 1957 and its 850 person staff “serves as the focal point for the Association’s advocacy efforts before Congress.” GAO Homepage. Last year the GAO lobbied Congress on more than one hundred issues. Id. As one commentator stated, “[n]o one on Capitol Hill blinks when representatives of the [GAO] show up to testify at congressional hearings on an array of issues affecting the justice system and the legal profession.” Rhonda McMillion, 50-Year-Dash: The ABA’s Lobbying Efforts Have Grown up Since a Modest Start in 1957, A.B.A. J., Apr. 2007, at 66. In 2002, the GAO spent
Once corporate lawyers have purchased the politician’s ear, they have an additional advantage—in the 107th Congress over one-third of Representatives in the House were lawyers, and importantly, 43% of the members of the Financial Services Committee were lawyers including the chairman, Michael Oxley. As such, it is reasonable to believe that corporate lawyers faced a receptive audience for their arguments against House Bill 3818. The influence of lawyers upon legislation is not a recent phenomenon but a historical truism: “We know . . . that lawyers have accounted for . . . a majority of the members of the United States Senate and United States House of Representatives, . . . [y]et lawyers have never constituted more than .2% of the United States labor force.” As Alexis de Tocqueville observed, “[lawyers] consequently exercise a powerful influence upon the formation of the law.” De Tocqueville further observed,

the lawyers of the United States form a party which is but little feared and scarcely perceived, which has no badge peculiar to itself, which adapts itself with great flexibility to the exigencies of the time and accommodates itself without resistance to all the movements of the

more than $1.3 million lobbying Congress. Lawyers/Law Firms Industry Profile 2002: The American Bar Association, http://www.opensecrets.org (follow “Influence & Lobbying” hyperlink; then follow “Lobbying” hyperlink; then follow “Industries” hyperlink; then follow “Alphabetical Listing of Industries” hyperlink; then follow “Lawyers/Law Firms” hyperlink; then follow “2002” hyperlink) (last visited Oct. 29, 2008). Lawyers present a disciplined and focused force in the form of the GAO. The power the lawyers’ lobby can muster to influence legislation has been commented on at length. See, e.g., David R. Derge, The Lawyer as Decision-Maker in the American State Legislature, 21 J. POL. 408, 409 (1959) (examining the lawyer’s role in state legislatures); Robert M. Howard, Wealth, Power, and Attorney Regulation in the U.S. States: License Entry and Maintenance Requirements, 28 PUBLIUS: J. FEDERALISM, Fall 1998, at 24, 32, (examining the influence that attorneys have on state legislatures). But see, e.g., Robert L. Nelson & John P. Heinz, Lawyers and the Structure of Influence in Washington, 22 LAW & SOC’Y REV. 237 (1988) (finding that lawyers do not enjoy the level of influence that popular images suggest).

149. Lawyers constituted 53% of Senators and 36% of House Representatives, respectively, in the 107th Congress. Michael B. Kelly, Who Knows?, 42 SAN DIEGO L. REV. 841, 845 n.10 (2005) (internal citations omitted).


152. DE TOCQUEVILLE, supra note 1, at 279.
social body... [I]t acts upon the country imperceptibly, but finally
fashions it to suit its own purposes.\textsuperscript{153}

The imperceptibility of the lawyers’ role in the Enron scandal served the
attorneys well as they were not in the spotlight.\textsuperscript{154} The business press seemed
not to recognize the corporate lawyers’ role in the Enron scandal,\textsuperscript{155} lawyers
were able to bring their influence to bear on Congress—House Bill 3818
never had a chance of making it out of the Financial Services Committee, let
alone passing.

\textbf{B. The Death of “Up and Out” Reporting}

In the aftermath of Enron, legal commentators also began to discuss the
possibility of requiring lawyers to “report up” wrongdoing to the board of
directors and, in some instances, “report out” wrongdoing to the SEC.\textsuperscript{157} A
letter from numerous law professors to the SEC argued that “in certain
circumstances a lawyer also should be required to do more than report to a
client’s board of directors,” that is, “report both to the client’s directors and
simultaneously to the SEC an illegal act if senior management fails to take
remedial action.”\textsuperscript{158} Senator John Edwards joined this call for greater lawyer
accountability and argued that the role of lawyers should be examined “[i]n the
wake of the Enron scandal”\textsuperscript{159}—going so far as to propose an amendment to
Sarbanes-Oxley that would require lawyers to report officers’ violations of the

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\textsuperscript{153} Id. at 280 (emphasis added).
\textsuperscript{154} See Hearing on H.R. 3763, supra note 143.
\textsuperscript{155} See discussion supra Part I.B.
\textsuperscript{156} Id.
\textsuperscript{157} See Letter from Richard W. Painter, Professor of Law at Univ. of Ill. Coll. of Law, to
www.abanet.org/buslaw/corporateresponsibility/pitt.pdf (letter endorsed by Professor Painter and
thirty-nine other law professors). Professor Painter’s letter and the SEC’s response are discussed in
Jill E. Fisch & Caroline M. Gentile, The Qualified Legal Compliance Committee: Using the
Of course, proposals to impose a duty on lawyers to report out are not new. See, e.g., Frederick D.
(1974) (“The SEC has signaled its intention to impose upon lawyers an obligation to the securities
market in releases, speeches and most significantly, in increasingly frequent suits against lawyers
and law firms.”).
\textsuperscript{158} Painter, supra note 157.
\textsuperscript{159} Letter from John Edwards, U.S. Senator from N.C., to Harvey L. Pitt, Chairman, Sec. &
Exch. Comm’n (June 18, 2002), reprinted in 148 CONG. REC. S5652, S5652–53 (daily ed. June 18,
2002).
\end{flushright}
For over 200 years, the legal profession has been regulated almost exclusively by the judicial branch of government, and today, judicial regulation of lawyers is a principle firmly established in every state. . . . [W]e believe that changes in this ethical rule, if any, ultimately should be accomplished through the adoption of new state court rules, not through federal legislation or federal agency regulations.  

One can almost hear the confusion at the ABA upon receiving Senator Edwards’s letter: “Isn’t he one of us? What is he doing?” In response to pressure, Senator Edwards punted—his amendment deferred the responsibility for implementing greater lawyer accountability to the SEC:

Not later than 180 days after the date of enactment of this section, the Commission shall establish rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of public companies, including a rule requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof) and, if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the company, or to the board of directors.  

In fairness, in the above language, Congress and Senator Edwards do set forth some guidance for the SEC, but any reference to reporting out is absent. In...
fact, the above language does not direct the SEC to change anything.\textsuperscript{163} One commentator observed,

\textit{[T]he language of Section 307 does not give the Commission the authority to impose any obligations on lawyers beyond those which have long been required of them by courts, the Model Rules, and the Restatement.} In addition to the language of Section 307, the legislative history supports the conclusion that Congress did not authorize the Commission to impose any new obligations on attorneys. In particular, in discussing Section 307 Senator [Edwards] stated that it “basically instructs the SEC to start doing exactly what they were doing 20 years ago, to start enforcing this up-the-ladder principle.” The drafters intended only to remind lawyers of their existing duties and ensure that the Commission and the ABA are appropriately enforcing those duties.\textsuperscript{164}

While the SEC has historically been content to defer to the “strong view among the bar that these matters are more appropriately addressed by state bar rules,”\textsuperscript{165} the SEC did propose a noisy withdrawal requirement\textsuperscript{166}—surprising


\textsuperscript{164} \textit{Id.} at 787–88 (internal citations omitted); see also Stephen M. Bainbridge & Christina J. Johnson, \textit{Managerialism, Legal Ethics, and Sarbanes-Oxley Section 307}, 2004 MICH. ST. L. REV. 299, 315–16 (2004) (arguing that section 307 of Sarbanes-Oxley merely gave the SEC tools to enlist corporate counsel in fraud prevention).

\textsuperscript{165} Letter from David Becker, Gen. Counsel, Sec. & Exch. Comm’n, to Richard W. Painter, Professor of Law at Univ. of Ill. Coll. of Law (Mar. 28, 2002), available at http://www.abanet.org/buslaw/corporateresponsibility/becker.pdf. The pertinent portion of the letter stated:

As you are aware, since the \textit{Carter and Johnson} Rule 102(e) proceeding, 47 SEC 471 (1981), the Commission has not brought Rule 102(e) proceedings against lawyers based on allegations of improper professional conduct, or otherwise used the Rule to establish professional responsibilities of lawyers. There has been a strong view among the bar that these matters are more appropriately addressed by state bar rules, which historically have been the source of professional responsibility requirements for lawyers, and have been overseen by state courts. As you noted in the 1996 SMU Law Review article which you enclosed, there may be reasons to prefer having one uniform nation-wide rule governing lawyers who participate in nation-wide securities law practices; but there are also good reasons why consideration of such a significant change in established practice should be undertaken in the context of Congressional legislation, as opposed to agency rulemaking. As I understand it, your 1996 article concludes that any such changes to the rules governing lawyers should be the result of Congressional changes to the securities laws, analogous to Section 10A’s rules for accountants.
many. The lawyers wasted no time in opposing it—arguing that "mandating noisy withdrawal as originally proposed in Section 205.3(d)(1) would . . . [d]estroy issuers’ trust and confidence in their attorneys by creating conflicts between the attorney’s personal interest and the client’s best interest; “[e]ncourage issuers to avoid consulting with attorneys on close issues or to withhold necessary facts when they do consult attorneys”; “[r]emove the flexibility attorneys need to have in order to counsel clients effectively on compliance with law in complex matters”; and “[e]ncourage premature withdrawal by attorneys in order to escape the mandatory noisy withdrawal threshold rather than encourage them to continue to counsel on difficult issues when the issuer most needs their services.”¹⁶⁷ In the end, like Congress, the SEC backed down—electing to assuage lawyers.¹⁶⁸ The SEC’s final rule does not

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Proposed § 205.3(d) would [have] follow[ed] §§ 205.3(b) and (c) as adopted, which set forth the duty of a lawyer to report evidence of a material violation up-the-ladder of the issuer’s governance structure, and, if appropriate, to explain to the issuer his or her reasons for believing that the issuer has not made a timely or appropriate response.

Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6324, 6326 n.32 (proposed Feb. 6, 2003). Proposed section 205.3(d) read:

(d) Notice to the Commission where there is no appropriate response within a reasonable time. (1) Where an attorney who has reported evidence of a material violation under paragraph 3(b) of this section rather than paragraph 3(c) of this section does not receive an appropriate response, or has not received a response in a reasonable time, to his or her report, 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 interest or property of the issuer or of investors:

(i) An attorney retained by the issuer shall:

(A) Withdraw forthwith from representing the issuer, indicating that the withdrawal is based on professional considerations;

(B) Within one business day of withdrawing, give written notice to the Commission of the attorney’s withdrawal, indicating that the withdrawal was based on professional considerations; and

(C) Promptly disaffirm to the Commission any opinion, document, affirmation, representation, characterization, or the like in a document filed with or submitted to the Commission, or incorporated into such a document, that the attorney has prepared or assisted in preparing and that the attorney reasonably believes is or may be materially false or misleading.[


¹⁶⁸ As reported in Congress Daily:
require corporate lawyers to report violations to the SEC or to effectuate noisy withdrawal. Like House Bill 3818, the lawyers defeated noisy withdrawal and mandatory reporting requirements at the rulemaking level as well.


The above discussion is not merely an academic frolic into how lawyers can usurp a representative democracy. The Supreme Court’s decision in Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc. illustrates the very real impact of Congress’s failure to act on House Bill 3818. In Stoneridge Investment Partners, plaintiffs asked the Court to do what House Bill 3818 failed to do—limit its prior decision in Central Bank of Denver and revive a private cause of action for aiding and abetting securities fraud. The facts of Stoneridge Investment Partners are straightforward. Charter Communications (Charter) was facing an operating cash flow shortfall of over $15 million. Charter did not want to disclose this shortfall on its financial statements filed

The SEC also assuaged attorneys by delaying rules they said would force them to “tattle” on their corporate clients. At issue is a section of the Sarbanes-Oxley Act written by Sen. John Edwards, D-N.C. It directs corporate attorneys to go “up the ladder” in their clients’ firms in reporting evidence of wrongdoing. Lawyers thought the SEC’s initial rule well exceeded Congress’ intent. They were especially peeved over a provision requiring lawyers who did not get a satisfactory response to their reports from corporate governors to make a “noisy withdrawal” by reporting to the SEC. However, in a ruling last month, the SEC modified the provisions to narrow the circumstances in which attorneys would be required to withdraw from representation. The SEC also gave corporate lawyers a 60-day extension to continue lobbying against the “noisy withdrawal” – a campaign many observers believe will be successful - and voted to propose a “silent withdrawal” alternative.


171. Id. at 766; see supra text accompanying notes 133–143.


173. Stoneridge, 128 S. Ct. at 766.
with the SEC out of fear that the disclosure could have a negative impact on its stock price. As such, Charter agreed with one of its suppliers, Scientific-Atlanta, that it would overpay Scientific-Atlanta S20 for cable boxes it purchased. Scientific-Atlanta agreed to “return the overpayment by purchasing advertising from Charter.” Charter capitalized the additional cost of the cable boxes, and the advertising proceeds added to Charter’s finances as revenue even though, in reality, there was no economic significance to the transaction. This allowed Charter to meet its revenue projections.

Of course, like Enron’s, Charter’s house of cards eventually collapsed. Charter’s investors lost hundreds of millions of dollars when Charter had to restate its financials and sued Scientific-Atlanta for aiding and abetting Charter’s fraud. The Court rejected the investors’ aiding and abetting suit, holding that “[t]he § 10(b) implied private right of action does not extend to aidsers and abettors.” Instead, there is only liability for “secondary actors who commit primary violations.” The plaintiff must show that the secondary actor meets each of the elements that is applicable to a primary actor facing section 10(b) liability: “(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.” Thus, the Court reaffirmed Central Bank, finding that there is no liability absent a deceptive statement or conduct relied upon by the investor.

Important in the Court’s determination was Congress’s failure to pass House Bill 3818 in the aftermath of Enron. The Court wrote,

Were we to adopt this construction of § 10(b) [allowing aiding and abetting liability], it would revive in substance the implied cause of action against all aiders and abettors except those who committed no

174. Id.
175. Id.
176. Id.
177. Id.
178. Id. A similar scheme was worked out between Charter and Motorola, where Charter would pay Motorola $20 in liquidated damages for any cable boxes it did not buy, with the understanding that Charter would fail to buy a given number. Motorola agreed to return the liquidated damages by purchasing advertising from Charter. Again, Charter added the advertising proceeds to its financials as revenue, which allowed it to meet its revenue projections. Id. at 767.
179. Brief for Petitioner, supra note 172, at 9.
180. Stoneridge, 128 S. Ct. at 769.
181. Id. at 773–74 (citing Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 191 (1994)).
182. Id. at 768.
183. Id. at 768–69.
deceptive act in the process of facilitating the fraud; and we would undermine Congress’[s] determination that this class of defendants should be pursued by the SEC and not by private litigants.¹⁸⁴

That exact point was, of course, the centerpiece of Scientific-Atlanta’s and Motorola’s briefs. “Congress revisited the issue again in 2002 when it considered the Sarbanes-Oxley Act. Some legislators argued in favor of amending the 1934 Act to subject aiders and abettors to private suits. . . . [However, as passed] it did not extend private civil liability to aiders and abettors.”¹⁸⁵ And, in 2002, Congress again considered and rejected efforts to extend the private right of action to reach aiders and abettors. Senator Shelby proposed an amendment to the bill that became the Sarbanes-Oxley Act of 2002 that would have added a “private litigation” provision stating that “persons that aid or abet violations . . . shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.” No such provision appears in the Sarbanes-Oxley Act of 2002.¹⁸⁶

In short, Congress’s failure to act on House Bill 3818 to amend section 10(b) effectively shields corporate lawyers from aiding and abetting liability.

V. SARBAINES-OXLEY HAMMERED CORPORATE OFFICERS AND ACCOUNTANTS

A. The Weakened Business and Accounting Lobby

In the immediate aftermath of Enron, the business lobby and the accounting lobby virtually shut down because of increased press scrutiny

¹⁸⁴ Id. at 771 (emphasis added).
¹⁸⁶ Brief for Business Roundtable as Amicus Curiae Supporting Respondents at 16 n.2, Stoneridge, 128 S. Ct. 761 (No. 06-43), 2007 WL 2363259 (quoting 148 Cong. Rec. S6584 (2002) (statement of Sen. Shelby)). See also H.R. Rep. No. 107-414, at 54 (2002) (minority view observing that the SEC and others had urged Congress to overturn Central Bank’s bar on private suits against aiders and abettors and lamenting that Congress did not “now heed these recommendations” to expand the private right of action). During oral arguments before the Supreme Court, the Court was highly skeptical of its ability to reevaluate its position in Central Bank absent congressional action—at oral argument “the Court appeared strongly inclined to leave it to Congress to define the circumstances under which secondary players . . . can be sued.” Linda Greenhouse, Skeptically, Court Hears Fraud Case, N.Y. Times, Oct. 10, 2007, at C1.
(compared to the lack of press scrutiny of lawyers’ role in the Enron scandal). Commentators observed, “[T]he collapse of Enron and its auditor, Arthur Anderson, politically weakened key groups affected by the legislation, the business community and the accounting profession.” And if Enron weakened the business and accounting lobbies, WorldCom killed them. One insider recalls,

There are limits to even the best lobbying. The day after the June 25 revelation that WorldCom Inc. had misled investors with $3.9 billion in faulty accounting, what had been a tepid corporate accountability bill suddenly turned into a serious effort to regulate the accounting industry. Ultimately, the Sarbanes-Oxley bill became the most sweeping corporate regulatory reform since the Depression. “Lobbying effectively stopped the day WorldCom hit,” says one lobbyist heavily involved in the bill. “I had a meeting on the Hill that day, and people were literally calling me, saying, ‘Do you still want to meet?‘”

And “as a lobbyist for the Chamber of Commerce . . . put it, ‘[w]hen the WorldCom scandal hit, it became, to me, a bit of a—a very different attitude and atmosphere, if not a political tsunami.’” All of a sudden, Congress needed “the most sweeping corporate reforms since the Great Depression,” and the path of least resistance for Congress was through the corporate officers and accountants.

As noted above, accountants did contribute a significant amount to members of the Financial Services Committee—approximately $800,000. However, due to the press scrutiny, and the fact that they had just been caught red handed shredding Enron documents, the accountants could not take

187. See supra text accompanying notes 20–21. Corporate lawyers were able to bring their influence to bear on Congress in the spring of 2002 in large part because few people knew the central role they had played. The lawyers “who provide the brains, the talent, and often the motivation, behind a fraud . . . avoid[ed] responsibilities to the victims simply because their appearance was not made visible to the investing public, and sadly, that’s the state of the law that we have today.” Hearing on H.R. 3763, supra note 143, at 140.
188. Romano, supra note 8, at 1528.
190. Romano, supra note 8, at 1567 (quoting World News Tonight (ABC television broadcast July 24, 2002)).
192. See supra text accompanying note 135.
advantage of access to the politician’s ear—even if campaign contributions bought such access—and certainly not with the same success that lawyers obtained in defeating House Bill 3818.\(^{194}\)

**B. Officer Bars**

The first casualties of Sarbanes-Oxley were officers; specifically, through the vehicle of section 305 of Sarbanes-Oxley, “Officer and Director Bars and Penalties,” Congress made it easier for the SEC to administratively prohibit a person from serving as an officer or director under appropriate circumstances.\(^{195}\) Before explaining what the law is as it pertains to officer and director bars, it is important to discuss what the law was, or perhaps more accurately, how the concept of officer and director bars evolved over time. Indeed, officer and director bars are an old idea simply waiting for the right time to be revived.

Felix Frankfurter, James Landis, Benjamin Cohen, and Thomas G. Corcoran wrote the Securities Act of 1933\(^{196}\) over a weekend and a case of Scotch in response to a belief that investment bankers, brokers, dealers, corporate directors, and accountants had systematically overreached and cheated the American public out of their hard earned money during the 1920s—causing the Great Depression.\(^{198}\) Fully half of all securities floated during this period were worthless, “and [those] cold figures spell[ed] tragedy in the lives of thousands of individuals who [had] invested their life savings, accumulated after years of effort, in [those] worthless securities.”\(^{199}\)

The model for the Securities Act was the English Companies Act (the Companies Act).\(^{200}\) Years later, Landis recounted the fierce debate over whether to incorporate section 217 of the Companies Act which allowed courts to bar directors.\(^{201}\) In the end, it was left out of the Securities Act.\(^{202}\) Officer and

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194. See supra text accompanying notes 136–144.
198. See H.R. REP. No. 73-85, at 2–3 (1933); see also James Landis, The Legislative History of the Securities Act of 1933, 28 GEO. WASH. L. REV. 29, 30 (1959) (arguing the Securities Act of 1933 was implemented in response to the American public’s loss of faith in securities institutions following the high financing of the 1920s and the stock market crash of 1929).
201. Landis, supra note 198, at 48. Sections 8 and 9 of the Company Directors Disqualification Act, which set forth in great detail when a court can bar a director, superseded
director bars were viewed as too drastic and too draconian a remedy, and the focus of the Act was on making sure investors had the information they needed to make sound investment decisions, not on punishing corporate principals.203

Fifty years later, in 1985, James C. Treadway Jr., then Commissioner of the SEC, gave a speech entitled Looking for the Perfect Enforcement Remedy.204 In his speech, Treadway tried to revive officer and director bars, arguing they were authorized under what one might call an implied SEC right of action; that is to say, inherent in the securities laws is an SEC right to bar officers and directors:

Section 15(c)(4) of the Exchange Act . . . may empower the Commission to issue administrative orders barring individuals who “cause” issuers to violate reporting, proxy, and recordkeeping requirements from holding corporate office. Section 15 (c)(4) has always authorized the Commission to require compliance “upon such terms and conditions as the Commission may specify,” and . . . a wide range of remedies are potentially available, including orders barring individuals from association with a public company.205


202. Landis described the debate as to the civil liability of directors as the “bitterest struggle.”

Landis, supra note 198, at 48.

203. H.R. REP. No. 73-85, at 2–3 (1933). As James Farrand observed:
[The SEC’s] enforcement powers under the principal securities statutes were for many years restricted by the acts’ narrow enforcement provisions. Most of these provisions authorize nothing more than the initiation of civil suits in the federal courts to obtain injunctions against future statutory violations. . . . [H]owever, [starting in the 1970s] the Commission has succeeded in securing various far reaching orders of “ancillary relief” to accompany the traditional statutory injunctions against future wrongdoing.


205. Id. The Exchange Act states:
If the Commission finds, after notice and opportunity for a hearing, that any person subject to the provisions of section 78l, 78m, 78n of this title, or subsection (d) of this section or any rule or regulation thereunder has failed to comply with any such provision, rule, or regulation in any material respect, the Commission may publish its findings and issue an order requiring such person, and any person who was a cause of the failure to comply due to an act or omission the person knew or should have known would contribute to the failure to comply, to comply, or to take steps to effect...
Despite Treadway’s attenuated pronouncement of implied authority to issue officer and director bars administratively, the reality was that the SEC was basing attempts to bar officers and directors on broader congressional “authorizations for SEC civil injunctive actions”\(^{206}\) that require the SEC to seek equitable relief through a court:

> Whenever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of this chapter, . . . it may in its discretion bring an action in the proper district court of the United States, . . . to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond.\(^{207}\)

In turn, “the [court’s] [a]uthority to [approve the SEC’s request for] such relief [was] based on the general equitable powers of the federal courts in the context of a comprehensive statutory scheme.”\(^{208}\) During this time, court approval of officer and director bars was generally seen as a rubber stamp, as the parties hammered out and formalized the details with a consent agreement.\(^{209}\)

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\(^{206}\) Farrand, supra note 203, at 1780.


\(^{208}\) Farrand, supra note 203, at 1781. Sarbanes-Oxley expressly codified the courts’ ability to grant equitable relief by amending section 21(d) of the Securities Exchange Act of 1934 with section 305 of Sarbanes-Oxley, which reads, “(5) Equitable Relief.—In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.” Sarbanes-Oxley Act of 2002, § 305, 15 U.S.C. § 78u(d)(5) (2006). However, the reported cases citing section 305 thus far relate to forcing disgorgement of funds rather than officer and director bars. See, e.g., SEC v. Dibella, 409 F. Supp. 2d 122, 132 (D. Conn. 2006) (citing § 305) (“Congress expressly clarified the SEC’s authority to seek equitable remedies, such as disgorgement, in the Sarbanes-Oxley Act.”); SEC v. Save the World Air, Inc., No. 01-11586, 2005 U.S. Dist. LEXIS 28313, at *61 (S.D.N.Y. Nov. 16, 2005) (“[T]he Court’s order requiring disgorgement to the Commission of the [money that defendant obtained] through his fraudulent scheme will act as a deterrent to further misconduct on his part.”); SEC v. Shiv, 379 F. Supp. 2d 609, 615 (S.D.N.Y. 2005) (“[T]his court has jurisdiction pursuant to § 305] . . . to cause [defrauded funds] to be disgorged . . . .”); SEC v. Zubkis, No. 97-8086, 2005 U.S. Dist. LEXIS 13086, at *15 (S.D.N.Y. June 30, 2005) (“The Court may use this broad equitable power [under § 305] to order the turnover of assets nominally held by third parties where the third party lacks a legitimate claim to the assets.”).

However, Commissioner Treadway was not as confident that there was an implied SEC right position as he appeared; two years later he was pushing for express congressional authorization to issue officer and director bars. Treadway was the lead drafter of the Report of the National Commission on Fraudulent Financial Reporting in 1987 (the Treadway Report) which was in response to “such spectacular failures as Drysdale Government Securities, Washington Public Power Supply System, Baldwin-United Corp., and E.S.M. Government Securities.” Congressional hearings into the causes for these failures “focused upon whether they could have been avoided by, among other things, better audit practice” and greater officer and director accountability. The Treadway Commission Report argued,

[S]tiffer penalties for corporate officers and directors involved in fraudulent financial reporting would be an effective deterrent. In considering enforcement proceedings against individual corporate officers or directors who aid and abet, cause, or participate in

SEC remove directors, it actually appointed its own candidates with the approval of the court and with the consent of the subject corporation:

[The Commissioner of the SEC explained] the Commission has stepped into the world of corporate management, and, in egregious cases, replaced elected management with impartial third parties. It has required the appointment of independent directors to a company’s board. The individuals are usually subject to prior court and Commission approval.

Let me give you an example—the often-cited Mattel case. Independent directors were brought into the toy company’s management structure to oversee accounting procedures and the preparation of financial statements. This imaginative approach allowed Mattel to continue its operations, but assured the SEC that Mattel would not continue to inflate its profits and make fraudulent disclosures.

A similar consent decree was entered into in connection with the settlement last year of the U.S. Surgical matter. Surgical was required to appoint two non-affiliated directors to its Board. The two were to serve on the audit committee that was charged with reviewing the company’s SEC filings and financial statements.


211. Id. at 1.


213. Id.
fraudulent financial reporting, the SEC therefore should consider whether to bar those individuals from future service in that capacity in a public company. The bar, which the SEC could tailor as appropriate to the case, could be either temporary, like a suspension, or permanent. The permanent bar would be appropriate if the violation was particularly egregious or the violator were a repeat offender.\textsuperscript{214}

On the Treadway Commission’s recommendation, Congress took a cautious first step and allowed the SEC to bar directors if a federal district court approved. The Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (the Remedies Act) provided that a court could issue officer and director bars for “substantial unfitness.”\textsuperscript{215} The Securities Act of 1933, as amended by the Remedies Act, states that a court may

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prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who violated section 17q(a)(1) of this title from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 78f of this title or that is required to file reports pursuant to section 78o(d) of this title if the person’s conduct demonstrates substantial unfitness to serve as an officer or director of any such issuer.\textsuperscript{216}
\end{quote}

For ten years there was no change. Parties agreed to and courts approved of occasional officer and director bars by consent decree. Then, in 2002, in the wake of Enron, Congress again focused on new ways, using old ideas, to force corporate principals to work within the bounds of the law. Congress’s conclusion was to make it easier for the SEC to bar persons from serving as corporate principals by giving the SEC the right to administratively issue officer

\textsuperscript{214} TREADWAY REPORT, supra note 210.


and director bars.\textsuperscript{217} Congress would cut the courts out of the process. One can imagine the conversation:

\textbf{CONGRESSMAN I:} I have a great idea; we will offer up the officers and directors as a sacrifice to the electoral gods. Let's give the courts the power to issue officer and director bars.

\textbf{CONGRESSMAN II:} But we already went after the officers and directors in 1990 when we gave the courts the power to bar . . .

\textbf{CONGRESSMAN I:} Alright then, we will give the power to the SEC to bar persons administratively. No bothersome courts. The officers and directors won't know what hit them.

The early version of Sarbanes-Oxley expanded SEC power by allowing the SEC to administratively issue officer and director bars, but it retained court created factors for determining "substantial unfitness" and allowed for an automatic stay of the bar pending judicial review.\textsuperscript{218} However, when the WorldCom scandal broke, it became clear that Enron was not an isolated incident. Calls for

\begin{itemize}
\item \textsuperscript{217} Hearing on H.R. 3763, supra note 143, at 77 (statement of Harvey L. Pitt, Chairman, Sec. & Exch. Comm'n).
\item \textsuperscript{218} H.R. 3763, 107th Cong. § 11 (as passed by House, Apr. 24, 2002). The first version of Sarbanes-Oxley stated,
\begin{enumerate}
\item \textbf{COMMISSION AUTHORITY TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.}—Notwithstanding any other provision of the securities laws, in any cease-and-desist proceeding . . . the Commission may issue an order to prohibit, conditionally or unconditionally, permanently or for such period of time as it shall determine, any person . . . from acting as an officer or director . . . if the person's conduct demonstrates substantial unfitness to serve as an officer or director of any such issuer.
\item \textbf{FINDING OF SUBSTANTIAL UNFITNESS.}—In making any determination that a person’s conduct demonstrates substantial unfitness to serve as an officer or director of any such issuer, the Commission shall consider—
\begin{enumerate}
\item the severity of the persons conduct giving rise to the violation, and the persons role or position when he engaged in the violation;
\item the person’s degree of scienter;
\item the person’s economic gain as a result of the violation; and
\item the likelihood that the conduct giving rise to the violation, or similar conduct as defined in subsection (a), may recur if the person is not so prohibited.
\end{enumerate}
\item \textbf{AUTOMATIC STAY PENDING APPEAL.}—The enforcement of any Commission order pursuant to subsection (a) shall be stayed—
\begin{enumerate}
\item for a period of at least 60 days after the entry of any such order or decision; and
\item upon the filing of a timely application for judicial review of such order or decision, pending the entry of a final order resolving the application for judicial review.
\end{enumerate}
\end{enumerate}
\end{itemize}

\textit{Id.}
officer and accountant accountability increased in the business press.\textsuperscript{219} Congress determined that the SEC may now issue an officer and director bar pursuant to a cease-and-desist proceeding:

In any cease-and-desist proceeding under subsection (a), the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who has violated section 10(b) or the rules or regulations thereunder, from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12, or that is required to file reports pursuant to section 15(d), if the conduct of that person demonstrates unfitness to serve as an officer or director of any such issuer.\textsuperscript{220}

The first things to notice are that the SEC may now issue a officer and director bar without court supervision, and there is no automatic stay of the bar pending judicial review.\textsuperscript{221} The second is that Congress actually lowered the standard from “substantial unfitness” to “unfitness.”\textsuperscript{222} As to whether substantial


\textsuperscript{221} Id. Sure, there is the ability to challenge the removal after the fact, but by then, the horse is out of the barn. The case of International Controls Corp. v. Vesco, 490 F.2d 1334 (2d Cir. 1974), is illustrative. In Vesco, the court ordered that, “[SEC approved directors] shall replace the existing board of directors of International Controls, and shall have full power under applicable corporate law to conduct the affairs of International Controls in conjunction with the Special Counsel.” Id. at 1340. The shareholder, Vesco, insisted that he had a right to elect directors; he went to state court to stop “the court-appointed board of directors from exercising their duties.” Id. at 1352. The federal court enjoined the state action, finding that the state court action “represents a direct assault on the Final Judgment [of the federal court] and constitutes an attempt to frustrate the court’s order appointing a new board of directors for ICC by seeking to enjoin the functioning of the board.” Id. As such, even if shareholders decide to stand on their rights, they will find no help from the courts.

\textsuperscript{222} 15 U.S.C. § 77T(e) (2002), \textit{amended by} Sarbanes-Oxley Act § 305(a)(1) (2002). The Amendment is as follows:

Sec. 305. Officer and Director Bars and Penalties.
(a) Unfitness Standard.—
unfitness is any different than unfitness, the author will leave to others to consider.\textsuperscript{223} For purposes of this Article it is sufficient to show that Congress amended the securities laws to allow the SEC to dole out greater and greater punishment against officers and directors while doing nothing to hold accountable the lawyers who knowingly structured the deals that led to securities fraud.\textsuperscript{224} Further, while the SEC showed itself to be very timid in its approach to holding lawyers accountable, it went full throttle after the officers and accountants.\textsuperscript{225} Harvey L. Pitt, the Chairman of the SEC in 2002, commented during his testimony before the House Committee on Banking, Housing and Urban Affairs that “the present securities laws authorize us to petition a court if we want to bar officers and directors who break our laws. We could use this tool more effectively and protect investors far more efficiently if we could impose this sanction administratively.”\textsuperscript{226} And later, in an exchange between Representative Shays and Mr. Pitt:

\begin{quote}
(2) \textbf{SECURITIES ACT OF 1933.}—Section 20(e) of the Securities Act of 1933 (15 U.S.C. 77t(e)) is amended by striking “substantial unfitness” and inserting “unfitness.” Sarbanes-Oxley Act § 305. Additionally, for these penalties to apply, the officer or director must work for an “issuer that has a class of securities registered pursuant to section 78l of this title or that is required to file reports pursuant to section 78o(d) of [the Securities Act].” 15 U.S.C. § 77t(e).

223. This Article makes no attempt to tackle other interesting questions, such as establishing a framework for director removal post-Sarbanes-Oxley. Commentators have already undertaken the question of how courts should view the reduced standard, with various results. \textit{See}, e.g., Jayne W. Barnard, \textit{Rule 10B-5 and the “Unfitness Question,”} 47 ARIZ. L. REV. 9, 46–53 (2005) (setting forth nine factors to determine unfitness); Jayne W. Barnard, \textit{SEC Debarment of Officers and Directors After Sarbanes-Oxley,} 59 BUS. LAW 391, 408 (2004) (“Ironically, it is not even clear from the legislative history of Sarbanes-Oxley that the change in language from ‘substantial unfitness’ to ‘unfitness’ was intended to \textit{reduce} the quantum of proof required of the government.”).

224. \textit{See supra} text accompanying notes 215–222.

225. \textit{Id.}

226. \textit{Accounting Reform and Investor Protection: Hearings Before the S. Comm. on Banking, Housing, and Urban Affairs,} 107th Cong. 1071 (2002) (statement of Harvey L. Pitt, Chairman, Sec. & Exch. Comm’n) [hereinafter Statement of Chairman Pitt]. At the first session of the 107th Congress, Pitt made the same request, stating:

the Commission should be given administrative authority to bar officers and directors of public companies who commit violations of the Federal securities laws from serving as officers and directors. We can do that in the securities industry. The banking agencies can do it with banks. I believe we should be able to do it with public corporations, obviously subject to review.” \textit{Hearing on H.R. 3763, supra} note 143, at 77 (statement of Harvey L. Pitt, Chairman, Sec. & Exch. Comm’n).
MR. SHAYS: In the Oxley-Baker bill, which I am a cosponsor of, is there any new authority that you would like to see in the bill that is not in the bill now?

MR. PITT: The principal authority that we would like to see included is our ability administratively to bar someone from serving as an officer or director of a company if we find that they have engaged in egregious misconduct.

MR. SHAYS: Is that the primary addition?

MR. PITT: That is the principal one.²²⁷

One would like to think that the stenographer did not get the rest of Mr. Pitt's answer, but that the whole answer was, "That is the principal one, and we should probably have something in there to hold accountable the lawyers that structured the deals that made all these financial machinations possible." Instead, it is more likely that Mr. Pitt thought it politically expedient to leave the lawyers alone.

C. Tougher Accounting Standards

As shown above, the ABA accused Congress of overstepping its bounds when Congress proposed additional ethical rules for lawyers—up and out reporting.²²⁸ That argument seems weak when you consider that accountants—like lawyers, a traditionally self-regulated profession—find themselves answering to the Public Company Accounting Oversight Board (PCAOB).²²⁹ The PCAOB "replac[ed] the system of self-regulation for the accounting profession" and

²²⁷. Hearing on H.R. 3763, supra note 143, at 83.
²²⁸. See supra text accompanying notes 157–170.
²²⁹. See, e.g., Hillary A. Sale, Gatekeepers, Disclosure, and Issuer Choice, 81 WASH. U. L.Q. 403, 408–09 (2003) ("Sarbanes-Oxley creates an entirely new structure for regulating accountants... These provisions directly regulate a formerly self-regulated... group."); France, What About the Lawyers?, supra note 4, at 58, 59 ("[A]ccountants will be answering to a new independent oversight board."). There are also technical changes. For instance, Sarbanes-Oxley requires that all financial reports be accurate and "disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations)... that may have a material current or future effect on financial condition." Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 401(a), 116 Stat. 745, 786 (codified at 15 U.S.C. § 78m(j) (2006)). Any non-GAAP financial calculations included in a financial report must be disclosed and not be "misleading." Id. § 401(b) (codified at 15 U.S.C. § 7261).
was given broad powers and authority, including those to register public accounting firms, to set by rule auditing, ethics, quality control and independence standards, to inspect the auditing operations of registered accounting firms, to investigate violations of ethics or conduct set by the profession itself and the PCAOB’s own rules, and to enforce compliance with the new legislation and the PCAOB’s own rules. 230

Many commentators have written in detail about the severity of subjecting accountants to the PCAOB. 231 For our purposes, it is sufficient to show that accountants receive less favorable treatment than lawyers despite the fact that the roles played by the two were comparable. Indeed, the lawyers were at least as culpable as the officers and directors in the fall of Enron.

VI. COUNTERARGUMENTS

Parts II through V of this Article have set forth and have defended a number of propositions related to the fall of Enron and the passage of Sarbanes-Oxley. First, corporate lawyers were at least as culpable as officers and accountants in the fall of Enron. Enron’s lawyers designed the schemes that hid billions of dollars in debt, drafted the documents that brought the schemes to life, and then drafted legal opinions Enron’s bankers relied upon in certifying that the entire process was perfectly legal. 232

Second, corporate lawyers received favorable legislative treatment despite their culpability. Lawyers avoided aiding and abetting liability and up and out reporting. On the other hand, corporate officers suffer under an expanded SEC power—officer and director bars—to administratively bar them from serving public corporations in any substantial capacity. Accountants face the scrutiny of the PCAOB and are no longer self-regulated. 233

Third, corporate lawyers’ role in the scandal was not immediately obvious in the aftermath of Enron, and the business press did not cover it. As such,
corporate lawyers were able to marshal their resistance to legislation. On the other hand, the business lobby and the accounting lobby virtually shut down in the face of increased business press scrutiny.\textsuperscript{234} Finally, Congress was more interested in quickly passing legislation to restore the investing masses’ confidence than in making sure that such legislation actually addressed the issues that led to the Enron scandal.\textsuperscript{235} Thus, the best explanation for Sarbanes-Oxley’s favorable treatment of corporate lawyers is their access to the politicians’ ear in the aftermath of Enron. Campaign contributions amplified an already close relationship between legislators and lawyers.\textsuperscript{236} This final statement is, of course, the most controversial. Part VI aims to dispel the counterargument that public policy considerations can best explain the favorable treatment of corporate lawyers—it cannot.

A. Policy Arguments Do Not Explain Why the Act Treated Corporate Lawyers Favorably

The intent of this Article is to tell a story about corporate lawyers’ influence in politics and, by extension, why Sarbanes-Oxley treated similarly situated parties differently. The Article has set forth competing policy arguments to show that policy arguments alone do not explain why Sarbanes-Oxley treated corporate lawyers favorably, compared to corporate officers and accountants.\textsuperscript{237}

Indeed, if we were to weigh the policy implications—considering theories of efficiency and societal betterment—Sarbanes-Oxley would look much different. Some might argue that this is too cynical; that, for example, legislators omitted up and out reporting requirements in Sarbanes-Oxley in order to save attorney–client confidentiality (an oft cited policy argument)\textsuperscript{238}—not because of campaign contributions. The fact is, our legal culture does not hold sacrosanct attorney–client confidentiality.\textsuperscript{239} Most jurisdictions adopt a specific exception to the attorney–client privilege providing that “[a] lawyer may reveal . . . [t]he intention of a client to commit a crime and the information

\begin{footnotesize}
\textsuperscript{234} See supra text accompanying notes 20–21, 157–158, 187–194.
\textsuperscript{235} See supra note 8 and accompanying text.
\textsuperscript{236} See supra Part IV.A.
\textsuperscript{237} As Arthur Leff so eloquently stated, when politicians pass legislation they “ought to have the political nerve to do so with some understanding (and some disclosure) of what [they] are doing.” Arthur Allen Leff, Unconscionability and the Code—The Emperor’s New Clause, 115 U. PA. L. REV. 485, 558 (1967) (emphasis added).
\textsuperscript{238} See, e.g., ABA Letter to the SEC, supra note 167 (arguing that noisy withdrawal will “destroy issuers’ trust and confidence in their attorneys”).
\textsuperscript{239} See, e.g., MODEL RULES OF PROF’L CONDUCT R. 1.6 (2002) (providing four exceptions to attorney–client confidentiality).
\end{footnotesize}
necessary to prevent the crime.”240 Texas, where Enron is located, allows a
lawyer to reveal confidential information about a client or a former client
“[w]hen the lawyer has reason to believe it is necessary to do so in order to
prevent the client from committing a criminal or fraudulent act” after trying to
dissuade the client from continuing in such conduct.241

Setting aside reporting out, what about liability for lawyers who aid and
abet securities fraud? Again, critics argue that the prospect of liability for aiding
and abetting would encourage attorneys to violate their duty of
confidentiality.242 In its motion to be dismissed from In re Enron Corp.
Securities, Derivative & ERISA Litigation, Enron’s lawyers argued that the
court should not revive aiding and abetting liability for lawyers because doing
so would create two conflicting duties: on one hand keeping their client’s
confidences and on the other hand disclosing those very confidences to avoid
liability.243 Judge Harmon rejected this argument, stating in essence that
reviving aiding and abetting liability would prohibit the firm from aiding and
abetting securities fraud; it would not require the lawyer to disclose anything.244
“[T]he firms could have withdrawn from the representation without also
reporting Enron; the two decisions were separate.”245 Judge Harmon got that
point right—the two decisions are separate. As such, the preferred policy
argument against lawyer accountability—client confidentiality—is not
dispositive.

B. Should the SEC Be Involved in Corporate Governance?

Additionally, there are strong policy arguments against involving the SEC
in the most sacrosanct of shareholder rights—choosing officers and directors.
The SEC should not be in the business of issuing officer and director bars and,
by implication, appointing officers and directors to public companies.246 Doing

242. See ABA Letter to the SEC, supra note 167.
243. Defendant Vinson & Elkins L.L.P.’s Motion to Dismiss and Memorandum in Support at
(No. H01-3625). But see In re Enron, 258 F. Supp. 2d at 587 (noting that while the court did not
revive aiding and abetting liability for lawyers, it did determine that a lawyer “may be liable as a
primary violator under § 10(b)”)
244. See In re Enron, 235 F. Supp. 2d at 589–91.
245. Sebok, supra note 124.
246. While this Article focuses on officer and director bars, the SEC has also increased the
appointment of directors to the boards of troubled corporations, as it did in SEC v. Mattell and SEC
v. U.S. Surgical. See discussion supra note 209. Examples abound: In 2003 the federal monitor
appointed to oversee WorldCom appointed an entirely new board of directors. See, e.g., Sue
Reisinger, Companies in Trouble Get Their Own Monitor, N.Y.L.J., Oct. 7, 2004 at 5, 5 (“[The

https://scholarcommons.sc.edu/sclr/vol60/iss1/5
so is in direct contravention of the traditional adherence to the legal doctrine of shareholder primacy. 247 At the risk of oversimplification, this doctrine provides that the officers and directors work for the shareholders. 248 As the owners of the corporation, the shareholders have absolute authority to choose directors and, through them, to manage the affairs of the corporation. 249

[D]irect shareholder control of the business . . . [is] a legitimate form of corporate governance. However, there are reasons to prefer an alternative. It would be very difficult to have . . . even a relatively small number of shareholders attempting to run the business directly through democratic means. . . . To deal with [this] practical difficult[y], the law provides for the election of directors to manage the business on [the shareholders’] behalf. However, . . . this is entirely facilitative: the goal is not to take control away from shareholders, but rather to place management responsibility in the hands of talented and dedicated individuals. 250

If the shareholders could better maximize profits, they would manage the corporation themselves—no officers or directors would be needed. Efficiency

247. Julian Velasco, The Fundamental Rights of the Shareholder, 40 U.C. DAVIS L. REV. 407, 437 (2006) ("According to the traditional view, . . . [s]hareholders are the owners of the corporation. They elect directors to manage the business on their behalf.").

248. Id. at 437–38. Indeed, the conclusions of this Article would be entirely different should we view corporations through the prism of social responsibility theory. See id. at 451–52 ("[Social responsibility theorists] do not believe that the corporation exists solely, or even primarily, for the benefit of its shareholders; they insist that there are other values that the corporation and corporate law must serve."); see also Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law, 89 GEO. L.J. 439, 440 (2001) (arguing that the intellectual debate has settled on shareholder primacy).

249. See Velasco, supra note 247. The New York Business Corporation Law clearly provides that the election and removal of directors is a power vested in the shareholders. N.Y. BUS. CORP. LAW § 703 (McKinney 2003) ("At each annual meeting of shareholders, directors shall be elected to hold office until the next annual meeting . . ."); id. § 706 ("Any or all of the directors may be removed for cause by vote of the shareholders. . . . If the certificate of incorporation or the by-laws so provide, any or all of the directors may be removed without cause by vote of the shareholders.").

250. Velasco, supra note 247, at 441 (emphasis added).
dictates otherwise. Indeed, a corporation is like a "little republic[]" where "[p]ower [is] distributed among [its] citizens—the shareholders—via suffrage, electoral, and other rights that were inscribed in the corporation’s constitution."\textsuperscript{251} Like the federal government’s power is derived from the people, so too, the corporation’s power is derived from the shareholders.\textsuperscript{252} Allowing the SEC to remove officers and directors is an assault on the cornerstone of shareholder primacy—shareholder suffrage.\textsuperscript{253} Yet this is exactly what allowing the SEC to choose who can and cannot serve as directors does.


\textsuperscript{252} This is especially surprising given that legislators recognized shareholder supremacy during the debates. \textit{See} 148 CONG. REC. 13829–35 (2002) (statement of Rep. McInnis). Representative McInnis succinctly emphasized the idea that shareholders are the owners of the corporation, and as such, absent externalities—such as poor information—can choose an effective management team:

[S]hareholders are really the foundation in the corporation. They pool their money together so that they can build a business. . . .

Now, the shareholders are represented by a number of different people and different people have different duties to the shareholders. Again, keep in mind the shareholders are the owners. For example, here, the shareholders elect a board of directors.

Now, what is a board of directors? A lot of people will tell you that the chief executive officer, which in the old days was called the president of the corporation, that the president of the corporation was really the person who ran that corporation. That is not true . . . .

. . . . [The chief executive officer] is not the top individual of that corporation. He or she answers to the board of directors [who in turn] answer to the shareholders. And . . . this is the fundamental structure, you have the shareholders who elect the board of directors . . . and they elect the[] board of directors to represent their interests, the interests of the shareholders. They do not elect this board of directors to represent the interests of the chief executive officer. The chief executive officer is simply a tool in the operation of this corporation.

Now, this sounds a little mundane; but you have to have a pretty good understanding of this to figure out where this fraud is taking place, why the checks and balances in our corporate structure in this country have broken down, what we need to do to bring back solutions.

\textit{Id.} at 13830.

\textsuperscript{253} At least some commentators have noted that the appointment of federal monitors is a "significant intrusion on shareholder suffrage," and by implication, an attack on shareholder primacy. Jennifer O’Hare, \textit{The Use of the Corporate Monitor in SEC Enforcement Actions}, 1 BROOK. J. CORP. FIN. & COM. L. 89, 93 (2006). Jeffrey J. Haas and Steven R. Howard wrote:

[A federal monitor] displaces . . . management entirely. This includes both the shareholder-elected board of directors and the officers appointed by the board. Second, the appointment of a receiver eliminates, either temporarily or permanently, shareholder suffrage. While the receivership remedy is the ultimate "no confidence" vote in the
Courts were traditionally hostile to SEC tampering in corporate governance, so much so that Sarbanes-Oxley’s officer and director bars can be seen as statutorily overruling prior court precedent. In Fallstaff Brewing Corporation, the Commission alleged that Fallstaff repeatedly violated the securities laws by disseminating materially false proxy statements, together with filing false and misleading reports with the SEC. The SEC requested that the court approve numerous independent directors to Fallstaff’s board of directors. The court refused, reasoning that “the [c]ourt should not, without considerable justification, impose a remedy which would in effect regulate areas traditionally left to internal corporate management.” In the more recent case of SEC v. Patel, the SEC again found itself in the position of having its efforts to interfere in corporate governance rejected, when the Second Circuit Court of Appeals held that the SEC could not bar the defendant from acting as a director on the facts presented.

...directors and officers, a court casts that vote at the SEC’s behest rather than shareholders.


256. Id. at 94,473.


In its initial complaint, the SEC alleged that in 1973 Mattel made filings and press releases that were false and misleading. Simultaneously with the filing of the complaint, Mattel consented to, and the court entered, a judgment that permanently enjoined Mattel from violating the 1934 Act. The judgment also required Mattel to appoint two new unaffiliated directors. . . . When Mattel informed the SEC a few months later of further securities law violations, the Commission obtained Mattel’s consent to additional relief, including the appointment and maintenance for five years of a majority of unaffiliated directors on a new executive committee and on the whole board. . . . Despite initial reluctance, the district judge granted the requested relief with certain modifications. The company and the SEC enforcement staff chose new directors from a list of persons cleared by the Commission. Shareholders played no role in this selection and were denied their usual right to fill these directorships during the five-year period of the decree. The judgment involved substantial, continuing court involvement in the corporation’s affairs.


258. 61 F.3d 137 (2d Cir. 1995).

259. Id. at 140–41.
In reversing the lifetime injunction against an officer of a company who was found to have violated the Federal securities laws, the court discussed a nonexclusive six factor test for considering fitness to serve as officer or director: (1) the egregiousness of the violation; (2) whether the defendant was a recidivist; (3) the defendant’s position when he engaged in the fraud; (4) the degree of scienter; (5) the defendant’s economic gain from the violation; and (6) the likelihood that the defendant would repeat the misconduct.\(^{260}\)

The Patel factors were intended to temper the drastic impact of the officer and director bar,\(^{261}\) yet Congress has thrown them out.\(^{262}\)

Additionally, there are better ways to protect the public from corporate fraud: “Publicity is justly commended as a remedy for industrial diseases. [And s]unlight is said to be the best of disinfectants.”\(^{263}\) That is to say, the intent of the securities laws is to protect shareholders by making sure that they have adequate information.\(^{264}\) Disclosure requirements have been “the basis for the

260. Statement of Chairman Pitt, supra note 226, at 1114 (citing Patel, 61 F.3d at 141). The fact is that the SEC was having fits about this case. Pitt complained about Patel at the Enron Hearings:

At present, the securities laws authorize us to seek officer and director bars in court in appropriate cases. But some courts have taken an inhospitable approach to the plain legislative language, thwarting our ability to prevent some officers and directors who inflict serious harm on investors from repeating that kind of conduct. We will continue to press for a more enlightened and hospitable reading of the statutory language, but we believe the Commission should have the ability, administratively, to affect such relief promptly, subject of course to subsequent judicial review of the Commission’s action. We also think the Commission should have the authority to impose penalties in these instances. By removing existing judicial restraints, and by providing for judicial review of the Commission’s imposition of such a sanction, you will be giving us a tool we need to address and deter corporate malfeasance and misfeasance—a tool to our authority to do the same with brokerage firm personnel, stock exchange officers, directors and others, akin to the authority of the banking regulators to bar future service by banking officers and directors. A recent edition of Business Week reported that a significant majority of the chief financial officers polled by Business Week and the Financial Executives International favored harsher penalties for officers and directors who fail to discharge their duties properly.

Id. (internal citations omitted).

261. See Patel, 61 F.3d at 141–42.


264. That is why the securities laws turn on what information is available to investors when determining if the registration requirements of the securities laws will apply. See, e.g., Securities
development of our strong securities markets" and have proven to be effective, without threatening shareholder supremacy.\textsuperscript{265} Preventing another Enron does not require SEC participation in corporate governance; it requires "force[ing] businesses to disclose much more financial information in real-time."\textsuperscript{266} Enron was not the result of a failure to bar certain persons from serving as officers or directors—an ex post facto remedy; instead, it was the result of financial information not making its way to shareholders.\textsuperscript{267} Enron's financial woes were directly attributable to investors receiving inaccurate—indeed fraudulent—financial information.

In fact, to the extent that Sarbanes-Oxley can be considered a success for returning investors' confidence to the markets,\textsuperscript{268} such success is attributable to Sarbanes-Oxley's strengthening of the mandatory reporting requirements contained within the Securities Exchange Act of 1934.\textsuperscript{269} As President Bush reassured the public during the signing of the Act, the "financial information [shareholders] receive from a company will be true and reliable."\textsuperscript{270} The accuracy enhancement model is the traditional model explaining the need for financial transparency of corporations and is summarized as follows:

[Mandatory disclosure [should] help[ ] market participants to determine prices for securities that accurately reflect all available information. Disclosure can contribute to informational efficiency (and ultimately to social welfare) by enabling traders to gather information, and thereby

\textsuperscript{267} Id. (statement of Rep. Lee) ("[I]nvestors lost money because Enron cooked its books.").
\textsuperscript{268} On September 27, 2007, five years after Enron, the Dow Jones Industrial Average (DJIA) was at 13,913. Dow Jones Indexes, http://www.djindexes.com (follow "Dow Jones Averages" hyperlink; then follow "Index Data" hyperlink; then select "Industrial average"; then select "September 27, 2007" as Begin Date and End Date; then follow "Get Report" hyperlink) (last visited Oct. 5, 2008). Just seven days prior to the signing of Sarbanes-Oxley, the DJIA was at 7,702. Id. (select "July 23, 2002" as Begin Date and End Date; then follow "Get Report" hyperlink).
\textsuperscript{270} Remarks on Signing the Sarbanes-Oxley Act of 2002, 2 Pub. Papers 1319 (July 30, 2002) (internal quotation marks omitted).
reflect new information in prices, at a reduced cost compared to a world without disclosure.²⁷¹

According to the accuracy enhancement model, Sarbanes-Oxley should provide people with accurate information to assist them in making efficient purchasing decisions.²⁷²

Once a prospective investor becomes a shareholder, the purpose of corporate financial transparency is best described by the agency cost model.²⁷³

As set out by Professor Paul G. Mahoney, the agency cost model provides that “the principal purpose of mandatory disclosure is to address certain agency problems that arise between corporate promoters and investors, and between


²⁷² Appropriately, Sarbanes-Oxley made financial transparency a cornerstone of the legislation by strengthening the mandatory reporting requirements of the securities laws. For example, Sarbanes-Oxley requires that all financial reports be accurate and “disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations) . . . that may have a material current or future effect on financial condition.” Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, § 401(a), 116 Stat. 743, 786 (codified at 15 U.S.C. § 78mm) (2006)). Any non-GAAP financial calculations included in a financial report must be disclosed and must not be “misleading.” Id. § 401(b) (codified at 15 U.S.C. § 7261(b) (2006)); see also 17 C.F.R. § 244.100 (2008) (“A registrant . . . shall not make public a non-GAAP financial measure that . . . contains an untrue statement . . . ”). The Act also requires that each year a corporation file a report summarizing the corporation’s internal control procedures that ensure accurate financial reporting. Sarbanes-Oxley Act § 404 (codified at 15 U.S.C. § 7262 (2006)). Finally, the Act requires that the financial disclosures of each company be reviewed by the SEC at least once every three years. Id. § 408 (codified at 15 U.S.C. § 7266 (2006)). This is, of course, a fundamental premise of neoclassical economics, that is, that actors have complete and accurate information. “Neoclassical economics . . . may be conveniently defined as an approach which (1) assumes rational, maximizing behavior by agents with given and stable preference functions, (2) focuses on attained, or movements toward, equilibrium states, and (3) excludes chronic information problems.” Geoffrey Hodgson, The Approach of Institutional Economics, 36 J. ECON. LITERATURE 166, 169 n.4 (1998); see also Zohar Goshen & Gideon Parchomovsky, The Essential Role of Securities Regulation, 55 DUKU L.J. 711, 755–66 (2006) (discussing financial disclosure’s effect on an efficient market); Dale Arthur Oesterle, The Inexorable March Toward a Continuous Disclosure Requirement for Publicly Traded Corporations: “Are We There Yet?,” 20 CARDOZO L. REV. 135, 197–98 (1998) (discussing whether mandatory disclosure under the accuracy enhancement justification makes us better off).

²⁷³ See Mahoney, supra note 271, at 1048.
corporate managers and shareholders." Mahoney’s view is that “[d]isclosure can help reduce the cost of monitoring promoters’ and managers’ use of corporate assets for self-interested purposes." In short, under the agency cost model, the purpose of mandatory disclosure is to allow shareholders to control directors, which in turn reinforces shareholder primacy. The foregoing analysis indicates that a better method for preventing corporate fraud is improved disclosure—not officer and director bars.

VII. CONCLUSION

In 1934, in the wake of the Great Depression, then Associate Justice Harlan F. Stone gave a speech at the University of Michigan where he argued that lawyers had enabled the financial excesses of the 1920s that resulted in the great stock market crash of October 29, 1929. The corresponding “harm done to a social order founded upon business and dependent upon its integrity, [is] incalculable.” He continued,

There is little to suggest that the Bar has yet recognized that it must bear some burden of responsibility for these evils. But when we know and face the facts we shall have to acknowledge that such departures from the fiduciary principle do not usually occur without the active assistance of some member of our profession, and that their increasing recurrence would have been impossible but for the complaisance of a Bar, too absorbed in the workaday care of private interests to take account of these events of profound import or to sound the warning that

274. Id.
275. Id.
276. See id. Of course, even the transparency requirements of Sarbanes-Oxley have detractors, many of whom believe that the requirements are too burdensome. See, e.g., Tosha Huffman, Note, Section 404 of the Sarbanes-Oxley Act: Where the Knee Jerk Bruises Shareholders and Lifts the External Auditor, 43 BRANDEIS L.J. 239, 257 (2004) (“Section 404 of Sarbanes-Oxley should be repealed for the betterment of corporate America and in order to preserve shareholder wealth.”). Huffman argues that increased accounting expenses take money directly from shareholders’ pockets. Id. (citing PHILIP L. COOLEY, BUSINESS FINANCIAL MANAGEMENT 15 (3d ed. 1994)). I believe that is a misplaced criticism. A well run corporation should meet these requirements anyway. There is no doubt that Enron’s shareholders would have valued better accounting practices on the part of the company, even if it meant a marginal decrease in stock value.

the profession looks askance upon these, as things that “are not done.”

Like the lawyers of the 1920s, the lawyers of today enabled—indeed cooked up—the legal structures that resulted in the fall of Enron; now, like in 1934, “There is little to suggest that the Bar has yet recognized that it must bear some burden of responsibility for these evils.” Instead, corporate officers and accountants—both of whom made easier legislative targets—shouldered the burden of Sarbanes-Oxley.

Whatever Sarbanes-Oxley purported to do to stop corporate scandals, its arbitrary structure—different treatment of lawyers, officers, and accountants—does little to prevent lawyers from helping companies hide debt in the future. If you need proof, just look at the front page of the Financial Times or the Wall Street Journal from the first part of 2008. The new aider and abettor scandals range from the simple (as the Financial Times reported, “an internal probe triggered by a regulatory investigation found ‘significant deficiencies’ in how [GE] books revenues”) to the exotic (Citibank, Merrill Lynch, and Morgan Stanley have relied on complicated schemes engineered by corporate lawyers to bundle and sell overvalued mortgages in private securities transactions and use loopholes to pass those securities onto the public markets).

And the scandals continue.

278. Id. (emphasis added).
279. Id.
280. See supra text accompanying notes 157–170, 228–231.