

THE EVOLVING LEGAL AND ETHICAL  
ROLE OF THE CORPORATE ATTORNEY AFTER  
THE SARBANES-OXLEY ACT OF 2002

KEYNOTE ADDRESS

Washington, D.C.

Friday, November 22, 2002

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### PROCEEDINGS

PROFESSOR GUTTMAN: Good afternoon. For those who may not know me, I'm Egon Guttman. I am a professor here at American University Washington College of Law. The *Law Review* awarded me the honor to introduce the keynote speaker of this symposium, Judge Stanley Sporkin.

When I first met Judge Sporkin, he was part of that outstanding duo of securities lawyers that made the SEC the envy of all other U.S. government agencies. Stanley Sporkin and Irv Pollock gave the lead by imbuing professionalism and competence in what was to become an outstanding U.S. independent agency, the Securities and Exchange Commission ("SEC").<sup>1</sup> Irv went on to become a commissioner and Stanley Sporkin became the director of the Division of Enforcement. Without losing the respect and affection of both the lawyers who came before him and the lawyers on his staff, Stanley Sporkin was a person who not only understood the issues, but also knew how to be fair and responsible in applying the powers that his division had over the future of issuers, broker-dealers, and the lawyers representing them.

This often gave rise to some discussions I had with Stanley Sporkin regarding the ethics of some defendants' counselors. In many cases, after reviewing a Wells submission<sup>2</sup> and the terms of an injunction negotiated by the staff that was to be placed before the Commission and the courts (terms under which the defendant, without admitting or denying liability agreed to refrain from further violations of securities law), the defendants often made public statements on the steps of the court that they only submitted to an injunction so as to allow them to continue to work for the betterment of the entity that

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1. Established in 1934, the Securities and Exchange Commission ("SEC") is charged with enforcing the nation's security laws, promoting stability in the markets, and protecting investors. SEC Website, *The Investor's Advocate: How the SEC Protects Investors and Maintains Market Integrity*, at <http://www.sec.gov/about/whatwedo.shtml> (last visited Feb. 25, 2003).

2. A "Wells submission" is named for John A. Wells, who chaired the SEC Advisory Committee on Enforcement Policies and Practices that recommended the practice of using the submissions. Joshua A. Naftalis, "Wells Submissions" to the SEC as *Offers of Settlement Under Rule of Evidence 408 and their Protection from Third-Party Discovery*, 102 COLUM. L. REV. 1912, 1913 n.3 (2002). In administrative hearings brought by the SEC, the SEC will normally conduct a pre-institution fact-finding investigation. See 17 C.F.R. § 202.5(c) (outlining the procedure for making a Wells submission to the government). The defendant is given the results of the investigation and is allowed to submit a written "Wells" statement presenting arguments against commencement of action. *Id.*

had just been enjoined. I often felt that this was a denial of liability and should have been followed by contempt proceedings. But Stanley knew better.

During Stanley Sporkin's watch, the issue involving a lawyer in the firm of Kaye Scholer arose—a lawyer who went too far in representing his client to the extent that he became part of the problem. The question, both as Director of Enforcement and later as judge, was posed by Stanley Sporkin, "Where were the lawyers?"<sup>3</sup>

After twenty years at the SEC, Stanley Sporkin moved to the Central Intelligence Agency as general counsel where William Casey, a former chairman of the SEC, was the director. At that agency, Stanley surrounded himself with a very competent group of lawyers, recruiting some from the SEC. Five years later, President Reagan nominated Stanley Sporkin to the Federal District Court for the District of Columbia.

One of the cases over which Judge Sporkin presided was that of the *Lincoln Savings and Loan Ass'n*,<sup>4</sup> which had been assisted by the law firms of Kaye Scholer; Jones, Day, Reaves & Pogue; and Sidley & Austin—pillars of the legal profession—as well as the accounting firm of Ernst & Ernst. This was 1990 when proceedings involving the law firms and the auditing firms, such as Arthur Andersen, Touche Ross & Co., et cetera, were being settled.<sup>5</sup>

In 1992, Judge Sporkin addressed the Securities Regulation Institute on *The New World of Lawyering: The Need for Separate Codes of Professional Conduct for the Various Specialties*.<sup>6</sup> In this talk, he tackled the question of how far counsel should go in devising strategies in the corporate takeover area, asking whether the legal system was always ethically served by those who devised and used tactics such as "poison pills,"<sup>7</sup> "scorched earth,"<sup>8</sup> or "green mail."<sup>9</sup>

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3. See *Lincoln Sav. & Loan Ass'n v. Wall*, 743 F. Supp. 901, 920 (D.D.C. 1990) (Sporkin, J.) (asking specifically "where . . . were the outside accountants and attorneys when these transactions were effectuated?").

4. *Id.*

5. See Reid Anthony Muoio, *An Independent Auditor's Suit for Wrongful Discharge*, 58 ALB. L. REV. 413, 413 (1994) (commenting on how the savings and loan scandal led to a drastic increase in suits against the largest accounting firms, which often ended in settlements totaling hundreds of millions of dollars).

6. Judge Stanley Sporkin, *The New World of Lawyering: The Need for Separate Code of Conduct for the Various Specialties*, 18 S.F. ATT'Y 17 (1992).

7. Poison pill is defined as "a corporation's defense against an unwanted takeover bid whereby shareholders are granted the right to acquire equity or debt securities at a favorable price to increase the bidder's acquisition costs." BLACK'S LAW DICTIONARY 1177 (7th ed. 1999).

8. Scorched earth is defined as "an anti-takeover tactic by which a target corporation sells its most valuable assets or divisions in order to reduce its value after acquisition and thus try to defeat a hostile bidder's tender offer." *Id.* at 1348.

But above all, his question, “Where were the lawyers?,” still requires an answer and must still be asked in the environment we live in after disclosure of activities by lawyers and accountants in Enron, WorldCom, et cetera.<sup>10</sup> What remains to be seen is whether the Sarbanes-Oxley Act<sup>11</sup> will clarify the duties of an attorney. The Act itself, however, is vague. It calls upon the SEC to promulgate rules calling upon attorneys to “report evidence of a material violation of securities laws or breach of fiduciary duty or similar violation” by the company or agency thereof.<sup>12</sup> The term “material” has repeatedly raised the specter of vagueness, causing litigation—a problem compounded by the use of the phrase “similar violation.”

The SEC proposed rule<sup>13</sup> raises even more issues in its attempts to implement the Act and regulate attorney functions. It creates a new securities law offense applicable solely to attorneys.<sup>14</sup> In addition to the usual remedies, the SEC now would have statutory jurisdiction to discipline lawyers by a Rule 2(e) proceeding where the offense may not be clearly indicated by securities law.<sup>15</sup> For example, where an attorney’s activities were non-conforming to the rule, the question is raised, does that make the attorney a party to an alleged statutory violation through nonfeasance in not giving the required notice, or the absence of a “noisy withdrawal”? There are interesting points that were discussed this morning regarding this rule, and I keep on asking myself, does Sarbanes-Oxley really clarify the situation insofar as an

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9. Green mail is defined as “the act of buying enough stock in a company to threaten a hostile takeover and then selling the stock back to the corporation at an inflated price.” *Id.* at 709.

10. *See Accountability Issues: Lessons Learned from ENRON’s Fall: Hearing Before the S. Comm. on the Judiciary*, 107th Cong. (2002) (statement of Professor Susan P. Koniak) (referring to Judge Sporkin’s question posed in the Savings & Loan case and answering it in regards to Arthur Andersen’s lawyers by stating that they were either encouraging the destruction of documents, ignoring the destruction, or negligently failing to preserve documents), available at <http://www.senate.gov/%7Ejudiciary/hearing.cfm?id=149> (last visited Feb. 25, 2003).

11. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (to be codified at 15 U.S.C. §§ 7201-7266).

12. *Id.* § 307, 116 Stat. at 784 (to be codified at 15 U.S.C. § 7245).

13. Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. 71670, 71671 (proposed Dec. 2, 2002) (to be codified at 17 C.F.R. pt. 205).

14. *See id.* at 71674 (requiring any attorney who appears or practices before the SEC to report evidence of any material violation up the corporate ladder until it is addressed).

15. *See* 17 C.F.R. § 201.102(e) (reflecting the new redesignation of what was formerly known as Rule 2(e)); *see also* Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. at 71671 (describing the SEC’s ability to discipline attorneys under Rule 102(e)). The SEC’s approach regarding the obligation to give notice in the form of a “noisy withdrawal” appears to reinforce the position of attorneys as counsel for the entity and its board or directors or other agents.

attorney being subject to Rule 2(e) is concerned?

But, I'm going too far afield. Judge Sporkin is known to all of us. His distinguished career has been widely recognized. He received the Rockefeller Award for Public Service from Princeton University's Woodrow Wilson School of Public and International Affairs, the President's Award for Distinguished Federal Service, and the award given to him by the Association of Securities and Exchange Commission Alumni, the William O. Douglas Award for Lifetime Achievement in this area. Judge Stanley Sporkin.

JUDGE SPORKIN: Thank you, Professor Guttman, for those very nice words. After that speech, are there any questions? I don't have to say anything, do I?

Being here today sort of reminds me of the fellow who goes and visits an attorney and he says, "I need an attorney to represent me effectively and honestly." The lawyer says, "make up your mind."

There are some new definitions. You've heard of the word, "EBIT."<sup>16</sup> The new definition is "earnings before irregularities and tampering." "CEO"<sup>17</sup> is the "chief embezzlement officer." The "CFO"<sup>18</sup> is the "chief corporate fraud officer." "PE"<sup>19</sup> is "Parole Entitlement." "EPS"<sup>20</sup> is "eventual prison sentence." Momentum investing—the fine art of buying high and selling low. Value investing—the art of buying low and selling lower. Broker—what my broker has made me. Bye-bye—a flight attendant making market recommendations as you get off the plane. Standard & Poor—your life in a nutshell. A market correction—the day after you buy stocks. Yahoo—what you yell after selling it to some poor sucker for \$240 per share. Windows 2000—what you jump out of when you're the sucker that bought the Yahoo for \$240 a share. An institutional investor—past years investor who is now locked up in a nuthouse.

All right. Enough of that. You've got to wake yourself up after lunch, you know.

We are really in troubled times. We have had financial breakdowns that are literally off the charts. Virtually every field of endeavor has been implicated and the daily revelations are an indictment of our system that has always been presumed to be honest and with a high degree of integrity. The dishonest and unethical conduct cuts across

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16. "Earnings before interest and taxes." BLACK'S LAW DICTIONARY, *supra* note 7, at 529.

17. "Chief Executive Officer." *Id.* at 232.

18. "Chief Financial Officer." 1 ACRONYMS, INITIALISM, & ABBREVIATIONS 834 (Mary Rose Bonk ed., Thomson Learning 31st ed. 2002).

19. "Price Earnings Ratio." *Id.* at 3365.

20. "Earnings Per Share." BLACK'S LAW DICTIONARY, *supra* note 7, at 625.

the fields of all endeavors. In recent times we have seen scandals in sports, the professions, the industrial and financial services community, and I might even add, in academia. That is very distressing. Of course, I am not even excluding government.

Corruption big and small is rampant. I marvel at the way our public officials react every time a new indiscretion is revealed. Their professed naivete is wonderful to observe. It reminds me of the fellow who comments after spending time in Las Vegas, "My, there is a lot of gambling going on in that city." Obviously, something has to be done about the present state of affairs.

We, as citizens, have to rededicate our efforts to insist that our oversight bodies do more to make our societal institutions, both public and private, live up to the highest standards of honesty and ethical behavior. Congress has now reacted with a vengeance. It has passed legislation which is extremely far reaching. The new Sarbanes-Oxley legislation singles out four targets in its effort to make our corporations live up to their reputation for being the most honest and ethical in the world.<sup>21</sup>

I must tell you that in all my years—and Professor Guttman, Professor Siegel, Professor Karmel and Professor Bauman . . . I think we could all agree that this is probably the farthest reaching legislation in the financial services field that I can remember. It really just sort of engulfs us. We do not realize how important it is going to be, but as the days go on, you are going to see what is happening.

But, let us look and see what the legislation does. What it does—it really targets the gatekeepers. It targets the corporation's top officers.<sup>22</sup> They must certify now to their financial statements.<sup>23</sup> It targets the professionals, the lawyers,<sup>24</sup> and the accountants.<sup>25</sup> It targets the corporate boards of directors.<sup>26</sup>

Corporate law was always thought to be a prerogative of the states. Well, that is no longer the case. The federal government has now

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21. See *infra* notes 22-25 and accompanying text (noting that the Sarbanes-Oxley Act targets corporate officers, lawyers, accountants and boards of directors).

22. See Sarbanes-Oxley Act of 2002, § 302, Pub. L. No. 107-204, 116 Stat. 745, 777 (to be codified at 15 U.S.C. § 7241) (requiring corporate officers to certify the accuracy and completeness of company reports).

23. *Id.*

24. See *id.* § 307, 116 Stat. at 784 (to be codified at 15 U.S.C. § 7245) (establishing standards of conduct for attorneys).

25. See *id.* § 105, 116 Stat. at 762 (to be codified at 15 U.S.C. § 7215) (imposing sanctions on accountants who violate the Act).

26. See *id.* § 301, 116 Stat. at 775 (to be codified at 15 U.S.C. § 78(j)(1)) (establishing standards for audit committees which are comprised of members of a corporation's board of directors).

gotten into the corporate governance field with a vengeance. With respect to corporate officials, new and important duties are imposed on them. The CEO and his chief operating officer must now personally certify to the accuracy of the corporation's financial statements.<sup>27</sup> If their statements turn out to be knowingly wrong, they face stiff civil and criminal penalties.<sup>28</sup> They range from being barred from serving as an officer or a director of a public corporation, and having to pay back certain monies received from their corporation,<sup>29</sup> to spending ten to twenty years in prison for a knowing and willful violation.<sup>30</sup> If you realize that now the federal government can determine who is going to be an officer and director, or discipline by exception who is going to be an officer or director, I think that probably exceeds even the widest corporate law, the most liberal corporate law, in the nation.

Who makes that decision? It's going to be really up to the SEC. They now can make that decision administratively. You do not even have to go to court. They have gone very far. Maybe some might say, too far. This may well be a question of whether they could go this far. This may well be a constitutional issue.

The professionals who normally represent corporations, the accountants and the lawyers, are the second and third groups targeted in the new legislation.<sup>31</sup>

Professor Guttman mentioned the *Lincoln Savings & Loan* case.<sup>32</sup> As Charlie Keating<sup>33</sup> was trying to get back his savings and loan which had been taken from him, he brings a case and I get assigned to it as the judge. It was an interesting case because everybody was afraid of Charles Keating for some reason and nobody wanted to call him as a witness. I was sitting there trying to determine what I should do. I

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27. *Id.* § 302, 116 Stat. at 777 (to be codified at 15 U.S.C. § 7241).

28. *See infra* notes 29-30 and accompanying text (covering the range of civil and criminal penalties available under the Act).

29. Sarbanes-Oxley Act of 2002, § 906, 116 Stat. at 806 (to be codified at 15 U.S.C. § 7215).

30. *Id.*

31. *See id.* §§ 307, 906, 116 Stat. at 784, 806 (to be codified at 15 U.S.C. §§ 7215, 7245) (laying out the requirements imposed on corporate attorneys and accountants). *See generally* *President's Remarks Signing the Sarbanes-Oxley Act of 2002*, 38 WEEKLY COMP. PRES. DOC. 1283 (July 30, 2002) (discussing the focus and background of the Act and highlighting the various corporate players affected by the Act), available at <http://www.whitehouse.gov/news/releases/2002/07/20020730-1.html> (last visited Mar. 3, 2003).

32. *Lincoln Sav. & Loan Ass'n v. Wall*, 743 F. Supp. 901 (D.D.C. 1990).

33. Charles Keating, Jr., was the Chairman and Chief Executive Officer of American Continental Corporation ("ACC"), a company that developed and constructed single-family homes. *Id.* at 906. In 1980, Keating sought to expand ACC's real estate business and acquired Lincoln Savings & Loan. *Id.*

used a provision in the law that is rarely used by judges, and I called Mr. Keating as *my* witness.<sup>34</sup>

I said, "What am I going to do about this?" Here I've got him as my witness. I've done no preparation. I had no discovery. What does a lawyer do when he calls a witness and he doesn't know what the witness is going to say?

I'll do two things. I will try to first of all be his lawyer. So I will examine him directly, and then I will cross-examine him. Because if I do the direct, I will get the information to cross-examine him. Right?

That is what I did. I directed him. It was interesting because he was a man in his late sixties and the first question I asked him, I said, "Mr. Keating, tell me something about yourself. Who is Charles Keating? What's your background?" He started to tell about his beginnings and what not. Of course, he had humble beginnings. He didn't talk about any of the senators he knew but—then, of course, I cross-examined him. It was during the cross-examination that I said, "Explain how you justify what you are doing here with all these funny transactions—transactions in which they were booking income in the millions and millions of dollars that didn't really exist."<sup>35</sup>

The whole scheme was that he bought a savings and loan at a time when savings and loans were drags on the market and anybody could buy them. He buys it, and he then has the billion dollar savings—he has a savings and loan with a billion dollars of investors' money in it. This was the money, the billion dollars, he wanted to get his hands on.

He knew that the regulators were looking at him because he had a history of having problems. As a matter of fact, one of the problems he had was with the SEC. I happened to be the Director of the Division of Enforcement at the time, but I didn't know a whole lot about him. In any event, this sort of came back the second time like a bad meal. He has a scheme of how he is going to get the billion dollars—how is he going to get his hands on the billion dollars?

The regulators are looking at him. He tries to do a loan. They say, "No, you can't do the loan." So, what he did was he took the savings and loan and he bought it with a corporation that he owned 100%.<sup>36</sup>

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34. FED. R. EVID. 614 ("The court may, on its own motion or at the suggestion of a party, call witnesses, and all parties are entitled to cross-examine witnesses thus called.").

35. See *Lincoln Sav. & Loan Ass'n*, 743 F. Supp. at 916-18 (explaining that Lincoln disguised transactions where it was required to lay out millions of dollars for the sole purpose of recording paper profits and upstreaming monies to its parent ACC, when its assets were dissipated without deriving any benefit for Lincoln).

36. *Id.* at 907-08.

That corporation had a \$200 million tax loss carry forward. His scheme was to get a tax-sharing agreement.<sup>37</sup> The lawyers came up with the idea of a tax-sharing agreement, that is, the savings and loan and the parent company would be combined in paying taxes. The savings and loan would send up, pursuant to GAAP accounting, their profits quarterly to the parent company.<sup>38</sup> The parent company would then pay the taxes.<sup>39</sup> But, if they have a \$200 million tax carry forward, they don't have to pay any taxes until they reach \$200 million in taxes. At that point the corporate rate was fifty percent. So he was able to keep fifty percent of any profit that the savings and loan was going to send up to him.

In order to effectuate the scheme, the savings and loan had to make money because if you do not make money, then you can not send up any money. What they did is they would go out and buy property worth \$3 million, and then get somebody to buy it for \$15 million. Then they would declare a profit of \$12 million and send up \$6 million to the parent company.

They did this—various transactions used up the whole \$200 million. In that way he was able to get the money out of the savings and loan. His testimony was, “But look, everything was done legally here. I didn't put my hand in the treasury. I didn't steal any money.” More important, he said, “I surrounded myself with many lawyers, many accountants, and they all approved these transactions.”<sup>40</sup> The lawyers drafted the agreement. So this thing was absolutely approved by lawyers, accountants, all the professionals. He said, “Therefore, I did nothing wrong.”

What I learned when I was on the bench was that in virtually every case there is a key to the case. There is a key to the solution of the case and how you are going to come out. How do you deal with the defenses? As I was writing this opinion, it hit me like a ton of bricks.

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37. Under the tax-sharing agreement, Lincoln Savings & Loan was required to remit to ACC on a quarterly basis the amount of tax it would ostensibly owe to the Internal Revenue Service on the basis of its net profits, calculated pursuant to the application of Generally Accepted Accounting Principles (“GAAP”). *Id.* at 908-09. What made this tax agreement advantageous to ACC was that ACC had many millions of dollars stored-up net operating loss carry forwards. *Id.* This meant that since ACC owned Lincoln and was responsible for the payment of taxes for the entire ACC consolidated group, including profits generated by Lincoln, it could keep the actual “tax” remitted by Lincoln without having to forward them to the U.S. Treasury. *Id.*

38. *Id.*

39. *Id.*

40. *See id.* at 909 (noting that the tax-sharing agreement was approved by ACC's Board through correspondence from Sydney Mar, Supervisory Agent, Andre Neibling, Lincoln's chief executive officer, and Mark Sauter, ACC's corporate counsel).

I said, this is the answer: the answer is the professionals. I said to myself, "Where were they?" "Why didn't they do anything?" "Why didn't someone say something here?" I said that has got to be the solution.

Not only did I figure out the solution to this case, but it actually turned out to be, as Professor Guttman said, the solution to many of the savings and loan cases in which there was overreaching during this period of time. Indeed, Harris Weinstein, who was the lawyer for the Resolution Trust, or whatever the government agency was that was going after the money, picked up that theme. He told me he picked it up, and then proceeded collecting hundreds of millions of dollars back from the insurance carriers of these law firms.<sup>41</sup>

The key was the lawyers and accountants. In my opinion, I asked that question, "Where were they?"<sup>42</sup> Just think of the tremendous power of the profession—what they could have done, how they could be doing all these things. So, isn't it interesting now that some twelve years later, or even longer than that, we now have Sarbanes-Oxley and they pick up on that theme? What they are doing is setting up this accountability board that is going to be looking at accounting firms, and if that board does its job, I think you are not going to see that type of accounting anymore.<sup>43</sup>

The legislation is a heavy-handed kind of thing. The kind of legislation that we would have never thought of being adopted by the U.S. government. I mean, we have lived through government that is unbelievable. First, it was the notion of not getting involved with the free enterprise system. Let the free enterprise system do it, so we pulled down all those structures. Now we have, in a Republican administration, probably the most bureaucratic organization that has been developed in many, many years coming into play.

Now, you have in the legislation assignments being given to boards of directors, and assignments being given to audit committees.<sup>44</sup> I

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41. See John H. Cushman, Jr., *\$400 Million Paid by S&L Auditors, Settling U.S. Case*, N.Y. TIMES, Nov. 24, 1992, at A1 (announcing that Ernst & Young settled with the government in its case alleging that the accounting firm "improperly audited federally insured banks and savings institutions that later failed"); Stephen Labaton, *\$400 Million Bargain for Ernst*, N.Y. TIMES, Nov. 25, 1992, at D1 (defining the Resolution Trust Corporation as the "federal savings and loans bail out agency"); *id.* (indicating that Harris Weinstein was the Chief Counsel of the Office of Thrift Supervision, which also assisted in the resolution of the savings and loans scandal).

42. *Lincoln Sav. & Loan Ass'n*, 743 F. Supp. at 920.

43. See Sarbanes-Oxley Act of 2002, § 2, Pub. L. No. 107-204, 116 Stat. 745, 746-47 (to be codified at 15 U.S.C. § 7213) (directing the Public Company Accounting Oversight Board, a creation of the Act, to conduct investigations and related disciplinary proceedings for public accounting firms).

44. See *id.*, 116 Stat. at 747 (to be codified at 15 U.S.C. § 7201(3)(A)) (allowing

2003]

KEYNOTE ADDRESS

649

don't think there is any state statute that talks about audit committees. That's *now* a legal requirement. I don't know whether you have to have audit committees, but they talk in terms of the audit committee, the independence of the committees, and things of that kind.

You really are going to have a tremendous amount of federalism that is creeping in. The thing that I wanted to mention here, because I'm in a law school here, is what I think about the responsibility of the law schools. What sort of always bothered me was this tremendous leap from academia to the practice of law. It is a sea change. It is incredible to be able to go directly from the theoretical out to the real world. It is traumatic to many of the students, and indeed, there are many students that do not practice, instead that quit and say, "We can't take it." It seems to me there has got to be some kind of a bridge in that gap.

Law clerking was sort of a half-way house I used to find when I used to bring in clerks. Because you still have the theoretical approach and also a lot of the practical. You see the cases coming and all that. That is one way to do it, but I do not know if you have come up with other ways to deal with this.

The other thing that I think is necessary is noting the tremendous pressures that new associates are put under when they go into practice. This leaves them very few places to which they can turn. They might have a concern—and many times they raise concerns which are really not concerns. But, in any event, there ought to be some mechanism in the law firm where an associate can go to get answers.

I am not talking about an ethics officer. I am talking about someone the young associate in a law firm can go to when confronted with what we recently read in the paper where law firms have 2200 billable hours a year required minimums. That is a lot of hours and I hope you students know that. There has to be someplace in the law firm you can turn, and I do not know whether the firms have that kind of a person who is dedicated to the associate, and not dedicated to the firm itself.

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audit committees to be established by and amongst the corporation's board of directors to oversee accounting and financial reporting); *see, e.g.*, Paul Sweeney & Cynthia Waller Vallario, *NYSE Sets Audit Committees on New Road*, J. OF ACCOUNTANCY (Nov. 2002) (discussing proposed New York Stock Exchange standards requiring member companies' audit committees to assume responsibility for their fiduciary obligations and elevated obligations for committee decision making), *available at* <http://www.aicpa.org/pubs/jofa/nov2002/sweeney.htm> (last visited Feb. 25, 2003).

What I think you need is in the law school. Do you have counseling that goes to your student who is out working, as opposed to someone who wants a career change or something like that? In other words, do you have somebody who, if the law firm does not provide it, you can provide it to your recent graduates where they can come to you and say, "Here's my problem, what am I going to do?"

I am trying to tell you about these tremendous pressures that are being imposed. I believe these are ethical pressures and every other kind of pressure. I really believe that the law school, in its education of its people going out into the real world as well as post-education help, can have a movement in which to deal with these law firms and try to negotiate something with them to change the ways that they are operating.

I chose not to go into the private practice of law until after I completed my public service career and had the greatest fulfillment that anybody could ever have. It was only after all that that I decided to come and practice law outside governmental service. Only after I had the financial stability that nobody could do anything to me. The worst thing that could happen to me is I could go to the beach somewhere and have a good time for the rest of my life.

I do not want to say that has to be the route that everybody here ought to take or the route that everybody could take. It seems to me that there has got to be some kind of a conversation or dialogue between the academy and the profession to somehow find out what those issues are, what those problems are, and to try to deal with them. In that way, I think, we're going to see the ethical standards go up and everything else. But you have to do it.

Any questions?

**SPEAKER:** There was a lot of discussion before about the role of the attorneys, and I was frankly mystified that this was not a violation of attorney-client privilege.

**JUDGE SPORKIN:** Well, it is called the "laddering up" process.<sup>45</sup> What you are going to be facing, there is—if it's good hard information, I agree with you 100%. If you have information that the company's violating the law and you bring it to the general counsel's attention, and he brings it, or should bring it, to the CEO's attention and nothing is done, then you go to the board.<sup>46</sup>

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45. See MODEL RULES OF PROF'L CONDUCT R. 1.13 (2000) (allowing an attorney to escalate a problem up the corporate ladder if necessary to protect client interests).

46. See *id.* R. 1.13(b) (permitting an attorney to take measures, such as "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 on behalf of the organization" when the company is violating the law).

You are right. There is no violation of any attorney-client privilege. There is no violation of anything there. I do not understand why there should be any real question raised.

As a matter of fact, there may come a time where that person might have to go to the shareholders, and even there, there is a real question of whether there is a violation of the attorney-client privilege.<sup>47</sup> Because if somebody in the corporation is acting contrary to the interests of the shareholders—take a case recently, we won't mention any names, of somebody taking all kinds of money from the company. Should the shareholders know that? I mean why shouldn't the shareholders . . . how could there conceivably be a violation of the attorney-client privilege? Who is it to protect?

There really is an issue there of who is the client.<sup>48</sup> One of the things that I have been thinking about is [who is the client]. There is a problem there—clearly it is not the CEO. It can not be the CEO unless the CEO is going to pay that person out of his own pocket. As long as he is using or she is using corporation funds, it should be that.

It may be that you might want to write in the bylaws of a company as to who the lawyer is to report to and that might clear it up a little bit as to where that privilege lies and who can exercise that privilege. Nobody that I know has gone that far by putting it into the bylaws, to at least define who the client is for the lawyer.

I think the general counsels of law firms—no, the general counsels of corporations, before they take that position, should have it as clear as possible who that general counsel is going to report to.

There are a lot of overbearing CEOs that think that because they hire the general counsel the general counsel better be beholden to that person. I think it is a tough job to be a general counsel of a corporation. I think it is a very difficult job.

**SPEAKER:** After you asked that question, “Where were the lawyers and law firms who have millions of dollars,” has the organized bar focused on what the ethics rule should be? What is your view of the bar's response to that ten years leading up to Section 307?<sup>49</sup>

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47. *Id.*; see also *id.* R. 1.6(a) (prohibiting a lawyer from revealing client information related to representation unless the client consents or the disclosure is necessary to carry out the representation).

48. See *id.* R. 1.13(a) (stating that an attorney employed by an organization represents the organization through its constituents). See generally Ralph Jonas, *Who is the Client?: The Corporate Lawyer's Dilemma*, 39 HASTINGS L.J. 617 (1988) (noting the conflict in representing a publicly-held corporation, where the attorney is retained by and reports to the officers and directors of the corporation, but the shareholders are collectively the owners of the corporation).

49. See 15 U.S.C. § 7245 (codifying § 307 of the Sarbanes-Oxley Act, Pub. L. No.

JUDGE SPORKIN: You and I both know that—the distinction that you have here, that these kinds of offenses that we are seeing are not the offenses of the two bit crook that is going to come in with a crow bar and hit you on the head and take your money. They were done with the semblance of complying with the law.

With every one of these, I think you are going to find lawyers were involved in drafting documents. Accountants were involved. What they were doing is looking like a horse running down the racetrack with blinders on. They were not looking at a broader concept.

Why are they being asked to draft this document? How is this document going to be used? Why are they trying to—I mean at some point, lawyers don't get it. They do not make any judgments. All they do is write what people tell them to write. That is clearly not the way it works.

We have to start thinking more in the box now. As I have said to others, this is the year of the nerd lawyer, the person that is going to be fairly conservative. Maybe we need that respite. Maybe we need that period to sort of—before the grass starts to grow or the trees, or the shrubs start to grow again. I think it is a good awakening.

Is it going to happen again? Of course it is going to happen. Everybody wants to game the system and that is what you had here. What we have to find out is, where did this all start? Where did these SPEs,<sup>50</sup> and all of this other stuff that we're seeing, all originate? If we could find out where it all originated, then we could probably deal with it.

I do not believe, for example, that it all originated with Enron. I do not believe that those people sat down there and said, "We're going to have SPEs," "we're going to do all these others." I believe they had advisors that told them. I believe it was more than just the lawyers and accountants. It probably goes back to Wall Street where you have a lot of brilliant smart people. They are always figuring out how they can do things to get the—you know, to get a leg up on matters.

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107-204, 116 Stat. 745, and setting forth minimum standards of professional conduct for attorneys appearing and practicing before the SEC in representation of public companies).

50. Kathleen Day & Peter Behr, *Enron Directors Backed Moving Debt Off Books*, WASH. POST, Jan. 31, 2002, at A1 (explaining that Enron approved controversial partnerships, which implemented aggressive accounting tactics that moved losses off the books, and that whose losses eventually contributed to the company's bankruptcy); Ronald Fink & Marie Leone, *Partners to the End?*, CFO.COM, Jan. 28, 2002 (indicating that Enron used special purpose entities (SPE) to conceal its debt and increase its income), at <http://www.cfo.com/article/1,5309,66131112,00.html>.

2003]

KEYNOTE ADDRESS

653

I think that we have to find out where it all started and—because otherwise we are not going to be able to deal with the problem. It is going to be like you get roaches or something. Unless you get back to the nest, they'll come back again.

PROFESSOR GUTTMAN: Let me just say this one point that everybody who is going to practice at the bar will have to remember. That is, learn to know who is your judge. Mr. Keating did not realize that Judge Sporkin knew accounting and he was addressing him, "you know how we do things in business." But Judge Sporkin knew that you don't do that in accounting. Thank you very much, Judge Sporkin.

WHEREUPON, A RECESS WAS TAKEN