

1-1993

## Where Were the Lawyers? A Behavioral Inquiry Into Lawyers' Responsibility for Clients' Fraud

Donald C. Langevoort

Follow this and additional works at: <https://scholarship.law.vanderbilt.edu/vlr>



Part of the [Legal Profession Commons](#)

---

### Recommended Citation

Donald C. Langevoort, Where Were the Lawyers? A Behavioral Inquiry Into Lawyers' Responsibility for Clients' Fraud, 46 *Vanderbilt Law Review* 75 (1993)

Available at: <https://scholarship.law.vanderbilt.edu/vlr/vol46/iss1/2>

This Article is brought to you for free and open access by Scholarship@Vanderbilt Law. It has been accepted for inclusion in Vanderbilt Law Review by an authorized editor of Scholarship@Vanderbilt Law. For more information, please contact [mark.j.williams@vanderbilt.edu](mailto:mark.j.williams@vanderbilt.edu).

# Where Were the Lawyers? A Behavioral Inquiry Into Lawyers' Responsibility for Clients' Fraud

Donald C. Langevoort\*

I. INTRODUCTION .....	76
II. THE AMBIVALENCE OF THE GENERAL NORM .....	79
A. <i>Knowledge-Based Regimes</i> .....	80
1. Ethical Rules .....	80
2. Fraud .....	83
3. Aiding and Abetting .....	84
B. <i>Notice-Based Rules</i> .....	89
1. Negligent Misrepresentation .....	89
2. Duty to the Client .....	91
C. <i>Pleading and Proof</i> .....	92
D. <i>An Assessment</i> .....	94
III. LAWYERS, CLIENTS, AND SOCIAL COGNITION .....	95
A. <i>Beginning the Representation: Constructing a Schema</i> .....	98
B. <i>Schema Evolution: The Process of Representation</i> .....	100
C. <i>Motivated Reasoning and the "Red Flag"</i> .....	101
D. <i>Lawyers in Groups</i> .....	105
E. <i>OPM as an Illustration</i> .....	106
F. <i>The Credibility Problem</i> .....	108
G. <i>Another Assessment</i> .....	109
IV. THERAPEUTIC INTERVENTION .....	111
A. <i>Reputational Incentives</i> .....	111
B. <i>Legal Incentives</i> .....	115
V. CONCLUSION .....	117

---

\* Lee S. and Charles A. Speir Professor of Law, Vanderbilt University. The author wishes to thank Tom Morgan, Al Sommer, Harold Levinson, Bob Rasmussen, Don Welch and Nancy King for their helpful comments.

## I. INTRODUCTION

Where were the lawyers? Perhaps rhetorical, even sarcastic, this question is being asked all too frequently after large financial frauds. "[W]ith all the professional talent involved," mused Judge Sporkin in a decision growing out of the Lincoln Savings & Loan scandal, "why [didn't] at least one . . . [blow] the whistle to stop the overreaching that took place in this case[?]"<sup>1</sup> The Lincoln matter alone ensnared a number of the country's most prominent law firms,<sup>2</sup> and many others have been blamed in comparable, if less notorious, banking delicts. Clark Clifford's indictment in the BCCI proceeding has extended the dark shadow even further up the reputational hierarchy.<sup>3</sup>

The banking problems are only the most recent problems that have provoked the question of complicity and generated extensive, emotional counterreaction by the bar. *SEC v. National Student Marketing Corp.*<sup>4</sup> in the 1970s and *In re OPM Leasing Services*,

1. *Lincoln Sav. & Loan Ass'n v. Wall*, 743 F. Supp. 901, 920 (D.D.C. 1990).

2. Most notably, the prestigious New York law firm of Kaye Scholer Fierman & Handler agreed to pay a \$41 million fine, along with extensive ancillary relief, in settling a government enforcement action. See *OTS Freezes Kaye, Scholer's Assets, Asks for \$275 Million in Restitution*, 58 BNA Banking Rep. 419 (Mar. 9, 1992); *OTS, Kaye, Scholer Agree to Settle; Firm Will Pay \$41 Million Restitution*, 58 BNA Banking Rep. 472 (Mar. 16, 1992). The government's action against Kaye Scholer was quite controversial, at least with respect to freezing the firm's assets. Compare John C. Coffee, Jr., *Due Process for Kaye, Scholer?*, Legal Times 22 (Mar. 16, 1992) with Steve France, *Just Deserts: Don't Cry for Kaye, Scholer*, Legal Times 28 (Apr. 6, 1992). Other firms also have faced charges of complicity in the Lincoln matter. See Miriam Rozen, *Jones, Day Hit By Lincoln Savings Fallout—Again*, American Lawyer 34 (Mar. 1992).

3. Steve Lohr, *Indictment Charges Clifford Took Bribes: Broader Inquiry into B.C.C.I. Disclosed*, N.Y. Times A1 (July 30, 1992).

4. 457 F. Supp. 682 (D.D.C. 1978). In the early 1970s, the SEC charged attorneys at two major law firms, New York's White & Case and Chicago's Lord, Bissell & Brook, with aiding in large-scale securities fraud by failing to stop the closing of a merger between National Student Marketing Corporation and Interstate National Corporation. *Id.* at 686-87. The filing of the complaint generated a massive outpouring of legal commentary, largely critical of the Commission for imposing a chill on the attorney-client relationship. Among the better critical analyses, see Joseph C. Daley and Roberta S. Karmel, *Attorneys' Responsibilities: Adversaries at the Bar of the SEC*, 24 Emory L. J. 747 (1975); Frederick D. Lipman, *The SEC's Reluctant Police Force: A New Role for Lawyers*, 49 N.Y.U. L. Rev. 437 (1974); Simon M. Lorne, *The Corporate and Securities Adviser, the Public Interest, and Professional Ethics*, 76 Mich. L. Rev. 423 (1978). For more sympathetic accounts, see the remarks of then SEC Commissioner A. A. Sommer, Jr., *The Emerging Responsibilities of the Securities Lawyer*, [1973-74 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,631 (Feb. 6, 1974). See also Lewis D. Lowenfels, *Expanding Public Responsibilities of Securities Lawyers: An Analysis of the New Trend in Standard of Care and Priorities of Duties*, 74 Colum. L. Rev. 412 (1974); Samuel H. Gruenbaum, *Corporate/Securities Lawyers: Disclosure, Responsibility, Liability to Investors, and National Student Marketing Corp.*, 54 Notre Dame L. Rev. 795 (1979). Concern about the SEC's enforcement philosophy was renewed with its enforcement action against two Wall Street attorneys for their alleged role in the false publicity generated by their client National Telephone Co., *In re Carter and Johnson*, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847 (Feb. 8, 1981), but assuaged somewhat by the Commission's ultimate disposition of the matter. See notes 25-26.

*Inc.*<sup>5</sup> in the early 1980s were focal points for self-examination, weighing heavily upon the American Bar Association's reformulation of its ethical rules in 1983.<sup>6</sup> Attorney involvement in insider trading also has been quite visible.<sup>7</sup>

In all fairness, of course, we do not know whether a serious problem really exists.<sup>8</sup> The scandals, publicized more through indictments and allegations than legal findings of complicity, are highly salient, vivid bits of information that naturally skew our impressions. We lack actual base-rate data establishing the incidence of complicity, or documentation of the offsetting events when attorney involvement has somehow deterred client misconduct. Still, the apparent incidence of complicity must trouble both the public and the profession.

This Article explores the concept of observed lawyer complicity without making any claims about its extent. It focuses less on the normative issue—what rules should govern lawyer conduct—than the behavioral one—why the apparent involvement *might* be so extensive. The Article takes the behavioral approach for two reasons. First, understanding the forces underlying lawyers' behavior is interesting and important in and of itself, for it has received relatively scant attention in the literature. Second, behavioral insights can help us gauge the likelihood that particular changes in the prevailing legal regime may or may not be effective.

To pose the question of attorney motivation is to invite a prompt answer from many people: greed and moral corruption, of course. Lawyers know of their clients' misdeeds, or at best deliberately close their eyes to the evidence, simply to preserve their wealth, status and power. Those lawyers guess—often correctly, in all probability—that they will never be caught. The stories behind the scandals only strengthen this impression. Clark Clifford admitted that his involvement in BCCI almost forces the observer who reviews the evidence in retrospect to con-

---

5. 32 Bankr. R. 199 (S.D.N.Y. 1983). See text accompanying notes 128-34. See generally Robert P. Gandossy, *Bad Business* (Basic Books, 1985). *OPM* is the most commented upon of the lawyer-fraud problem cases in the ethics and gatekeeper literature of the 1980s. See, for example, Harry I. Subin, *The Lawyer as a Superego: Disclosure of Client Confidences to Prevent Harm*, 70 Iowa L. Rev. 1091, 1109-11, 1118, 1149-50 (1985); Martin Riger, *The Model Rules and Corporate Practice—New Ethics for a Competitive Era*, 17 Conn. L. Rev. 729, 731-32 (1985); Kenneth F. Krach, Note, *The Client-Fraud Dilemma: A Need for Consensus*, 46 Md. L. Rev. 436, 437-43 (1987). It weighed particularly heavily when the ABA's new ethical rules were being finalized.

6. This is not to suggest that the ABA's new rules were revised to remedy the problem, as opposed to reducing the exposure. See text accompanying notes 19-23.

7. For an overview, see Donald C. Langevoort, 18 *Insider Trading: Regulation, Enforcement and Prevention* § 12.03[3] (CPC, 1991) and sources cited therein.

8. The same can be said about more general claims regarding a lawyer's loss of the sense of professionalism. See Ronald J. Gilson, *The Devolution of the Legal Profession: A Demand Side Perspective*, 49 Md. L. Rev. 869, 873 n.3 (1990).

clude that he was either stupid or venal.<sup>9</sup> His career up to this point rules out stupidity.

Without doubting that the venality hypothesis does explain some of the misconduct, this Article looks for other possible explanations. Part II is law-oriented and concentrates on lawyer involvement in commonplace business transactions, such as financing and control shifts. It is often observed, and demonstrably true, that lawyers' professional norms are conflicting. On one hand (and to an accelerating degree) the profession and the law demand loyalty to clients and respect for even their dark confidences. At the same time, an attorney's loyalty is subject to the overriding general norm, in both ethics and law, that lawyers must not knowingly give substantial assistance to client fraud. This Article considers the possibility that this general norm has been undermined sufficiently that, at least implicitly, loyalty emerges as the dominant justification, thus providing a basis for lawyers to rationalize continued involvement.<sup>10</sup> This, however, is at best only a partial answer.

Part III is more speculative, but probably more important. It draws heavily from recent work in the field of social cognition to raise the possibility that lawyers have a diminished cognitive capacity to appreciate the likely harm flowing from their clients' actions. Both ego and stress can induce blind spots. By the time the lawyer actually becomes aware of the wrong, his or her complicity already is fixed. Denial and rationalization ensue. Only at the very late stages, if at all, is there something like a conscious cover-up. Although there are ample instances of conscious complicity, other cases of apparent complicity will fall into this less blameworthy category.

In sum, this Article suggests that venality competes not so much with stupidity as with honest, even good faith behavior that only in hindsight seems incredible. We, of course, have no way of knowing the empirical mix of these explanations, for most lawyer wrongdoers—even the most venal—offer excuses that sound the same. Part IV turns briefly to the question of whether the profession's own reputational interest or some tinkering with the legal regime is likely to produce efficient reductions in the incidence of complicity.

The analysis proceeds from two working assumptions. First, our legal discussion will accept the idea that the issue of attorney complicity is one of the appropriate incentives for deterrence. Lawyers are treated

---

9. David E. Rosenbaum, *A Charm for Plebeian and Patrician*, N.Y. Times C5 (July 30, 1992).

10. See Subin, 70 Iowa L. Rev. at 1171-72 (cited in note 5) (observing that the illusion of loyalty may offer emotional comfort for attorney guilt). For a view that loyalty and confidentiality are the heart of the profession's "nomos," see Susan P. Koniak, *The Law Between the Bar and the State*, 70 N.C. L. Rev. 1389 (1992).

as "gatekeepers," to borrow Reinier Kraakman's term.<sup>11</sup> We structure the legal rules to minimize the incidence of client fraud by directing lawyers to withhold their services from miscreant clients. While the motivation to sue lawyers is overwhelmingly pecuniary, to get at a deep pocket for what the plaintiff believes is just compensation, the prevailing structure of the rules suggests a more functional design.<sup>12</sup>

This Article also assumes that neither clients nor lawyers can be categorized neatly as good or bad, honest or corrupt.<sup>13</sup> While moral dispositions do vary, situations are apt to have an even greater influence on behavior, and situations change over time. So far as clients are concerned, we assume that while relatively few are either dispositionally corrupt or involved in situations of extensive wrongdoing, there are not many who are perfectly pure or without any troubles either. More specifically, lawyers in transactional settings often are exposed to facts relating to the client or the situation that they would prefer not to find and would rather withhold from the other parties. Lawyers operate in very noisy, ambiguous, informational environments.<sup>14</sup>

## II. THE AMBIVALENCE OF THE GENERAL NORM

To say that there is a general norm prohibiting lawyers from assisting client fraud means little without a closer examination of the precise legal standards involved. Perhaps they are constructed in a way that reduces the effectiveness of the general norm. If so, that alone might be a reason for the observed incidence of attorney complicity.

---

11. Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Liability Strategy*, 2 J. L. Econ. & Org. 53 (1986). See also Gilson, 49 Md. L. Rev. at 883 (cited in note 8). Gatekeeping is slightly different from whistleblowing in that the latter imposes a duty to warn the victim or the appropriate authorities, but the former simply commands inaction and withdrawal.

12. Nor is there reason to believe that attorneys' liability operates as a very good insurance system. On the problems with liability as an asset insufficiency strategy in the context of managerial activity on behalf of a corporation, see Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 Yale L. J. 857 (1984). In any event, the exclusion of this possibility is not central to this Article's major points, and hence is left to separate inquiry.

Fraud relating to federally-insured financial institutions also is excluded from our legal analysis. This is partly because of its greater emphasis on compensation, as well as its idiosyncratic statutory and political ecology. For a discussion of the attorney liability issues with respect to these institutions, see H. Brent Helms, Comment, *Financial Institutions Reform, Recovery, and Enforcement Act: An Ethical Quagmire for Attorneys Representing Financial Institutions*, 27 Wake Forest L. Rev. 277 (1992).

13. See Deborah L. Rhode, *Ethical Perspectives on Legal Practice*, 37 Stan. L. Rev. 589, 629 (1985). This is not to suggest that game theory could not generate interesting insights to the bargains between attorneys and clients in light of the informational asymmetries they face; Jason Scott Johnston, *Opting In and Opting Out: Bargaining for Fiduciary Duties in Cooperative Ventures*, 70 Wash. U. L. Q. 291 (1992).

14. The law, of course, tends not to impose a duty of full disclosure of even material adverse facts, but simply precludes lawyers and their clients from misrepresenting them or telling half-truths. Thus, the mere possession of adverse information does not imply the presence of fraud. Hence, the discovery of unfortunate facts does not necessarily signal client wrongdoing.

There are a number of disparate legal rules governing the behavior of business lawyers in transactional settings, which together buttress the general norm.<sup>15</sup> They fall into two principal categories. Some are knowledge-based, imposing liability only when the lawyer has an awareness, or is presumed to have such, of client misconduct. Others are negligence doctrines, creating responsibilities once the lawyer notices something amiss, and in limited respects, imposing an affirmative obligation of diligent investigation on the attorney to assure the legitimacy of at least some aspects of the transaction.

### A. Knowledge-Based Regimes

#### 1. Ethical Rules

Although ethical rules do not by themselves create liability to third persons, they have the potential to inform third-party litigation on appropriate standards of conduct.<sup>16</sup> Indeed, the ABA's most recent effort to codify standards of ethics, the Model Rules of Professional Conduct, was born of something of an obsession with that risk.<sup>17</sup> In addition, there is the remote possibility that a transactional lawyer will be disciplined for impropriety.<sup>18</sup> Hence, the ethical rules deserve some consideration as potential liability constructs.

Prior to the Model Rules, most states based their rules of lawyer ethics on the Code of Professional Responsibility, with its amalgam of disciplinary rules and ethical considerations. With respect to the duties of lawyers toward third persons in the event of client fraud, the Code was particularly murky, but could be construed, at least as originally

---

15. Useful overviews of these standards specifically for business lawyers can be found in a number of sources. See, for example, Marc I. Steinberg, *Corporate and Securities Malpractice* (PLI, 1992); Robert Haft, *Liability of Attorneys and Accountants for Securities Transactions* (Clark Boardman Callaghan, 1991). See generally Ronald E. Mallen and Jeffrey M. Smith, *Legal Malpractice* chs. 6-7 (West, 3d ed. 1988).

16. Courts differ on whether ethics rules may be invoked at all in malpractice and related liability proceedings. Compare *FDIC v. O'Melveny & Myers*, 969 F.2d 744, 748 n.4 (9th Cir. 1992) with *Tew v. Arky, Freed, Stearns, et al.*, 655 F. Supp. 1571, 1573 (S.D. Fla. 1987), *aff'd*, 846 F.2d 753 (11th Cir. 1988). For a discussion of this issue, see Charles N. Wolfram, *Modern Legal Ethics* § 2.6 at 51-53 (West, 2d ed. 1986). Nothing here is meant to disparage the ethical rules in their purely aspirational or educational function, which may play a useful role in guiding behavior, especially of younger professionals. See Deborah L. Rhode, *Ethics by the Pervasive Method*, 42 *J. Legal Educ.* 31, 46-47 (1992).

17. See Ted Schneyer, *Professionalism as Bar Politics: The Making of the Model Rules of Professional Conduct*, 14 *L. & Soc. Inquiry* 677 (1989).

18. Ethical disciplinary actions against business lawyers or lawyers in large firms are exceedingly rare. Placing responsibility for assuring appropriate conduct by corporate lawyers on their clients and injured third parties may be a more efficient enforcement mechanism. See David B. Wilkins, *Who Should Regulate Lawyers?*, 105 *Harv. L. Rev.* 799 (1992).

drafted, to obligate the lawyer to prevent or rectify the fraud. Although the Model Rules reorient the emphasis,<sup>19</sup> the general norm is still stated clearly: "A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent. . . ."<sup>20</sup> With regard to truthfulness in negotiations and other nonlitigation contexts, the lawyer may not knowingly "make a false statement of material fact or law to a third person" or knowingly "fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client."<sup>21</sup> The nondisclosure standard, however, is limited by an overarching duty of confidentiality. The lawyer may not reveal information relating to the client's representation to anyone without the client's consent, except to prevent imminent death or substantial bodily harm or in cases where it is necessary for the lawyer's self-defense.<sup>22</sup> Read together, the Model Rules plainly create a gate-

---

19. This shift was a centerpiece of the debate over the Model Rules and it has received extensive academic commentary. The best source of background on the meaning of the standard, albeit from the perspective of one heavily involved in the process, is Geoffrey C. Hazard, Jr., *Rectification of Client Fraud: Death and Revival of a Professional Norm*, 33 Emory L. J. 271 (1984). Criticism abounds. See, for example, Subin, 70 Iowa L. Rev. 1091 (cited in note 5); Stephen Gillers, *What We Talked About When We Talked About Ethics: A Critical View of the Model Rules*, 46 Ohio St. L. J. 243 (1985). Under the Code, some form of which still is in effect in a number of states, Disciplinary Rule 7-102(B)(1) states that when a lawyer had information clearly establishing that a client had perpetrated a fraud in the course of the representation, the lawyer shall call upon the client to rectify it, and if the client does not, "shall reveal the fraud to the affected person." A 1974 amendment, however, limited the duty to disclose when the information is protected as a privileged communication. See Hazard, 33 Emory L. J. at 293-94 & n. 38. A very good discussion of the Code as it relates to lawyers' liability issues is found in Junius Hoffman, *On Learning of a Corporate Client's Crime or Fraud—the Lawyer's Dilemma*, 33 Bus. Law. 1389 (1978).

20. See Model Rules of Professional Conduct Rule 1.2(d) (1983). The best overview of the substantial assistance problem is Geoffrey C. Hazard, Jr., *How Far May a Lawyer Go in Assisting a Client in Legally Wrongful Conduct?*, 35 U. Miami L. Rev. 669 (1981). See also Wolfram, *Modern Legal Ethics* at § 13.3 (cited in note 16); Geoffrey C. Hazard and W. William Hodes, *The Law of Lawyering* § 1.2.500 (Prentice Hall, 2d ed. 1990). A rare example of a disciplinary proceeding is *In re Blatt*, 324 A.2d 15 (N.J. 1974). Knowledge is actual knowledge, though it may be inferred from the circumstances. See Model Rules, Scope note [5]. The question of knowledge under the Rules is discussed thoughtfully in W. William Hodes, *The Code of Professional Responsibility, The Kutak Rules, and the Trial Lawyer's Code: Surprisingly, Three Peas in a Pod*, 35 U. Miami L. Rev. 739, 802-10 (1981), with the observation that knowledge often will be difficult to prove in cases where the lawyer says that the client duped him, unless the client wishes to drag the lawyer down with it.

21. Model Rules of Professional Conduct Rule 4.1 (1983).

22. *Id.* Rule 1.6 (1983). The self-defense exception permits the lawyer to divulge confidences when charged with wrongdoing by either the client or a third party. Though perfectly sensible, this exception is at odds with the ABA's more general claim that clients must have nearly absolute confidence that lawyers will not reveal confidential information, the underlying theory behind the Model Rules' newly restrictive formulations. The lawyer must resign rather than facilitate client fraud, and the rules relating to resignation quite possibly allow the lawyer to do so "noisily," i.e., in such a way that effectively blows the whistle on client misconduct notwithstanding the confidentiality rules. See Ronald D. Rotunda, *The Notice of Withdrawal and the New Model Rules of Pro-*



keeper rather than whistleblower regime, directing the lawyer to withhold services or withdraw rather than disclose the fraud to potential victims.

Although a majority of states follow some form of the Model Rules, others continue to adhere to the more open-ended formulations of the earlier Code of Professional Responsibility. A few Model Rule-based states modify the ethical duties. New Jersey, for instance, has revised the duty of confidentiality to oblige lawyers to warn the appropriate authorities when they know of client fraud that threatens severe financial harm.<sup>23</sup>

With respect to securities practice, the SEC authorizes the disbarment of lawyers practicing before it who are guilty of irresponsible professional behavior.<sup>24</sup> The Commission is not bound by ABA or state-level norms. Although its ethics component rarely has been invoked over the past decade, the Commission has construed Rule 2(e) to prohibit attorneys from passively acquiescing when they become aware of client fraud.<sup>25</sup> Consistent with the Model Rules, the SEC has not imposed any whistleblowing obligation.<sup>26</sup>

---

*Professional Conduct: Blowing the Whistle and Waving the Red Flag*, 63 Or. L. Rev. 455 (1984); Hazard, 33 Emory L. J. at 304-08 (cited in note 19). At the prompting of corporate and securities members of the bar, an effort was made in 1991 to have the ABA amend Rule 1.6 to permit disclosure when the lawyer believes that his services were used to perpetuate a fraud. The motion was defeated. See Richard M. Phillips, *Client Fraud and the Securities Lawyer's Duty of Confidentiality*, 49 Wash. & Lee L. Rev. 823, 828-29 (1992).

23. New Jersey Rules of Professional Conduct Rule 1.6 (West 1991). The New Jersey Rule was the basis for a malpractice action by a nonclient when the attorney failed to blow the whistle. See *Philadelphia Reserve Supply Co. v. Nowalk & Assoc.*, No. 91-0449, 1992 U.S. Dist. LEXIS 12745 (E.D. Pa. Aug. 25, 1992).

24. SEC Rule 2(c).

25. *In re Carter and Johnson*, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847 (Feb. 28, 1981). Rule 2(e) allows for suspension or disbarment when attorneys either willfully violate or willfully aid and abet a violation of the securities laws, or are found to be "lacking in character or integrity or to have engaged in unethical or improper professional conduct." In *Carter and Johnson*, the Commission found that two Wall Street attorneys did not willfully aid or abet their clients' violations of the securities laws in covering up financial difficulty through false filings and press releases, but they did act improperly in not taking stronger action to remedy the problem. For example, the Commission suggested that they could have approached the company's board of directors. However, the attorneys were not disciplined because the Commission believed that they did not have fair notice of the prevailing ethical standard. See Mitchell F. Dolin, *SEC Rule 2(e) After Carter-Johnson: Toward a Reconciliation of Purpose and Scope*, 9 Sec. Reg. L. J. 331 (1982); Steinberg, *Corporate and Securities Malpractice* at 170-77 (cited in note 15). Since 1981, all SEC Rule 2(e) actions against attorneys have proceeded on the basis of primary or secondary violations of law, rather than merely improper conduct.

26. The *Carter and Johnson* opinion was specific in rejecting a duty to go over the head of the client and directly to its shareholders. As noted earlier, the SEC in the 1970s raised the specter of such an obligation in its enforcement action in the *National Student Marketing* case (see note 54), a cause celebre that provoked a strong backlash from the legal community. The Commission was asked to impose a whistleblowing rule, but never adopted one. See Kent Gross, *Attorneys and Their Corporate Clients: SEC Rule 2(e) and the Georgetown "Whistle Blowing" Proposal*, 3 Corp.

## 2. Fraud

A common form of legal assistance rendered by lawyers is negotiation. When lawyers speak on behalf of their clients, they assume the same legal obligations as their clients regarding truth-telling: it is no defense that the lies were told for the client's benefit so that the client alone should be held responsible.<sup>27</sup> Accordingly, attorneys may not knowingly or recklessly make material misrepresentations, tell half-truths, or conceal information when there is a duty to disclose if the other party has a right to rely.<sup>28</sup> Fraud is a common-law doctrine enforceable under state law. Antifraud doctrine also has been codified as a matter of federal securities law, so long as the fraud touches the purchase or sale of a security, as it often will in a financial setting under Rule 10b-5 of the Securities Exchange Act of 1934.<sup>29</sup> Under both state and federal law, the duty of truthfulness is triggered when the lawyer comes into sufficiently direct communication with the third parties so as to bear primary responsibility for the flow of information.<sup>30</sup> So long as victims of fraud can establish reliance and causation they may recover against the attorney under both state and federal securities law. In securities matters, the SEC is empowered to bring enforcement pro-

---

L. Rev. 197 (1980). For a recent comprehensive survey of the Commission's use of Rule 2(e), see Robert Emerson, *Rule 2(e) Revisited: SEC Disciplining of Attorneys Since In re Carter*, 29 Am. Bus. L. J. 155 (1991).

27. See Restatement (Second) of Agency §§ 343, 348 (1957); Mallen and Smith, *Legal Malpractice* at § 6.4 (cited in note 15); Hazard, 33 Emory L. J. at 678-79 (cited in note 19). For an illustration, see *Bongard v. Winter*, 516 S.2d 27 (Fla. Dist. Ct. App. 1987).

28. See Restatement (Second) of Torts § 551 (1977). As to state of mind, fraud requires either intentional or reckless deception. For a case imposing fraud liability when a lawyer specifically vouched for his client's probity, see *Bonavire v. Wampler*, 779 F.2d 1011 (4th Cir. 1985). In contrast to *Bonavire*, most fraud cases brought against attorneys are ones alleging secondary rather than primary liability. The line, however, is an indistinct one. See *Molecular Technology Corp. v. Valentine*, 925 F.2d 910 (6th Cir. 1991).

29. Securities Exchange Act of 1934, Rule 10b-5, 17 C.F.R. § 240.10b-5 (1992). On the required nexus between the fraud and a securities transaction, see James D. Cox, Robert W. Hillman and Donald C. Langevoort, *Securities Regulation* 719-29 (Little Brown, 1991). Rule 10b-5 requires either intentional or reckless deception for primary liability. *Id.* at 730-40.

30. Precisely how direct the communication must be is not clear. For cases dealing with primary attorney liability in the absence of a formal opinion letter, see *Breard v. Sachnoff & Weaver, Ltd.*, 941 F.2d 142 (2d Cir. 1991) (discussing liability with respect to drafting); *Molecular Technology v. Valentine*, 925 F.2d 910 (6th Cir. 1991) (discussing liability with respect to editing); *In re Rospatch Sec. Lit.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,939 (W.D. Mich. July 8, 1992) (discussing liability with respect to press releases and 10-K, 10-Q forms). Although the courts have not done a very good job of distinguishing between primary and secondary liability, the test should not be a particularly difficult one: primary liability is appropriate when the lawyer's involvement in the disclosure materials is such that a reasonable investor would rely directly on her skill, diligence and expertise in evaluating its contents. That would take into account both the extent of the involvement and, more important, how much information was communicated to investors about the attorneys' role.

ceedings leading to possible civil penalties and equitable relief.<sup>31</sup>

### 3. Aiding and Abetting

A considerably broader and more complicated restraint on the lawyer's ability to assist client wrongdoing derives from the joint tortfeasor concept which creates tort liability for anyone who engages in concerted tortious action with another or who "knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other. . . ."<sup>32</sup> Somewhat unfortunately, many courts in common-law cases refer to this as an aiding-and-abetting standard, borrowing the name from the analogous criminal-law construct.<sup>33</sup>

While aiding and abetting a client's fraud is a common-law harm, it has received substantially greater judicial attention with respect to attorney activity when used as a means of imposing secondary liability under Rule 10b-5.<sup>34</sup> In these federal law aiding-and-abetting cases, the courts have pursued a complicated, and not entirely coherent, gate-keeper strategy. While complete synthesis is not possible,<sup>35</sup> we can de-

31. See Securities Exchange Act of 1934 § 21(d), 15 U.S.C. § 78u(d) (1988). There are many other liability consequences to actual fraud. Willful fraud is criminal under a variety of theories (for example, mail and wire fraud, false pretenses, conspiracy). Civil RICO is increasingly used against attorneys who act improperly on behalf of their clients. A pattern of racketeering activity may be established by showing more than one separate but related predicate violation such as mail and wire fraud and securities fraud. If such a pattern produces a cognizable injury, the victim may recover treble damages. For an examination of the use of RICO and other remedies with respect to the issuance of false attorney's opinions, see John Freeman, *Current Trends in Legal Opinion Liability*, 1989 Colum. Bus. L. Rev. 235, 236-39 & n. 8.

32. Restatement (Second) of Torts § 876(b) (1977).

33. For a comprehensive review of common-law aiding and abetting, see *Halberstam v. Welch*, 705 F.2d 472 (D.C. Cir. 1983). The criminal law's locution may be unfortunate in that some courts have been led to impose criminal-law limitations, for example, higher state-of-mind standards, on the liability construct, ostensibly to honor the concept's roots. For example, *Abell v. Potomac Ins. Co.*, 858 F.2d 1104 (5th Cir. 1988). Although the term aiding and abetting is criminal in nature, the underlying concept—the bar against knowingly giving substantial assistance to wrongdoing—is based firmly in tort law, and is a civil-law doctrine. Much confusion could have been avoided if the SEC and the early courts used the phrase "substantial assistance" in naming the doctrine rather than "aiding and abetting." The criminal-law nature of aiding and abetting has led a few courts to deny that it operates as a separate common-law tort. See, for example, *Cenco, Inc. v. Seidman & Seidman*, 686 F.2d 449, 452 (7th Cir. 1982). That, of course, is simply a matter of semantics.

34. For good reviews of the case law involving secondary liability and the federal securities laws, see Alan R. Bromberg and Lewis D. Lowenfels, *Aiding and Abetting Securities Fraud: A Critical Examination*, 52 Alb. L. Rev. 637 (1988); William Kuehnle, *Secondary Liability Under the Federal Securities Laws—Aiding and Abetting, Conspiracy, Controlling Person and Agency*, 14 J. Corp. L. 313 (1988); Haft, *Liability of Attorneys* at § 3.05 (cited in note 15); Steinberg, *Corporate and Securities Malpractice* at § 2.4.1 (cited in note 15). The classic exposition, still cited by many courts, is David Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification and Contribution*, 120 U. Pa. L. Rev. 597 (1972).

35. The Seventh Circuit stands apart from the other federal courts of appeals, severely re-

scribe its rough contours:

(1) Attorneys and others will be held jointly and severally liable if they assist client fraud with the requisite degree of scienter (i.e., intent to deceive). If the lawyer is said to owe a *duty* to the defrauded person, then that standard will be satisfied by showing either actual awareness or reckless disregard of the fraud.<sup>36</sup> The courts divide in describing recklessness: some emphasize a subjective standard, such as deliberate disregard of the truth; others use an objective one that tends to blend indistinguishably into gross negligence.<sup>37</sup>

(2) A duty exists whenever there is a fiduciary relationship or one of trust and confidence. That rarely will be the case except when the lawyer is at the same time also representing the victim. However, a fair number of courts also are willing to find a duty when a lawyer disseminates information under her own name at the client's behest, such as in an opinion letter, understanding that it is meant to be relied upon by an identifiable class of third-party investors.<sup>38</sup> The result is far less clear when the attorney is involved merely in the preparation of general disclosure documentation that will be disseminated under the client's name. One notable case, *Abell v. Potomac Insurance Co.*,<sup>39</sup> held that

---

stricting the availability of aiding-and-abetting liability, and even raising questions about its viability as a matter of legislative intent. See, for example, *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490 (7th Cir. 1986); *DiLeo v. Ernst & Young*, 901 F.2d 624 (7th Cir. 1990). The Seventh Circuit has suggested that all liability for aiding and abetting requires some breach of common-law duty, and that the defendant must himself have committed one of the deceptive or manipulative acts making up the underlying violation. See generally Joel Feldman, *The Breakdown of Securities Fraud Aiding and Abetting Liability: Can a Uniform Standard Be Resurrected?*, 19 Sec. Reg. L. J. 45 (1991) (suggesting that the Ninth Circuit is somewhat-aberrational, albeit in its liberality rather than its conservatism). For a careful survey of the law from the SEC's perspective (with a natural tendency toward expansive construction), see Kuehnle, 14 J. Corp. L. 313.

36. See, for example, *Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983); *FDIC v. First Interstate Bank*, 885 F.2d 423 (8th Cir. 1989).

37. One of the common formulations is that recklessness is an "extreme departure from the standards of ordinary care, [presenting] a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it." *Woods v. Barnett Bank*, 765 F.2d 1004, 1010 (11th Cir. 1985), quoting *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 961-62 (5th Cir. 1981). See generally Cox, Hillman and Langevoort, *Securities Regulation* at 740 (cited in note 29). For an example of allegedly deliberate ignorance by a law firm outside the scope of the securities laws, see *Wyle v. R. J. Reynolds Ind., Inc.*, 709 F.2d 585, 590 (9th Cir. 1983).

38. See *Andreo v. Friedlander, Gaines, Cohen, Rosenthal & Rosenberg*, 660 F. Supp. 1362, 1368 (D. Conn. 1987) and cases cited therein. This risk is discussed extensively in Edward F. Donahoe, *Attorney Liability in the Preparation of Securities Disclosure Documents: Limiting Liability in the Face of Expanded Duties*, 18 Sec. Reg. L. J. 115 (1990).

39. 858 F.2d 1104 (5th Cir. 1988). *Abell* has a complicated subsequent history with respect to its RICO holding, which was later vacated by the Supreme Court, 492 U.S. 914 (1989). For lawyer-related holdings similar to *Abell*, see *Friedman v. Arizona World Nurseries Ltd.*, 730 F. Supp. 521 (S.D.N.Y. 1990); *Buford White Lumber Co. v. Octagon Prop.*, 740 F. Supp. 1553 (W.D. Okla. 1989)

attorneys for an underwriter in a bond offering had no duty to investors with respect to misstatements in the prospectus, even though they were involved actively in its preparation, purportedly did due diligence, and were named therein. *Abell* limits the duty to those situations where the lawyers provide information directly, as in an opinion letter.<sup>40</sup> By contrast, other courts have found a duty based simply on the lawyer's role as author or editor of disclosure materials.<sup>41</sup>

(3) If there is no duty, many courts eliminate recklessness as a possible liability standard.<sup>42</sup> Others do not, so long as there is substantial assistance given to the fraud.<sup>43</sup> Of those insisting on a higher scienter standard, most require a showing that the lawyer actually was aware both of the fraud, and usually her role in it as well. An increasing number of courts, however, have indicated that in the absence of duty, it is necessary to show high conscious intent, a criminal-law derivative that requires proof that the lawyer desired the fraud to succeed<sup>44</sup> or had

(holding that there was no liability even though the attorney drafted the disclosure document, unless the representations were the attorney's own).

40. 858 F.2d at 1125-26. This result is troubling, for when the lawyer bears such primary responsibility for the misinformation, there is no need to invoke secondary liability. The very idea of aiding-and-abetting liability is to reach those who only assist, rather than commit, a primary violation. For a curious decision that seems to find attorneys who drafted the offering materials to be *primary* and not secondary actors, so that reckless involvement was sufficient for liability, see *Breard v. Sachnoff & Weaver, Ltd.*, 941 F.2d 142 (2d Cir. 1991).

41. See, for example, *Molecular Technology Corp.*, 925 F.2d 910 (6th Cir. 1991) (editing); *In re Rospatch Sec. Lit.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,939 (drafting press release and 10-K, 10-Q Forms); *S.E.C. v. Electronic Warehouse Inc.*, 689 F. Supp. 53, 60 (D. Conn. 1988) (drafting offering materials); *Lubin v. Sybedon Corp.*, 688 F. Supp. 1425, 1449 (S.D. Cal. 1988) ("preparation" of offering materials). For an earlier case with an extensive discussion of attorneys' responsibilities in the drafting of SEC filings, see *SEC v. Frank*, 388 F.2d 486 (2d Cir. 1968). Forced to articulate a common-law duty, the more recent courts derived it from the tort of negligent misrepresentation. That is somewhat unfortunate, since the policy question involved in negligence cases—the appropriate level of risk to impose for simple carelessness—is quite different from that with respect to reckless misconduct. Indeed, the seminal case on common-law duty, *Ultramares Corp. v. Touche Niven & Co.*, 255 N.Y. 170, 189 (1931) took pains to point out that the limited scope of duty would offer no protection were the accountants reckless, rather than merely negligent, in their conduct. A number of courts have developed a separate federal test for duty, taking into account the defendants' relationship to the plaintiff, their access to information, the benefits derived from the relationship with the plaintiff, the defendants' awareness of the plaintiff's reliance and the defendants' activity in initiating the transaction. See *Arthur Young & Co. v. Reves*, 937 F.2d 1310, 1330 (8th Cir. 1991). Whether under a state or federal test, a law firm must have a major role in the disclosure process to assume a duty. See *Roberts v. Peat, Marwick, Mitchell & Co.*, 857 F.2d 646, 653-54 (9th Cir. 1988) (limiting the law firm's role to marketability of title inquiry).

42. The most often cited sources are *IIT v. Cornfeld*, 619 F.2d 909, 923 (2d Cir. 1980) and *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 96 (5th Cir. 1975).

43. See, for example, *First Interstate Bank v. Pring*, 969 F.2d 891 (10th Cir. 1992).

44. See *Abell*, 858 F.2d at 1127; *Schatz v. Rosenberg*, 943 F.2d 485 (4th Cir. 1991). Somewhat troublingly, this standard is derived from the criminal law. See note 33. Even the criminal law, however, is less than clear as to the appropriate level of intent. Wayne R. LaFare and Austin W. Scott, Jr., *Criminal Law* § 6.7(d) (West, 2d ed. 1986).

otherwise “thrown in his lot”<sup>45</sup> with the primary wrongdoers. Under this latter formulation, extensive provision of legal services is not sufficient to impose liability even if the lawyer has no doubts about the client’s wrongful purpose, so long as she exhibits no particular enthusiasm for the consequences. This trend severely undercuts the general norm in securities cases.<sup>46</sup>

(4) Except in those jurisdictions that adopt the high-conscious-intent locution for all aiding-and-abetting cases, a lawyer faces a threat of liability if she knowingly, or perhaps recklessly, renders “substantial assistance” to the wrongdoer. In defining substantial assistance, most courts invoke a proximate cause construct: substantial assistance is aid that proximately causes the victim’s harm.<sup>47</sup> Here we find a second, perhaps more profound, winnowing doctrine. When the attorneys are not actually responsible for preparing the communications containing the misstatements or omissions—for instance, where they simply prepared contracts or closing materials—there is a strong tendency to find insufficient assistance on which to impose liability. Most noteworthy in this regard is the recent *Schatz v. Rosenberg*<sup>48</sup> decision. The Baltimore law firm of Weinberg & Green was alleged to have knowingly aided the buyer of a business in defrauding the sellers. The client-buyer grossly misrepresented his financial condition, leading the sellers to accept promissory notes that later turned out to be worthless. The law firm prepared all the necessary legal documents, and some of the misrepresentations were incorporated by the firm into the contracts. In affirming

---

45. See *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495 (7th Cir. 1986). In making that assessment, the pecuniary motivation is important, and requires something more than the expectation of a legal fee. See also *In re AM Int’l Sec. Lit.*, 606 F. Supp. 600, 607 (S.D.N.Y. 1985) (stating that for “high conscious intent,” it is not enough that an accounting firm was motivated by a desire to keep the client).

46. When there is such “high conscious intent,” on the other hand, some courts will dispense with the requirement of substantial assistance and impose secondary liability based simply on silence or inaction. See *Pring*, 969 F.2d 891; *Metge v. Baehler*, 762 F.2d 621, 624 (8th Cir. 1985); *Woodward*, 522 F.2d at 95-97. Although *Woodward* is often cited for the high conscious intent locution, reading the opinion in context suggests that its holding was simply meant to require a high level of awareness (in contrast to more liberal recklessness-oriented formulations) in such cases of inaction or silence, not when there is substantial assistance. Later in the opinion, for instance, the court states that liability is appropriate when the facts demonstrate both “an awareness of complicity and substantial assistance.” *Id.* at 100.

47. See *Landy v. FDIC*, 486 F.2d 139, 163 (3d Cir. 1973). Whether as part of a substantial assistance inquiry or invocation as a stand-alone requirement for Rule 10b-5 liability, many cases have found lawyers insufficiently responsible for causing plaintiffs’ losses. See, for example, *First Interstate Bank of Nevada v. Chapman & Cutler*, 837 F.2d 775, 779-80 (7th Cir. 1988). In many of these cases, the lawyers’ active involvement with the client ceased before the fraud began. That by itself is sufficient to justify the conclusion in a case like *Barker*. See text accompanying note 45.

48. 943 F.2d 485 (4th Cir. 1991). *Schatz* is criticized severely in Geoffrey Hazard, *Schatz Ruling Errs on Legal, Moral Basis*, Nat’l L. J. 17 (Jan. 20, 1992) (stating that its reasoning “would embarrass a first-year law student”).

the dismissal of the action against the firm notwithstanding allegations of knowledge, the court held that preparing the documents and doing the closing was mere "scrivener's work," not rising to the level of substantial assistance.<sup>49</sup>

Such a conclusion is striking, for reasons beyond the suspicion that Weinberg & Green was not charging scriveners' wages for its work. As Ron Gilson has demonstrated, business transactions are complicated events, confronting a host of informational asymmetries and transaction costs.<sup>50</sup> The lawyer who advises a client in structuring a transaction typically operates as one side's financial engineer, developing the efficient mix of contract terms, representations and warranties for the satisfaction of both parties. Done artfully, this engineering readily can maximize the client's advantage, conceal client weaknesses and avoid contractual devices or remedies that might thwart any fraud.<sup>51</sup> Law firms frequently utilize their reputational capital to overcome lingering suspicions by opposing parties. It is thus too quick to say that lawyers are not a proximate cause of a tainted transaction simply because their role was limited to advice and drafting.

Similarly, a number of courts have stated that when lawyers' services simply represent "the grist of the mill" in business settings, then liability will not follow without a showing of the highest version of conscious intent—a desire to make the fraud succeed.<sup>52</sup> They then place a large number of standard legal services in the grist category and outside

---

49. *Schatz*, 943 F.2d at 495. As a separate matter, the court also found plaintiffs' allegations of knowledge insufficient for failing to provide factual support for a desire to aid the fraud. *Id.*

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

51. The precise role played by Weinberg & Green is not set forth in the *Schatz* appellate opinion, although the complaint did allege some facts that hint the firm acted as financial engineers: for example, the lawyers negotiated language regarding the nature of the buyer's representations to the sellers about its financial condition.

52. See, for example, *Camp v. Dema*, 948 F.2d 455 (8th Cir. 1991). Presumably, many courts would not place involvement in the preparation of the disclosure materials themselves in the high conscious intent category. In *Abell*, however, the Fifth Circuit treated the lawyers' involvement in the preparation of disclosure materials for a bond offering as grist, so justifying the high standard of intent. 858 F.2d at 1128. Compare *Kilmartin v. Wainwright*, 580 F. Supp. 604, 608 (D. Mass. 1984), as well as the cases finding a duty based on such involvement, cited in notes 38, 40. The SEC plainly considers drafting assistance to be substantial assistance, and has sanctioned lawyers for their roles in client misrepresentation and nondisclosure. See, for example, *Mark Sauter*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 73,860 (Aug. 4, 1992) (Rule 2(e) proceeding against inside counsel). The grist terminology traces back to *Woodward*. There was no indication, however, that involvement in a highly sensitive setting like the preparation of a securities offering prospectus would be considered mere grist. Underlying the grist idea may be the concept of proximate cause: were the attorney to withhold some simple, routine service, then the primary wrongdoer would simply look elsewhere for a less honest provider. For a view that the intentional provision of even simple services to a wrongdoer should not be protected on this ground, see *Kahn v. Chase Manhattan Bank*, 760 F. Supp. 369, 374-75 (S.D.N.Y. 1991).

the definition of substantial assistance. This distinction reserves the label of unusual for cases in which the lawyer actively solicits the transaction or otherwise has a pecuniary interest in it beyond the expectation of a legal fee.<sup>53</sup> To this extent, the power of the general norm can disappear almost completely under Rule 10b-5.<sup>54</sup>

### B. Notice-Based Rules

#### 1. Negligent Misrepresentation

At one time, the liability of professionals who negligently provided false information in the course of their duties was limited by the notion of privity. Ever since Judge Cardozo's famous decision in *Ultramares v. Touche Niven & Co.*,<sup>55</sup> involving accountants' liability, however, privity has diminished in significance. Most of the recent decisions involving lawyers' alleged negligence leave at least some room for liability to non-clients. The bulk of the law in this area involves the issuance of opinion letters, facilitating some transaction, that rest on misinformation supplied by the client.<sup>56</sup>

Just how much privity has eroded depends on the jurisdiction. The question is one of economics, for an expanded scope of liability adds verification, precaution and risk premium costs to the lawyer-client contract.<sup>57</sup> Many courts have moved just a little, requiring a showing that the lawyer was directed by the client to prepare the information

---

53. A notable counterpoint to this line is *In re Rospatch Sec. Lit.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,939 (W.D. Mich. July 8, 1992), where the court refused to characterize a law firm's involvement as grist when it had over 50 active accounts with the same client, and one partner was also a director of the client.

54. After cases like *Schatz, Abell and Barker*, it may be that the most notorious of the lawyers' aiding-and-abetting cases—*SEC v. National Student Marketing Corp.*, 457 F. Supp. 682 (D.D.C. 1978)—is becoming something of an anachronism. There, the court found the lawyers responsible for failing to take action to stop the closing of a merger once they understood that shareholder approval had been obtained on the basis of false financial data in the proxy materials. The *National Student Marketing* court's discussion of substantial assistance and duty to the client is murky at best, and appears to run counter to the more recent appellate decisions. As to knowledge, there was no evidence at all that the attorneys desired to facilitate the fraud. Compare the SEC's discussion of aiding-and-abetting liability in the *Carter and Johnson 2(e)* proceeding, in which the Commission found no *willful* aiding and abetting with respect to silence or inaction in the face of rather egregious client behavior when the lawyers were simply "at a loss for how to deal with a difficult client." [1981 Transfer Binder] Fed. Sec. L. Rep. at ¶ 84,169.

55. 255 N.Y. 170 (1931).

56. For good reviews of the relevant case law, see Donahoe, 18 Sec. Reg. L. J. 115 (cited in note 38); Steinberg, *Corporate and Securities Malpractice* at 1.4.2 (cited in note 15); Haft, *Liability of Attorneys* at ch. 5 (cited in note 15); Freeman, 1989 Colum. Bus. L. Rev. 235 (cited in note 31). See also Richard Howe, *The Duties and Liabilities of Attorneys in Rendering Legal Opinions*, 1989 Colum. Bus. L. Rev. 283.

57. See William Bishop, *Negligent Misrepresentation Through Economists' Eyes*, 96 L. Q. Rev. 360 (1980). As Part III of my Article seeks to demonstrate, however, the perception of risk associated with any given representation is likely to be distorted.



for the benefit of an identifiable third party before a duty to that non-client arises.<sup>58</sup> Others expand the group of persons to whom the duty is owed to those whose reliance the lawyer, at the client's direction, intends to influence, or perhaps even to all those foreseeably influenced by the information.<sup>59</sup>

However this duty is defined, it attaches only when the lawyer bears responsibility for preparing the information alleged to be fraudulent. Precisely how much responsibility is unclear. As in the aiding-and-abetting cases, some courts have emphasized the visibility of the lawyer's involvement, suggesting that liability follows when a reasonable investor would believe that the disclosures bear the lawyer's imprimatur.<sup>60</sup> Others suggest, less persuasively, that behind-the-scenes drafting responsibility will suffice.<sup>61</sup>

The most intriguing question in the law of negligent misrepresentation relates to the lawyer's duty of investigation, or due diligence. If suspicions are raised with respect to client-supplied information, the lawyer must inquire. But there is little authority for the view that lawyers have an automatic obligation to investigate client-supplied information,<sup>62</sup> except in those situations in which the disclosure strongly

---

58. See *Ackerman v. Schwartz*, 947 F.2d 841 (7th Cir. 1991) (involving lawyers); *Vereins-Und Westbank, A.G. v. Carter*, 691 F. Supp. 704 (S.D.N.Y. 1988) (same); *Credit Alliance Corp. v. Arthur Andersen & Co.*, 493 N.Y.S.2d 435 (N.Y. 1985) (involving accountants).

59. There are a variety of formulations that go beyond near-privacy. The Restatement (Second) of Torts § 552 (1977) uses a standard that creates a duty to third parties who are part of a limited group of persons whom the lawyer intends to influence. See *Greycas v. Proud*, 826 F.2d 1560, 1565 (7th Cir. 1987) (applying a similar standard under Illinois law); *Eisenberg v. Gagnon*, 766 F.2d 770 (3d Cir. 1985). Other states go further, making foreseeability or other policy-based concerns the test. See, for example, *Zendell v. Newport Oil Corp.*, 544 A.2d 878 (N.J. Super. 1988). California has applied a very open-ended balancing approach, which has not met with great favor in other jurisdictions. See, for example, *Goodman v. Kennedy*, 18 Cal.3d 335 (1976); *Cicone v. URS Corp.*, 227 Cal. Rptr. 887 (Cal. Ct. App. 1986). In a recent decision involving accountants' liability, the California Supreme Court indicated that a far more restrictive posture is likely. *Bily v. Arthur Young & Co.*, 3 Cal.4th 370 (Cal. 1992).

60. In other words, there must be evidence that the lawyers themselves were "speaking." See, for example, *Buford White Lumber Co. v. Octagon Properties*, 740 F. Supp. 1553, 1570 (W.D. Okla. 1989).

61. See notes 39-41; *Donahoe*, 18 Sec. Reg. L. J. at 127 & n.57 (cited in note 38). Once again, to avoid confusing questions of primary and secondary liability, the key question should be whether investors are given some reason to rely on the special expertise or reputation of the preparing lawyers. See, for example, *Morin v. Trupin*, 711 F. Supp. 97, 104 (S.D.N.Y. 1988); *Andreo v. Friedlander, Gaines, Cohen, Rosenthal & Rosenberg*, 660 F. Supp. 1362 (D. Conn. 1987) (Rule 10b-5). If the attorney is retained to perform a limited service, the duty will apply only to matters within the scope of the retention. See *Geaslen v. Berkson Gorov & Levin*, 581 N.E.2d 138 (Ill. Ct. App. 1991).

62. For cases suggesting such a duty of inquiry, see *F.D.I.C. v. O'Melveny & Myers*, 969 F.2d 744 (9th Cir. 1992) (involving duty to the client; there is indication, however, that firm was on notice of wrongdoing); *Felts v. Nat'l Account Systems Assn., Inc.*, 469 F. Supp. 54, 67 (N.D. Miss. 1978). The strongest rejection of the duty to investigate is *Milliner v. Elmer Fox & Co.*, 529 P.2d

indicates to the nonclient that the lawyer had assumed a verifying role.<sup>63</sup> The lawyer can limit due diligence exposure through disclosure of limited knowledge, making this a relatively mild form of gatekeeping liability.<sup>64</sup>

## 2. Duty to the Client

A relatively novel form of negligence-based liability exposure is illustrated by the *F.D.I.C. v. O'Melveny & Myers*<sup>65</sup> decision. There, the court of appeals held the law firm could be found liable for not discovering the falsity of information that dishonest bank managers had supplied the firm in the course of preparing offering materials for securities disclosure purposes. Investors already had succeeded in obtaining rescission,<sup>66</sup> and the FDIC, as receiver, was seeking to shift a portion of the loss to the firm on grounds that the firm's lack of due diligence was a proximate cause of the harm.

---

806, 808 (Utah 1974). See also ABA Formal Op. 335 (1974) (indicating that a lawyer is not expected to "audit" client-supplied information with respect to determining the availability of a Securities Act exemption for a distribution of securities). Another line of cases imposes a duty on real estate brokers to investigate facts supplied by the client that assume central importance in a transaction. See *Tennant v. Lawton*, 615 P.2d 1305, 1309 (Wash. Ct. App. 1980); *Hoffman v. Connall*, 736 P.2d 242 (Wash. 1987). Compare *Provost v. Miller*, 473 A.2d 1162 (Vt. 1984) (finding no such duty).

63. Although no court has so articulated, determining whether the disclosure suggests verification should be a matter of the reasonable expectations created: it is an issue of signalling. A number of social scientists have observed that the simple association of a reputable person with another in a transactional setting creates a halo, leading people to place more trust in that other person. Wittingly or not, therefore, such associations can facilitate fraud. See Stanton Wheeler and Mitchell Lewis Rothman, *The Organization as Weapon in White-Collar Crime*, 80 Mich. L. Rev. 1403 (1982); Gandossy, *Bad Business* at 207-09 (cited in note 5). A law firm named in a prospectus or offering circular as having prepared the disclosures, or making oral representations on behalf of a client, probably will add to the impression that the information is accurate. It would not be foolish for the law to impose on the lawyer who has assumed such a role a duty to investigate key facts and assumptions unless the disclosure effectively negated that expectation. To date, however, the law has not clearly articulated such a position, probably on the haughty assumption that rational people are not misled by mere associations.

64. Were the law to presume attorneys responsible for the preparation of documents in which they are named, this presumption would be overcome simply by including a disclaimer in the materials at some appropriate level of visibility. The methods of negating unintended expectations are discussed thoroughly in Donahoe, 13 Sec. Reg. L. J. at 129, 136-37 (cited in note 38). Less reducible through disclosure, and far more unlikely is the risk under the securities laws that the lawyer or law firm could be treated as a controlling person of the primary wrongdoer. Pursuant to Section 20(a) of the Securities Exchange Act, controlling persons can be held liable unless they could show good faith and lack of knowledge, which many courts equate with reasonable supervision. For a case raising the possibility that a law firm be considered a controlling person, see *In re Rospatch Sec. Lit.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,939 (W.D. Mich. July 8, 1992). Another negligence-based form of liability exposure may be found under certain state blue sky laws. See Douglas M. Branson, *Collateral Participant Liability Under State Securities Laws*, 19 Pepperdine L. Rev. 1027 (1992).

65. 969 F.2d 744 (9th Cir. 1992).

66. The FDIC, as receiver, initiated the rescission program, and took in return an assignment of their causes of action. *Id.* at 747.

How wide the exposure created by an *O'Melveny* theory is not clear. There were special facts that arguably placed the firm on notice of management dishonesty, triggering in the court's mind a duty of vigilance. On the other hand, there is also a good bit in the opinion that points to a general duty of inquiry regarding client-supplied information in transactional settings. As between attorney and client, however, the level of diligence required in the preparation of disclosure is implicitly a matter of contract. Absent express definition or limitation, the court must imply the missing term. When an independent legal obligation or some observable custom in the legal community requires the client to obtain due diligence, and thus verify management-supplied data,<sup>67</sup> there is reason to assume that the parties intend attorney due diligence in a way that precludes reliance on management's representations. Otherwise not. Management is the most efficient provider of the information, and verification is costly. We can predict that to the extent that *O'Melveny* alters the implied contract as lawyers and clients normally understand it, more specific risk-allocation language will appear in attorney-client agreements.<sup>68</sup> Once again the contractual nature of the problem suggests that it is unlikely to operate as a strong gatekeeping norm except in highly specialized circumstances.

### C. Pleading and Proof

The foregoing liability strategies employ differing state of mind standards. Even within the knowledge constructs, there are variations based on recklessness, actual awareness and motivated intent. Within negligence, there is a gray area between reactive and proactive duties. To a factfinder during a trial, however, the various state of mind possibilities will blend together. Absent confession or some incriminating documentation or testimony regarding knowledge, the factfinder will look at the evidence circumstantially. How vivid the fraud warnings ap-

---

67. The court in *O'Melveny* suggested that such custom existed, although the principal authority related to the preparation of opinion letters, rather than documentation going out under the client's name. 969 F.2d at 749. On the process of gap-filling, which most scholars assume is the process of structuring incentives to minimize transaction and information costs, see, for example, David Charny, *Hypothetical Bargains: The Normative Structure of Contract Interpretation*, 89 Mich. L. Rev. 1815 (1991).

68. *O'Melveny* also may be of limited relevance in that it held, using federal estoppel law, that the FDIC was not precluded from bringing suit against the law firm even though the bank's own management was the primary wrongdoer. Although the court indicated that the result might be the same under state law, that is dicta. In the cases in which the wrongdoers perpetrated a fraud on third parties primarily in order to benefit the company and not themselves, their knowledge may be attributed to the company, possibly precluding a claim of breach against the attorneys. See *FDIC v. Ernst & Young*, 967 F.2d 166 (5th Cir. 1992) (finding that the FDIC was estopped where management made fraudulent bookkeeping entries to benefit the bank).

pear will lead it to infer whether the lawyer must have known (knowledge or awareness),<sup>69</sup> deliberately ignored (subjective recklessness) or should have known (a range from objective recklessness to simple negligence) of the fraud. Such inference is likely to be imprecise, the product of trial strategy as much as historic fact.<sup>70</sup>

The far greater bite to the variations in state of mind standards comes at the pretrial stage. Plaintiffs' actions against lawyers often are dismissed, at least in cases under the securities laws that require a showing of actual knowledge, if they can do no more than allege that the attorneys' involvement with the client was such that they "must have known" of the fraud.<sup>71</sup> More liberal forms of scienter pleading, allowed against a company's control group through inference by association, do not extend to the company's attorneys.<sup>72</sup> In those courts that insist on a higher state of mind standard, successful pleading is nearly impossible. In contrast, lesser standards like negligence and recklessness permit far greater latitude in inferential pleading.<sup>73</sup>

The effect of higher state of mind requirements is to bias the law considerably against straight substantial assistance claims against lawyers, especially under the securities laws. When the lawyer is involved in the disclosure process the potential for negligent misrepresentation liability arises.<sup>74</sup> Under Rule 10b-5, that same common-law duty of care can become the basis in some jurisdictions for aiding-and-abetting liability based on recklessness. Without such involvement, however, the higher state of mind standards apply. It is rare that a plaintiff at the pleadings stage will have access to evidence that creates more than an inferential claim against the lawyers, unless some prior SEC investiga-

---

69. The courts in many settings, including aiding-and-abetting cases brought under the securities laws, have made clear that the fact finder may infer knowledge from circumstantial evidence, including evidence of recklessness. See, for example, *Woodward v. Metro Bank*, 522 F.2d 84, 96 (5th Cir. 1975). One of the most frequently cited illustrations regarding a lawyer's involvement in client misconduct is *United States v. Benjamin*, 328 F.2d 854, 861-62 (2d Cir. 1964).

70. See text accompanying notes 138-40.

71. This rule was articulated most firmly in *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490 (7th Cir. 1986). For a discussion of dismissals on the pleadings, see Feldman, 19 Sec. Reg. L. J. at 54-55 (cited in note 35); Haft, *Liability of Attorneys* § 3.06 (cited in note 5). Closely related as a preclusive device is the motion for summary judgment. See, for example, *Ockerman v. May Zima & Co.*, 785 F. Supp. 695 (M.D. Tenn. 1992).

72. See *In re Citisource, Inc. Sec. Lit.*, 694 F. Supp. 1069 (S.D.N.Y. 1988). Compare *Wool v. Tandem Computers Inc.*, 818 F.2d 1433, 1440 (9th Cir. 1987) (holding that controlling officers' knowledge could be inferred based upon the assumption that misstatements were their collective product).

73. See *Rudolph v. Arthur Andersen & Co.*, 800 F.2d 1040, 1045-46 (11th Cir. 1986). Interesting in this regard is *Breard v. Sachnoff & Weaver, Ltd.*, 941 F.2d 142 (2d Cir. 1991), upholding a complaint against a law firm that drafted offering materials because a strong inference of fraud could be made given the nature of the misrepresentations.

74. See text accompanying notes 55-61.

tion or journalistic exposé has uncovered tangible evidence of consciously wrongful activity. This means that some unknown number of claims that presumably would succeed if allowed to go to discovery and trial are eliminated at the pleadings stage.

#### D. *An Assessment*

The standards of attorney liability as applied explain in part the observations of attorney inaction in the face of client fraud. A variety of doctrinal twists and pleadings traps, most visible in the securities cases, make it far less than likely that attorneys who simply give business planning assistance to a miscreant client will be exposed to liability. Even when the attorney becomes actively involved in fraudulent disclosure, which creates a far greater potential exposure under both federal and state law, there are some well-known decisions like *Abell* or *Barker v. Henderson, Franklin, Starnes & Holt*<sup>75</sup> that send offsetting messages of comfort to the community of lawyers. Together with the well-publicized efforts of the bar in favor of client loyalty and against whistleblowing, the tone of such holdings readily can create the misimpression that continued involvement with a wrongdoing client is ethically acceptable, perhaps even laudable.<sup>76</sup> To lawyers predisposed by economic incentive to desire that message, it may be powerful support.

It is doubtful, however, that this explanation is a complete one. From the *ex ante* perspective of the lawyer who either knows of or suspects client wrongdoing, the exposure is still palpable. There are the risks of an SEC investigation, of state law actions unrestrained by some of the doctrinal developments under Rule 10b-5, of reputational damage even in unsuccessful claims. Therefore, we should continue to look for other explanations.

---

75. 797 F.2d 490 (7th Cir. 1986). The court's remark that "[w]e are satisfied . . . that an award of damages under the securities laws is not the way to blaze the trail toward improved ethical standards [in the legal profession,]" *id.* at 497, is often quoted. *Barker's* comfort is more in the language of the opinion than the actual holding, since the attorney's role in the fraud in that case was quite remote, ceasing before the fraud took place.

76. Professor Hazard has observed that in the aftermath of the final adoption of the Model Rules, some attorneys misperceived it as a vindication of the lawyers who had assisted OPM (see text accompanying notes 128-34) in its fraud. Hazard, 33 *Emory L. J.* at 306 (cited in note 19). The tendency of the ABA's nomos of strong client loyalty to trump weak or ambiguous legal norms to the contrary is noted in Koniak, 70 *N.C. L. Rev.* at 1461-69 (cited in note 10).

## III. LAWYERS, CLIENTS, AND SOCIAL COGNITION

Nothing is easier than self-deceit.  
For what each man wishes, that he also believes to be true.  
Demosthenes, Third Olynthiac, sec. 19

Financial fraud is an exercise in the manipulation of abstractions. Sellers of assets seeking buyers who will pay too much, or less frequently, buyers trying to appropriate assets at an unduly low price will try to structure a setting in which the truth is hidden in a dense puzzle. The seller hopes that the other party's hope or greed will trump thoughtful inquiry.<sup>77</sup>

Typically, clients creating such fraud do not involve their lawyers directly in the wrongdoing. More commonly, they seek to deceive them as well. Sometimes they succeed, in a way that leads us to conclude that the attorney bears neither moral nor legal responsibility for the harm. This is especially likely when responsibility for a project is so diffused that neither the lawyer nor anyone else but the primary wrongdoer has the ability to put the puzzle pieces together. But in many cases, the stories told afterward make us wonder how the lawyers could be so glib or mindless to have missed the abundant signals of misbehavior. The claim that they were duped loses credibility in light of these signals, reinforcing the venality hypothesis.

There is reason to believe, however, that in a noisy world of complicated abstractions an involved actor has a diminished capacity to perceive danger signals that might indicate fraud. If so, traditional liability strategies, both intent- and notice-based, will operate with severely reduced efficacy.<sup>78</sup> In addition, we have the possibility that a portion of the observed incidence of lawyer complicity in financial fraud may be instances in which the attorneys are acting innocently, without sufficient cognitive awareness of the harmful consequences of their actions.

The scholarly literature that offers the most useful insights into the mindsets of lawyers whose clients are involved in fraud comes from the branch of psychology dealing with social cognition,<sup>79</sup> the intersection

---

77. For an intriguing account of the role of hope and mindlessness in investment decisions in the context of purchasing biotechnology stocks, see Robert Teitelman, *Gene Dreams: Wall Street, Academia, and the Rise of Biotechnology* (Basic Books, 1989).

78. This is separate from the related question of whether a lawyer who is aware of the impropriety is likely to assess the risk of detection or sanction accurately. For a discussion of the social cognition literature on this question, see Jeff Casey and John Scholtz, *Beyond Deterrence: Behavioral Decision Theory and Tax Compliance*, 25 L. & Soc'y Rev. 821 (1991).

79. For useful overviews of the voluminous research in this field, see Susan T. Fiske and Shelley E. Taylor, *Social Cognition* (McGraw-Hill, 2d ed. 1991); Elliot Aronson, *The Social Animal* 115-240 (W. H. Freeman, 6th ed. 1992); Hazel Markus and R. B. Zajonc, *The Cognitive Perspective in Social Psychology*, in Gardner Lindzey and Elliot Aronson, eds., 1 *Handbook of Social Psychology* 137 (Random House, 3d ed. 1985).

between the traditionally separate disciplines of social and cognitive psychology. For our purposes, it must be used somewhat gingerly. Like most social scientists, social cognitivists' findings have been generated largely by laboratory experiments, under pragmatic limitations and research protocols that make it hard to replicate the richness of everyday life.<sup>80</sup> Efforts to theorize beget endless criticism. Social cognition is an intellectually young field, with palpable divisions among its best-known theorists that make it difficult to find points of consensus to import readily into legal analysis. Still, the field is most tempting to legal academics because, like the economics literature a decade or two ago, it offers unexpected insights into well-worn habits of legal thinking. To those intrigued by the foibles, frustrations and inefficiencies of human behavior, it provides support and explanation.<sup>81</sup> Not surprisingly, then, social cognition research has begun to inform work by well-known scholars in torts,<sup>82</sup> criminal law,<sup>83</sup> contracts,<sup>84</sup> corporate law,<sup>85</sup> and pol-

---

80. See Robin M. Hogarth, *Beyond Discrete Biases: Functional and Dysfunctional Aspects of Judgmental Heuristics*, 90 *Psych. Bull.* 197 (1981). On the methodology of the social sciences and the relationship to positive law, see David L. Faigman, *To Have and Have Not: Assessing the Value of Social Science to the Law as Science and Policy*, 38 *Emory L. J.* 1005 (1989) (noting the long distance from the laboratory to real life). The psychological literature operates as a threat to some of the underlying assumptions of economics in particular, although there is no doubt that market and institutional forces can offset these biases in many instances. For a rich and thoughtful set of articles on this confrontation, see Robin M. Hogarth and Melvin W. Reder, eds., *The Behavioral Foundations of Economic Theory*, 59 *J. Bus.* S181 (1986). For a formal effort at integration, see George A. Akerlof and William T. Dickens, *The Economic Consequences of Cognitive Dissonance*, 72 *Am. Econ. Rev.* 307 (1982). Some experimental evidence on the limited ability of markets to filter biases is found in Colin Camerer, *The Rationality of Prices and Volume in Experimental Markets*, 51 *Org. Behav. & Hum. Dec. Processes* 237 (1992).

81. The strongest call for the use of this literature generally is Robert C. Ellickson, *Bringing Culture and Human Frailty to Rational Actors: A Critique of Classical Law and Economics*, 65 *Chi. Kent L. Rev.* 23 (1989). A helpful introduction to the cognitive illusions phase of social cognition is Ward Edwards and Detlof von Winterfeldt, *Cognitive Illusions and Their Implications for the Law*, 59 *S. Cal. L. Rev.* 225 (1986).

82. See, for example, Howard A. Latin, *Problem-Solving Behavior and Theories of Tort Liability*, 73 *Cal. L. Rev.* 677, 682-85 (1985). For a cautionary note, see Paul J. Heald and James E. Heald, *Mindlessness and the Law*, 77 *Va. L. Rev.* 1127 (1991) (emphasizing that even mindless behavior may be adaptive to legal standards).

83. See, for example, Leo Katz, *Bad Acts and Guilty Minds: Conundrums of the Criminal Law* (Chi., 1987); Ronald L. Akers, *Rational Choice, Deterrence and Social Learning Theory in Criminology: The Path Not Taken*, 81 *J. Crim. L. & Criminol.* 653 (1990). From the economics literature, see William Dickens, *Crime and Punishment Again: The Economics Approach with a Psychological Twist*, 30 *J. Pub. Econ.* 97 (1986).

84. See, for example, William N. Eskridge, Jr., *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consonant with the Economic and Psychological Dynamics of the Home Sale and Loan Transaction*, 70 *Va. L. Rev.* 1083, 1112-18 (1984). Compare Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 *Va. L. Rev.* 821, 877-88 (1992) (discussing consciousness in contract formation).

85. See, for example, James D. Cox and Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, 48 *L. & Contemp. Probs.* 83 (1985). On securities law, see Donald Langevoort, *Theories, Assumptions and Securities Regu-*

icy analysis.<sup>86</sup>

Social cognition is the process by which people acquire information, beliefs and attitudes about themselves and others. Psychologists presume that individuals engage in subjective construals—that the lenses through which they perceive people and events produce pictures heavily affected, and sometimes distorted, by both cognitive and motivational influences.<sup>87</sup> A lawyer's ability to spot client misconduct, they would argue, can be evaluated only in light of those influences.

To begin this review, we should note that most of the mental processes of social cognition are understood to operate out of consciousness. The label "preconscious" often is applied, meaning mental activity of which the person is not aware, but can come to understand later upon proper prompting.<sup>88</sup> Cognitive biases often take cover under what the subject firmly believes is rational thinking.<sup>89</sup> Professional hubris aside, there is no reason to think that lawyers are any less susceptible to such self-deception than others. Indeed, serious biases have been identified regularly in the work of many other elite professions whose tasks are highly inferential.<sup>90</sup>

lation: *Market Efficiency Revisited*, 140 U. Pa. L. Rev. 851, 857-61 (1992).

86. See Roger G. Noll and James E. Krier, *Some Implications of Cognitive Psychology for Risk Regulation*, 19 J. Legal Stud. 747 (1990).

87. See, for example, Aronson, *The Social Animal* at 115-240 (cited in note 79).

88. See Irving L. Janis and Leon Mann, *Decision-Making: A Psychological Analysis of Conflict, Choice and Commitment* 95-96 (Free Press, 1977); Fiske and Taylor, *Social Cognition* at 228 (cited in note 79). See also Phillip Zimbardo and Michael Lippé, *The Psychology of Attitude Change and Social Influence* 245-46 (Temple, 1991). On self-deception, see Ruben C. Gur and Harold A. Sackeim, *Self-Deception: A Concept in Search of a Phenomenon*, 37 J. Person. & Soc. Psych. 147 (1979). But see Albert Bandura, *Social Cognitive Theory of Moral Thought and Action*, in William M. Kurtines and Jacob L. Gewirtz, eds., 1 *Handbook of Moral Behavior and Development* 45, 95 (Lawrence Erlbaum, 1991) (criticizing the idea of self-deception as contradictory). Of course, people sometimes seek to manipulate external impressions regarding matters of fault and blame in a very conscious fashion, making it hard to assess the consciousness of wrongdoing. See Philip E. Tetlock, *Toward an Intuitive Politician Model of Attribution Processes*, in Barry R. Schlenker, ed., *The Self and Social Life* 203, 218-24 (McGraw-Hill, 1985). Even self-presentational theories acknowledge the likelihood that thought processes are often subconscious or preconscious. See, for example, Roy F. Baumeister, *A Self-Presentational View of Social Phenomena*, 91 Psych. Bull. 3, 3 (1982).

89. See Ziva Kunda, *The Case for Motivated Reasoning*, 108 Psych. Bull. 480, 482-83 (1990).

90. Surprisingly, there has not been a significant body of social psychological research into lawyer decisionmaking. Deborah Rhode has invoked it in a number of respects relating to legal ethics. See Rhode, 42 J. Legal Educ. at 44-48 (cited in note 16); Rhode, 37 Stan. L. Rev. at 629 (cited in note 13). See also Mary Twitchell, *The Ethical Dilemmas of Lawyers on Teams*, 72 Minn. L. Rev. 697 (1988) (commenting on group dynamics). There is some sociological work that explores attitudes and influences. See Robert L. Nelson, *Partners With Power: The Social Transformation of the Large Law Firm* (Cal. 1987) (documenting the tendency of corporate lawyers to form attitudes consonant with client interests); Jeffrey S. Slovak, *The Ethics of Corporate Lawyers: A Sociological Approach*, 1981 Am. Bar Found. Res. J. 753. In contrast, the behavioral influences on auditor conduct is a widely studied phenomenon presumably because of the more standardized nature of auditing activities. See Robin M. Hogarth, *A Perspective on Cognitive Research in Ac-*



### A. *Beginning the Representation: Constructing a Schema*

Central to the field of social cognition is the schema: a person's mental representation of a set of stimuli.<sup>91</sup> As a lawyer begins representing a client in a transactional project, she constructs a schema that provides a general understanding of the people involved and their goals, and so orients her action. As in most social settings, the amount of definite information that can be used in drawing this cognitive map is at the outset quite limited, and many of the stimuli are ambiguous. As a result, the mind uses a variety of heuristic devices to fine-tune the initially fuzzy picture. It notes resemblances to prior encounters and occurrences, and extrapolates from readily observable characteristics of the actors or the situation. The strongest influence in schema formation, however, is likely to be the process of social learning:<sup>92</sup> taking cues from those apparently more familiar with the situation, and conforming to their beliefs and attitudes.

Although it is by no means inevitable, the business lawyer with a new client probably will build a fairly positive schema. Observing no immediate danger signs, perhaps initially impressed with the success-characteristics of the personalities involved,<sup>93</sup> and seeing other professionals already dealing with the client on an ostensibly normal and routine basis, she is entitled to invoke the mental shortcuts that produce an optimistic assessment.<sup>94</sup> Further, she may be motivated to do so.

---

counting, 66 *Acct. Rev.* 277 (1991). Much work has focused on the role of expertise in decisionmaking as well. Although experts do think differently when confronted with tasks, many researchers are pessimistic that expertise leads to the wholesale elimination of biases. See, for example, Ward Edwards, *Unfinished Tasks: A Research Agenda for Behavioral Decision Theory*, in Robin M. Hogarth, ed., *Insights in Decision Making: A Tribute to Hillel J. Einhorn* 44, 50 (Chi., 1990). A fair amount of research has focused on the suboptimal decisions made by physicians and clinical psychologists. For example, David M. Eddy, *Probabilistic Reasoning in Clinical Medicine: Problems and Opportunities*, in Daniel Kahneman, Paul Slovic and Amos Tversky, *Judgment Under Uncertainty: Heuristics and Biases* 249 (Cambridge, 1982).

91. See Fiske and Taylor, *Social Cognition* at 98 (cited in note 79); Hazel Markus, *Self-Schemata and Processing Information About the Self*, 35 *J. Pers. & Soc. Psych.* 63 (1977).

92. See, for example, Albert Bandura, *Social Foundations of Thought and Action: A Social Cognitive Theory* 47 (Prentice-Hall, 1986); Robert B. Cialdini, *Influence: Science and Practice* 108 (Scott, Foresman, 2d ed. 1987). Social learning is adaptive in the sense that absent better evidence, the behavior of others may be the best available information set.

93. The early stages of schema construction use highly stereotypical shortcuts in the formation of impressions. Appearance, salient bits of information about the past and other relatively unreliable evidence is overweighted, and a "halo" leads the observer to extrapolate these few positive impressions to a full tentative attitude toward the person or the situation. See, for example, Fiske and Taylor, *Social Cognition* at 142-47; Aronson, *Social Animal* at 136-37 (cited in note 79).

94. Unreasonable optimism is a common characteristic, leading people to overweight the likelihood of successful future outcomes, and underweight the likelihood of failure. See sources cited in Fiske and Taylor, *Social Cognition* at 215. People also tend to have an excessively inflated perception of how others perceive them, *id.* at 214, and a tendency to take personal credit for successes, while attributing failures to external situational factors.

Laboratory studies indicate that people whose success depends on the efforts of others have a strong tendency to form positive impressions of those on whom they depend.<sup>95</sup>

We should pause here to confront the skeptical reader's likely objection. Much of the literature in social cognition focuses, perhaps excessively, on cognitive "imperfections."<sup>96</sup> This sometimes creates the impression that those who trust these often unreliable mental shortcuts are inferior, unlikely to thrive in a competitive marketplace. What makes us think that successful lawyers could afford to think in such an unreliable fashion?

There are two important answers. The first is necessity. Attorneys are confronted with immense amounts of intellectual stimuli each day and must implicitly or explicitly make thousands of decisions and judgments through inductive reasoning. Without an internal management information system filled with preconscious filters and shortcuts, life would be unbearably chaotic.<sup>97</sup> The other is adaptation. Heuristics are adaptive so long as they work much of the time and no more efficient alternative is available.<sup>98</sup> In normal life, these rough judgments and rules of thumb work quite acceptably with relative frequency; more precise mechanisms, such as Bayesian analyses with full attention to base rates and other statistical properties, simply are not practicable. Feedback is not sufficiently repetitious and unambiguous to allow for more effective learning.<sup>99</sup> Moreover, many kinds of cognitive illusions are cu-

---

95. See Steven L. Neuberg and Susan T. Fiske, *Motivational Influences on Impression Formation: Outcome Dependency, Accuracy-Driven Attention, and Individuating Processes*, 53 *J. Pers. & Soc. Psych.* 431 (1987); Kunda, 108 *Psych. Bull.* at 486-87 (cited in note 89).

96. It has been said that "two plus two equals four is arithmetic; two plus two equals five is psychology." Kenneth R. Hammond, *Functionalism and Illusionism: Can Integration Be Usefully Achieved?*, in Hogarth, ed., *Insights in Decision Making* at 227, 237 (cited in note 90). A good overview of the competing viewpoints is Helmut Jungermann, *The Two Camps on Rationality*, in Hal R. Arkes and Kenneth R. Hammond, eds., *Judgment and Decision Making: An Interdisciplinary Reader* 627 (Cambridge, 1986). The tendency of the literature to overweight findings of imperfections is noted in Jay J. Christiansen-Szalanski and Lee Roy Beach, *The Citation Bias: Fad and Fashion in the Judgment and Decision Literature*, 39 *Am. Psych.* 75 (1984).

97. See Keith J. Holyoak and Richard E. Nisbett, *Induction*, in Robert J. Sternberg and Edward E. Smith, eds., *The Psychology of Human Thought* 50, 55 (Cambridge, 1988). See also Anthony G. Greenwald, *The Totalitarian Ego: Fabrication and Revision of Personal History*, 35 *Am. Psych.* 603, 612-13 (1980); Fiske and Taylor, *Social Cognition* at 91 (cited in note 79). For an insightful lawyer-oriented essay on the adaptive quality of "suboptimal" thought, see Robert E. Scott, *Error and Rationality in Individual Decisionmaking: An Essay on the Relationship Between Cognitive Illusions and the Management of Choices*, 59 *S. Cal. L. Rev.* 329 (1986).

98. See, for example, Richard Nisbett and Lee Ross, *Human Inference: Strategies and Shortcomings of Social Judgment* 254-55 (Prentice-Hall, 1981).

99. As noted earlier, human learning can overcome some of the biases that are particularly noticeable in laboratory experiments involving "one shot" cognitive tests. See text accompanying note 80. However, a number of psychologists have concluded that for feedback to work, it must be unambiguous and, unless particularly salient, repeated. See, for example, Baruch Fischhoff, *Judg-*

riously functional. Excessive optimism and the illusion of control,<sup>100</sup> for instance, are associated with physiological well-being, and may cause persons to assume greater risks and to be more persistent than "realists."<sup>101</sup> The illusion can thus become a self-fulfilling prophecy as a greater number of successful outcomes are generated, even if by chance, in turn leading to further expectations of success in the person's self-schema and the dispositional attributions of others.<sup>102</sup> The relationship among ego, self-esteem and lawyer behavior is something to which we shall return shortly.

### B. Schema Evolution: The Process of Representation

As the client representation continues, new information bits relating to the situation will confront a lawyer regularly. These will cause the schema to become more complex and well-developed, and under the right circumstances disconfirming evidence will cause a noticeable change in impression. But if there is general agreement about any concept in social cognition, it is that of cognitive conservatism.<sup>103</sup> The

---

*ment and Decision Making*, in Sternberg and Smith, eds., *Psychology of Human Thought* at 153, 172 (cited in note 97); Berndt Brehmer, *In One Word: Not From Experience*, in Arkes and Hammond, eds., *Judgment and Decision Making* at 705, 714-16 (cited in note 96). For an intriguing laboratory study confirming the importance of unambiguity and repetition, see Colin F. Camerer, *Behavioral Game Theory*, in Hogarth, ed., *Insights in Decision Making* at 311 (cited in note 90) (showing that learning optimal strategies in a lending "game" took several iterations with fairly discrete feedback). It is likely that lawyers operate in environments rarely characterized by unambiguous feedback.

100. See Ellen J. Langer, *The Illusion of Control*, 32 *J. Pers. & Soc. Psych.* 311 (1975). The illusion of control is the well-documented tendency of people to believe that their personal involvement in a situation makes the desired outcome more likely, even if there is in fact no necessary relationship between involvement and outcome.

101. With such a cognitive structure, positive outcomes will seem more probative in the development of self-concept, and the sense of control and optimism will grow. So long as egotistical behavior does not become self-destructive, it is likely to lead to further success through perseverance and greater risk-taking. The illusions of control and self-worth generally are absent in depressed people. See, for example, Albert Bandura, *Social Foundations* at 224-25 (cited in note 92).

102. On the role of the expectations of others in self-fulfilling prophecies, see Lee Ross and Richard E. Nisbett, *The Person and the Situation: Perspectives of Social Psychology* 154-58, 227-28 (Temple, 1991); Mark Snyder, *When Belief Creates Reality*, in Leonard Berkowitz, ed., 18 *Advances in Experimental Social Psychology* 247 (Acad., 1984).

103. See, for example, Fiske and Taylor, *Social Cognition* at 13, 149-51 (cited in note 79) (characterizing people as "cognitive misers"); Nisbett and Ross, *Human Inference* at 167 (cited in note 98). Elliot Aronson refers to the process of cognitive conservatism as the tendency to "preserve that which is already established—to maintain our preexisting knowledge, beliefs, attitudes and hypotheses." Aronson, *Social Animal* at 148 (cited in note 79). Some of the classic experiments on belief perseverance are Craig A. Anderson, Mark R. Lepper and Lee Ross, *Perseverance of Social Theories: The Role of Explanation in the Persistence of Discredited Information*, 39 *J. Pers. & Soc. Psych.* 1037 (1980); Charles G. Lord, Lee Ross and Mark R. Lepper, *Biased Assimilation and Attitude Polarization: The Effects of Prior Theories on Subsequently Considered Evidence*, 37 *J. Pers. & Soc. Psych.* 2098 (1979).

processing of new information and the search of memory to aid in inference are biased, sometimes heavily, toward the confirmation of existing schema. Though hardly immune, attitudes and beliefs are change-resistant. This resistance is strengthened by the act of explanation.<sup>104</sup> Cognitive conservatism is an adaptive response for two reasons: first, because a truly open mind—one that constantly rethinks all possible situations with attention to all plausible cues—would be unmanageable and ineffective; second, because consistency is a socially desirable trait. Furthermore, in a normal setting, the process of social learning contributes to reinforce existing schemas. Everyone else is acting as usual, so presumably nothing has changed. The resulting circularity should be clear.

The concept of cognitive conservatism suggests that even absent any motivational factors, a lawyer is likely to dismiss as unimportant or aberrational the first few negative bits of information that she receives regarding a client or situation. A lawyer, for example, will test a single complaint or warning first for schema consistency, and if any reasonable fit is possible, she will retain the positive impression.<sup>105</sup> Thus, the lawyer can readily dismiss a warning from an employee or investor as the product of idiosyncratic disgruntlement, since most others similarly situated apparently are not bothered. Moreover, the constant stream of additional bits of information about the situation—whether positive, or simply noisy—will often dilute the negatives,<sup>106</sup> providing an opportunity for manipulation by a clever client.

### C. *Motivated Reasoning and the "Red Flag"*

To this point, we have described mental processes that psychologists describe as purely cognitive or "cold."<sup>107</sup> They are simply heuristic devices that mediate the potential for overload. As such, reasonably intelligent people, surely all successful lawyers, should be capable of shifting to a more vigilant form of inference when situational cues prompt it. In fact, research shows that the purely cognitive tendency toward conservatism, though pervasive, is not by itself all that hard to overcome. An observer will factor in particularly salient bits of disconfirming information. If a person can be motivated toward diligence—i.e.,

---

104. See Anderson, Lepper and Ross, 39 *J. Pers. & Soc. Psych.* at 1047.

105. See Kunda, 108 *Psych. Bull.* at 482-83 (cited in note 89).

106. Dilution is an often-observed phenomenon. Simply by placing information in the context of additional irrelevant bits, its influence is diminished. See Nisbett and Ross, *Human Inference* at 154-56 (cited in note 98); Aronson, *Social Animal* at 131-32 (cited in note 79); Fiske and Taylor, *Social Cognition* at 355-57 (cited in note 79). Conversely, people overweight evidence that is particularly salient or vivid.

107. See generally, Jungermann, *The Two Camps on Rationality* in Arkes and Hammond, eds., *Judgment and Decision Making* 627 (cited in note 96).

offered a financial incentive, or told that she is accountable for the accuracy of her judgments<sup>108</sup>—a more careful information search and process of inference likely will follow.

According to many researchers, however, motivated reasoning is double-edged. The apparently ascendent view in psychology is that “hot” influences—such as ego, emotion and mood—have demonstrably significant effects on both perception and inference that can lead to diminished as well as enhanced vigilance.<sup>109</sup> And within this genre, much of the inquiry focuses on the role of self-serving biases in the cognitive process. This research suggests strongly that under special circumstances, people will be motivated preconsciously to avoid the appreciation of adverse information and hence fail to adopt appropriately vigilant cognitive modes. Their thinking turns wishful

When? One theory derives, but is now in many ways removed, from Leon Festinger’s classic work in the 1950s and ’60s on cognitive dissonance.<sup>110</sup> Central to it are two notions: commitment<sup>111</sup> and self-esteem. As noted earlier, many psychologists believe that self-esteem, even if excessive or unrealistic, is a highly adaptive human trait, associated with a large number of functional behaviors.<sup>112</sup> So, the cognitive apparatus operates to protect it. When people voluntarily commit themselves to a certain position, attitude or belief, the subsequent discovery of information that indicates harmful consequences flowing from that

108. See, for example, Philip E. Tetlock and Jae Il Kim, *Accountability and Judgment Processes in a Personality Prediction Task*, 52 *J. Pers. & Soc. Psych.* 700 (1987).

109. The distinction between hot and cold cognitive approaches represents one of the fundamental divisions in the field, and most experimental findings can be explained on either basis. See Philip E. Tetlock and Ariel Levi, *Attribution Bias: On the Inconclusiveness of the Cognition-Motivation Debate*, 18 *J. Exp. Soc. Psych.* 68 (1982). The cold cognitive approach is heavily influenced by work in artificial intelligence. Here, egocentric biases exist, but largely because of the distortion in perception caused by the high ratio of self-related information inputs to nonself-related ones in the reality construct. For representative examples of cold process emphasis, see Nisbett and Ross, *Human Inference* at 228 (cited in note 98); and the various papers in Daniel Kahneman, Paul Slovic and Amos Tversky, eds., *Judgment Under Uncertainty: Heuristics and Biases* (Cambridge, 1982). On the ascendancy of motivation theory, see Kunda, 108 *Psych. Bull.* at 480 (cited in note 89); Fiske and Taylor, *Social Cognition* at 13 (cited in note 79). In fact, many of the researchers in the “cold” camp acknowledge the likelihood of self-serving and other motivated biases, but simply question whether laboratory research has made a scientific case for their existence. See Nisbett and Ross, *Human Inference* at 233-34 (cited in note 98).

110. Leon Festinger, *A Theory of Cognitive Dissonance* (Row, Peterson, 1957).

111. Commitment is one of the most widely credited motivating factors in behavior. See generally Charles A. Kiesler, *The Psychology of Commitment* (Acad., 1971); Cialdini, *Influence* at 58 (cited in note 92); Joel Cooper and Russell H. Fazio, *A New Look at Dissonance Theory*, in Leonard Berkowitz, ed., 17 *Advances in Experimental Social Psychology* 229 (Acad., 1984). Commitment affects cognition even in circumstances where the subject is accountable for his judgments. See Philip E. Tetlock, Linda Skitka and Richard Boettger, *Social and Cognitive Strategies for Coping With Accountability: Conformity, Complexity and Bolstering*, 57 *J. Pers. & Soc. Psych.* 632 (1989).

112. See notes 100-02 and accompanying text.

commitment directly threatens their self-concept as good, worthwhile individuals. Thus, cognitive processes will work to suppress such information if at all possible.<sup>113</sup> If the cues are too salient to be suppressed, other defenses operate, such as, shifts in attitudes and avoidance of responsibility. The self-deception is compounded by people's tendency to believe that others see the world roughly like they do, something referred to as the false consensus effect,<sup>114</sup> and thus treat their myopic construal as self-evident fact in predicting the behavior of others.

What this means, of course, is that once commitment has occurred, and especially if it is publicly expressed and repeated, what might be an obvious red flag to a disinterested observer may not appear such to the actor. What lay people call "blind spots" may be pervasive whenever there is the requisite sunk cost of ego commitment. Psychologists and others have used this theory to explain the rather robust phenomenon of escalating commitment—why bankers often throw good money after bad,<sup>115</sup> why gamblers and investors persist much too long<sup>116</sup> and why nations often fight wars well beyond any apparent usefulness.<sup>117</sup> Its relevance to legal representation is palpable, for there are few settings in which commitment is more vivid and subject to public expression and repetition than when a lawyer undertakes to act on behalf of a client.

The most extensive and well-known work on the role of commitment in the decision-making process in an institutional environment was done by Irving Janis and Leon Mann.<sup>118</sup> Although they emphasize

---

113. For a particularly lucid discussion, see Aronson, *Social Animal* at 202-03 (cited in note 79). For specific research support for self-serving motivational bias in the processing of external cues, see Greenwald, 35 *Am. Psych.* at 606-08 (cited in note 97); Ziva Kunda, *Motivated Inference: Self-Serving Generation and Evaluation of Causal Theories*, 53 *J. Pers. & Soc. Psych.* 636 (1987); Kunda, 108 *Psych. Bull.* at 483 (cited in note 89); Tom Pyszczynski and Jeff Greenberg, *Toward an Integration of Cognitive and Motivational Perspectives on Social Inference: A Biased Hypothesis-Testing Model*, in Leonard Berkowitz, ed., 20 *Advances in Experimental Social Psychology* 297 (Acad., 1987) (discussing self-esteem); Fiske and Taylor, *Social Cognition* at 212-16 (cited in note 79) (discussing self-enhancement); id. at 468-71 (finding information processing consistent with attitudes).

114. See Gary Marks and Norman Miller, *Ten Years of Research on the False Consensus Effect: An Empirical and Theoretical Review*, 102 *Psych. Rev.* 72 (1987). Whether the purported consensus is really false, or whether instead the use of personal information may be a "best available" predictor, is an interesting question. See Robyn Dawes, *The Potential Nonfalsity of the False Consensus Effect*, in Hogarth, ed., *Insights in Decision Making* at 179 (cited in note 90).

115. See Barry Staw, *The Escalation of Commitment to a Course of Action*, 6 *Acad. Mgmt. Rev.* 577 (1981).

116. See id. For other related perspectives, see Thomas Gilovich, *Biased Evaluation and Persistence in Gambling*, 44 *J. Pers. & Soc. Psych.* 1110 (1983) (considering both cognitive and motivated influences). Compare Hersh Shefrin and Meir Stetman, *The Disposition to Sell Winners Too Early and Ride Losers Too Long: Theory and Evidence*, 40 *J. Fin.* 777 (1985).

117. See Janis and Mann, *Decision-Making* at 280 (cited in note 88); Aronson, *The Social Animal* at 188-89 (cited in note 79).

118. See Janis and Mann, *Decision-Making* at 280.

the avoidance of stress as opposed to the protection of self-esteem as the underlying motivation, their analysis is essentially the same. In those situations in which the negative consequences of prior commitment are foreseeable and there is little objective hope of finding satisfactory solutions, the human mind adopts a preconscious mode of defensive avoidance. This bolsters the commitment by "excluding information about the most threatening consequences of the least objectionable course of action,"<sup>119</sup> which typically is maintaining the status quo. The Janis and Mann research looks at these mental processes in connection with a variety of high-level decisions in situations that bear marked similarities to the unraveling of massive financial frauds,<sup>120</sup> with professionals acting in a far less vigilant fashion than the objective evidence would warrant.

That lawyers are particularly prone to blind spots regarding their clients should come as no surprise. Their commitment is clear and public, and they are called upon frequently to articulate the client's position—something that polarizes attitudes and beliefs, for the act of saying often strengthens belief.<sup>121</sup> Successful lawyers generally have extremely high levels of self-esteem, which makes defensive avoidance all the more likely.<sup>122</sup> In all probability, moreover, such a strong tendency will not subject the lawyer to a significant market penalty. To the contrary, the tendency to block or recast adverse information will enhance the optimism and sense of control by the lawyer as well as her sense of loyalty to the client. These attributes are attractive to both current and potential clients and predict ever higher levels of success over time. People who are highly confident of their client's position are likely to make superior negotiators,<sup>123</sup> probably the central skill of the transactional lawyer. From our working assumption that serious instances of client fraud are relatively infrequent, we would predict that the functional, adaptive role of ego-biased perception offers benefits that signifi-

---

119. *Id.* at 124 (cited in note 88). For a recent updating, see Irving Janis, *Crucial Decisions: Leadership in Policymaking and Crisis Management* (Free Press, 1989). Postcommitment defensive bolstering is also emphasized in Tetlock, Skitka and Boettger, 57 *J. Pers. & Soc. Psych.* 632 (cited in note 111).

120. Examples include planning for the energy crisis in the 1970s and Pearl Harbor.

121. See Aronson, *The Social Animal* at 197 (cited in note 79); Anderson, Lepper and Ross, 37 *J. Pers. & Soc. Psych.* at 1047 (cited in note 103). The generation of defensive explanations serves, moreover, to dilute the negative evidence. See Philip Tetlock and Richard Boettger, *Accountability: A Social Magnifier of the Dilution Effect*, 57 *J. Pers. & Soc. Psych.* 388 (1989).

122. See Fiske and Taylor, *Social Cognition* at 471-72 (cited in note 79).

123. On the role of self-confidence, see Gerald Williams, *Legal Negotiation and Settlement* 27 (West, 1983); Max Bazerman and Margaret Neale, *Heuristics in Negotiation: Limitations to Effective Dispute Resolution*, in Arkes and Hammond, eds., *Judgment and Decision Making* at 311, 316 (cited in note 96) (noting that appropriate confidence predicts success, although excessive optimism may not).

cantly outweigh the reputational risks associated with representing a client who turns out to be acting fraudulently. Reputational protection will occur largely in the process of choosing whether to represent the client in the first place. In other words, one can make the interesting claim that the lawyers' marketplace success may have a *positive* correlation with the presence of the specific egocentric biases we have described. Lawyers may be egotistic because they are successful, and successful because they are egotistic.<sup>124</sup>

#### D. Lawyers in Groups

To this point, the discussion has presumed a single lawyer representing a client. That, of course, is artificial, since most transactional representation of any significance is done by a team of lawyers. Our analysis of the process of social cognition must expand to confront the group dynamic.

The additional points to make are somewhat offsetting. On one hand, the presence of lower-level attorneys suggests that since they did not choose to commit to the representation but instead were assigned to the task, the threat of negative information to self-esteem is less and the likelihood of noticing red flags is greater. Even more, rotation of lawyers into the representation after it has begun introduces perspectives unencumbered by commitment biases. In fact, some psychologists recommend staffing rotation on projects in business settings precisely because it can be an antidote to the cover-up of misconduct.<sup>125</sup>

On the other hand, an attorney who is new to a situation, especially an inexperienced one, is particularly prone to rely on social learning as the basis for constructing a schema. The fact that those more senior and more familiar with the situation are behaving as if there is no problem provides a strong cue. This, indeed, is one explanation for the reduced tendency of people in groups to act heroically, since responsibility is effectively diffused.<sup>126</sup> To this, naturally, must be

---

124. Note that nothing that we have described suggests that the ego-biased lawyer operates under any disability in the processing of information generally. She may be particularly perceptive in most of the information processing tasks that lawyers perform, for example, perceiving threats to client interests or the motives of others.

125. See, for example, Jack Katz, *Concerted Ignorance: The Social Construction of a Cover-up*, 8 Urb. Life 295, 306-09 (1980); Staw, 6 Acad. Mgmt. Rev. at 585 (cited in note 115). For a set of articles on the translation of social cognition research to organizational behavior, see Henry Sims and Dennis Gioia, eds., *The Thinking Organization* (Jossey-Bass, 1986). Although junior persons, or others rotated into a representation do not make a commitment to that representation specifically, bias still might result from the prior commitment to the firm.

126. See Cialdini, *Influence* at 126 (cited in note 92); Bibb Latane and John Darley, *Group Inhibition of Bystander Intervention in Emergencies*, 10 J. Pers. & Soc. Psych. 215 (1968). In groups, moreover, the simple diffusion of information will reduce the likelihood that any one member will suspect the fraud, even in cold cognitive terms.



added the situational pressures on junior members of groups to conform to apparent norms.<sup>127</sup>

### E. OPM as an Illustration

As noted earlier, one of the most frequently adduced illustrations of lawyers' involvement in client fraud involved the law firm of Singer Hutner Levine & Seeman in its representation of *OPM Leasing Services, Inc.*<sup>128</sup> To summarize the complexly fascinating story,<sup>129</sup> OPM, an equipment leasing company, grew to a large size primarily through fraudulent financing. The same collateral was pledged multiple times, with concealment through forgeries and other defalcations. OPM's chief principals had actively and knowingly engaged in the fraud, and had assembled a team of loyal subordinates to assist them.

The aspect of the OPM scandal that has intrigued people the most relates to the participation of law firm Singer Hutner,<sup>130</sup> which prepared the documentation and closed nearly all the fraudulent transactions. Did the firm's principal partners know or consciously disregard the wrongdoing? The motive, as many have noted, was plain: the firm was disproportionately dependent on OPM for their revenues. The majority of Singer Hutner's business was OPM-related.

As the story is recounted, bright red flags abound. OPM's principals were indicted for a prior check-kiting scheme. Office routines and procedures were unusual. Certain auditing representations were withheld. Later, some accounting personnel resigned, warning that cash-flow

---

127. Irving Janis has termed the stress-related pressures toward group conformity "groupthink." Irving Janis, *Groupthink: Psychological Studies of Policy Decisions and Fiascos* (Houghton Mifflin, 1982). Groupthink in legal settings is noted in James C. Freund, *Advise and Invent: The Lawyer as Counselor—Strategies and Other Essays* 28-33 (Prentice Hall, 1990). For interesting discussions of ethical responsibilities when lawyers are acting in teams, see Twitchell, 72 Minn. L. Rev. 697 (cited in note 90); Harold Levinson, Book Review: *Ethics Inside the Law Firm*, 36 Vand. L. Rev. 847 (1983); Harold Levinson, *To A Young Lawyer: Thoughts on Disobedience*, 50 Mo. L. Rev. 483 (1985).

128. *In re OPM Leasing Services, Inc.*, 46 Bankr. 661 (S.D.N.Y. 1985). See text accompanying notes 5-7.

129. The primary source document exploring the OPM matter is the Report of the Bankruptcy Trustee, *In re OPM Leasing Services Inc.*, No. 81-B-10533 (Bankr., April 25, 1983), an extensive investigatory report prepared by the law firm of Wilmer, Cutler & Pickering as counsel for the trustee. OPM is also the subject of a book by Gandossy, entitled *Bad Business* (cited in note 5) and extensive journalistic commentary. See Stuart Taylor, *Ethics and the Law: A Case History*, N. Y. Times Mag. at 31 (Jan. 9, 1983). The Gandossy book is a thoughtful application of social psychological principles to the OPM case (see especially ch. 12), and makes some of the same points discussed here.

130. Since the firm is an entity, it is misleading to speak of what it knew. At least one of its partners, Andrew Reinhart, had a close personal relationship with the primary wrongdoers, and his knowledge, which would be attributed to the firm for liability purposes, may have been substantial. More representative would be the state of mind of the principal senior partner, Joseph Hutner.

problems were nearly insurmountable. Ultimately, OPM's principals confessed to their lawyers a significant volume of fraud, but the law firm kept doing closings after receiving simple, albeit emotional, assurances that the fraud had ceased. All this time, a relatively straightforward set of steps, most notably assembling accurate records regarding the collateral, would have exposed the wrongdoing. Singer Hutner finally did resign as counsel when events made the on-going character of the fraud unmistakable, although it did not pass this information on to successor counsel.

To any objective observer, the law firm's overall nonfeasance seems consciously reckless, perhaps even willful. Yet the firm's principals claim innocence, except for the commonplace and mild: "In retrospect, we probably should have. . . ." The credibility of that claim is, of course, hard to assess. Their story is hardly implausible from a psychological perspective, however. As danger signs were becoming more visible, the firm retained two well-known ethics consultants, an odd behavior for lawyers consciously engaged in wrongdoing.<sup>131</sup> The lawyers' commitment to OPM, well before any danger signals emerged, was plain. They were rapidly increasing their income and stature in the legal community, something that no doubt contributed to high reserves of self-esteem. Each of the negative, disconfirming bits of evidence was diluted by a constant display of positive signals—increasing business, highly publicized awards to some of OPM's principals for charitable and religious work—as well as a numbing routine.<sup>132</sup> Perhaps most important, the lawyers saw many others with direct interests at stake—OPM's lenders (including many major banks), its accountants and its investment bankers (Goldman Sachs)—acting without undue concern: a dramatic instance of social learning. There were, in other words, plenty of cues to support a strong preconscious bias toward preservation of a positive schema, which would block any cognitive shift to greater vigilance. To this was added one other common reasoning flaw: once the past fraud was uncovered, the lawyers imagined themselves in the position of the OPM officials and concluded that under no circumstances would they be so foolish as to continue it.<sup>133</sup> While particularly

---

131. Gandossy, *Bad Business* at 136-38 (cited in note 5). The ethics consultants, including the dean of Fordham Law School, were not asked to make a de novo assessment of the facts, and relied on information supplied by the firm to give their blessing to its continued involvement with OPM. Joseph Hutner also consulted with a number of professors at Harvard Law School. *Id.* at 255 n. 19.

132. The presence of routine (for example, paperwork, established bureaucratic procedures) as having the capacity to induce a false sense of comfort and diminished vigilance is made in Harold Wilensky, *Organizational Intelligence* 91-92 (Basic Books, 1967). See Gandossy, *Bad Business* at 211-12.

133. Gandossy, *Bad Business* at 144. See Robyn Dawes, *Rational Choice in an Uncertain*

vivid in the OPM situation, similar motivational influences can be found in other notable lawyer-assisted frauds.<sup>134</sup>

### F. The Credibility Problem

A common observation regarding lawyers' state of mind in liability settings is that what matters is not so much what the lawyer thought as what a judge or jury later thinks she thought.<sup>135</sup> As in OPM, there is a severe problem of credibility when lawyers claim lack of awareness or conscious appreciation of significant risk. The social cognition research simply strengthens the plausibility of such claims. No one, however, can deny that in a substantial number of cases, actual knowledge or conscious disregard does occur and subsequent excuses are disingenuous.<sup>136</sup>

Precisely how judges or juries will respond to the credibility problem is unpredictable, influenced by a host of situational factors, such as witness demeanor, character testimony and lawyering quality. Two aspects of the social cognition literature suggest, however, that all other things being equal, factfinders frequently will reject lack-of-awareness claims. First, none of the cognitive filtering mechanisms that infect ego-involved actors will affect unbiased observers, and they will not experience comparable difficulty perceiving the intensity of the red flags. Their schemas differ radically from the outset, and the circumstantial evidence of awareness will seem quite damning. Observers also show a strong bias toward dispositional attributions:<sup>137</sup> they explain failures in

*World* 245-46 (Harcourt Brace Jovanovich, 1988) (describing similar thinking on the part of Israeli officials before the Seven Days war). This tendency is closely related, if not the same as, the false consensus effect. See note 114; Thomas Gilovich, *Differential Construal and the False Consensus Effect*, 59 *J. Pers. & Soc. Psych.* 623 (1990); Dale Griffin and Lee Ross, *Subjective Construal, Social Inference, and Human Misunderstanding*, in Mark Zanna, ed., 24 *Advances in Experimental Social Psychology* 319, 345 (Acad., 1991).

134. For example, in *SEC v. National Student Marketing*, 457 F. Supp. 602 (D.D.C. 1978), the lawyers had invested substantial time and effort in creating the merger, something strongly likely to bias perception toward its consummation. Similarly, in *Carter and Johnson* [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847 (Feb. 28, 1981), we can observe an escalation of lawyer commitment through a series of small early steps.

135. See, for example, Hodes, 35 *U. Miami L. Rev.* at 804 n.233 (cited in note 20).

136. Even when wrongdoing properly may be characterized as intentional, a person may develop excuses that she later believes, an exercise in self-deception. See Charles Snyder, *The Excuse: An Amazing Grace?*, in B. Schlenker, ed., *The Self and Social Life* at 235, 252-53 (cited in note 88).

137. See, for example, Lee Ross and Richard E. Nisbett, *The Person and the Situation: Perspectives of Social Psychology* 87-89, 140-41 (Temple, 1991); Fiske and Taylor, *Social Cognition* at 72-75 (cited in note 79). To the extent that a lawyer is part of a group, some of the attributional problem may be avoided. See Valerie P. Hans and M. David Ermann, *Responses to Corporate Versus Individual Wrongdoing*, 13 *L. & Human Behav.* 151 (1989). The problem is a complicated one, since a reverse process also can work. If the factfinder can be led to construct an initial story or schema that assumes that the lawyer is a good person, based on her reputation, demeanor or testimony, the likelihood of finding wrongdoing in fact may diminish. For an interest-

terms of character flaws, with insufficient attention to situational influences. While it is by no means inevitable, a factfinder may be more likely to blame lawyers than is reasonable.<sup>138</sup>

The second concept is what psychologists refer to as the hindsight bias. Studies show that persons asked to assess the likelihood that some event would occur are affected strongly by knowing that the event did occur.<sup>139</sup> Persons with such knowledge will overestimate the risk considerably. What might be an ambiguous warning to even an objective actor will seem clear cut to a juror informed at the outset of trial of the calamity and its consequences. Research, then, has provided empirical support for the commonplace fear of the liability risks associated with 20/20 hindsight.

### G. Another Assessment

Whether we should place so much trust in social cognition research that we allow it to influence the formulation of legal strategies is a bothersome question. Social science theory is better suited to offer perspective than proof, and dominating legal paradigms will not retreat meekly from the assumption of pervasive rationality,<sup>140</sup> especially when the subject is lawyering. What the social cognition material does best is arm those already inclined, by observation or experience, toward a view of legal practice in which the influences of ego, self-deception and blind

ing discussion of the "story" model of factfinder decisionmaking, drawing on many of the principles of social cognition, see Nancy Pennington and Reid Hastie, *Explaining the Evidence: Tests of the Story Model for Juror Decision Making*, 62 *J. Pers. & Soc. Psych.* 189 (1992). See also Michael J. Saks and Robert F. Kidd, *Human Information Processing and Adjudication: Trial By Heuristics*, in Arkes and Hammond, eds., *Judgment and Decision Making* 213 (cited in note 96).

138. For a view that blaming can be a product of the observer's need to explain the actor's behavior in a way that makes it appear deviant and thus less threatening, see Kelly G. Shaver, *The Attribution of Blame: Causality, Responsibility, and Blameworthiness* 132-36 (Springer-Verlag, 1985). For an overview of how blaming behaviors are learned, see Thomas R. Schulz and John M. Darley, *An Information-Processing Model of Retributive Moral Judgments Based on "Legal Reasoning,"* in William M. Kurtines and Jacob L. Gewirtz, eds., *2 Handbook on Moral Behavior and Development* 247 (Lawrence Erlbaum, 1991).

139. See Jonathan D. Casper, Kennette Benedict and Jo L. Perry, *Juror Decision Making, Attitudes, and the Hindsight Bias*, 13 *L. & Human Behav.* 291 (1989); Baruch Fischhoff, *Perceived Informativeness of Facts*, 3 *J. Exp. Psych.; Human Percept. & Perf.* 349 (1977); Baruch Fischhoff, *For Those Condemned to Study the Past: Heuristics and Biases in Hindsight*, in Daniel Kahneman, Paul Slovic, and Amos Tversky, eds., *Judgment Under Uncertainty: Heuristics and Bias* 335 (Cambridge, 1982); Fiske and Taylor, *Social Cognition* at 376-77 (cited in note 79); Edwards and Von Winterfeldt, 59 *S. Cal. L. Rev.* at 243-44 (cited in note 81).

140. See text accompanying notes 171-73. The idea of diminished responsibility by virtue of unconscious impulses has long been debated in criminal law, with recognition that what may be plausible psychological theories fit uneasily in the legal framework of guilt and innocence. See, for example, Michael S. Moore, *Responsibility and the Unconscious*, 53 *S. Cal. L. Rev.* 1563 (1980); Stephen J. Morse, *Failed Explanations and Criminal Responsibility: Experts and the Unconscious*, 68 *Va. L. Rev.* 971 (1982).

spots compete with rationality and mindfulness—but not so cynical that they attribute the vast bulk of lawyer nonfeasance to simple greed or failures of will. Social cognition does help us account for why there is so little acknowledgement of guilt or responsibility in business and politics, even though there is so much harm.<sup>141</sup>

If we choose to credit it, the message of the psychology research is a simple one, and should not be overstated: In a representational setting, a lawyer's ability to detect client fraud is diminished by cognitive bias. Diminished is the key word; the ability to detect fraud is by no means rendered impossible. There are plenty of cases of intentional and subjectively reckless assistance, and plenty of disingenuous excuses. We simply have another behavioral explanation to consider before confidently hypothesizing about the apparent incidence of lawyer complicity.

Whether there is a legal message is speculative, for we have no way of knowing how frequently the behavioral explanation is the best one. Absent empirical evidence, we only can guess. But if the behavioral explanation is accurate with some frequency, then there will be a strong impact on the legal standard when liability requires a subjectively culpable state of mind. To the extent that factfinders generally make accurate state of mind determinations, the behavioral explanation would circumscribe the attorney's scope of liability noticeably. This sort of gatekeeper liability would be less than potent, and the expected return on our investment of enforcement resources would be comparatively low. There is some reason to doubt the ability of factfinders to judge state of mind accurately, however, and to expect some bias in favor of liability. While this will expand the incidence of liability findings, it does so by effectively introducing something more akin to a legal regime based on objective fault, i.e., negligence or gross negligence. It may be that the major consequence of moving to a "knowledge plus" state of mind standard for attorneys' liability, as many courts have done in the securities area, is to protect against this risk of error and assure the limited liability net.<sup>142</sup>

To the extent that the prevailing liability standard is based on negligence, the message of the social cognition literature is different. From a doctrinal standpoint, the absence of conscious disregard of risk does

---

141. On tobacco company executives' ability to disbelieve evidence regarding the harms of smoking, see Aronson, *The Social Animal* at 179 (cited in note 79). For an interesting account of the decision of Beech-Nut executives to authorize the dilution of apple juice with foreign materials, drawing heavily on cognitive dissonance materials, see Zimbardo and Leippe, *The Psychology of Attitude* at 120-21 (cited in note 88).

142. See text accompanying notes 44-46. As in cases like *Schatz* and *Abell*, the presence of the high-conscious-intent standard makes it possible to remove cases from jury consideration simply because of plaintiffs' failure to plead facts to suggest such a state of mind.

not preclude a factfinder from determining that the lawyer's conduct failed to satisfy the social norm of due care.<sup>143</sup> Gatekeeper liability structures, however, generally are justified on the assumption that they provide incentives to careful client monitoring. Lawyers with a diminished cognitive capacity for monitoring may not be the best candidates for that role. For this strategy to succeed, we must assume that either the law can reduce the incapacity or that efficient institutional structures will develop to minimize the risks associated with the cognitive imperfections of individual lawyers. The next section tests those assumptions.

#### IV. THERAPEUTIC INTERVENTION

Our discussion to this point has been descriptive, not normative. We have considered reasons why there might be an unexpectedly high level of apparent lawyer complicity in client fraud, without saying anything about the quality of the prevailing norms or whether anything should change as a matter of policy. This Part visits those questions by thinking through how the psychological insights might inform the policy debate. In so doing, we shall simply assume that diminished cognitive capacity is a nontrivial explanation for lawyer complicity.

Both individuals and social institutions adapt to ecological change. To suggest that cognitive tendencies diminish the ability to comprehend the harm that one causes is not to imply that the condition is incurable. If the perception of lawyer complicity is problematic, we should consider whether patterns of behavior might evolve or be induced to remedy it. We shall first examine whether there are reputational incentives—at the individual, firm or profession levels—to neutralize the incentives that induce complicity. Then we will discuss the efficacy of altering the prevailing legal regime to make lawyers more sensitive to the risk of client misconduct.

##### A. Reputational Incentives

The role of reputation in marketplace behavior is an often-studied phenomenon. To economists, a good reputation is an asset to be cultivated, preserved, rented out or wasted.<sup>144</sup> Accountants, lawyers and in-

---

143. The element of intent is one of the features distinguishing criminal from tort law. See, for example, Kenneth G. Dau-Schmidt, *An Economic Analysis of the Criminal Law as a Preference-Shaping Policy*, 1990 Duke L. J. 1, 25-26.

144. See, for example, Kraakman, 2 J. L. Econ. & Org. at 96-100 (cited in note 11); Ronald J. Gilson and Reiner H. Kraakman, *The Mechanisms of Market Efficiency*, 70 Va. L. Rev. 549 (1984); Ronald T. Gilson and Robert H. Mnookin, *Sharing Among Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 Stan. L. Rev. 313, 356-68 (1985).

vestment bankers, in particular, have strong reasons to put their reputational capital to profitable use. We might expect these professionals to seek to avoid complicity for reputational reasons alone, and to respond promptly to evidence of abuse. In aiding-and-abetting cases, the Seventh Circuit has referred specifically to the check of reputational interest, invoking heavy pleading burdens that force plaintiffs to explain why professional firms would be willing to risk their reputations for the simple receipt of hourly fees from a corrupt client.<sup>145</sup>

From a psychological perspective, reputation is different, a catch-all that describes the schemas that people develop about others to generate expectations about their future behavior. Like all schemas, reputation often is built from a limited set of first-hand observations, extensively supplemented by social learning. A good reputation can be fortuitous, but once established is quite resistant to change. It readily becomes self-fulfilling. Likewise, people's impressions of their own reputations rarely are realistic, but do have the same prophetic capacity.

There are numerous reasons to doubt that either the legal or social cognitive version of reputation would by itself cause lawyers to become more circumspect in dealing with existing clients. Foremost, we can question whether an instance of complicity really will generate a serious marketplace penalty. While some clients do require reputational assistance by their lawyers in business transactions, many others will prefer zealous representation and strategic counselling, leaving bonding assistance to other mechanisms, if desired at all. A firm charged with going too far in the representation of a client may find other and prospective clients unbothered, perhaps even pleased. Skillful public relations can soften any concern about moral turpitude: individual personnel can be scapegoated, prosecutors or plaintiffs can be charged with excess, and the firm can portray itself as the victim of client deceit. The reputational feedback, in other words, readily can be neutral or ambiguous.<sup>146</sup>

---

145. See *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 495 (7th Cir. 1986). See also *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir. 1990) (noting that it would be irrational for the accountants to risk their reputations with involvement in a fraud); *SEC v. Price Waterhouse*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,914 (S.D.N.Y. July 29, 1992). It often has been noted that individual lawyers and accountants have different preferences from their firms. They may be tempted to risk the firm's reputational capital in return for pecuniary or career-specific gain, and the firm's supervisory procedures simply may be insufficient to deter them.

146. For an interesting discussion of how moral turpitude often has no marketplace penalty, noting the ambiguity of reputational feedback, see Amar Bhide and Howard H. Stevenson, *Why Be Honest if Honesty Doesn't Pay*, Harv. Bus. Rev. 121, 125 (Sept.-Oct. 1990). On the need for unambiguous feedback as the basis for accurate social learning, see text accompanying notes 98-99. Some journalists have commented that the Kaye Scholer firm (see note 2) has not suffered significantly from its involvement with Lincoln Federal, in part because of a major public relations campaign designed to make itself appear the victim. See France, *Legal Times* at 28 (cited in note 2); Susan Beck and Michael Orey, *They Got What They Deserved*, Am. Law 68 (May 1992).

Even aside from this, we can be exceedingly skeptical that the reputational incentive alone can motivate individual lawyers to be more vigilant in assessing their clients' situations. True, the public repetition of stories of lawyer complicity may trigger some self-reflection and re-consideration of one's own client relationships. The message of the literature on motivated reasoning, however, is that the ego protection and stress reduction provided by preconscious cognitive buffers is not so easily overcome.<sup>147</sup> Moreover, these buffers in the marketplace have an adaptive quality that leads to less conflicted, more client-centered performance of most legal tasks.<sup>148</sup> Most successful lawyers will view the misfortune that befalls some of their colleagues as excusable (e.g., the colleague will be seen as a victim) or they will attribute it to venality or other flaws to which they think themselves not so susceptible.

Law firms will approach the reputational problem somewhat differently. The risk of lawyer blind spots is one of a number of reputational threats to the firm. Corruption by individual lawyers must be controlled. Practices such as the lock-step compensation systems once prevalent in large law firms<sup>149</sup> and the careful scrutiny of clients<sup>150</sup> can be understood as efforts to deal with the moral hazard problem. There are practical limits, however, to firms' motivation and ability to detect and monitor fraud. A number of institutional devices can be implemented in an effort to overcome some of the cognitive biases that we have observed. Such devices include rotation of personnel,<sup>151</sup> inducing greater familiarity with categories of red flags through in-house education programs,<sup>152</sup> recordkeeping regarding all suspicious circumstances and, most important, peer review, which introduces noncommitted

---

147. See text accompanying notes 109-23.

148. See text accompanying notes 123-24. These adaptive qualities make it far less likely that lawyers' collective consciousness will be raised effectively over time. In contrast, racism and sexism have little, if any, adaptive value in a professional setting. Thus, predicting that "client-centric" biases will diminish in the same way as racial or sexual stereotypes may be overoptimistic.

149. See Gilson and Mnookin, 37 *Stan. L. Rev.* at 384-89 (cited in note 144). As the authors note, such practices are under great stress as clients become more savvy and willing to shop around, using multiple law firms on a transaction-specific basis, and as lawyer mobility increases. See also Gilson, 49 *Md. L. Rev.* 869 (cited in note 8), for an update on the questionable viability of lawyers as gatekeepers in such an environment.

150. For a useful discussion of various screening mechanisms law firms might adopt, see Mary C. Daly, *Lawyering After Kaye, Scholer: Preventing the Problems Before They Arise*, in Jonathan J. Leiner, *The Attorney-Client Relationship After Kaye, Scholer* 183 (P.L.I., 1992).

151. See note 125.

152. Much work in this direction has been undertaken with respect to the training of auditors. See, for example, W. Steve Albrecht, David J. Cherrington, I. Reed Payne, Allan V. Roe and Marshall B. Romney, *Auditor Involvement in the Detection of Fraud*, in Robert K. Elliott and John J. Willingham, eds., *Management Fraud: Detection and Deterrence* 207 (Petrocelli, 1980). That volume contains a number of articles from a social psychological perspective on the control of fraud.



points of view to the process of representation.<sup>153</sup> Each of these bureaucratic interventions comes at considerable cost, however, in terms of time and effort as well as the more subtle interference with individual partner autonomy that otherwise characterizes many highly successful firms. Such steps also may threaten working relationships with many clients, signalling an environment of mistrust rather than loyalty. Moreover, none of these interventions is even remotely foolproof.

Nor is it clear that the expected return would make these reputational expenditures profitable. As Reiner Kraakman has observed,<sup>154</sup> outsiders often lack the ability to distinguish among firms, so they apply average reputations derived from a broad market segment. The firm that invests heavily in an internal monitoring system will not reap a commensurate reward unless it can distinguish itself from competitors' imitations. The first firm attempting to pass on those costs probably will be rebuffed.

For the profession as a whole, there are some possibilities through bar association activities.<sup>155</sup> Law schools might try to alter the cognitive biases before the young lawyer begins her professional career.<sup>156</sup> Continuing legal education could play a comparable role. Standardized monitoring procedures, such as agreements as to what precautionary steps are appropriate in transactional representations, in some cases could minimize the competitive disadvantage incurred by firms hesitant to be too far out front of their peers. Transactions come in such a wide variety, however, that standard procedures must be at a high level of generality, leaving ample room for both honest misunderstanding and cheating. Moreover, there are likely to be substantial difficulties in arriving at an appropriate consensus given the diversity of providers of legal services and their conflicting interests. Finally, the growing internalization of legal services by clients further limits the bar's ability to standardize more costly forms of representation in the name of its own reputational interest.<sup>157</sup>

---

153. See, for example, Janis and Mann, *Decision-Making* at 367-404 (cited in note 88).

154. Kraakman, 2 J. L. Econ. & Org. at 97-98 (cited in note 11).

155. For a thoughtful discussion of self-regulatory steps, see James H. Cheek, III, *Professional Responsibility and Self-Regulation of the Securities Lawyer*, 32 Wash. & Lee L. Rev. 597 (1975).

156. In all likelihood, individual lawyers will never be resistant to commitment-generated biases unless and until they see their relationship with a client as something different from a commitment. Given the ABA's celebration of loyalty and commitment, it may be impossible to generate more perceptive, as opposed to more ethical, lawyers.

157. See Gilson, 49 Md. L. Rev. at 913-15 (cited in note 8). The ethical issues relating to the internalization of legal business by clients are reviewed in Robert Eli Rosen, *The Inside Counsel Movement, Professional Judgment and Organizational Representation*, 64 Ind. L. J. 479 (1989). See also Ted Schneyer, *Professionalism and Public Policy: The Case of House Counsel*, 2 Georgetown J. Legal Ethics 449 (1988). Naturally, the sort of biases identified with respect to outside

*B. Legal Incentives*

The foregoing should make clear that if we are unsatisfied with the perceived incidence of attorney complicity in client fraud, then some tinkering with legal incentives is necessary. Without underestimating the practical difficulty of this task, given the fragmented legal structure governing attorney behavior,<sup>158</sup> we should consider at least in theory whether strengthening the general norm is likely to be an efficient method of thwarting client fraud.

There are a number of public- and private-law strategies that could alter the prevailing legal structure. As we have seen, there has been a tendency to undermine the general norm through a niggardly application of the substantial assistance standard even in cases where attorneys are alleged to have acted with full knowledge of client misconduct.<sup>159</sup> The norm could be strengthened by presuming that full-service legal assistance in a business transaction constitutes substantial assistance. Alternatively, and more aggressively, we could expand the due diligence responsibilities of attorneys in business transactions. Even without doctrinal change, modification could come from adding new public or private enforcement resources, which would increase the likelihood of detection and prosecution.

The expected benefits of strengthening the gatekeeper regime depend on the nature of the changes made. Given the psychological impediments preventing lawyers from acknowledging their own complicity, low-level changes are unlikely to have much direct impact on individual behaviors.<sup>160</sup> So long as the standards of lawyer conduct remain highly conflicted—an ambivalence that characterizes today's legal rules—the cognitive status quo is likely to be preserved.

Presumably, however, some level of fear would change the calculus. With assistance from bar associations, firms at least could be expected to respond to the additional liability exposure. Clients needing outside legal assistance could be expected to develop procedures that simplify the lawyers' precautionary steps. But once again, skepticism is in order. Neither cultures nor power structures change easily, and the autonomy of individual partners in a firm is embedded strongly in both.<sup>161</sup> In business settings, there is much evidence that compliance procedures rarely

---

lawyers likely apply a fortiori with respect to inside counsel.

158. Another complicating factor is the fact that most standards, like Rule 10b-5, are not lawyer-specific and cannot be adjusted without impacts far beyond the problem at hand.

159. See text accompanying notes 48-54.

160. In particular, rules that sanction knowing involvement are ineffective with respect to cognitive blindness; reactive negligence rules—i.e., those that expect the lawyer to react to red flags—suffer from the same problem.

161. See Nelson, *Partners with Power* at 37-86 (cited in note 90).

work as designed. Psychologically, attorneys in many firms are likely to acknowledge the presence of legal risk, but minimize it unduly with respect to their own trusted partners. Finally, there are problems with respect to multiple contracting and "black market" searches by clients seeking pliant counsel.<sup>162</sup>

To the extent that stricter liability rules plausibly would generate some gatekeeper benefits, next come questions of cost. Once again, precautionary steps are expensive; insofar as precaution is imperfect, the residual risk must either be internalized or dealt with through pricing or insurance. There are also more subtle costs. Changing the legal standards to make claims against lawyers easier to bring means not only that litigation and administrative costs will increase, but also that the incidence of low- or no-merit claims will mount as well, with the consequent resource drain and reputational damage.<sup>163</sup> If lawyers become too skittish, they may resign prematurely, when in fact the client is not engaged in fraud.<sup>164</sup> Law firms may become less willing to take on unknown, speculative clients<sup>165</sup> or more likely to charge them a risk premium, a particular burden for smaller businesses. And there is the concern, albeit extremely speculative, about chilling communications between attorney and client.<sup>166</sup> All these are familiar fears, stated

---

162. See Kraakman, 2 J. L. Econ. & Org. at 69-74 (cited in note 11). Gatekeeping also may be undermined to the extent that clients parcel out small aspects of a single project to a group of lawyers, none of whom has the level of involvement necessary to comprehend the situation fully.

163. For a significant study documenting the likelihood that even low-merit claims will be settled, see Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497 (1991). Interestingly, California has a statutory provision designed to make pretrial dismissal of claims against lawyers easier when they are alleged to have improperly conspired with their clients, and this has been applied to aiding-and-abetting-type claims. See *Howard v. Superior Court*, 3 Cal. Rep. 2d 575 (Cal. Ct. App. 1992). Presumably, this sort of process is justified on reputational grounds, although self-serving motivations may not be unduly hard to find.

164. See Lorne, 76 Mich. L. Rev. at 455-57 (cited in note 4). That would not only disrupt the lawyer-client relationship but also would threaten both reputational and confidentiality interests if the resignation is sufficiently noisy. See note 22.

165. See Lowenfels, 74 Colum. L. Rev. at 436 (cited in note 4).

166. On one hand, it seems self-evident that clients who fear that lawyers might withhold services if they learned the wrong thing would themselves limit the amount of information available to the lawyers, thus reducing the quality of legal advice and perhaps, the lawyer's ability to alter the client's plans. See Lorne, 76 Mich. L. Rev. 423 (cited in note 4). In *DiLeo v. Ernst & Young*, 901 F.2d 624 (7th Cir. 1990), the court observed with respect to accountants' obligations that under a strong gatekeeper regime "[f]irms would withhold documents, allow auditors to see but not copy, and otherwise emulate the CIA, if they feared that access might lead to destructive disclosure—for even an honest firm may fear that one of its accountant's many auditors would misunderstand the situation and ring the tocsin needlessly, with great loss to the firm." *Id.* at 629. Others have pointed out, however, that the *existing* legal environment provides far less protection to confidentiality than initially meets the eye (with the crime-fraud and attorney self-defense protections, for instance), yet there is no documented evidence of such a chill right now. See, for example, Rhode, 37 Stan. L. Rev. at 612-14 (cited in note 13); Subin, 70 Iowa L. Rev. 1091 (cited in

loudly during the last decades' debates over whistle-blowing. But none can be dismissed out of hand.

In the end, deciding whether to alter the prevailing legal regime can be nothing more than a "best guess" as to whether the likely benefits exceed the expected costs.<sup>167</sup> Given the lack of base-rate data regarding how much fraud, or lawyer complicity exists or data to quantify the specific costs that a stricter liability standard would cause, there is little reason to hope that any such guess will be particularly accurate. My own intuition is that the benefits of increasing sanctions would be minimal, and the costs at least equal. If the psychologists are right, however, intuitions—mine, or those of judges and other policymakers charged with administering the legal regime—are extraordinarily suspicious when they deal with questions as affective and value-laden as these.

## V. CONCLUSION

To help understand the phenomenon of lawyers aiding their clients' fraud, our discussion has offered two accounts beyond the simplistic hypotheses of venality and stupidity. To some extent lawyers' behavior may be shaped by conflicted legal rules that in many ways undermine the general norm against knowingly assisting client fraud. The weakening of the norm as applied signals lawyers that the competing norms of loyalty and confidentiality are primary, encouraging rationalization of continued involvement. Second, and perhaps more important, there are reasons derived from research in social cognition to doubt that lawyers will be very good gatekeepers once they have committed to representation and built a positive schema regarding the client and the situation. Finally, we have suggested that while change is possible through the modification of legal rules, we can be skeptical of its likely efficacy.

We end with an irony. Work in social cognition predicts that its

---

note 5); Fred C. Zacharias, *Rethinking Confidentiality*, 74 Iowa L. Rev. 351, 378, 376 (1989) (offering evidence that confidentiality rules have relatively little effect on the behavior of clients in a litigation setting). It does seem likely that clients who believe that they have little to hide will place trust in their chosen lawyers regardless of the legal rules. Those with adverse facts in their possession are likely to withhold it in any event, and are probably quite confident in their ability to deceive their lawyer. In organizations, information blockages are likely to result from sources having little to do with expectations of confidentiality. See, for example, John C. Coffee, Jr., *Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response*, 63 Va. L. Rev. 1099, 1131-32 (1977).

167. Kraakman, 2 J. L. Econ. & Org. at 78 (cited in note 11). For a skeptical review of whether the cost-benefit calculus is likely to be improved by imposing greater due diligence responsibilities on auditors, see John A. Siliciano, *Negligent Accounting and the Limits of Instrumental Tort Reform*, 86 Mich. L. Rev. 1929, 1960-68 (1988) (stressing the evasive nature of auditors' responses to increased liability).

own conclusions, particularly those based on pervasive situationalism, will never be broadly embraced, no matter how well they are established empirically. One of the strong themes in the social cognition literature is the need for order and causal explanation. In judging others, we look for dispositional flaws that explain why things went wrong, rather than acknowledging the complex presence of situational factors that make the action more ambiguous.<sup>168</sup> The act of blaming someone offers comfort and stability, for we can marginalize the wrongdoers as deviant rather than the threatening product of chance.<sup>169</sup> In many ways, our legal system generally, on issues far beyond lawyer involvement in client fraud, serves to polarize the process of judging others, providing a useful social illusion. Outsiders' strong perceptions of lawyer complicity—the venality hypothesis—may be a product of this need, aided by negative associations with impressions of excess litigiousness and too much lawyer wealth. Perhaps these perceptions are unfair.<sup>170</sup>

Nor are lawyers likely to take a strong situationist perspective. From the first day of law school, the legal profession celebrates hyperrationality,<sup>171</sup> and so will hardly endorse a widespread characterization of attorney behavior in which ego-driven thought processes interfere with mindful scrutiny of the available facts and circumstances. That characterization is too threatening to the profession's self-esteem. Instead, we would guess that attitudes within the profession will be polarized, albeit in similarly self-protective ways. Consistent with the ego protection associated with excessive blaming, some will call for exceptionally harsh treatment of deviant lawyers who have breached the sacred trust. Others, by contrast, will develop attitudes that are too forgiving of their reputable colleagues. While excessive blaming may be the norm, insufficient blaming is a predictable tendency when those passing judgment see so much of themselves in the actor and the situation that they are unable to dismiss the behavior as mere deviance.<sup>172</sup> The fearful “there

---

168. See Nisbett and Ross, *Human Inference* at 3-4, 204 (cited in note 98).

169. See Shaver, *The Attribution of Blame* at 132-34 (cited in note 138); Jack Katz, *Seductions of Crime* 316-17 (1988); Melvin Lerner, *The Belief in a Just World* 20-22, 118-22 (1980). See also note 138.

170. For an interesting discussion of how policymakers should deal with biased perceptions by the public involving societal risks, see Sarah Lichtenstein, Robin Gregory, Paul Slovic and Willem A. Wagenaar, *When Lives are in Your Hands: Dilemmas of the Societal Decision Maker*, in Hogarth, ed., *Insights in Decision Making* at 91 (cited in note 90).

171. Legal academics, too, are likely to resist these characterizations for a variety of reasons, one of the most significant of which is that it diminishes the role of law in behavior and hence the authority of legal reasoning. See Langevoort, 140 U. Pa. L. Rev. at 916-19 (cited in note 85).

172. See Shaver, *The Attribution of Blame* at 135 (cited in note 138). The judging of moral (and presumably legal) responsibility also is affected by class and other factors. Persons of lower status positions are more willing to accept excuses based on submission to authority, presumably

but for the grace of God go I" may lead preconsciously to attitudes about lawyer complicity that too readily accept duping or similar explanations. For reasons apart from crass self-protectionism, then, a legal system administered largely by judges and lawyer policymakers could evolve over time to be excessively accommodating to their once or future colleagues if that cognition dominates.<sup>173</sup>

So, we have a problem—if there is one at all—that few people are motivated to evaluate without bias. There may be good reason to accept more willingly the excuses of lawyers strangely blind to their clients' fraud. Consistency, however, suggests that we should not do so without acknowledging that comparable blindness affects many nonlawyers whom we smugly blame in tort and criminal law as we characterize their conduct as intentional or negligent.<sup>174</sup>

In the end, the issue of lawyer complicity is only dimly illuminated by what we in fact know. The relative incidence of venality, ego-induced blindness and actual duping is something about which we can only wonder. We are thus free to view the issue as we wish, perhaps without realizing the inventive nature of our perception. Sadly, the prevailing rules of attorney behavior probably will continue to reflect a clash of unconscious biases, not rational estimation. In that, however, it differs from other hard legal choices only in the peculiarly self-serving nature of the likely solutions.

---

because of the identification between actor and observer. See Carl W. Backman, *Identity, Self Presentation, and the Resolution of Moral Dilemmas: Towards a Social Psychological Theory of Moral Behavior*, in Schlenker, ed., *The Self and Social Life* at 275-76 (cited in note 88).

173. Without offering this as a primary explanation, we can at least note that many of the doctrinal developments we have traced are consistent with this prediction.

174. Compare Rhode, 37 *Stan. L. Rev.* at 619-20 (cited in note 13) (criticizing lawyers who claim an inability to know of client wrongdoing while holding people generally to sanction under comparable legal rules).

