Testimony of

Prof. Susan P. Koniak

February 6, 2002

For inviting me to testify, I want to thank the Chairman of this committee, Senator Leahy; the ranking member, Senator Hatch; and Senator Edwards, who was the first to approach me on the issue of lawyer involvement in, and lawyer responsibility for, the Enron debacle.

I. Introduction

Twelve years ago in a court opinion dealing with some aspects of the Lincoln Savings and Loan fraud, Judge Stanley Sporkin wrote: "Where ... were the ... accountants and attorneys ... ? ... [W]ith all the professional talent involved (both accounting and legal), why [didn't] at least one professional ... [act] to stop the overreaching that took place in this case"?1 Now, there is Enron. And we are here asking the same questions, Judge Sporkin and others were asking 12 years ago. To paraphrase Pete Seeger, "When will [we] ever learn?"

No one should have been surprised in the aftermath of the savings and loan crisis to learn that lawyers and accountants had averted their eyes from the fraud being perpetrated by some in the banking industry during the 1980s. Before the savings and loan debacle, there was OPM, a computer leasing company in New York that was a virtual fraud-factory that bilked such venerable institutions as Manufacturers Hanover and American Express. After filing bankruptcy, OPM's Trustee issued a report that detailed how much OPM's lawyers knew about its client's shennanigans and how much help they provided their fraud-doing client; Stuart Taylor wrote a detailed expose of the involvement of OPM's lawyers in seeing to it that their client's fraud went undiscovered. And no one should have been surprised by that either.

Before OPM, in the 1970s, lawyers and accountants aided and abetted the fraud that brought down National Student Marketing Corporation. And the law firms in most of these instances were not marginal players, they were pillars of the bar: venerable and well respected firms. Firms who settled with the government (and/or with defrauded investors) for their role in assisting Charles Keating, the head of Lincoln Savings and Loan included: Sidley and Austin, Kaye, Scholer and Jones Day. And participating as helpers in the National Student Marketing fraud were the law firms of Lord Bissell and Brook and White & Case. I hasten to add that had I had "world enough and time" those firms would appear on a much larger list, a list that would include many other prestigious firms. That is to say, the firms named above did nothing, unfortunately, that most other prestigious law firms haven't done themselves. And now we sit here in 2002 professing to be shocked, shocked that gambling is going on at Rick's saloon and that well respected law firms and accounting firms may have been involved.

Thus far, Enron's accountants have borne the lion's share of the blame for helping the wrongdoers at Enron commit what appears now to have been massive fraud. Let me put this as plainly as possible: To pull the wool over the eyes of the investing public, regulators and the media for any considerable period of time a corporation needs more than malleable accountants, it needs the help of lawyers. Perhaps Lee Harvey Oswald acted alone, but Enron and its accountants did not. When all the facts that can be known about what happened here are known, one thing will be clear everyone in the drama had a lawyer whispering in its ear (Enron, Arthur Andersen, the investment banks, the questionable partnerships that hid Enron's losses and bilked Enron's funds, the investors in those partnerships and on and on). And one more thing will be clear: no lawyer stepped in to stop this calamity.

Tightening the reins on accountants is a good idea, but, as I have just said, accountants have lawyers too.2 Those lawyers are perfectly capable of helping accountants slip loose of whatever reins you devise, just as they apparently helped Enron slip loose the reins of corporate and securities law unless Congress, the SEC and state regulators3 rein in lawyers too. Something needs to be done about the lawyers, if confidence is to be restored in the financial statements issued by companies. What the securities laws demand, is ultimately a legal question, not one for accountants. When documents must be preserved, is not simply a matter of some accounting convention; it depends on law: tax law, statutes prohibiting obstruction of justice, civil rules on spoliation of evidence, state laws on tampering with evidence and other such legal constraints.

All too often lawyers act as if they were wearing magic caps-hats that transport them to some alternative reality, a law free zone, in which they are free to do anything and everything for the person or entity paying the lawyers' fees-hats that transport them to a magic land where lawyers need not fear that law will come crashing down on them.4 "It may hit the client, but it will never hit me." There are no such magic caps. But the scant attention that has thus far been paid to the role of lawyers in this mess suggests that the myth of the magic cap has spread far and wide. With the report issued by Enron this weekend, Vinson & Elkins, Enron's primary outside law firm, which has thus far received relatively little grief, will undoubtedly receive much more scrutiny. Later on, I will get to that firm and the other firms that Enron may have employed to help it with its financial shennanigans later. But to make concrete just how pervasive the magic cap myth has become, I want to start not with Enron's lawyers, but with Arthur Andersen's, in particular with the lawyers who are advising Arthur Andersen right now. They're acting like they're wearing magic caps, and everyone appears to be going along. Let me explain what I mean.

II. To Shred or not to Shred, To Investigate or to Step Aside

Some group of people at Arthur Andersen shredded some substantial number of Enron documents. The shredding not only left Andersen's reputation in ruins, it put Andersen into serious legal jeopardy under civil and criminal law. What were Andersen's lawyers doing while Andersen's accountants and staff were doing that shredding? The facts disclosed thus far suggest three possibilities; none of them good. Andersen's lawyers were either (1) encouraging this destruction through none-too-subtle hints; (2) recklessly ignoring the strong likelihood that documents were headed for the shredder; or (3) acting carelessly in relation to whether the Enron files were preserved or not.

What should they have done to prevent the wholesale shredding that apparently began on or about October 23rd and continued for some considerable time thereafter? What they did way too late: Issue unequivocal legal advice that all Enron documents were to be preserved and suggest procedures to Andersen's management that would have helped ensure that the documents were actually preserved.

Instead on October 12th Nancy Temple, a member of Andersen's in-house legal staff, wrote the now infamously ambiguous retention/destruction memo that David Duncan, the Andersen partner in charge of Enron's account, has told congressional investigators he read as authorizing him to begin the shredding. I have read that memo and the policy that it says might be "helpful" and thus suggests should be followed. As I read those documents, it seems like Attorney Temple's memo was an effort to encourage others to destroy Enron documents, while preserving for its author the ability to deny that she meant any such thing. (Indeed, Andersen's retention/ destruction policy seems designed to achieve that same result and was probably written by a lawyer too).

Perhaps, Attorney Temple did not mean the memo that way She has testified that she did not. She says that she meant the partner in charge, Mr. Duncan, to read the policy and interpret what it meant for himself. Why? Was she unsure of what the policy demanded? If so, was it sensible to believe an accountant would have an easier time deciphering it, this document that resembles a legal regulation much more than an accounting rule? And what of the law's demands? Did she have no information to give Mr. Duncan and the other accountants on that either?

But this is not a tale of one poorly-intentioned or careless lawyer, writing a reckless or slip-shod memo on one particular day. The story gets much worse. Attorney Temple wrote her incredibly unhelpful memo on October 12th. A few days earlier, Arthur Andersen hired the well respected firm of Davis, Polk & Wardwell to advise it on Enron-related matters. Now, according to the testimony of Mr. Andrews, a senior partner at Arthur Andersen, while Davis Polk was retained before the October 12th memo was written, it did not begin its work for Andersen until October 16th.5 No matter. Attorney Temple has testified that on Davis Polk's first day on the job, October 16th, she consulted with Davis Polk lawyers on "document retention and destruction."6 Thus, before the major shredding party at Andersen began, which was on or around October 23rd,7 Davis Polk was consulted on the steps Andersen was taking or not taking to see to it that documents were preserved.

Did Davis Polk advise Temple or anyone else at Arthur Andersen to clarify Temple's October 12th memo when she talked to Davis Polk lawyers on October 16th?

Davis Polk was on the job about a week before the shredding extravaganza began. Why didn't it take steps to see to it that Andersen's notes, drafts and e-mails on Enron were preserved? We don't know what, if anything, Davis Polk did advise because Arthur Andersen seems to be relying on attorney-client privilege when it comes to what Davis Polk said,8 but we do know that the Temple memo was not withdrawn and the Andersen retention/destruction policy was not clarified in the first week of Davis Polk's involvement in this case or the second week or the third.

Before October 22nd, Arthur Andersen's lawyers should have done something to make it clear to Andersen partners and staff that the Enron files were tp preserved. The preservation of those Enron documents was necessary to protect Andersen's legal interests as well as its future viability as a respected accounting firm. First, how is Andersen to demonstrate its innocence, assuming it is innocent, when its files are not intact. Second, assuming someone at Andersen did something wrong on the Enron account, how is Andersen to convince people that it has not gotten to the bottom of the problem and made all necessary changes when its files are incomplete. Third, if your client destroys documents when it is reasonably foreseeable that it will be sued and the documents will be relevant to that suit, a judge can instruct the jury to assume that the destroyed evidence would have shown your client's guilt.9 And that is the least of the legal troubles that the destruction of these documents might bring.

On October 22nd, Enron disclosed that the SEC had opened an inquiry into the company's financial dealings, particularly the strange partnership transactions and Enron's fuzzy disclosures on those deals. As with most legal matters, there is some uncertainty on precisely how formal an investigation by a government agency must be before destroying documents might qualify as obstruction of justice.10 But there is precedent that holds that some, if not all, preliminary inquiries by the SEC qualify.11 Even more ominous, another section of the obstruction statute, 18 U.S.C. § 1512, provides, a person may be fined or imprisoned for "knowingly . . . engaging in misleading conduct toward another person, with intent to cause or induce any person to (A) ... withhold a record, document, or other object, from an official proceeding; [or] (B) alter, destroy, mutilate, or conceal an object with intent to impair the object's integrity or availability for use in an official proceeding."12 Under § 1512, the proceeding need not be pending at the time of the offense, so some of the questions presented by § 1505 do not arise.13

Presumably, Arthur Andersen had no interest in being accused of obstructing justice, even if it could ultimately establish its innocence because the government could not quite prove that it had the requisite corrupt intent, because some court held that the SEC's inquiry of Enron was not formal enough to constitute "a proceeding" under the obstruction statute or because the elements of 18 U.S.C. § 1512 were not precisely met. Given that Andersen's very survival might be threatened, if it managed to convey that as Enron started coming apart, Andersen was busy flirting with violations of the criminal code, Andersen's lawyers should have done everything possible to clarify the Temple memo and Andersen's poorly written policy-at the latest-immediately after they became aware that an informal SEC inquiry of Enron was underway. They didn't.

On October 25, Enron, getting good legal advice-at least at this point-sent emails to its employees worldwide and to its auditors at Andersen, directing everyone to preserve all Enron documents. Andersen's lawyers take no action to rescind the Temple memo or to clarify the policy to which the memo refers. A few more days go by, and on October 31, Enron announces that the SEC investigation has been upgraded to "formal." Now any doubt about the potential applicability of § 1505 should have been removed. Still Andersen's lawyers did nothing. Even assuming that they somehow imagined that Temple's memo and Andersen's nonrobust, poorly written retention policy14 were adequate to convey the "don't destroy documents" advice that they should have been giving, why weren't Andersen's lawyers checking to see what procedures Andersen was following to ensure that Temple's supposed directive was being followed by Andersen's Enron team?

Finally, Andersen receives its own subpoena from the SEC. That happened, I believe, on November 8th. The next day Attorney Temple calls Duncan, the head of Andersen's Enron team, and leaves him a message to preserve all documents. Apparently, that message managed to convey what Temple's October 12th e-mail and Andersen's woefully inadequate retention/ destruction policy could not. Duncan's assistant now sends out an e-mal to those shredding Enron documents and tells them to stop. That e-mail went out the same day Temple left her voice message for Duncan with its clear legal advice. The following day, November 10th, Attorney Temple sends an e-mail memo to the personnel at Andersen, which said in part, according to press reports:

One of the first things we must do in preparing to respond to this subpoena and the lawsuits is to take all necessary steps to preserve all the documents and other materials that we may have relating to the claims that are being filed. ...

To do this we must first insure [sic] that all documents and materials already in existence are preserved and that nothing is done to destroy or discard any documents or materials now in your possession.15

What took her so long? And why didn't Davis Polk, Andersen's outside counsel, do any better than Attorney Temple and the rest of Andersen's in-house legal team managed to do?

Most troubling, how is it possible that Davis Polk has agreed to conduct an investigation for Arthur Andersen to discover how so much shredding could have gone on at Arthur Andersen between October 23rd and November 9th? That shredding occurred on Davis Polk's watch. Who is going to find out why Arthur Andersen's outside counsel, Davis Polk, did not properly protect its client and Enron's documents? Davis Polk? One of the first questions Andersen needs to ask in its internal investigation is: where were the lawyers? The lawyers who were out to lunch at the critical time should not be the ones Andersen or the rest of us should be depending on to explain what went wrong. It's that simple.

Vinson & Elkins should have refused to investigate allegations of misconduct at Enron that happened on their watch, even if the firm had played no active part in any of the alleged wrongdoing.16 But they accepted an engagement that, if done right, would have required them to assess objectively their own competence, honesty and adherence to the law. That law firms routinely accept just such assignments is outrageous, but they do. It shows just how deeply they believe in those magic caps-deeply enough to imagine that they can assess a legal landscape that they were part of, as if they were not there at all. Vinson & Elkins had no magic cap and Davis Polk doesn't have one either.

III. Assume there was Securities Fraud, Now Assume there Were Lawyers. You see I Repeat Myself

The mere fact that there are always lawyers around when securities fraud is taking place does not mean that lawyers cause securities fraud nor does it demonstrate that they are always in a position to discover it or stop it from taking place. They aren't. In plain English, fraud, as I tell my students year in and year out, is lying to someone to get them to give you their stuff.17 Fraud-doers are by definition liars (sneaks, cheats) and many are slick enough at lying to fool a room full of experienced lawyers. On the other hand, not all fraud-doers are quite that slick, and I dare say when it comes to securities fraud being slick enough to keep it from one's lawyers for a significant period of time takes some considerable degree of skill. Don't get me wrong, even a sophisticated and careful lawyer may not be able to detect a complex and well crafted scheme to defraud others in connection with the sale or purchase of securities. But then again many a sophisticated lawyer is not careful, at least, not about detecting securities fraud, and all too many sophisticated lawyers are all too willing to turn a blind eye.

Enron released the Powers report this weekend. I have not yet had a chance to review it thoroughly, but it seems to support, not dispel, the idea that Enron, acting through its agents, was committing securities fraud and engaging in other violations of the securities laws and other laws as well, civil and criminal wrongs. Let's assume that's so for purposes of analyzing whether Enron's in-house and outside counsel did wrong.

To make this as simple as possible a lawyer has done wrong and is likely to be in significant legal trouble when three things are true. One, the client is breaking the law. Two, the lawyer has enough facts in front of her to have been able to figure out, with the exercise of reasonable care, that number one is true. And three, with number one and number two in place, the lawyer either acts to help the client to break the law or does nothing to stop the client from breaking the law in those instances (which are not as few as some would like to think) when the lawyer has a duty to intervene.18

Using the three part test I have just laid out, we can gauge the universe of lawyers who might be in trouble by asking which clients are we likely, in the end, to discover were breaking the law? I started by assuming Enron will be in that category; possibly Arthur Andersen, possibly the partnerships that appear to have been part of what now appears to be a fraudulent scheme, some investors in those partnerships, maybe some investment banks. And while that list may include some innocent parties, it is at least as likely to have left out some individuals and entities who we will later discover were involved in violations of law.

The lawyers for any of the individuals or entities that turn out to be on the "broke the law" list constitute the universe of lawyers who need to start worrying. Vinson & Elkins was Enron's outside counsel, but other law firms may have represented Enron during what may have been its crime spree and might have been in a position to have figured out that Enron was breaking the law and to have helped it to do so. Enron's in-house counsel were certainly in a position to satisfy all three parts of the test I set forth above, as were Andersen's in-house counsel, and any outside law firms who may have advised Andersen on Enron related-questions during the years Andersen was auditing and advising Enron. (Having given Davis Polk some considerable amount of grief above, I want to make clear that here I am not referring to that law firm because to my knowledge they were not providing Andersen with advice during the period of time when Andersen might have been violating the securities laws through its work for Enron).

But as my list of potential law breakers was designed to emphasize, the lawyers who may be in trouble for assisting their clients' unlawful conduct (assuming those clients turn out to have broken the law) does not end with lawyers representing Enron and Andersen.19

Now, we move to question two: Did any of the lawyers for clients who were breaking the law have enough facts in front of them to have figured out with the exercise of reasonable care that law breaking was going on? Well, the Powers report strongly suggests that if Enron was breaking the law, its in-house counsel and Vinson & Elkins had enough facts in front of them to have figured it out, had they been exercising reasonable care. I hasten to add that does not make either in-house counsel or outside counsel, guilty of any crime, but it does leave them in legal jeopardy in malpractice actions brought on Enron's behalf by the Trustee in bankruptcy or whomever ultimately emerges as the new management or entity in control of Enron.

To take just one example detailed in the Powers report, knowing that the Board had waived Enron's conflict of interest rules (and possibly having advised that it was a good idea to do so), it does not appear that any lawyer (within or outside) Enron bothered to worry much about the "procedures" that were supposed to prevent bad things from happening to Enron due to the conflicting roles its CFO was not licensed to play. The Powers report says whatever procedures were supposed to be in place, not only failed miserably but were not designed well enough to do anything but fail. It was Enron's lawyers who should have designed better procedures, or at least, monitored whatever procedures were designed to see to it that they had some reasonable chance of working. I do not know whether this was within the scope of Vinson & Elkins retainer, but in-house counsel was apparently not paying all this much mind. Some lawyer or group of lawyers appears to have been hopelessly careless on this matter. Indeed, it seems to me that a reasonably careful lawyer would have strongly advised the board not to waive the conflict rules in the first place, especially not as to the company's CFO.

The fact that agents within Enron, including senior management, may have been actively engaged in fraud does not, in most states, relieve the lawyer from a claim of negligence for having failed to take steps to have saved her client, the corporation, from harm (legal and financial) that these wrongdoing agents may have been causing.20 Again, if a careful lawyer would not have discerned that agents within the client corporation were acting unlawfully, which includes breaching their duties to the corporation by self-dealing or taking actions that would leave the corporation open to a multitude of civil lawsuits and possibly criminal charges, the lawyer should not be found liable. The liability of the lawyer will turn on how many red flags were in front of him, indicating ongoing fraud. The Powers report suggests there were signs aplenty. A company's lawyers can avoid liability for negligence, but not if they are careless about detecting wrongdoing by the CEO or CFO or other senior management, and only if they take steps to bring any signs of serious wrongdoing to the attention of the board and advise management and the board that the wrongdoing must stop. The Powers report suggests that that did not happen, although we have yet to hear from the lawyers involved.

Malpractice, is of course a matter of state law. But extreme negligence amounting to reckless disregard of the fact that corporate actors are engaged in securities fraud has long been a matter of federal law, although that may no longer be the case. Before the mid-1990s, federal securities law, as interpreted by the courts, provided that lawyers could be sued by shareholders in a derivative action and by the SEC for failing to take steps to stop securities fraud that those lawyers had to be deaf, dumb and blind not to have detected (i.e., fraud the lawyers recklessly ignored or to which the lawyers deliberately closed their eyes). This was "aiding and abetting" securities fraud. It should be the law today, but for a number of reasons it isn't. That should change.

Before getting to why it should change. Let me explain why it is necessary for federal law to punish lawyer recklessness when state law allows a malpractice action for negligence and thus by definition presumably deters recklessness as well, both by leaving lawyers liable for less serious carelessness (negligence) and by providing punitive damages when that negligence gets out of control and rises to the level of recklessness.

First, there is the fact plain for all to see: the existence of state negligence actions has not proven to be an effective deterrent, possibly because lawyers bet on the fraud-doers staying in control of the corporation through fraud and thus there being no "clean, new" management with an interest in suing them. Possibly because lawyers believe that the wrongdoing of high corporate officials will somehow be attributed to the corporation in such a way as to bar a negligence suit or that even if such a suit may legally proceed, a jury will be loathe to hit the lawyers hard when management was so dirty itself. Perhaps, some state tort law reform, e.g., laws capping damages, have rendered it worthwhile for lawyers to risk a negligence suit when the fees to be reaped are high enough to pay whatever damages may be imposed (discounted by the risk that the negligence may go undiscovered or unprosecuted).

Perhaps it is as simple as lawyers believing (and being trained to act) as if the agents for their clients were their clients, making it much more difficult to internalize the notion that there is a client out there that doesn't know what's going on. Perhaps (and I believe there is something to this) the elimination of private causes of action against lawyers for aiding and abetting liability, the changes to RICO, restrictions on joint and several liability in many actions against lawyers, and other changes in federal law have encouraged lawyers to overlook that something as relatively trivial as negligently failing to take action to stop a fraud could still offend the law at all.

"That still couldn't be what state law says? Could it? Our magic caps undoubtedly will protect us."

The Supreme Court's decision in Central Bank21 and the changes Congress made in the Private Securities Litigation Reform Act22 that helped lawyers to imagine themselves free (or nearly free from the constraints of law) were monumentally bad ideas.
It really is no wonder that lawyers believe they are wearing magic caps. It is true that as a response to Congress' elimination of the private cause of action against lawyers for aiding and abetting securities fraud, many courts have not been shy about holding lawyers liable as primary violators of the securities law in cases that previously would have been framed as aiding and abetting cases.23 But the degree to which lawyers may be liable as primary violators for what used to be thought of as "aiding" a client's fraud is quite uncertain, and that uncertainty alone is enough to encourage lawyers to avoid "knowing" that fraud is being committed by their clients and to continue acting in a reckless manner that helps the fraud continue and makes it harder to discover. Lawyers are not dumb.

Consider the case of Kline v. Boyd,24 the lawyer there tried to sidestep liability as a primary violator of the securities laws by writing the materially misleading disclosure statements without putting the law firm's name, the respected firm of Drinker, Biddle, or his own name on any of the blatantly misleading disclosure statements that the lawyer drafted and which the lawyer knew the client would give to investors. The Third Circuit had a hell of a time explaining how that conduct-- which was clearly enough to qualify as substantial assistance had private parties been able to recover for aiding and abetting-amounted to a primary violation of the securities laws. It managed and I believe its effort was admirable because any other result would invite lawyers to further securities fraud behind the curtain of the lawyer-client relationship, free from the law's reach so long as they kept their participation secret from the investors. Surely, not a good result.

While I thus applaud the result in Kline, I recognize that the reasoning that called this bad behavior a "primary" violation instead of aiding and abetting stretched the law as far as it could go. (I do not think it broke it, but many others disagree.) And that stretch rendered the judgment quite vulnerable and ended up destroying its value as precedent. The entire Third Circuit apparently noticed the stretch and granted a rehearing of the case en banc. That rehearing never occurred because a settlement was reached while rehearing was pending, and the decision in Kline that I described above was vacated as part of that settlement.

In the end then we really don't know whether a lawyer who did what the lawyer in Kline did may be successfully sued by investors harmed by the lawyers actions. We should know. A lawyer who does what the lawyer in Kline did is no different than one who puts his name on work product that he knew or should have known was materially misleading, except insofar as the anonymous draftsman may be somewhat more despicable. What sense does it make to let that guy escape damages in a civil suit?

It is true that the SEC retains jurisdiction to bring a civil cause of action against lawyers who aid and abet their clients' securities fraud, but the statutory provision that now sets out that authority provides that the SEC must allege that the lawyer "knowingly" helped.25 Sounds fair enough on its face, but it's not. If one kills someone with reckless indifference to human life, most states call that murder and treat the defendant with little or no difference from one who kills someone with intent (premeditated murders are treated more harshly but I am not speaking here about them). If reckless indifference equals intent for ordinary folks charged with all sorts of crimes, not just murder, why should lawyers not be held to that standard too? Indeed, there is more not less reason to insist that reckless is as bad as actual knowledge when the defendant is a lawyer.

Lawyers are notorious for never "knowing" their clients are guilty. That inability is built into the ethos of the bar, which still takes its shape from the paradigm of the lawyer as advocate, And by and large, as to lawyers charged with defending client's in court, that ethos is okay. We do not want lawyers to substitute their judgment of the client's guilt for that of the jury or that of the judge. Although I hasten to add that this "no judging" attitude sometimes leads to abuse in courtrooms too, as when litigators believe they have a license in civil and criminal cases to assist perjury on the ground that they are incapable of "knowing" what the truth of the matter is. That caveat made, in general it is appropriate that the trial lawyer leave "judging" the client to the finder of fact. That's what trials are for.

But none of that applies to the lawyer who is not litigating a matter after the alleged wrong has occurred, but rather one who enters the scene before or during the client's wrongdoing-the lawyer in the role of a facilitator of the client's transactions. Indeed, very few lawyers practice in court compared to the number whose daily work is to facilitate transactions. The transaction or office lawyer, as distinguished from her trial colleagues, must understand what the client is doing and whether that is within or without the law. Otherwise, there is simply no reason for the lawyer being there.

But transaction lawyers share the ethic of trial lawyers that makes it difficult to believe, difficult to "know" that their clients are breaking the law. Complicating that problem is the fact that every good transaction lawyer understands, what every good lawyer knows, the lines of the law are almost always fuzzy at the edges. It is simply not easy to "know for sure" when those lines have been crossed, particularly when clients want to walk on the wild side and expect their lawyers to support that behavior. The lawyer who seems too quick to judge his client is likely to be replaced rapidly with one much more willing to "believe" that his client is right.

Letting lawyers know that there is a price to be paid for failing to "know" what the facts in front of the lawyer plainly suggest-that the client is committing fraud- is absolutely necessary. Without that we create a world in which fraud doers can count on high-priced and savvy lawyers to help them with their schemes, as long as the fraud doer never directly admits to the lawyer precisely what he is up to. This is not a world we should encourage. It is a world our law should try to erase.

In 1964, Judge Friendly said this about the importance of holding lawyers and accountants liable when they recklessly disregarded evidence of their client's securities fraud:

Congress did not mean that every mistake of law or misstatement of fact should subject an attorney or an accountant to criminal liability simply because more skilled practitioners would not have made them. But Congress equally could not have intended that men holding themselves out as members of these ancient professions should be able to escape criminal liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen or have represented a knowledge they knew they did not possess.26

Congress should change the securities laws to make clear once again that such recklessness on the part of lawyers and accountants is enough to subject a lawyer to a private suit for money damages from those the lawyer's recklessness has helped to harm. Such recklessness is rightly thought of as "criminal," given the learning, privileged position, substantial financial rewards and expertise that come with being a securities lawyer. And if it's rightly thought of as criminal when such privileged folks behave recklessly, it should be a civil wrong as well.

Were the lawyers who represented Enron negligent? Were they reckless? Did they actually know, what we now suspect, that Enron through its agents was committing securities fraud? I can tell you this much I am highly doubtful that they "knew," if "knowing" means subjectively believing that Enron was breaking the law. I am sure they convinced themselves that however close to the legal line Enron was, it had not crossed it. I am sure they refused to see and took no steps to actively ferret out, facts that would have burst that bubble-facts that would have made it difficult to maintain their "belief" that nothing was rotten in the state of Denmark. Hard as I am on lawyers, I can hardly blame them. The law as "reformed" by Congress invited them to act that way. If they "knew" I am sure that it was only in the sense that it may have crossed their mind, but any agile legal mind can formulate a doubt about whether something is "illegal" to chase those occasional bogey-men away.

But the facts (as we know them so far) do seem to suggest that at least some of Enron's lawyers and likely some of the lawyers for other actors in this drama went way beyond negligence. According to the Powers report there were not just red flags all over the place but cannons booming and music playing, all with the same message: Enron's financial condition is way different than what it (with its lawyers' help and its accountants' blessings) was leading everyone to believe. A jury need not accept a lawyer's denial of knowledge. It is perfectly free to infer that with so many major clues, some of these lawyers did "know," no matter what they were telling themselves or what they tell the jury under oath. That is, a jury can decide not to believe the lawyer, assuming a court allows the case to get to the jury, something Congress's reforms discourage judges from doing in cases when "actual knowledge" is in doubt.27
But whatever happens or doesn't happen to the lawyers in Enron, there is every reason to believe that there will be securities fraud in our future and every reason to believe that its success will depend in part on lawyer's being asleep at the wheel or acting with reckless abandon. Keep in mind that in the past, as will be the case here--assuming lawyers are found to have substantially assisted fraud at Enron- the lawyers who have done wrong were (and will be) members of our finest law firms, not some nobodies from nowhere. The bar can complain all it wants about federal encroachment on self-regulation, but one thing should be abundantly clear by now: Without the discipline that fairly certain and substantial liability brings, the bar will not reform itself. Lawyers need law at least as much, if not more, than everyone else.28 You do neither the bar nor anyone else a favor by leaving them behind the curtain trusting in their magic caps.

Recommendations for Reform

1. Restore private causes of action against lawyers for aiding and abetting securities law (and against accountants too).

2. Replace the "knowingly" standard that now defines the scope of the SEC's ability to bring civil actions against lawyers and provide that recklessness will suffice in actions brought by the SEC and by private parties as well.

3. Pass legislation that removes the legal cloud that has long surrounded Rule 102(e), the securities regulation promulgated by the SEC to discipline securities lawyers and accountants.29 Make it clear in that legislation that the SEC need not first secure a ruling from a federal district court affirming that the lawyer has violated the securities laws before proceeding against that lawyer via Rule 102(e).30 Finally, affirm a version of the standard that the SEC has been pushing for years: in-house and outside counsel who become aware of facts strongly suggesting that an agent of a corporation is involved in securities fraud must take steps, designed to be effective, to ensure that the board understands what the lawyer has discovered and must take steps to encourage the board to take action to disclose what it has discovered to the SEC and investing public.31 A lawyer who fails to take such action should be subject to discipline by the SEC whether or not he has been found liable or would ever be found liable by a court for aiding and abetting a violation of the securities law.

4. Ensure that RICO can reach organizations, as Enron may yet turn out to be, whose profits are largely the product of fraud. To the extent that the restrictions now in RICO on securities fraud as a predicate act make that statute ineffective against organizations that are (or that evolve into)

little more than giant fraud machines, the restrictions are unjustified and arbitrarily exclude a set of criminal enterprises that cause much more harm than some now covered by the statute.32

5. Restore joint and several liability, when a defendant has acted recklessly, at least when the defendant is a lawyer, for the reasons given above on the problems and inadequacy of an "actual knowledge" standard of liability for lawyers. (I believe accountants too should be jointly and several liable, even when their mental state is "reckless" and not "actual knowledge." As to lawyers and accountants, as I explained earlier, their recklessness makes them liable to their corporate client for malpractice and punitive damages (in almost all states). Given that the corporation already has a claim against the lawyers for damages, it makes little sense to make defrauded investors wait until the corporation recovers from its lawyers (in a negligence action) to have access to money that will belong to the corporation sooner or later, assuming it pursues its lawyers (and accountants) for malpractice. By eliminating joint and several liability, you simply require that there be two lawsuits (the investor action against the corporation and the negligence action by the corporation against its lawyers and accountants) for the corporation to get its hands on the assets that it may have to distribute to those harmed by the fraud.

6. Provide the SEC with sufficient funds to enforce Rule 102(e) (or preferably it's new statutory counterpart, see recommendation 4 above) and enough funds to bring enforcement actions against lawyers (and accountants) who aid and abet securities fraud.

7. Make clear that language in the Administrative Procedure Act that provides that lawyers admitted to the bar of any state may practice before any federal agency does not preclude the SEC from setting standards for securities lawyers and imposing those standards through discipline, including disbarment, in a Rule 102(e) proceeding, an administrative enforcement action or any new statutory vehicle you may provide.33

8. Require, or at least encourage, the SEC and the Justice Department to announce that neither will accept for consideration of any sort any so-called "internal investigation" or "compliance report" or any similar document that purports to report on alleged wrongdoing of a corporation that was prepared by any law firm who was in the employ of the corporation at the time that the wrongdoing occurred, at least not if that law firm's representation of the corporation during the alleged wrongdoing included any matter that is covered by the investigatory report. All such reports should include a statement by the law firm attesting to its compliance with this statutory requirement or government policy.

9. Finally, I am more than deeply conversant, having written numerous articles on the subject, with the abuses committed by plaintiffs' lawyers in class action suits, including the abuses that occur in securities suits. I am indeed so familiar with this problem that I know that much of the most serious abuse involves a form of joint venture between unlikely allies: plaintiffs' lawyers and defendant corporations (and defense lawyers, of course). The aim of the venture: to make money for the venturers at the expense of the absent class.

I would be happy in the future to work with any member of this Committee, majority or minority staff, on meaningful reforms to cure class action abuse. But making it safe for lawyers and accountants to aid fraud-doers with reckless abandon is not the way to address abuses in class actions. The primary victims of most class action abuse, in securities cases and all other kinds of cases, are members of the absent class. Don't "cure" that problem by leaving them subject to injury by a different group of actors. That would make the cure worse than the disease.

Conclusion

If Enron was the Emerald City, no matter what individual or groups of individuals end up to have been standing behind the curtain playing the Wizard of Oz (be it Enron's CEO, its CFO, some or all of its board of directors or whomever), I guarantee you one thing: A lawyer was standing beside them making sure the curtain stayed drawn and all the bells and whistles were hooked up and operating to fool Dorothy, the brainless scarecrow and the cowardly lion.

You want to clean this mess up? Cherchez les avocats. Take off their magic caps by passing legislation that leaves them with no doubt that the law applies to them too, not just when they "know" what's going on but when they act recklessly with little regard for the harm they thereby help inflict on the rest of us and on their clients too.