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Myth of the Attorney Whistleblower

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ABSTRACT

Notwithstanding the political grandstanding and legal regimes put in place to prevent the next Enron, this article explores whether attorney whistleblower provisions provided in the Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer and in the Model Rules of Professional Conduct are effective. When faced with attorney involvement in Enron, Congress passed § 307 of the Sarbanes Oxley Act (Sarbanes), which required the Securities and Exchange Commission (SEC) to amend its standards governing the conduct of attorneys practicing before the SEC. In response, the SEC and the American Bar Association drafted or amended rules to remind attorneys that the client is the company, not its agents, and to enable attorneys to disclose information. The new rules require attorneys to report suspicious activity up the chain, going as far as the board of directors, if necessary, and permits attorneys to "blow the whistle" by reporting externally in some extreme circumstances. These changes were fueled by a belief that a well-informed, willing, and diligent attorney can act as a gatekeeper, stopping its clients from committing corporate fraud or, if the client cannot be stopped, acting as a whistleblower to mitigate harm to the market. Not only are those provisions ineffective, but the entire premise behind those regimes is fundamentally flawed because of its failure to understand the attorney-client relationship, corporate structure, and corporate criminal wrongdoing. For any and all of these reasons, the idea of an attorney as a whistleblower is a myth.

Even worse, the failure of Congress to understand corporate and attorney behavior has left the market exposed to extraordinary criminal wrong-

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doing with only after-the-fact investigations, if anything, available to deter. More importantly, these regimes have left people—you, me, and our families—vulnerable to be preyed on in the name of a corporate profit. This is because at their core, corporate fraud scandals are about deception in conjunction with the use of tactics and structures that are legal and, at times, complex. Legal corporate structuring renders the whistleblowing mandate found in Sarbanes ineffective. Companies still have tools that were essential to the pre-Sarbanes fraud and market manipulation—namely, the ability to use business structures and rules defining the attorney-client relationship to evade detection. This article takes a novel approach of exploring the usage of legal business structures, the placement of attorneys within those structures, and the role these activities have in corporate misconduct.

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I. INTRODUCTION

RECENT media stories have noted that in the modern era, businesses are plagued with scandal that has minimal legal consequence due to lack of enforcement and lack of criminal and civil penalties.[1] Unlike past eras, tort and criminal liability are not serving as a check on corporate misconduct. When combined with a lax regulatory regime and decreasing competition, companies can commit malfeasance

1. *See Scandal Suggests Standards Have Slipped in Corporate America*, Economist (Apr. 6, 2019), https://www.economist.com/business/2019/04/06/scandals-suggest-standards-have-slipped-in-corporate-america [https://perma.cc/494L-LK2G]. Although these scandals do not result in trial verdicts, enforcements, or convictions, they are still costly to companies and have negative impacts on stock prices.

and continue to thrive.[2] Further, a regulatory regime that is centered on disclosure and reporting inundates the market with information that is difficult to understand. It allows bad actors to hide in plain sight. Without crisis and without the market forces of fear of litigation or regulatory enforcement, the incentives to comply come from shareholders and the capital markets.[3] But when the capital markets and shareholders accept what they perceive as worthwhile risks for the gains, it is difficult for attorneys and other gatekeepers[4] to have an impact on management behavior.[5] The attorney, regulatory, and law enforcement desires are at odds in the current corporate climate because the current corporate climate is light on regulation while the market is heavy on the promotion of a corporate culture focused on innovation and disruption.[6] If the ultimate job of the attorney is to represent the corporation's interests on behalf of its shareholders, an attorney whistleblower who desires to follow the letter of the law in a climate that does not enforce the law does more harm than good.[7]

Following the collapse of Enron, which was based primarily upon market manipulation utilizing special purpose entities and illegal accounting practices, Congress passed the Sarbanes-Oxley Act (Sarbanes).[8] Among many changes, Sarbanes increased disclosure and reporting requirements and made changes to accounting rules.[9] Congress responded to the Enron attorney problem in § 307 of Sarbanes,[10] a last-minute amendment to the bill proposed by Senator John Edwards during floor debate.[11] It seeks to acknowledge and provide a remedy to the presence of attorneys at every

2. *See* Elizabeth Pollman, *Corporate Disobedience*, 68 DUKE L.J. 709, 712–14 (2019) (noting the benefits to breaking laws by companies like Uber and the marijuana industry).

3. *Id.* at 755–56 (highlighting the inadequacy of shareholder litigation and fiduciary duties to ameliorate corporate misconduct).

4. *See* Sung Hui Kim, *Gatekeepers Inside Out*, 21 GEO. J. LEGAL ETHICS 411, 413 (2008) [hereinafter Kim, *Gatekeepers Inside Out*] (defining gatekeepers as "private intermediaries who can prevent harm to the securities markets by disrupting the misconduct of their client representatives").

5. *See* Pollman, *supra* note 2, at 712–15.

6. *See* Elizabeth Pollman & Jordan M. Barry, *Regulatory Entrepreneurship*, 90 S. CAL. L. REV. 383, 398 (2017) ("Many regulatory entrepreneurs follow the maxim that it is better to beg forgiveness than to ask for permission. In this context, that means that it is better to enter markets and start providing services to the public—legally or otherwise—than to seek approval from regulators. Companies often justify this behavior by construing some gray area in the law as permitting the action in question. A motivated entrepreneur can often manufacture a legal gray area, blurring the line between outright lawbreaking and aggressive interpretation."). Notably, the examples highlighted by Pollman and Barry have had their manipulation of grey areas rewarded with continued investment. *See, e.g.*, Biz Carson, *Uber IPO: Inside the 2008 Pitch That Birthed an $80 Billion Startup*, FORBES (May 10, 2019), https://www.forbes.com/sites/bizcarson/2019/05/10/uber-ipo-original-2008-pitch-deck/#4bc3b6924a57 [https://perma.cc/7WW7-B5G9].

7. *See* Pollman, *supra* note 2, at 755.

8. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 U.S.C. and 18 U.S.C.).

9. 18 U.S.C. § 1514A(a)(1) (2018); *see also* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1526–27 (2005).

10. 15 U.S.C. § 7245.

11. 148 CONG. REC. S5,652–53 (daily ed. June 18, 2002) (statement of Sen. Edwards).

stage of Enron's fraudulent scheme.[12] Sarbanes and the changes made to accounting standards cover accountants and the action of Arthur Anderson extensively,[13] but until Edwards's proposal, the role of attorneys in the fraud was unaddressed.[14]

As a result of § 307, the Securities and Exchange Commission (SEC) added a requirement to the Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer[15] (SEC Standards[16]) that attorneys practicing before the SEC report evidence of wrongdoing up the ladder within the company, going as high up as a company's board of directors and, in extreme circumstances, externally.[17] The American Bar Association (ABA) also updated the ethical rules for all attorneys.[18] In 2003, the ABA House of Delegates voted to make changes to Model Rules of Professional Conduct (Model Rules) 1.6 and 1.13, confirming the status of the corporation as the client and adapting the SEC's mandatory up-the-ladder and optional external reporting scheme for all attorneys, not just those representing issuers before the SEC.[19] When another crisis emerged in 2008, Congress chose to extend its encouragement of whistleblowing in the Dodd-Frank Act (Dodd-Frank).[20] Congress, regulators, and law enforcement appear to hold the belief that if they had more information sooner, they could prevent fraud on the market. Unfortunately, for shareholders and the capital markets, this belief is mistaken.

The difficulty, or even impossibility, of an attorney assuming the role of a whistleblower is evident in the lack of enforcements, post-Enron, for attorney participation in corporate misconduct.[21] Following the changes, there have been zero SEC actions against attorneys for violations of the SEC Standards developed under the mandate found in Sarbanes. There

12. *Id.*; *see also* STEPHEN M. BAINBRIDGE, THE COMPLETE GUIDE TO SARBANES-OXLEY 110 (2007); Jennifer M. Pacella, *Conflicted Counselors: Retaliation Protections for Attorney-Whistleblowers in an Inconsistent Regulatory Regime*, 33 YALE J. ON REG. 491, 502, 529 (2016).

13. *See* BAINBRIDGE, *supra* note 12, at 186–222.

14. *Id.* at 110; Sung Hui Kim, *Naked Self-Interest? Why the Legal Profession Resists Gatekeeping*, 63 FLA. L. REV. 129, 131–32 (2011) [hereinafter Kim, *Naked Self-Interest?*] (explaining that Sarbanes marks Congress' formal recognition of the lawyer's role as a gatekeeper, but that these efforts were met with aggressive lobbying against the measures by the bar); *see also Corporate Counsel Critique SEC Proposal on Lawyer Reporting Mandated by New Law*, 18 ABA/BNA LAW. MAN. PROF. CONDUCT 698, 698 (2002) (Sarbanes-Oxley regulations put "attorneys in the role of judge rather than advocate").

15. 17 C.F.R § 205.1 (2019).

16. "SEC Standards" refers only to the standards governing lawyers.

17. *See* 17 C.F.R. § 205.3.

18. *See* Lawrence A. Hamermesh, *The ABA Task Force on Corporate Responsibility and the 2003 Changes to the Model Rules of Professional Conduct*, 17 GEO. J. LEGAL ETHICS 35, 36–37 (2003).

19. *See id.* at 35–37; *see also* MODEL RULES OF PROF'L CONDUCT r. 1.6, 1.13 (AM. BAR. ASS'N 2018).

20. *See* 15 U.S.C. § 78u-6 (2010).

21. An extensive review of SEC enforcements from 2002 through August 1, 2019, resulted in zero actions against attorneys for failure to report externally under the limited circumstances found in 1.6 or to report up the chain under Rule 1.13.

are also no disciplinary proceedings for violation of the applicable provisions of the Model Rules. This result is not only in line with the modern era of reduced enforcement, but it is also the result of the distorted "prisoner's dilemma"[22] that faces an attorney whistleblower and even some attorneys who attempt to act as gatekeeper. Instead of the traditional, clear incentive to do the right thing or face punishment, the lack of enforcement incentivizes the attorney to do nothing.[23]

An attorney who cooperates with their client will face penalties under the ethical rules that predated Sarbanes.[24] An attorney acting in the role of a gatekeeper for SEC reporting, who may be required to certify disclosures, also faces penalties for false representations under preexisting rules.[25] Yet, under the new whistleblower regime, an attorney who is aware of wrongdoing but fails to report may, at most, be the test case for enforcement. An attorney who reports may be incorrect in their interpretation of the SEC Standards and the Model Rules, the actions may fall outside of the requirements for whistleblower protections and rewards, and the attorney will, most likely, lose the client relationship. Studies also show that shareholder litigation and enforcement activity have a negative impact on corporate values, so an attorney who is zealous but mistaken may actually reduce the shareholder value they sought to protect.[26] Market forces render it debatable whether an attorney who is being steadfast about ethics actually serves the corporate good. If the focus is to protect the assets of the shareholder, a lawyer who finds questionable activity faces a prisoner's dilemma with no upside—a situation that is more of a catch-22 than a dilemma. The silent attorney faces no discipline.[27] The disclosing attorney receives no protection. This is the post-Enron reality.

The regulatory measures taken have not motivated attorneys to change their behavior in a way that prevents corruption and fraud. There are factors other than market forces responsible for this failure. The attorney whistleblower scheme is inconsistent—compliance with the SEC Standards requires violation of the Model Rules in many circumstances. The changes were also made with little thought as to their impact on the attorney-client relationship or attorney behavior.[28] When these changes were debated, attorneys in private practice warned that they would not only be

22. *See* Jim Chappelow, *Prisoner's Dilemma*, INVESTOPEDIA (May 23, 2019), https://www.investopedia.com/terms/p/prisoners-dilemma.asp [https://perma.cc/F5G2-TAGN] (The prisoner's dilemma is a concept in game theory "in which two individuals acting in their own self-interests do not produce the optimal outcome. . . . [B]oth parties choose to protect themselves at the expense of the other participant" and end up in a worse situation than if they had cooperated with each other).

23. *See* Kim, *Gatekeepers Inside Out*, *supra* note 4, at 417–18.

24. *See* MODEL RULES OF PROF'L CONDUCT r. 1.6 cmt. 7.

25. *See id.* r. 8.4(c).

26. *See* Kim, *Gatekeepers Inside Out*, *supra* note 4, at 436.

27. *See* Pacella, *supra* note 12, at 527.

28. *See* ROBERT ELI ROSEN, LAWYERS IN CORPORATE DECISION-MAKING 148 n.450 (2010).

ineffective but could also be harmful to the attorney-client relationship.[29] Attorneys, both in-house and at Am Law 100 firms,[30] warned that clients may avoid legal services and expressed concern that it would be difficult to provide candid advice in a climate in which clients are concerned that an attorney may report externally. Practitioners felt that the mere possibility would have a chilling effect on the market for legal advice, even without evidence of a shift to a culture of attorney disclosures.[31] The results appear to prove that these attorneys were correct. To regulators and legislators, avoiding the impact of fraud on the economy is worth sacrificing long-standing relationships of trust, including the attorney-client relationship. However, when this sacrifice is attempted without a proper look at the financial market or the market for legal services, it has no positive impact. Although noble, the attorney whistleblower cause is futile.

Companies have resolved the Enron attorney problem by holding fast to the Enron method of corporate governance, with additional instructions through the whistleblower regime, on how to keep an attorney who desires to blow the whistle in check. A trusting and reputable board of directors (board) loyal to management can stop a potential whistleblower attorney in her tracks, especially in a company led by a dominant chief executive officer (CEO) perceived to be successful by the board.[32] In companies engaged in high-tech enterprises or companies with complicated structures, a dominant CEO can become the arbiter of information, preventing attorneys from knowing enough to even justify reporting up the chain. If the board, responsible for oversight, trusts management, a disloyal attorney can be fired for reporting to them without management facing any consequences.[33] If shareholders are in support of the corporate disobedience and believe it is worth the risk to maximize profits and innovate, an external report merely contradicts the shareholders' interests, ultimately causing harm to the corporation even if it benefits the mission of regulators.[34] Harmful management can silo and embargo information, rely on complexity, and if financially successful in the short term, con-

29. *See* Kim, *Naked Self-Interest?*, *supra* note 14, at 132–33 (explaining the opposition of the ABA and attorneys); *see also* Romano, *supra* note 9 (noting that the literature suggesting that the proposed mandates would not be effective was ignored by legislators as they drafted Sarbanes, rendering the quality of the legislation sub-optimal).

30. The *American Lawyer* publishes an annual list of big law firms, ranking them based on financial data. *See, e.g.*, Ben Seal, *The 2019 Am Law 100: By the Numbers*, LAW.COM (Apr. 23, 2019), https://www.law.com/americanlawyer/2019/04/23/the-2019-am-law-100-by-the-numbers/ [https://perma.cc/ZKD7-E269].

31. *See* Kim, *Naked Self-Interest?*, *supra* note 14, at 132–33 (explaining the opposition of the ABA and attorneys).

32. *See, e.g.*, JOHN CARREYROU, BAD BLOOD: SECRETS AND LIES IN A SILICON VALLEY STARTUP 268–80 (2018) (describing how, at Theranos, Elizabeth Holmes had the full trust of the board, even when they were given negative information from insiders and even after the company started to fail).

33. *See* Kabir Ahmed & Dezso Farkas, *A Proposal to Encourage Up-the-Ladder Reporting by Insulating In-House Corporate Attorneys from Managerial Power*, 39 DEL. J. CORP. L. 861, 873–75 (2015).

34. *See* Pollman, *supra* note 2, at 750 ("Some corporate lawbreaking may have redeeming virtues.").

tinue bad behavior until it is too late.[35]

We know about the behavioral, cultural, and regulatory failures that led to the collapse of Enron.[36] We know about the somewhat draconian nature of Sarbanes and how it may contribute to the current trend of high-net-worth, privately held companies, commonly referred to as unicorns, as companies have sought to evade the requirements.[37] But do we understand how laws intended to discourage corporate fraud have unintentionally incentivized corporate misconduct at the hands of its professionally trained representatives? This article takes a novel approach of exploring the usage of legal business structures, the placement of attorneys within those structures, and the role these activities have in corporate misconduct. Before instituting changes to the attorney-client relationship, regulators failed to look at real-life lawyers and to analyze the realities of legal practice. Instead, they imposed an aspirational regime based on an unsubstantiated belief that attorneys desire to assume the roles of gatekeeper and whistleblower. Because of corporate structuring and the definition of an attorney-client relationship, the whistleblowing mandate found in Sarbanes and the Model Rules is rendered ineffective. Without measurable rewards for whistleblowing, market forces discourage attorneys to report, particularly in a regime where there is no punishment for failure to comply.

In this article, Part II explains the practice of law and the prisoner's dilemma imposed on attorneys by the whistleblower regime. Businesses, particularly those intent on committing fraud, are smart and reactive, and attorneys are not motivated to contradict client actions. Instead, attorneys rely on the operation of law and the Model Rules to silo through specialization and bury their heads in the sand to avoid unpleasant information. Congress has provided smart, potentially criminal, actors with a blueprint for evading detection while giving attorneys an additional reason to look away.

Part III uses the story of Enron to illustrate how business structure and corporate governance norms can stop an attorney from whistleblowing or keep an attorney from having the information required to blow the whistle. Part III also reveals that the interaction of how attorneys practice with the whistleblower regime does not resolve the Enron attorney problem; instead, the whistleblower regime provides companies with a roadmap for avoiding the problem. Market forces and business norms incentivize attorneys to bury their heads in the sand, take advantage of

35. Sanctions imposed and regulatory changes made *ex post* do not adequately compensate the parties harmed by market manipulation. *See, e.g.*, CARREYROU, *supra* note 32, at 267–80 (highlighting that corporate lawbreaking often continues during the regulatory review process).

36. *See, e.g.*, Romano, *supra* note 9, at 1523.

37. *See, e.g.*, Kate Livak, *Defensive Management: Does the Sarbanes-Oxley Act Discourage Corporate Risk-Taking?*, 2014 U. ILL. L. REV. 1663, 1665 nn.4–11, 1673 (2014) (summarizing the literature critical of Sarbanes and noting the private company trend).

silos and information embargoes, and generally avoid assuming the role of gatekeeper or whistleblower.

In Part IV, the results of deputizing attorney whistleblowers are discussed, using the modern examples of Theranos and Tesla to explain why attorney whistleblowers are a myth. After more than fifteen years, zero enforcements, and zero disciplinary actions against attorneys, it is clear that other measures are needed to minimize attorney participation in corporate fraud. Eliminating corporate fraud requires cultural change, which is not accomplished by merely deputizing attorneys as whistleblowers.

II. THE PRACTICE OF LAW: HEAD IN THE SAND AND SILOS

Regulators, investigators, and Congress discussed the presence of counsel at various stages of Enron's fraudulent scheme during the development of Sarbanes.[38] Congress noted that attorneys prepared the formation documents, gave advice on whether activities were legal, and in some circumstances made suggestions that may have prolonged the scheme.[39] The preexisting standards, which penalized attorneys for participating in a client's crimes or frauds, were not triggered by the attorney conduct at Enron.[40] The attorney conduct also failed to trigger the securities regulations governing gatekeepers.[41] Attorneys who were not coconspirators were included but eventually dismissed from the resulting litigation and were not subjected to disciplinary action from state bar associations or the SEC. Congress struggled with the idea that an attorney could be present yet also be a nonparticipant in such an all-consuming governance failure. That outcome fit within the norms of the attorney-client relationship, as defined by state rules and common law principles, so the federal solution is disconnected and ineffective.

This part explains the basics of legal practice, which, in many ways, leave attorneys siloed, unable to get a full picture of the operations of a client's business. When the new whistleblower framework combines with the siloed practice of law, it never encourages disclosure. Instead, an attorney is best served by avoiding information—burying their head in the proverbial sand.

A. Practicing Law in the Silos

Enron, WorldCom, and other corporations were able to commit fraud in plain sight, with the assistance of expert and reputational in-

38. *See* Romano, *supra* note 9, at 1523–29; *see also* Bainbridge, *supra* note 12, at 32.

39. *See* Final Report of Neal Batson, Court-Appointed Examiner at 48–55, *In re* Enron Corp., 370 B.R. 583 (Bankr. S.D.N.Y. 2007) (No. 01-16034) [hereinafter Final Batson Report].

40. *See* Appendix C (Role of Enron's Attorneys) to Final Report of Neal Batson, Court-Appointed Examiner at 179, 187, 190, *In re Enron Corp.*, 370 B.R. 583 (No. 01-16034) [hereinafter Appendix C to Final Batson Report].

41. *Id.*

termediaries[42]—namely lawyers and accountants—who, because of expertise and access, were found to either be complicit or willfully ignorant of their client's behavior.[43] Accountants and lawyers were present at nearly every stage of the fraud.[44] Lawyers prepared formation documents and regulatory reports and served as advisors on legal compliance.[45] Accountants prepared the financial statements and audits, signing off on the documents containing the material misstatements that allowed Enron and others to carry out their schemes longer.[46] At the time of the scandal, securities regulations and state ethical codes had long established legal duties for attorneys and accountants that required them to be more than just corporate facilitators.[47] In some circumstances, the experts were required to act as gatekeepers,[48] and in others, attorneys and accountants could be subject to personal criminal and civil liability for joining in their client's activities.[49] Yet, the preexisting structures regulating attorneys and accountants failed to stop Enron or to motivate the experts to contradict Enron's periodic reports and public statements,[50] just as other laws failed to expose the corruption before it was too late.[51]

Business laws and ethical rules have always defined the client as the company—not the agents of the company. The law has also prohibited attorneys from acting as coconspirators with clients or agents of the clients.[52] For these reasons, on the surface, measures which go slightly further—making these roles clearer while also mandating a scheme for attorney internal and external reporting—seem to be just more of the

42. *See* Christine Hurt, *Counselor, Gatekeeper, Shareholder, Thief: Why Attorneys Who Invest in Their Clients in a Post-Enron World Are Selling Out, Not Buying In*, 64 OHIO ST. L.J. 897, 927–28 (2003) (Attorneys and accountants have the ability as independent third parties to make parties more comfortable and confident when doing business with strangers. This is based in part on the reputation of the law firm or accounting firm, and the belief that they would not risk that reputation by cheating for a client).

43. *See* Final Batson Report, *supra* note 39, at 48–55.

44. *Id.*

45. *See* Appendix C to Final Batson Report, *supra* note 40, at 6–14.

46. *See* Final Batson Report, *supra* note 39, at 108–13.

47. *See, e.g.*, Larry Catá Backer, *The Duty to Monitor: Emerging Obligations of Outside Lawyers and Auditors to Detect and Report Corporate Wrongdoing beyond the Federal Securities Laws*, 77 ST. JOHN'S L. REV. 919, 968–69 (2003); James A. Gardner, *The Crime or Fraud Exception to the Attorney-Client Privilege*, 47 A.B.A. J. 708, 711 (1961); Leon Green, *The Duty to Give Accurate Information*, 12 UCLA L. REV. 464, 468–69 (1965).

48. *See* THOMAS LEE HAZEN, PRINCIPLES OF SECURITIES REGULATION 223 (2006) (citing *In re* Carter & Johnson, Exchange Act Release No. 34-17597, 22 SEC Docket 292 (Feb. 28, 1981)). Hazen explains that the SEC has held the view that lawyers should be held accountable for failing to prevent their clients for failing to comply with the securities laws' disclosure requirements. *See also* John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293, 1296–97 (2003) (providing an example and explanations of gatekeepers).

49. *See* Coffee, *supra* note 48, at 1314.

50. *See* Appendix C to Final Batson Report, *supra* note 40, at 179, 187.

51. *See* Rebecca Smith & John R. Emshwiller, *'24 Days': Behind Enron's Demise*, WALL ST. J. (Aug. 8, 2003), https://www.wsj.com/articles/SB106029336126554600 [https://perma.cc/B74Y-7N5U].

52. *See* MODEL RULES OF PROF'L CONDUCT r. 8.4(c) (AM. BAR ASS'N 2018).

same.[53] The attorney-client relationship is, however, a delicate relationship of trust and confidence that turns on the informed judgment of the attorney, as it is formulated using the secrets of the client.[54] Quality legal advice cannot be produced in an informational vacuum. So, when the law is changed in a way that has a chilling effect on the free exchange between attorney and client, the impact, though difficult to measure, is real.

When Congress reacted to the presence of attorneys at every stage of the Enron scheme, it failed to acknowledge the delicate balance of the attorney-client relationship and the norms of the practice of law. These norms strike a balance between blind and unchecked loyalty to a client through zealous representation and adhering to a higher code of ethics that recognizes the special role of attorneys.[55] State ethical rules and common law maintained its balance until Congress intervened post-Enron. These changes, made without acknowledgment of the attorney role, have made the regulation of attorneys more complicated but not better. This section explains the attorney's role in society.

1. The Position of Attorneys in Society

Attorneys hold a special role in society. Lawyers serve as advocates for clients but are also viewed as gatekeepers of justice.[56] The attorney-client relationship is prioritized because we have decided as a society that it is important to provide clients with unbiased and zealous representation.[57] As a result, many feel there is no violation greater than breaking confidentiality or privilege, even if doing so might prevent harm to another.[58] It is more important to protect this relationship than to learn about actual misconduct or attorney speculation about their client's businesses or behaviors. An attorney must keep a client's secrets in all but a few very limited circumstances.[59]

An attorney's role is to steer the client towards outcomes that meet the client's goals without crossing the line ethically or breaking the law.[60] Attorneys serve as their clients' advocates and trusted advisors, but one cannot advocate or advise in an informational vacuum.[61] To serve clients

53. *See, e.g.*, Romano, *supra* note 9.
54. *See* Coffee, *supra* note 48, at 1302.
55. *See* Model Rules of Prof'l Conduct pmbl., paras. 1–5.
56. *See* Larry E. Ribstein, *The Death of Big Law*, 2010 Wis. L. Rev. 749, 767–68 (2010) [hereinafter Ribstein, *The Death of Big Law*]; *see also* Coffee, *supra* note 48, at 1303–07; David E. Rovella, *Going from Bad to Worse; Defense Bar Fears Jail Over Tainted Fees*, Nat'l L.J., Mar. 11, 2002, at A9 (quoting practitioners who argue that efforts "to make lawyers 'gatekeepers' of the financial system may further impede the ability of criminal defense lawyers to properly represent their clients"); Howard Stock, *S-O's Lawyer Rule May Chill Information Flow*, Investor Rel. Bus., Aug. 18, 2003 (quoting Professor Jill Fisch: "There are plenty of watchdogs already in place, and lawyers are poorly positioned to be gatekeepers.").
57. *See* Hamermesh, *supra* note 18, at 46.
58. *Id.* at 48.
59. *See also* Coffee, *supra* note 48, at 1307–10. *See generally* Fed. R. Evid. 501; Model Rules of Prof'l Conduct r. 1.6.
60. *See* Model Rules of Prof'l Conduct r. 1.2(d), 1.6.
61. *See, e.g.*, Hamermesh, *supra* note 18, at 48–50.

best, attorneys and clients need an honest exchange of all relevant information.[62] To facilitate this open exchange, the law shields the attorney-client relationship with privilege and confidentiality that prohibits an attorney from disclosing client communications in all but a few exceptional circumstances.[63] The belief is that this protection enables clients to trust their lawyers, which enables lawyers to represent clients effectively, which then improves the administration of justice, improves business relationships, and helps to protect the market.[64]

On the other hand, law enforcement and regulators work to prevent crime or fraud, not simply to punish it. Early access to information enables law enforcement to stop a crime before it happens and allows regulators to adopt a regime that more accurately reflects reality. The information required by regulatory disclosures, however, will not show the entire picture when parties are intentionally engaging in fraud to manipulate the market.[65] Yet, in the hindsight following a corporate scandal or market collapse, there is always the belief that if we only had all the information held by a company's insiders and experts, including the information protected by confidentiality and privilege, regulators could put the pieces together and prevent the harm to the market.[66]

The primary source of rules governing attorneys is the Model Rules, promulgated by the ABA. These rules, when adopted, apply to all attorneys practicing within a jurisdiction. The sanctity of the relationship of trust and confidence between attorney and client is the cornerstone of the Model Rules and of the privilege rules found in the Federal Rules of Evidence.[67] Under Model Rule 1.6, an attorney must not reveal information related to the representation of a client without that client's informed consent.[68] The Federal Rules of Evidence give the client the right to refuse to disclose and to prevent the disclosure of confidential communications between attorney and client.[69] This attorney-client privilege is one of the oldest and most recognized privileges.[70] The goal of the attorney-client privilege and Rule 1.6 is to encourage full and frank discussions amongst attorneys and clients.[71] In fact, attorneys have been subject to discipline for improperly revealing confidential client information even when doing so for noble reasons.

The information necessary to competently complete engagement is in

62. Coffee, *supra* note 48, at 1307.

63. *See* FED. R. EVID. 501; MODEL RULES OF PROF'L CONDUCT r. 1.6.

64. Coffee, *supra* note 48, at 1307–08.

65. *See infra* Part III.A.

66. *See generally, e.g.*, FIN. CRISIS INQUIRY COMM'N, FINANCIAL CRISIS INQUIRY REPORT (2011), http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf [https://perma.cc/Q2KT-SKD6].

67. MODEL RULES OF PROF'L CONDUCT pmbl., para. 2.

68. *Id.* r. 1.6 cmt. 2; *see also* Coffee, *supra* note 48, at 1307–10.

69. *See* FED. R. EVID. 501.

70. *See id.*

71. *See* MODEL RULES OF PROF'L CONDUCT r. 1.6 cmt. 2.

an attorney's discretion.[72] Similarly, whether the actions of the client or its agents are reasonably likely to result in harm to the company itself, the shareholders, or the market is also within the attorney's judgment.[73] An attorney must balance the duty to not over-bill or be inefficient in investigation through researching outside of the representation and what is necessary for the representation, with the duty to obtain any information required to comply with a regulatory scheme. It is the client, not the government, who retains the attorney. As a result, when acting as a gatekeeper of justice, the attorney's job is to defend the client and advocate on their behalf, not to preserve the integrity of a regulatory regime.

When an attorney represents a company, they interact with management and employees but represent the entity not its agents.[74] This relationship is further complicated when a company is comprised of numerous companies with separate management and multiple lawyers.[75] The business structure and management logistics determine whether the various entities are treated as truly separate under the law.[76] Notably, this is often a legal decision made with the advice of counsel. Attorneys structure these entities based on legal realities and business desires, not on the impact to the market. Attorneys do not make moral decisions when structuring entities for clients. Yet, these decisions determine the location of the top-of-the-chain and who to consider as a constituent when deciding financial harm for purposes of the whistleblower regime.

In all attorney-client relationships, the closeness between attorneys and the agents of corporate clients makes them susceptible to capture.[77] While attorneys know that they represent the corporation and not its management and employees, they must work closely with the company's agents to maintain the relationship. A successful attorney is a friend of the client, serving a special purpose in a time of need, and that friendship cannot be forged with a fictitious entity that is only a person on paper. Instead, human nature trends toward the attorney forming a friendship with the general counsel (GC), CEO, or other employee contact, and that friendship may cause an attorney to investigate less and trust the agent's word more often than they should.[78] Sarbanes attempts to address this

72. *See id.* cmt. 5.

73. 17 C.F.R. § 205.3(b)(2) (2019).

74. *See* Ribstein, *The Death of Big Law*, *supra* note 56; *see also* Larry E. Ribstein, *Delawyering the Corporation*, 2012 Wis. L. Rev. 305, 324–28 (2012) [hereinafter Ribstein, *Delawyering the Corporation*].

75. *See* Model Rules of Prof'l Conduct r. 1.13 cmt. 1–2.

76. *See infra* note 77.

77. Regulatory capture is a form of government failure which occurs when a regulatory agency, created to act in the public interest, instead advances the commercial or political concerns of special interest groups that dominate the industry or sector it is charged with regulating. When regulatory capture occurs, the interests of firms, organizations, or political groups are prioritized over the interests of the public, leading to a net loss for society. When attorneys are captured, they work in the interest of their clients, not to promote the greater social good. *See* Kim, *Gatekeepers Inside Out*, *supra* note 4, at 413.

78. *See* Rosen, *supra* note 28, at 46 (noting the prevalence of personal relationships between lawyers and clients).

issue, as do the changes to the Model Rules, but the whistleblower regime does so without any adjustment to the remaining Model Rules that promotes some degree of capture.[79] This creates confusion and an inherent conflict for an attorney who seeks to defer properly to the judgment of a client or the client's representative, while also engaging in some degree of investigation into the actions of the client's representatives to ensure that they are not doing the client harm.

2. *How Attorneys Practice*

Attorneys can wear many hats in corporate practice. They can hold hybrid positions that combine legal representation with external obligations, like compliance officers, or they may hold roles that do not require the practice of law.[80] These roles may provide an attorney with a separate obligation and adequate knowledge to serve as a gatekeeper or to report externally as a whistleblower.[81] In-house attorneys have always served as both employee and attorney, creating a competing obligation to adhere to the Model Rules and to be aware of scenarios in which they may be obligated to report externally under SEC regulations or other laws.[82] Attorneys engaged in quasi-legal or nonlegal roles within a corporation have the duties of any employee or officer, but the company is not afforded attorney-client privilege and confidentiality merely because the attorney has attended law school or is licensed to practice law. Thus, Sarbanes impacted these in-house attorneys practicing law similar to how other company employees were impacted.[83]

For outside counsel, the realities of the practice of law combined with the structures of business entities encourage attorneys to limit their investigation of clients to what is necessary for a particular representation.[84] This is because every aspect of the attorney-client relationship, from engagement letters and conflicts of interest checks at the outset to determinations about privilege and confidentiality during representation to the determination of future conflicts with third parties and ongoing duties after termination of an attorney-client relationship, is based on an accurate determination of client and matter.[85] Ethical and evidentiary rules require that attorneys either clearly delineate and separate clients and matters or face future conflicts determinations that may hinder business. Thus, if an attorney is hired to only give tax advice, to provide regulatory advice on compliance with a statute, or to handle a single trial, the client-

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79. *See* Kim, *Gatekeepers Inside Out*, *supra* note 4, at 413–18.

80. *See* Ribstein, *Delawyering the Corporation*, *supra* note 74, at 306–07.

81. *See* Bainbridge, *supra* note 12, at 32, 110; *see also* Coffee, *supra* note 48, at 1298–99.

82. *See* Hazen, *supra* note 48, at 200–01.

83. *See* Bainbridge, *supra* note 12, at 31–32 (explaining the requirements in Sarbanes on CEOs and CFOs).

84. *See, e.g.*, Carliss N. Chatman, *The Corporate Personhood Two-Step*, 18 Nev. L.J. 811, 816 (2018) (explaining that each business entity is a separate legal person).

85. *See, e.g.*, Model Rules of Prof'l Conduct r. 1.7, 1.8, 1.9 (Am. Bar Ass'n 2018).

matter system requires that attorney to tailor the representation.[86] An outside attorney will not have the general knowledge of a client's business operations that in-house counsel may obtain through their employment.

In addition, the nature of the practice encourages specialization that will limit an attorney's ability to see the full picture when analyzing a client's business.[87] That specialization, when combined with requirements to remain competent and to bill fairly, promotes siloing of information as opposed to open and broad investigation. Within a law firm, attorneys often specialize, either within sections of a large firm or into stand-alone boutique law firms, to command the highest rates for services.[88] The market for legal services is also highly competitive, so attorneys must demonstrate expertise and efficiency to obtain the best clients.[89] Clients do not want an attorney who is a generalist with the intent of diving into every aspect of the client's business.[90] Instead, outside counsel is retained to handle a matter or series of matters based on their specialty or to serve as experts filling in the gaps in expertise held by the in-house legal department.[91]

Further, the internal structure of law firms and legal practice imposes additional restrictions on information reaching the top of the chain within a client's company.[92] There are often layers of authority at the firm between those in power with a client and the attorneys doing the work day-to-day. The associates and junior partners receive instructions from and often have an obligation to report to a more senior partner or a partner who is in charge of the relationship with the client.[93] In many firms, attorneys are expected to first report issues internally to a partner and defer to or allow the partner to proceed with the client if that partner believes it is necessary. Most large firms also have a GC's office of their own where concerns should be reported before going to the client or others outside of the firm. The Model Rules insulate this hierarchy through rules that allow attorneys to defer to the judgment and authority of more senior, superior attorneys.[94] Reporting outside of the law firm to the powers-that-be at the client company may be a career-ending move that is unprotected by the ethical rules and has yet to receive any substantial protection in the courts.

In-house attorneys engaged exclusively in the practice of law can either

86. *See id.* r. 1.2.

87. *See* Rosen, *supra* note 28, at 5–6; Ribstein, *Delawyering the Corporation*, *supra* note 74, at 308–09; *see also* Ribstein, *The Death of Big Law*, *supra* note 56, at 753–55.

88. *See* Ribstein, *The Death of Big Law*, *supra* note 56, at 755–56.

89. *Id.* at 757–60.

90. *Id.* at 759–60.

91. *Id.* at 756–58.

92. *See* Rosen, *supra* note 28, at 19–21.

93. *See* Ribstein, *The Death of Big Law*, *supra* note 56, at 757 (noting that firms often have "rainmaking" partners primarily responsible for client relationships).

94. *See* Model Rules of Prof'l Conduct r. 5.1, 5.2, 5.3 (Am. Bar Ass'n 2018).

serve as generalists or specialists.[95] Some in-house legal departments closely mimic law firm structures, with attorneys assigned directly to a specialized group or a single subsidiary within a corporate family.[96] For the attorneys who are specializing in-house, the same influences of siloing and the client-matter system apply. An attorney who serves as GC or who is employed to be a jack-of-all-trades generalist may have substantially more information about the operations of the company's business. But a generalist in-house attorney may also lack detailed information about operations or they may lack the subject matter expertise necessary to understand anything beyond purely legal matters. The in-house generalist will not be siloed but will know only the facts relevant to legal representation. The generalist can rely on the requirements for competence to bury their head in the sand, focusing only on assigned tasks and the information necessary to provide the advice sought.[97] Even in-house, competent representation does not require investigation into decisions that are purely based in business judgment if the attorney's only job is to serve as a lawyer.[98]

3. *The Attorney's Role in Client Wrongdoing*

By the very nature of attorney representation, when fraud happens, the lawyers often know something. An attorney may have suspicions and may be counseling clients to avoid activities constituting crime or a fraud, but unless the client uses the attorney's services to engage in crime or fraud, the attorney is prohibited from disclosing the information.[99] Under the preexisting standards, when communications between attorney and client are used to further a crime, fraud, or tort, the crime-fraud exception renders the privilege moot—but only if the action is carried out.[100] Mere speculation does not allow disclosure; instead, an attorney must have a reasonable belief.[101]

Even under the new whistleblower regime, attorney determinations must be based in facts obtained from the attorney's representation of the client.[102] An attorney is not permitted to report externally because they simply disagree with governance; an attorney needs evidence, gained from representation or at least related to representation, that wrongdoing will result in substantial harm to the company, its shareholders, or the market.[103] The Model Rules, however, exclude lawyers from the decision-

95. *See* Rosen, *supra* note 28, at 5; Kim, *Gatekeepers Inside Out*, *supra* note 4, at 455–57.
96. *See* Ribstein, *The Death of Big Law*, *supra* note 56, at 760, 798.
97. *See* Kim, *Gatekeepers Inside Out*, *supra* note 4, at 418 ("A gatekeeper who potentially faces the hard decision of either losing one's job . . . or losing one's professional license . . . will prefer to cloister herself within her office and hear no evil.").
98. *See* Ribstein, *The Death of Big Law*, *supra* note 56, at 798.
99. *See generally* Fed. R. Evid. 501; Model Rules of Prof'l Conduct r. 1.6.
100. *See* Model Rules of Prof'l Conduct r. 1.6(b)(2).
101. *Id*.
102. *See* 17 C.F.R. § 205.3 (2019).
103. *Id.*

making process, place them in the role of counselor and advocate, and then reinsert them in the process as deputized regulators and corporate monitors.[104] The whistleblower regime coexists with the Model Rules that allow a lawyer to bury their head in the sand and focus only on what they are retained to address. Yet, the whistleblower regime expects lawyers to be observant of hierarchical violations, reporting externally only when they have knowledge they cannot possibly have if they act efficiently and competently pursuant to other Model Rules.[105]

No regulatory system is perfect, and it is an improper conclusion that the Model Rules and securities regulations in place for lawyers at the time of Enron were flawed because Enron's attorneys failed to detect and mitigate the fraud.[106] Attorneys and accountants, although both experts, operate under different standards due to their roles in society. Accountants prepare reports that provide an accurate snapshot of a company's financial performance.[107] They are held personally liable for audits and other reports they certify, and they make statements that their representations to the public are accurate and that they have reviewed all relevant and material information.[108] An accountant is not only an expert serving a company but also an intermediary who protects the public by ensuring that an accurate account of a company's financials is available.[109] Although one would anticipate that adding gatekeeping and whistleblowing would be more plausible and nondisruptive because it is in line with other aspects of an accountant's role, Sarbanes and the creation of the Public Company Accounting Oversight Board have created major changes to accountant liability.[110] Accountants have faced increased liability, yet attorneys have managed to avoid any enforcement as a result of Sarbanes.

The reason for this lack of attorney enforcement is that the role of an attorney is different. As an advocate of the client, there is no requirement to investigate fully or to represent absolute truth to the public.[111] Instead, competency, which includes a duty not to excessively bill a client or over-investigate, requires an attorney to use their best professional judgment to determine what information is necessary to give the services a client

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104. *See* Rosen, *supra* note 28, at 149.

105. *See id.*

106. The Final Batson Report does not blame attorneys; it notes they may have committed malpractice but does not allege participation in criminal activities. *See* Final Batson Report, *supra* note 39, at 114–17.

107. *See* Hazen, supra note 48, at 188–89 (accountants act as certifiers of financial statements and thus are specifically subject to independent requirements).

108. *See* Final Batson Report, *supra* note 39, at 39–47.

109. *See* Hazen, supra note 48, at 188–89 (accountants act as certifiers of financial statements and thus are specifically subject to independent requirements).

110. *See id.*; *see also* A.C. Pritchard, *The Irrational Auditor and Irrational Liability*, 10 Lewis & Clark L. Rev. 19, 33 (2006).

111. *See* Model Rules of Prof'l Conduct r. 1.2(d), 1.3 (Am. Bar Ass'n 2018); *see also* Larry E. Ribstein, *Ethical Rules, Agency Costs, and Law Firm Structure*, 84 Va. L. Rev. 1707, 1714–15 (1998) (highlighting importance of loyalty to clients). Rule 1.2(d) prohibits attorneys from counseling clients to commit crimes/frauds but does not require attorneys to investigate and prevent crimes.

needs while avoiding blatant misrepresentations to the public.[112] Candor requires that an attorney not knowingly make false statements and to correct any false statements made, but candor does not impose a duty on an attorney to investigate to verify that representations made on a client's behalf are absolutely true.[113] The information necessary to competently complete engagement is in an attorney's discretion.[114] Lawyers are experts at the practice of law with only knowledge of other business matters needed to competently represent the client.

In most scenarios, attorneys are not privy to all business information, nor do they have the requisite expertise to understand it.[115] Attorney advice is only as good as what the attorney knows, and attorney suspicions about wrongdoing are only as definite as their business knowledge. For these reasons, the presence of attorneys, and even their involvement in transactions, does not guarantee that the attorneys are seeing the whole picture in a way that enables them to simultaneously act as counsel while doing the work of regulators and law enforcement.[116] It may simply indicate that an attorney did not ask enough questions to serve as an investigator, while still obtaining all material information necessary to provide competent services. The legal practice does not have bright-line rules regarding what information is relevant or material like those found in accounting. Attorneys cannot counsel clients to commit crime or fraud, or encourage them to commit perjury, but attorneys are under no obligation to investigate beyond the scope of representation to unearth crimes.[117]

Even when attorneys are giving optimal advice, they cannot force clients to follow that advice. This is because the future is unknown. So, what an attorney provides a client is an informed opinion based on the laws as they exist at a given point in time, in a specific jurisdiction, and as they apply to the facts the client provides. Attorneys cannot stop clients from taking that opinion and using it to find an end-run around the operation of the law. Unfortunately, the impact of a failure to follow legal advice is quite subjective and the results are purely speculative given the average attorney's limited knowledge of the client's overall business and day-to-

112. *See* MODEL RULES OF PROF'L CONDUCT r. 1.1, 1.5.

113. *Id.* r. 3.3 cmt. 2 ("A lawyer acting as an advocate in an adjudicative proceeding has an obligation to present the client's case with persuasive force. Performance of that duty while maintaining confidences of the client, however, is qualified by the advocate's duty of candor to the tribunal. Consequently, although a lawyer in an adversary proceeding is not required to present an impartial exposition of the law or to vouch for the evidence submitted in a cause, the lawyer must not allow the tribunal to be misled by false statements of law or fact or evidence that the lawyer knows to be false."); *id.* cmt. 8 ("The prohibition against offering false evidence only applies if the lawyer knows that the evidence is false. A lawyer's reasonable belief that evidence is false does not preclude its presentation to the trier of fact. A lawyer's knowledge that evidence is false, however, can be inferred from the circumstances.").

114. *See id.* r. 1.3 cmt. 1.

115. *See* ROSEN, *supra* note 28, at 15, 18.

116. *Id.* at 18, 20.

117. *See* MODEL RULES OF PROF'L CONDUCT r. 1.2(d).

day activities.[118] Clients are autonomous entities, balancing attorney opinions with business goals and the advice of other experts. An attorney's gatekeeping and whistleblowing roles are not triggered simply because a client takes an alternative approach.[119] At times, the optimal legal decision is not the optimal business decision, so a client chooses to follow a good enough opinion that promotes business goals. It is possible for such a decision to be legally suboptimal without crossing the line to illegal activity, and it is often only the benefit of hindsight that reveals a legal misstep.

When combined with the trend towards attorney specialization, these factors make it virtually impossible to develop a viable solution to corporate fraud that incorporates information held by attorneys.[120] The preexisting system acknowledged these realities. The crime-fraud exception, confidentiality, and gatekeeper rules struck a proper balance, discouraging attorneys from participating while protecting the attorney-client relationship. These rules acknowledged that when regulating the practice of law, attorneys should be required to issue opinions that do not counsel clients to break the law, and these rules encouraged attorneys to withdraw from representation or disclose if their services are used for crime or fraud. Whistleblowing and gatekeeping regimes fail because they expect attorneys to be forward-looking and accurate without the benefit of hindsight in a justice system that requires attorneys to provide defenses for past behavior, while offering opinions that mitigate liability in the present.

B. The Whistleblower Regime Prisoner's Dilemma

While regulators desire to be forward-looking, the justice system is focused on past and concurrent behavior. Compliance emphasizes best practices, but criminal prosecution and regulatory enforcement emphasize punishment and deterrence. The system does not punish parties for what they might do or what they are considering, and it also does not punish parties for bad outcomes. Parties are punished for action, inaction, or attempted action. In this action and intent-based justice system, attorneys straddle the line by giving forward-looking advice to avoid violating the law and placing the client in the best position legally and then providing investigation and defense services when a client faces enforcement or prosecution.[121] The fact and intent-based system prohibits attorneys from issuing proclamations. Instead, what an attorney provides is an opinion

118. SEC counsels against reporting subjective information; rather, disclosures should be based on objective information. Comments to the Model Rules do the same. *See, e.g.*, *id.* r. 1.6 cmt. 7.

119. *Id.* r. 1.2 cmt. 9. Notably, this also does not trigger director and officer liability. *See infra* Part III.C.

120. *See, e.g.*, Richard R. Carlson, *Citizen Employees*, 70 La. L. Rev. 237, 240 (2009) (whistleblowers serve the public despite the demands of their employment and face many obstacles in the workplace).

121. *See, e.g.*, Ribstein, *The Death of Big Law*, *supra* note 56, at 761–63 (highlighting lawyers' roles of advice-giving and "mobilizing" when issues arise).

that is limited by the quality of ever-changing inputs. The practice of law is more art than science.

The whistleblower regime creates a series of prisoner's dilemmas on the market for legal services. For consumers of legal services, they face a choice of seeking attorney advice whenever necessary, being completely open and candid, or avoiding attorneys unless absolutely necessary. If prospective clients are open with their attorneys, they risk having counsel that will challenge business decisions, disrupt business operations with inquiry and internal reporting, and potentially report externally, in pursuit of their role as a whistleblower. If clients are less than forthcoming with attorneys, or avoid attorneys completely, they risk violating the law and operating in a way that could subject them to future liability. It is debatable which choice is the less favorable decision in a climate that is currently lax on enforcement and that has limited the impact of many common law forces that serve as a check on business behavior.

The practice norms are currently at play in an environment that requires law firms to justify their utility and existence to survive. In response to articles that bring the reduction in enforcement to the attention of the general public, law firms are publishing content to reassure clients that they are necessary. The market for corporate legal services still exists, but in a world where Facebook can mishandle user personal information with *de minimis* penalties,[122] Elon Musk can violate securities regulations with minimal consequences,[123] and a company like Theranos can defraud both investors and patients and still receive disproportionately low penalties,[124] it is difficult to justify why spending millions on legal fees to avoid the nonexistent consequences is worth it. For a company the size of Facebook, a five billion dollar fine as punishment for a decade of playing fast and loose with client data while flaunting Federal Trade Commission rules is not worth the cost of avoidance—not when it continues to generate profits year-over-year at 28%.[125] The rational actor would take their chances, and their shareholders may encourage the risk.[126] These are, after all, business decisions made in a market that is trending toward the promotion of companies that disobey.[127]

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122. *See generally* Stipulated Order for Civil Penalties, Monetary Judgment, and Injunctive Relief, United States v. Facebook, Inc., No. 19-cv-2184 (D.D.C. July 24, 2019).

123. *See* Sean O'Kane, *Court Approves Elon Musk's Securities Fraud Settlement with the SEC*, VERGE (Oct. 16, 2018), https://www.theverge.com/2018/10/16/17983032/elon-musk-sec-securities-fraud-settlement [https://perma.cc/8N8D-3AYV].

124. *See* Pete Schroeder, *Theranos and Its Founder Settle U.S. Fraud Charges: SEC*, REUTERS (Mar. 14, 2018), https://www.reuters.com/article/us-theranos-sec/theranos-and-its-founder-settle-u-s-fraud-charges-sec-idUSKCN1GQ2HC [https://perma.cc/ALW2-ZY5M]. Note, there are still other claims pending against Theranos founder Elizabeth Holmes.

125. *See* Theo Francis, *For Facebook and Alphabet, Big-Ticket Fines Cause Limited Pain*, WALL ST. J. (July 30, 2019), https://www.wsj.com/articles/for-facebook-and-alphabet-big-ticket-fines-cause-limited-pain-11564498156?mod=searchresults&page=1&pos=15 [https://perma.cc/3ALP-V2TA].

126. *See* Pollman, *supra* note 2, at 755–56.

127. *Id.* at 712–15.

As a result of the client incentives, the prisoner's dilemma that motivates the whistleblower regime loses the incentive necessary to make it effective. Why should clients hire lawyers, who could say no to their ideas and stop the flow of market disruption and creativity, when no one else is following the rules? A company like Wells Fargo can clean up their act later. Or a company like Uber can take advantage of the environment and then become compliant when they are ready to go public, hiring the best and brightest for the initial public offering stage while being a pioneer for market disruption when operating in the more forgiving and less regulated private equity space. Why conform when the most successful businesses do not? Lawyers are attempting to justify their existence in a market that does not think they are necessary, while saddled with a whistleblower regime that seeks to prevent capture by deputizing attorneys to act as gatekeepers and whistleblowers on their clients. But, in many ways, what clients pay for is capture. Clients pay for candid advice based on the sharing of information that could be illegal or otherwise harmful to the company. A free exchange of information is necessary for this system to work, which is why the previous rules struck a balance. The attorney must be loyal but cannot participate in a client's crimes or frauds, and the lawyer must remember that it is the company, not its agents, who pays the bills.[128]

Under the new regime, lawyers are faced with the options of complying fully with the rules, betraying their client, and possibly causing personal economic harm; or with remaining silent and facing disciplinary and regulatory action. The reward for silence is maintenance of the attorney-client relationship, and the punishment is a theoretical harm. In the face of an environment with zero enforcements and zero reported disciplinary actions in fifteen years, the rational choice is simple. Attorneys may rely on the norms of legal practice, which favor specialization, by being conscientious of costs to clients and focusing on only the tasks at hand, only accepting matters in which they can provide competent representation, burying their heads in the sand when they become aware of information outside of the scope of their representation, and siloing themselves to only their areas of expertise. Burying their heads in the sand and siloing is legal, and it is reinforced and encouraged by the outcome of over fifteen years of § 307 and the changes to the Model Rules.

When legislators and administrators attempt to make attorneys whistleblowers, and in some scenarios gatekeepers, they believe they are operating under the assumption that it is a scenario that creates a prisoner's dilemma that makes disclosure a clearer and easier choice. They assume that an attorney faced with client wrongdoing is practicing in a binary in which the choice is to either participate and face future punishment with coconspirators or disclose client information to receive protection. But what they actually create for attorneys is a catch-22. A prisoner's dilemma with no upside is no dilemma at all. Attorneys are

128. *See* Model Rules of Prof'l Conduct r. 1.6 (Am. Bar Ass'n 2018).

taking the action that makes the most sense economically and professionally.

Clients prefer legal advice that allows them to accomplish their goals.[129] In a transactional setting where the role of the attorney is less clear, clients want an attorney who will help them to avoid future liability and who will help them achieve the goals they want, not an attorney who will interrogate them or who will delay the transaction with investigation.[130] In addition, due to long-standing corporate law principles, such as the business judgment rule, simply seeking advice of an expert raises the burden of proof in court, even if that advice is not implemented.[131] Enron utilized this device frequently. For example, Enron executives sought advice about conflicts of interest, and instead of avoiding the conflicts, they restructured the transactions and concealed the conflicts when utilized. The whistleblower regime has not changed this phenomenon.

III. THE IMPACT OF BUSINESS STRUCTURE

The foundation of § 307 is that federal intervention is necessary to remedy the failure of state ethical codes to prevent attorney participation in fraud on the market. This assumption is not based in the reality of corporate governance, and it may, in fact, contradict shareholder desires. If up-the-chain reporting results in no change, it is improper to assume that it means the board and management are colluding to minimize shareholder value and commit fraud. The top of the chain could be acting with authority from shareholders to innovate and even with authority to push the envelope to make new law.[132]

At Enron, for example, shareholders and analysts were aware that the company was taking an aggressive approach to accounting and utilizing complex business structures. Investors believed that it was this innovation that was responsible for the record growth of the company, so they continued to reward Enron with positive analyst ratings and record stock price gains. These stakeholders were unaware of the fraud, but the existence of fraud does not automatically revoke the endorsement of disruption and innovation. Post-Enron, the market continues to reward companies that push the envelope and continues to invest in companies that are structurally complex.

This part analyzes corporate structure and governance, and its impacts on the operation of the SEC Standards, the updated Model Rules, and Dodd-Frank inspired changes to whistleblower rewards. This examination illustrates why the attorney whistleblower is a myth through an analysis of how Enron's legal department operated and how it interfaced with the

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129. Pollman, *supra* note 2, at 757–58.

130. *See, e.g.*, ROSEN, *supra* note 28, at 15.

131. *See* Kenneth B. Davis, Jr., *Once More, the Business Judgment Rule*, 2000 WIS. L. REV. 573, 573–74 (2000); Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 283–84 (1986).

132. *See* Pollman, *supra* note 2, at 755–56.

business and outside counsel. To highlight the role of our business culture and legally available business structures in Enron, WorldCom, and the financial crisis of 2007–2008, this part explains the role of attorneys in the face of corporate creativity, innovation, and fraud. By maintaining the same corporate culture while invoking fear of attorney whistleblowing, a scheme intended to improve conditions may have made actors more criminally sophisticated while offering no real solutions to prevent corporate wrongdoing. The corporate governance problems may remain the same or get worse in exchange for a damaged attorney-client relationship.

A. The Enron Lawyer Problem

The SEC's attempt to comply with a congressional mandate that contradicts their traditional deference to state control of attorneys resulted in a non-regulation regulation that confuses the requirements for practice and has produced no measurable results to date. This outcome is not a surprise given that the SEC Standards would not have impacted the behavior or outcomes for attorneys at Enron—the very constituency John Edwards intended to address when proposing his last-minute amendment. The attorneys retained by Enron were, in many respects, already acting as gatekeepers. Market forces demanded that they bury their heads in the sand and rely on structure to silo. The decision was protected by the fundamentals of business law, which define each legal entity as a separate person, and the Model Rules definitions of a client for conflicts, confidentiality, and competence. The whistleblower regime does not address the source of attorney capture—structure and the very nature of the practice of law.

Enron's legal department had a very traditional structure. Each established business unit of Enron had its own legal department and Assistant General Counsel (AGC), who reported to both the business unit leader and the overall GC, James Derrick.[133] The AGCs met with Derrick weekly.[134] Outside counsel reported to the GC and the AGCs who retained them. Enron also retained outside counsel in a traditional way. Vinson & Elkins (V&E) served as primary outside counsel and provided advice on corporate governance, mergers and acquisitions, and tax, relying on their internal practice group and client-matter structure to properly segregate information when necessary.[135] Andrews Kurth also served as outside counsel, advising primarily on FAS 140 transactions.[136] In its role as primary outside counsel, V&E acted like an external legal depart-

133. Derrick was a V&E partner before becoming GC of Enron. *See* Appendix C to Final Batson Report, *supra* note 40, at 16–20; *see also* Sung Hui Kim, *The Banality of Fraud: Re-Situating the Inside Counsel as Gatekeeper*, 74 Fordham L. Rev. 983, 985–86 (2005).

134. Appendix C to Final Batson Report, *supra* note 40, at 18.

135. *Id.* at 21.

136. *Id.* at 24; *see also* Neal Newman, *Enron and the Special Purpose Entities—Use or Abuse?—The Real Problem—The Real Focus*, 13 Law & Bus. Rev. Am. 97, 118–20 (2007) (explaining the FAS 140 deals).

ment, possibly because of Derrick's relationship with the firm as one of its former partners. Notably, post-Enron, corporations rarely retain outside counsel in this general way.

The rest of Enron's business structure can best be described as fuzzy.[137] Its experts and the markets viewed this fuzziness as innovation not chaos.[138] Enron celebrated and rewarded V&E financially for serving as an external GC office, adopting the Enron culture, and handling any matter needed at any given moment.[139] V&E celebrated and profited from representing Enron in a general way without clearly defined clients or roles.[140] The firm would be retained by the GC or AGC of a particular business unit but would then fall in line with the rest of Enron's culture. The same was true for Arthur Anderson in representation of accounting matters.[141]

At Enron, attorneys were involved with two classes of misconduct: (1) mis-categorization of entities and transactions and (2) assisting with activities lacking a genuine business purpose.[142] The Final Batson Report organized the wrongdoing into six categories, four of which involved lawyers: FAS 140 transactions, tax manipulation, noneconomic hedges, and minority interest transactions.[143] Although Enron maintained a complex structure and kept information siloed, it primarily relied on its two outside law firms to assist its in-house attorneys with these activities. This reliance on a small number of firms that were jacks-of-all-trades, and essentially an outside legal department, made it more likely that attorneys could obtain the information necessary to report up the chain or even externally. V&E was not strict about identifying clients, so it did not avail itself of the head-in-the-sand aspect of the practice that is facilitated by the client-matter system. The firm was, however, able to rely on the siloing effect of subject matter expertise broken down by sections and groups. No single attorney or even law firm was in every room.[144] So, even though the Final Batson Report delineates fraudulent activities that the attorneys were involved in, the attorneys at outside firms were not found to be in violation of preexisting ethical standards.[145]

Enron's business structure allowed senior management to obtain advice from counsel—both accounting and legal—then easily work around it by relying on the structural irregularities to evade the internal con-

137. *See infra* Parts III.B–C.

138. *See* Marianne M. Jennings, *A Primer on Enron: Lessons from a Perfect Storm of Financial Reporting, Corporate Governance and Ethical Culture Failures*, 39 Cal. W. L. Rev. 163, 231 (2013); *see also* Pollman & Barry, *supra* note 6 (showing this celebration of difference persists today).

139. *See* Appendix C to Final Batson Report, *supra* note 40, at 21–24.

140. *Id.*

141. *See* Final Batson Report, *supra* note 39, at 39.

142. *Id.* at 7–9.

143. *Id.* at 48–55.

144. *See generally id.* at 6–10.

145. *Id.* at 41 (making no definitive conclusions).

trols.[146] Senior management could manipulate the external experts using many of the same techniques it used to obfuscate internal controls.[147] Enron took a "move fast, break things"[148] approach to business management, allowing employees to collaborate across units, work in temporary teams with little structure, and generally do whatever was necessary to generate as much revenue as possible in the short term to produce positive public financial reports. Partial information and a moving-target business structure, combined with financial incentives, made it difficult to dig deeper and disadvantageous to do so. Enron and its champions called this lack of structure innovative and creative. In reality, it was the breeding ground for fraud. In a system of legal representation based upon the designation of clients and matters, Enron's structure made both impossible to pin down.[149]

Attorneys of every variety worked in an environment that did not lend itself to competent legal representation, because they were not in every room and could not get a clear picture of what they were giving advice about when their clients actively chose to conceal information and to use attorney advice to evade detection even longer. These attorneys took their clients at their word and issued opinions anyway, without deeper investigation or clear understanding of the accounting or business significance of their actions.[150] The representations of Enron's employees and management, combined with feedback from outside experts, created an echo chamber with no individual party wanting to be the one to raise a flag.[151]

The Sarbanes-inspired changes to the attorney-client relationship seek to solve the problem of corporate fraud by allowing attorneys to provide the market with more information about their clients' actions before the harm is significant. The information that led to Enron's demise, however, was found through a careful analysis of publicly available reports.[152] For accountants, regulators recognized that a change in the characterization of the accountant-client relationship was necessary to provide the market with more truthful reports. The solution for financial reporting was not more inaccurate reporting but instead an improvement in the practice of accounting to generate reliable reports. Yet, when turning to the lawyer problem, regulators chose to maintain the existing system and instead developed the possibility of breaking privilege and confidentiality to pro-

146. *Id.* at 26, 81.
147. *Id.* at 26.
148. The original Facebook motto was "move fast and break things." Facebook has since decided to take a different approach. *See* Aaron Pressman & Adam Lashinsky, *Data Sheet—Why 'Move Fast and Break Things' Is Out*, FORTUNE (Apr. 8, 2019), http://fortune.com/2019/04/08/data-sheet-facebook-social-media-regulation/ [Permalink unavailable].
149. *See* ROSEN, *supra* note 28, at 26 (the lawyer's job is to evaluate a particular matter); *see also* MODEL RULES OF PROF'L CONDUCT r. 1.7 cmt. 6 (AM. BAR ASS'N 2018) (highlighting the importance of delineating by matter).
150. *See, e.g.*, Appendix C to Final Batson Report, *supra* note 40, at 179–83.
151. *Id.* (noting the possibility of the lawyers' reliance on inside employees and outside accountants).
152. *See* Smith & Emshwiller, *supra* note 51.

vide the market with more information through a regulatory agency. This change to legal reporting requirements was made by Congress and the SEC without acknowledgment of the attorney's role or the elements of corporate crime and fraud. The ABA's attempt at an incremental change simply muddies the waters, rendering the whistleblower framework ineffective.

There is value in ensuring that attorneys do not hide behind their role and its privileges to act as coconspirators to corporate fraud. Ethical codes have well-established mandates to act against this tendency, as does the criminal justice system. Securities regulations also had a preexisting gatekeeper requirement. Yet, this system failed to prevent the fraud on the market by Enron, which happened with the aid of legal counsel at nearly every step. Enron's attorneys were not found to engage at a level to make them criminally liable, and only civil malpractice claims carried any weight. The level of engagement, or lack thereof, by V&E and Andrews Kurth was uncomfortable and disturbing but not illegal or even found to be unethical under the rules and regulations in existence at the time.[153] In the wake of the outrage at this result, Sarbanes attempted to implement a scheme that created an attorney duty to the market—not just a duty to the client. Yet, that duty is subordinate to the duty owed to clients in nearly every circumstance. This deference to state ethical codes and recognition of the traditional attorney-client and business entity structures means that the SEC Standards and the Model Rules act merely as a warning to attorneys and a signal to clients that the attorneys can never be a coconspirator and may be legally required to be more loyal to the market than the client.

If one disregards the realities of legal practice, there is promise in enhancing the preexisting crime-fraud and gatekeeping standards, allowing attorneys to share information when they believe the client's agents will not or have not responded appropriately and that there will be harm to the company, its shareholders, or the market. The realities of corporate legal practice, both in-house and outside counsel, cannot and should not be ignored. If Congress truly desires to prevent attorney participation in corporate fraud, it should leave attorney governance to states. Creating a mechanism for disclosure without a parallel change to the nature of the attorney-client relationship does not create the intended prisoner's dilemma-based incentives, it instead creates a catch-22 for attorneys stuck between loyalty to their clients and a yet unenforced duty to the market.[154]

The definition of the client and the nature of the legal business itself is within near exclusive state domain. Congress, acting in a crisis, appeared incapable of working with the nuanced attorney's role in the same way that states have over hundreds of years of development of ethical rules and common law principles. Removing attorneys from Sarbanes would

153. *See* Final Batson Report, *supra* note 39, at 1–6.
154. *See* Part II.B.

not leave an attorney governance vacuum because Sarbanes currently fails to make material change to how attorneys practice in its current state. Rather than attempting to revise the law in a way that is both effective and appropriately and constitutionally deferential to states, the poorly developed change should be repealed. States are capable of striking a balance that discourages Enron attorney-like behavior without creating alternative negative incentives.

Enron was not the first time attorneys represented people engaged in a criminal enterprise during the representation. It is a part of what attorneys do. What the ethical rules require is that an attorney not participate. At Enron, although investigators found attorney behavior to be troubling, under preexisting laws, only those who knowingly participated were penalized. The whistleblower framework would not result in additional measures taken against Enron's attorneys, and its design fails to encourage attorneys to be more forthcoming with their clients' information. This is because Enron's legal department operated under the head-in-the-sand and siloed model for legal representation that persists today.

B. Separate People, Separate Representation

While attorneys can refrain from engaging in fraud and can encourage best practices, an attorney is not armed with the level of information required or properly incentivized to act as a whistleblower. This is due to the way attorneys practice law and the nature of relationships between attorneys, corporate management, and corporate legal departments, as defined by both the client's structure and the client-matter system of representation. The Model Rules on conflicts of interest, competence, and billing lead attorneys to employ a narrowly tailored client-matter system and to specialize in order to command the highest rates and avoid having conflicts of interest shrink the pool of future clients.[155] This client-matter system is deployed in companies that are often multitiered and organized into various entities that, by operation of law, are separate legal people and separate clients.[156] When business structure is added to corporate culture and attorney-client relationship fundamentals, it can act as a tool that can be manipulated by bad actors to conceal wrongdoing and evade attorney reporting requirements.[157] Thus, a system that relies on attorney reporting does not resolve the problem. A better solution impacts culture by reimagining how companies and special relationships of trust are defined.

Before its downfall, Enron was a market darling.[158] Touted as the future of energy trading and marketing, Enron was rewarded for its innovation and rapidly rising revenues.[159] For five years straight, Enron was

155. *See* Rosen, *supra* note 28, at 5, 18–21.
156. *Id.*
157. *Id.* at 19–21.
158. *See* Smith & Emshwiller, *supra* note 51.
159. *Id.*

awarded most innovative company by Fortune.[160] Only one analyst bothered to ask to see the business behind the curtain[161] and quickly discovered that there was no business.[162] Ironically, the information that led to Enron's demise was hidden in plain sight, right in the financial statements for anyone who dared to look beyond the record-breaking profits to read the footnotes.[163]

Under Jeffrey Skilling's leadership, Enron's maintenance of a complicated yet disorganized business structure helped it to evade detection.[164] The company rewarded employees extensively for improving the bottom line and encouraged them to do so without regard for business units or internal controls.[165] Employees formed groups outside of the business structure to accomplish specific goals, and employee sponsored business initiatives were not uncommon.[166] In addition, management at all levels competed for the performance-based bonuses.[167] Managers poached employees from competing units, if they were high performers with little documentation or accountability.[168] Skilling's Enron was a high risk, high reward, no risk, no reward culture.[169] A failure to make money in the short-term would result in termination.[170] Employees were encouraged to give little thought to long-term goals, because thinking long-term could result in an end to the employee's relationship with Enron.[171] The fungible business structure made it very easy and advantageous to evade internal controls. At Enron, many of the factors that encourage employees to commit fraud existed: (1) incentives and pressures that incentivized fraud; (2) opportunity to commit fraud through weakened internal controls; and (3) a culture that enabled fraud.[172]

Skilling's Enron played fast and loose with its financials, borrowing money at a rate that could damage its credit ratings and chill investor confidence. Skilling, in conjunction with Enron's Chief Financial Officer (CFO) Andrew Fastow, began manipulating business structures through the use of Special Purpose Entities (SPEs) to reduce Enron's hard assets while increasing paper profits and to conceal its risky behavior.[173] Fastow simply transferred assets off of Enron's balance sheets and into an SPE,

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160. Jennings, *supra* note 138, at 169.
161. *See* Smith & Emshwiller, *supra* note 51.
162. *Id.*
163. *Id.*
164. C. William Thomas, *The Rise and Fall of Enron*, J. ACCOUNTANCY (Mar. 31, 2002), https://www.journalofaccountancy.com/issues/2002/apr/theriseandfallofenron.html [https://perma.cc/4LEX-EKR5].
165. *Id.*
166. *Id.*
167. *Id.*
168. *Id.*
169. *Id.*
170. *Id.*
171. *Id.*
172. *See* CHAD MADDOX, CONSTRUCTION ACCOUNTING & TAXATION: SAS 99 CONSIDERATION OF FRAUD IN A FINANCIAL STATEMENT AUDIT (2004), 2004 WL 6392019.
173. *See* Newman, *supra* note 136, at 113–19.

in exchange for ownership interest in the SPE.[174] The SPE itself would borrow from financial institutions to conduct business and purchase assets, which kept the transactions off Enron's financials. Enron also sold assets to the SPE, often at a price above the asset's value, which enabled Enron to record more profits and park bad assets in the SPE to avoid recording losses.[175] This structure enabled Enron to increase the return on assets and reduce its debt-to-total-assets ratio. This made Enron look more profitable and stable in periodic financial reports, which in turn made the company look more attractive to credit agencies and investors, enabling Enron to obtain more access to capital.

Enron conducted business through thousands of these SPEs. Guidelines in existence at the time required that only 3% of a company be owned by outside investors to avoid classification as a subsidiary that should be reported on a company's financials.[176] Enron manipulated this requirement, sometimes partnering with other companies to form SPEs and other times simply granting ownership and management interest in an SPE to an employee in their capacity as an individual.[177] Enron's SPEs often took the form of a limited partnership, an entity that has a general partner who serves as manager and limited partners who are investors with limited liability.[178] The Enron employee or outside entity received at least 3% interest in the SPE and assumed the role of general partner, and Enron assumed the role of limited partner.[179] General partners were incentivized with Enron stock and management fees. Enron also granted stock to the SPEs as the capital contribution, which in turn helped to incentivize lenders to loan to the SPEs due to the increasing value of Enron stock.

Fastow personally managed two of the most controversial limited partnerships, LJM Cayman LP and LJM2 Co-Investment LP (together, LJM Partnerships), receiving over $30 million in management fees.[180] The board granted Fastow an exemption from Enron's Code of Ethics, which prohibited such conflicts of interest. In 1999, the LJM Partnerships were created solely to serve as an outside equity investor—which created yet another level of nesting and concealment. With Enron stock as its capital contribution and with Enron guaranteeing the debts, the LJM Partnerships obtained funding of approximately $390 million from multiple investors, including Wachovia, J.P. Morgan Chase, Credit Suisse First Boston, and Citigroup.[181] Merrill Lynch also contributed $22 million.[182]

174. *Id.* at 118.
175. *Id.*
176. *Id.* at 104.
177. *See id.* at 114–16.
178. *Id.* at 113–14.
179. *See id.* at 115.
180. *Id.*
181. *See* William W. Bratton, *Does Corporate Law Protect the Interests of Shareholders and Other Stakeholders?: Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275, 1309 (2002).
182. *Id.* at 1310.

Enron used the LJM Partnerships to manipulate billions of dollars and enter into derivative contracts backed by even more Enron stock.[183] Enron's use of SPEs created an echo chamber of artificial value. SPEs were used to improve the financial outlook of Enron, which increased the stock price, incentivizing SPE financiers to take a bet on Enron's future stock performance based solely on the artificially created values.[184]

The legal treatment of the SPEs mirrored that of the accounting treatment. The default rule is that businesses are treated as separate entities and separate legal people responsible for their own liabilities without regard for whether the owners are natural persons or other companies.[185] A parent corporation, sibling subsidiary, or other associated entity may only be liable for the actions of a related company under the theory of enterprise liability, a form of piercing the corporate veil. Enterprise liability is an equitable doctrine that has two relatively vague requirements: (1) that there be such a unity of interest and ownership that the separate personalities of the corporation and the individual (or related corporation) no longer exists and (2) that if the actions are treated as those of the corporation alone, an inequitable result will follow.[186] If Enron's SPEs met the accounting standards for separate treatment, they would also meet the corporate law standard. This is legally significant because each legal person, natural or corporate, is viewed as an individual client for conflicts purposes and sharing information across entities is only allowed with client consent.[187] Enron Corporation always had legal counsel, but the SPEs often had no legal counsel at all. If the general partner was an individual Enron employee, that person did not have representation separate from what they may receive through Enron's legal department. Enron's attorneys advised against these conflicts of interest, but Fastow and Skilling chose to either disregard the advice or structure entities and transactions in a way that it was not clear the advice was ignored.

Notably, Enron's use of SPEs was not, in and of itself, fraudulent or illegal.[188] Instead, the fraud occurred when Enron misrepresented its relationship to the SPEs in financial statements or, in some cases, buried the details in the footnotes that no one bothered to read.[189] The board did not investigate Fastow and Skilling's representations that the entities were independent, nor did they challenge the ownership of entities by employees, including Fastow. Skilling and Fastow reported the self-dealing relationships between Enron and its entities to the directors and backed their conclusions with reports from accountants and attorneys who rendered opinions with only the information they obtained from

183. *See id.* at 1311.
184. *See id.* at 1307.
185. *See* Chatman, *supra* note 84, at 861.
186. *See* Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 Iowa J. Corp. L. 479, 527–28 (2001).
187. *See* Chatman, *supra* note 84, at 823.
188. *See* Newman, *supra* note 136, at 118.
189. *See* Smith & Emshwiller, *supra* note 51.

their respective silos. The fraud occurred when Skilling and Fastow told only partial truths to the board and its experts, resulting in inaccurate opinions and a lack of board action. Enron hedged with itself—like a series of nesting dolls—but it only showed the public the financial outcomes of Enron Corporation, the doll that concealed a complicated network of businesses designed solely for the purpose of manipulating financial statements and obtaining more capital from lenders and business partners. The attorneys representing Enron were instrumental to the scheme yet were not conspirators. Instead, they were given just enough information to provide support for the scheme and were not incentivized ethically or economically to question the reasoning for the structure.

Then and now, the practice of law does not lend itself to the representation of entities without defined structure or with structures that intentionally evade corporate governance norms. Remedying this known shortcoming of governance and the attorney-client relationship could be a successful solution to the Enron attorney problem. Skilling, Fastow, and others took advantage of the trust of the board and the market to be "innovative" with the market's blatant disregard of norms, making optimal legal representation difficult. A clear identity of a client is at the heart of legal representation, as are clearly defined matters.[190] The existence of a conflict of interest is determined by the identity of the client and the scope of representation.[191] Similarly, to determine to whom confidentiality and privilege belongs and what is in the scope of representation, such that it may be subject to work-product protection, an attorney must designate a client and matter.[192] Fuzziness in the identity of a client or a matter makes compliance with conflicts and confidentiality rules nearly impossible.

In reports analyzing the downfall of Enron, investigators criticized V&E, Andrews Kurth, and others for disregarding proper structure. Adhering to these protocols may not have stopped Skilling and Fastow, but it would make it far more difficult to engage in the behavior using attorney assistance. The lawyers who were not participants in the fraud had a difficult time keeping track of the moving parts.[193] Resolving the problems created by structure, which are state-created vehicles, in conjunction with state norms for attorney governance, requires a solution that addresses the source of the fraud, not one that simply deputizes those who may witness it.

C. Corporate Governance vs. Whistleblower Standard

Corporations are "creatures[s] of State law."[194] State business codes

190. *See* Model Rules of Prof'l Conduct r. 1.7 (Am. Bar Ass'n 2018).
191. *Id.* cmt. 2.
192. *Id.* cmt. 3.
193. *See* Appendix C to Final Batson Report, *supra* note 40, at 179, 187, 190.
194. Chatman, *supra* note 84, at 827.

define the requirements for corporate formation and for governance.[195] There are no legal requirements for board membership in the state statutes, but market forces tend to impose requirements on corporations with desires to cultivate outside investors or to go public to choose a board that lends an air of legitimacy and expertise. The board manages the corporation on behalf of the shareholders acting as a fiduciary and owes the shareholders duties of loyalty, care, and good faith.[196] The board must ensure that information given to stockholders, the government, and the public is accurate. This is accomplished through the institution of proper internal controls, auditing, and legal compliance. Corporate officers are hired by the board and handle the day-to-day operations of the corporation.

Directors are tasked with exercising care and loyalty for the general well-being of the entire corporation or to outsource when they cannot provide adequate oversight.[197] They must act in the best interest of the corporation, not themselves; they must exercise the same due care in management of the business that a reasonable person would exercise in the management of their own affairs; and they must act without a corrupt motive.[198] Directors and officers can be liable in some circumstances for a failure to act. When considering whether directors and officers are in breach of these duties, courts defer to the business judgment of directors and officers under a doctrine known as the business judgment rule.[199] This rule presumes that directors and officers are motivated to act in the best interest of the corporation and its shareholders.[200] If management has proper internal controls in place, acts in a disinterested manner, and acts in good faith, a shareholder plaintiff must present evidence to overcome the presumption.

In many ways, the up-the-chain reporting requirements and the optional external reports change the attorney from a corporate agent into a fiduciary with a higher duty of care to the corporation than that held by directors and officers. Historically, attorneys owe the corporation fiduciary duties as well, but that does not require the attorney to oversee the well-being of the corporation itself.[201] An attorney is retained or hired to complete the matter or assigned tasks with loyalty, care, and utmost good faith and fair dealing. Attorneys are bound by preexisting ethical norms to operate with a heightened level of expertise and knowledge, but attorneys cannot shelter behind a business judgment rule that allows them to consult with experts and disregard that expert advice for business rea-

195. *Id.*
196. *See generally* Kelli A. Alces, *Debunking the Corporate Fiduciary Myth*, 35 J. CORP. L. 239 (2009) (recognizing that corporate law is based on the concept that boards of directors owe duties to the corporation and its stockholders).
197. *See* Davis, *supra* note 131, at 575–76; Fischel & Bradley, *supra* note 131, at 290–91.
198. *See* Davis, *supra* note 131, at 575–76; Fischel & Bradley, *supra* note 131, at 290–91.
199. *See* Davis, *supra* note 131, at 573; Fischel & Bradley, *supra* note 131.
200. *See* Davis, *supra* note 131, at 573; Fischel & Bradley, *supra* note 131.
201. See *supra* Part II.

sons.[202] Instead, attorneys must provide services that are competent based on their own reasonable judgment.

Under the new regime, attorneys appearing and practicing before the SEC who are subject to the SEC Standards "operate in a unique advisory context focused on self-regulation" of the business.[203] Attorneys are expected to

> independently decid[e] whether their client's conduct is unlawful, advis[e] the client about such determinations, and tak[e] action to prevent harm to the organization itself by escalating knowledge of the illegal conduct to executives and board members so that it may be properly addressed, thereby mitigating overall damage to the entity.[204]

This advisory role imposes business judgment duties on attorneys without business judgment rule protection and places attorneys in a position to challenge corporate actions in a way not previously sanctioned by state law and not required of corporate management. The whistleblower provisions require attorneys to do more than their job. Reporting up the chain may often result in a request for information not in the attorney's control or possession.

The disconnect between attorney duties as proposed by the whistleblower regime and director and officer duties is exacerbated by the difficulty in proving the elements of even the simplest claims that may be levied against corporate bad actors. Common law fraud forms the foundation of many claims against directors and officers. The elements include: (1) that a party make a materially false representation of fact; (2) that the party have both knowledge of its falsity or ignorance of its truth and intend that it should be actioned upon by the injured party in a manner they reasonably contemplate; (3) that the injured party have ignorance of the falsity and rely on its truth; (4) that the injured party has a right to rely on its truth; and (5) that the injured party is damaged and the false statements are the proximate cause of that injury.[205] A claim for breach of fiduciary duties against a director or officer follows traditional tort principles, requiring duty, breach, causation, and damages. The business judgment rule alters the determination of a breach of duty. Director and officer corporate liability is based on intention of actions and not outcomes alone because acting otherwise would punish management for activities that are only fully understood in hindsight. Corporate law does not punish the typical ways businesses fail: non-criminal incompetence, continuing to engage in an obsolete business, or the negative outcomes of a free-market system. Even the law of agency discourages penalizing

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202. *See supra* Part II.
203. Pacella, *supra* note 12, at 500.
204. *Id.*
205. *See* Geoffrey Christopher Rapp, *Mutiny by the Bounties? The Attempt to Reform Wall Street by the New Whistleblower Provisions of the Dodd-Frank Act*, 2012 BYU L. Rev. 73, 107 nn.235–37 (2012).

agents for actions they take on the imperfect information that may lead to a decision that does not produce the desired results.

Corporate fraud is not based on an absence of information or on obvious and easily discernible misconduct. Instead, the most successful acts of fraud are based on small lies about things that are complex and difficult to understand, in a culture that does not punish outcomes that are harmful but intentional and cloaked in process.[206] What is wrongful is the lie, not the outcome of the actions that survive the business judgment rule. The wrongful conduct is based on the falsity of representations, a conscious disregard for truth, and the intentions of the parties to harm. It is difficult to discern the role of an attorney gatekeeper or whistleblower when a client is not lying or when a client does not express the requisite intent to harm.

In a climate where most corporate conduct is not questioned by courts and not recoverable by shareholders, the whistleblower regime expects an attorney to use their reasonable legal judgment to serve as an internal regulator, instead of as an advocate. Commission of a corporate crime and corporate fraud both have standards that are higher than a breach of fiduciary duties. Disclosure alone changes the nature of actions under the law of fiduciary duties, which is sheltered by the business judgment rule and adequate internal control processes. So, what was once improper self-dealing, and even questionable business and accounting practices, is anesthetized if bad actors inform the board, the board puts systems in place to address concerns and analyze actions, and the board's decisions are informed by those systems. The lies in such a system are always wrong, but biased and misguided decisions are not. An attorney cannot be expected to discern between the lie and the mistake.

Attorneys can play a role in eradicating corporate fraud and modeling good governance but cannot be the only party within a company working in the best long-term interests of investors and the market. The same is true of all whistleblowers. Whistleblowing depends on employees, agents, and experts having access to truthful information that is harmful to the corporation and then having the courage to disclose to assuage the harm. The incentive—for market reasons and self-preservation—is to conceal and fix, rather than to disclose. Whistleblower bounties attempt to minimize or eliminate the impact of these incentives.[207] The whistleblower regime is imposed, however, on a system that relies heavily on the reasonable judgment of those in a position of trust and avoids punishing them in all but the most egregious of situations for actions that are only clearly improper with the benefit of hindsight. This is the spirit of the business judgment rule and other corporate fiduciary standards that focus

206. *See generally* CARREYROU, *supra* note 32.

207. *See, e.g.*, Carlson, *supra* note 120, at 240–41 (2009); Jisoo Kim, Comment, *Confessions of a Whistleblower: The Need to Reform the Whistleblower Provision of Sarbanes-Oxley Act*, 43 J. MARSHALL L. REV. 241, 256 (2009) [hereinafter Kim, *Confessions of a Whistleblower*].

on punishing a lack of process and truthfulness at the time of the action, as opposed to the absolute truth that may be revealed later.

The proposed change to the way attorneys think about the attorney-client relationship could help to eradicate corporate fraud, but the change fails without a parallel change to business culture. In a culture that rewards companies that are innovative while generating consistent returns for investors, an overly cautious attorney who flags marginal behavior is either kept out of the loop, completely disregarded, or dismissed.[208] A whistleblower regime without a parallel governance and cultural change encourages attorneys to avoid exposure to information that could lead to a need to disclose to remain employed. The failure is compounded by the ways that attorneys practice law, businesses are structured, and companies are governed. To eradicate corporate fraud, there must also be adjustments to business culture, so that managers do not maintain the belief that, to be innovative and successful, they must get as close to the line as possible without crossing it or they must focus their efforts on crossing the line without getting caught instead of complying with the law.

IV. THE ATTORNEY WHISTLEBLOWER MYTH

Before the Enron-inspired whistleblower scheme was developed, the Model Rules, Federal Rules of Evidence, and securities regulations all incorporated exceptions that permitted attorneys to break privilege and confidentiality or to withdraw from representation, if their services were used to commit a crime or fraud, if they believed they could not continue to represent the client without violating the ethical rules, or if they knew the client would commit perjury or otherwise violate the law.[209] Attorneys have always been explicitly prohibited from counseling clients to commit a crime or fraud.[210] These preexisting carve outs set a clear line between zealous representation of the client and participation in a client's wrongdoing. The whistleblower scheme is intended to move that line to allow attorney disclosure when an attorney is aware of client wrongdoing, has taken the required steps to remedy the situation with the client, and the client's response is inadequate;[211] or when the attorney is of the belief that remedial steps are futile and disclosure is necessary to protect the business or the market.[212] The whistleblower scheme also provides a means for penalizing attorney conduct that does amount to coconspirator but amounts to a disregard of duty to the client, its shareholders, and the market as a whole when an attorney fails to take action when they have knowledge of harmful conduct through representation.[213]

208. *Cf.* Pollman, *supra* note 2, at 735.
209. *See supra* text accompanying notes 65–72.
210. *See* MODEL RULES OF PROF'L CONDUCT r. 1.2 (AM. BAR ASS'N 2018).
211. 17 C.F.R. § 205.3(b)(1)–(3) (2019).
212. *Id.*; MODEL RULES OF PROF'L CONDUCT r. 1.6.
213. *See* 17 C.F.R. § 205.6.

Even in the face of this new regime, the most egregious corporate conduct in the years following Enron has happened without any attorney discipline. This lack of discipline highlights the role of attorneys in the representation of corporations and the nature of pure legal advice.[214] It also confirms that the very measures taken to stop attorney involvement at Enron would not have accomplished this goal at Enron. This part first explains the attorney whistleblower framework then confirms that little has occurred regarding attorney participation in corporate wrongdoing using Theranos and Tesla as examples. This part then analyzes the results of over fifteen years of changes to the SEC Standards and the Model Rules.

A. The Attorney Whistleblower Framework

Crafting legislation that maintains the attorney advocate and counselor roles while allowing for gatekeeping and whistleblowing roles is difficult. Lawyers may be present and may be one of the parties to decision making without being a coconspirator in fraud.[215] As a result, the solutions in Sarbanes, which have significantly changed other aspects of corporate governance, including accounting, have not had a similar outcome on attorneys.[216] There have been numerous Sarbanes-inspired administrative, civil, and criminal actions against other actors but zero against attorneys.[217]

The realities of the practice of law make it a difficult subject for nationwide, "federal [ ] action, let alone mandates."[218] The SEC Standards attempt to intervene as little as possible, yet still have impact. Attorney discipline should be left in state hands, as states are better situated to react quickly in the face of attorney misconduct. The SEC Standards, in conjunction with the Model Rules, create confusion and conflict that has yielded no results to date. A better solution is the repeal of the Sarbanes-inspired standards, leaving attorney conduct in state hands. This is particularly true if the courts continue to view the attorney whistleblower as an anathema—a producer of worthwhile information but too disrespectful of attorney-client norms to be worthy of protection.[219]

The changes to the SEC Standards and the Model Rules delineate extensive procedures for both outside counsel and in-house attorneys to serve as a stopgap for corporate misconduct. At nearly every step, however, there is a call for the attorney to rely on their own judgment to decide whether it is appropriate to act.[220] The Sarbanes-inspired changes to the SEC Standards and the Model Rules require attorneys to: (1) ob-

214. *See* Ribstein, *The Death of Big Law*, *supra* note 74, at 757–60.
215. *See* Rosen, supra note 28, at 47–50.
216. *See id.*
217. *See generally* Carreyrou, *supra* note 32. There have been no enforcements against attorneys in any roles. *See supra* note 21.
218. Romano, *supra* note 9, at 1597.
219. *See, e.g.*, Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767, 781–82 (2018).
220. *See* 17 C.F.R. § 205.3 (2019).

tain information through representation; (2) make a judgment call on whether it is evidence of a violation of law or harmful to shareholders or the market as a whole, then report the information internally; (3) make an intermediary set of judgment calls to determine whether the representatives of the company took adequate steps to address the matter, and if the attorney feels those efforts fell short, report further up the chain internally; and (4) if the matter is still not appropriately handled, make a final optional decision to report externally.[221] A flaw of the whistleblower regime includes its over-reliance on attorney judgment of elements including reasonableness, materiality, harm, and even what constitutes evidence of wrongdoing.[222] It also includes several escape valves, including disclosure to an internal Part 205 Committee, which enables an attorney to comply enough to avoid discipline and also avoid being a disrupter at their law firm or company.

The whistleblower regime would have little impact, if it only existed in the SEC Standards. The SEC Standards do not apply to all attorneys representing a publicly traded corporation. To be governed by the SEC Standards, an attorney must, on the behalf of a client who is an issuer of securities, transact business with the SEC, communicate with the SEC, represent the client at administrative proceedings or in connection with the SEC, advise on or prepare documents that the attorney knows will be filed with the SEC, or advise clients on what materials are required by the SEC.[223] The SEC Standards state that an attorney owes his duties to the issuer as an organization and has a duty to report evidence of a material violation by the issuer or any agent of the issuer to the GC, the CEO, or both.[224] It reminds the attorney that reporting internally does not reveal client confidences or otherwise violate privilege.[225]

Through most stages of the SEC Standards, all information is exchanged within the company and there is no breach of confidentiality. The risk to the attorney who reports is not an ethical violation but retaliation through the termination of employment or discharge from representation.[226] The only remedy an attorney who believes they have been discharged for reporting evidence of a material violation has is to report their belief to the company's board or a committee.[227] The whistleblower protections and bounties only apply when an attorney qualifies as a "whistleblower" under Sarbanes and Dodd-Frank, and all statutes require external reporting as the initial stage of whistleblowing.[228] This fact, in conjunction with the unclear definitions found in the SEC Standards and the Part 205 Committee loophole, make it difficult for an attorney to be

221. *See id.*; *see also* MODEL RULES OF PROF'L CONDUCT r. 1.2, 1.6, 1.13 (AM. BAR ASS'N 2018).
222. 17 C.F.R. § 205.3.
223. *Id.* § 205.2(a)(1).
224. *Id.* § 205.2(a)–(b)(1).
225. *Id.*
226. *See* Pacella, *supra* note 12, at 502–03.
227. 17 C.F.R. § 205.3(b).
228. Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767, 780 (2018).

motivated to initiate the first steps of the whistleblower regime and equally difficult to find an attorney liable for failure to do so.

An attorney may break client confidentiality and privilege and report to the SEC without the client's consent, to the extent the attorney believes it is necessary to prevent the client from

> committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors; [or t]o prevent the issuer . . . from committing perjury, . . . or committing any act . . . that is likely to perpetrate a fraud upon the Commission; or . . . [t]o rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in furtherance of which the attorney's services were used.[229]

External reporting is optional, not mandatory like up-the-chain or compliance committee reporting, and rests on reasonableness. It also has an unusual approach for attorney-client representation in that it allows retroactive action. Typically, exceptions to confidentiality and privilege only apply to future, non-contemporaneous or prior actions. In addition, the standard for external reporting is stronger than the material violation required for up-the-chain reporting. Actions must cause substantial injury to financial interests or be clearly false statements that could lead to perjury or fraud.[230] There is no clear definition of what constitutes substantial financial interest, nor is there guidance. Instead, an attorney is expected to question the business judgment of its clients in a way that is not required of other parties elsewhere in securities and corporate law.

Historically, the SEC Standards have always given deference to the power of the states to regulate attorneys. This has remained true even in the context of the Enron-inspired whistleblower regime. An attorney practicing before the SEC in the representation of an issuer is subject to two systems simultaneously: the rules governing lawyers in all jurisdictions where they are admitted and the SEC Standards. Part 205 supplements state bar rules and does not "limit the ability of any jurisdiction to impose additional obligations," so long as those additional obligations do not contradict Part 205.[231] When there is a conflict, Part 205 governs. Not all jurisdictions have adopted the changes to Model Rules 1.6 or 1.13, so those attorneys have the advantage of only complying with one change that may result in liability.

The biggest flaw in the whistleblower regime is the conflict between what is required under the Model Rules and what is required under the SEC Standards. The different lines for external reporting, coupled with access to whistleblower protection that is based on compliance with the SEC Standards, create a scheme in which compliance with the SEC Standards may violate the Model Rules but may be the only means an attor-

229. 17 C.F.R. § 205.3(d)(2).
230. *See* Model Rules of Prof'l Conduct r. 1.6 (Am. Bar Ass'n 2018).
231. 17 C.F.R. § 205.1.

ney has to protect their livelihood. It is no surprise that attorneys are not reporting client misconduct in this system. It is also no surprise that there have been no enforcements.

The new version of Rule 1.6 allows a lawyer to reveal information relating to the representation of a client "to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another," if the attorney's services are used to further the crime or fraud.[232] Rule 1.6 also allows an attorney to disclose information to "prevent, mitigate or rectify substantial injury to [] financial interests."[233]

The previous version of Rule 1.6 did not include any exceptions for financial harm. Instead, an attorney could only reveal confidential information to prevent a crime or fraud likely to result in death or bodily harm. Notably, all exceptions to confidentiality are forward-looking, except those related to financial interests. Rule 1.6(b)(3)'s allowance of disclosure "to prevent, mitigate or rectify" is unusual, as it is not found elsewhere in the ethical rules or even in the Federal Rules of Evidence.[234] For example, once a client has actually caused the death or bodily harm, disclosure of the crime is a clear violation of the Model Rules, even if disclosure would prevent the wrongful conviction of another or give comfort to the family members of victims. An attorney who chooses to disclose may be subject to discipline. This is no longer the case with harm to the market or shareholders.

The Model Rules and the SEC Standards are similar but not the same. They are consistent conceptually—there are actions that require the attorney to report up the chain, the client is the company not its constituents, and there is a threshold upon which more egregious behavior may be reported externally. Up-the-chain reporting is virtually identical with the Model Rules having fewer steps defining what "up the chain" means.[235] Where they differ is external reporting, which happens to be what is required for attorneys to access bounties and whistleblower protection under the SEC Standards. The external reporting conflict coupled with minimal protections and awards may be why there are no enforcements and no evidence of external attorney reports.

Notably, while Sarbanes and the Model Rules deputize attorney whistleblowers to report externally when there is likely to be substantial harm to shareholders or the market,[236] Dodd-Frank back tracks, eliminating the ability for attorneys to claim bounties and protections in most circumstances involving the traditional practice of law.[237] Section 922 of Dodd-Frank required the SEC to adopt rules to reward whistleblowers,

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232. MODEL RULES OF PROF'L CONDUCT r. 1.6(b)(2).
233. *Id.*
234. *See generally* FED. R. EVID.; MODEL RULES OF PROF'L CONDUCT.
235. *See* MODEL RULES OF PROF'L CONDUCT r. 1.13.
236. The SEC Standards also allow for disclosure for perjury or fraud on the SEC. 17 C.F.R. § 205.3(d)(ii).
237. *See* 15 U.S.C. § 78u-6(h) (2010).

which the SEC implemented in 2011.[238] In most circumstances, the SEC excludes attorneys from these rewards. In statements, the SEC explains that they intend to "send a clear, important signal to attorneys, clients, and others that there will be no prospect of financial benefit for submitting information in violation of an attorney's ethical obligations."[239] This clarification for attorneys happens at a time when whistleblowing for other parties is being promoted. The SEC whistleblower reward excludes information if it was obtained through a privileged communication; in connection with legal representation; because the person was an officer, director, trustee, or partner or learned the information in connection with the entity's duty to report; if the person was an employee with a principal duty involving compliance; or if they were retained for an investigation.[240] Essentially, the reward excludes every role an attorney would hold in representing an issuer before the SEC. The regulations state that an attorney can disclose confidential client information and possibly be eligible for an award, if it qualifies for an external disclosure under the SEC Standards and the Model Rules. The law does not protect attorneys unless they fit the limited circumstances for an external report. In states that have not adopted the updated version of the Model Rules, there may be no circumstances in which an attorney can make a qualifying external report. The Supreme Court confirms this interpretation of Dodd-Frank whistleblower requirements in *Digital Realty Trust, Inc. v. Somers*, holding that the very definition of whistleblower under Dodd-Frank requires reporting to the SEC.[241]

The definitions provided by the SEC and the ABA are all circular and provide little guidance, which, in turn, does not provide a clear path for enforcement and discipline. They are also inconsistent. Under the SEC Standards, a company can stop a whistleblower in their tracks by forming a Part 205 Committee, enabling the company to avoid the risk that a report by an attorney dissatisfied with the actions taken by management will result in a report to the SEC or other external bodies.[242] The committee's existence, which stops the internal whistleblower from having grounds to report externally, also thwarts the whistleblower's ability to avail themselves of remedies for retaliation.[243] The Model Rules provide a space for external reporting but also rely heavily on attorney judgment and maintain the previous options of noisy withdrawal from representation of problematic clients.[244] The Model Rules leave more in the hands of attorneys and attorney judgment. Thus, while the SEC Standards and

238. *Id.* § 78u-6(b). The SEC must pay from 10%–30% of amounts collected. *Id.*

239. Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34,300, 34,315 (June 13, 2011) (codified as amended at 17 C.F.R. §§ 240, 249).

240. 17 C.F.R. § 240.21F–4.

241. Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767, 777 (2018).

242. *See* 17 C.F.R. § 205.3(c)(2).

243. *Digital Realty*, 138 S. Ct. at 780 (holding that the anti-retaliation provision of the Dodd-Frank Act does not extend to individuals who do not report a violation of the securities laws to the SEC).

244. *See* Model Rules of Prof'l Conduct r. 1.2(d) (Am. Bar Ass'n 2018).

the Model Rules provide an extensive attorney whistleblower regime with clear steps for an attorney to take to properly report internally and externally without violating preexisting confidentiality and privilege rules, they also create a system with new places for information on corporate wrongdoing to linger and a process by which attorneys can rely on reasonable judgment to avoid reporting at all. The differing standards create an ambiguity that can be manipulated.

In concert, the SEC Standards and the updated Model Rules create a regulatory regime that makes attorney whistleblowing a possibility and that requires attorneys to disrupt the internal culture of their clients through reporting to higher-ups. The conflict between the requirements for external reporting and the requirements to receive bounties shows intent to deputize attorneys as internal regulators, forcing them to dissuade wrongful behavior and jeopardize their livelihood without the protections awarded to other employee whistleblowers.[245] Although the SEC alludes to the possibility that a scenario exists in which an attorney can report externally and receive whistleblower protection and awards, so far, courts have explicitly excluded attorneys from the awards in many jurisdictions and found that attorneys do not meet the standards for protections in others.[246] This exclusion from bounties and whistleblower protections emphasizes the minimal impact of the Sarbanes changes.[247] If protection is for whistleblowers but state ethical and evidence laws can exclude attorneys from the protective scheme, the SEC is acknowledging in a roundabout way that the attorney whistleblower is not real. The courts are telling us that the attorney whistleblower is impossible. Attorney-client privilege and confidentiality are sacrosanct. Courts will not allow an attorney to profit from secrets, even when revealing them serves the greater good, yet expect attorneys to maintain the integrity of the system through gatekeeping and whistleblowing without redress. Without incentives for the attorney whistleblower, the attorney gatekeeper role fails. Regulators like the idea of attorneys in these roles but have done nothing to facilitate them.

The whistleblower framework fails in part because the definition of this new line for attorney disclosure of client misconduct is ambiguous and the SEC Standards and the Model Rules are inconsistent. The new whistleblower regime does not have a clear, bright-line definition of how much attorney knowledge is enough to allow an attorney to disclose without violating privilege and confidentiality, and it disregards the norms that govern directors and officers.[248] Nor is there a bright-line rule for when internal escalation up the chain is required, and often, the attorney must operate internally before ever considering external action.[249] The

245. *See supra* notes 194–218 and accompanying text.
246. *See id.*
247. *See, e.g.*, Carlson, *supra* note 120, at 240; Kim, *Confessions of a Whistleblower*, *supra* note 207, at 249–50.
248. *See* 17 C.F.R. § 205.3 (2019); Model Rules of Prof'l Conduct r. 1.6, 1.13.
249. *See* 17 C.F.R. § 205.3; Model Rules of Prof'l Conduct r. 1.6, 1.13.

discretionary nature of the legal practice makes it difficult to define a clear line from protected client communications to information that may be disclosed.[250] Determining what disclosure is allowed beyond the previous, clearly defined crime-fraud exception is difficult without the benefits of hindsight.[251] This is because, when legislators designed the whistleblower regime, they did so with the purpose of giving attorneys an option to fill roles that contradict the very purposes of relying on legal representation.[252]

Securities laws, including the SEC Standards, create a scheme that regulates financial rights where other laws fall short. When investment opportunities have a proximity to capital markets or when an activity gives the public an expectation that it will fit within the bounds of the Securities Act, courts tend to apply the laws. When another regulatory regime adequately addresses the harm, however, courts and regulators are hesitant to extend the securities laws to incorporate the activities. In cases that determine whether activities fall under the purview of the SEC, courts have disregarded the label attached by promoters and managers when the underlying activity appears to fit within the regime. The role of attorneys at companies that fall within the securities regulatory regime presents a unique hybrid scenario. When engaged in the practice of law, attorney conduct is fully regulated by state bar associations, who determine qualifications, administer bar exams, and impose discipline. The attorney disciplinary regime does not, however, require attorneys to assume the role of protecting the market from their clients' fraudulent behavior. Nor does it apply when attorneys are engaged in nonlegal representation. Yet, the SEC continues to give deference to state law definitions of the attorney-client relationship, including the definition of a client and the corresponding privileges.[253] When it comes to regulating the activities of attorneys, even when drafting new regulations that govern attorney behavior, the SEC has held fast to the definitions found in business law and state attorney ethics codes.[254] The SEC's desire to impose the new role on attorneys while deferring to state law judgments on attorney conduct, business structure, and corporate governance means that it is impossible to successfully deploy the attorney whistleblower regime. It conflicts with every aspect of state law that the SEC desires to leave unchanged. The best solution is a repeal of Part 205 and the resulting SEC Standards.

The structure of the practice of law naturally leads to a breakdown in reporting and, if attorneys are a true source of material information, detection.[255] The Sarbanes-inspired changes seek to require attorneys to

250. *See* 17 C.F.R. § 205.3; MODEL RULES OF PROF'L CONDUCT r. 1.6, 1.13.
251. *See* 17 C.F.R. § 205.3; MODEL RULES OF PROF'L CONDUCT r. 1.6, 1.13.
252. *See* Pacella, *supra* note 12, at 529.
253. *See* HAZEN, *supra* note 48, at 200–02 (explaining the history of SEC regulation of attorneys).
254. *See id.* at 223–25.
255. *See id.*

share more information up the chain internally and, in extreme circumstances, report to the SEC, but an attorney cannot report what they do not know.[256] When representing a company under the Model Rules, an attorney cannot bring issues to the attention of a GC or board that they do not understand. Whistleblowing for other employees can be based on a hunch because they do not have an overarching regime of privilege and confidentiality that create a floor for external disclosure. But for attorneys engaged in the practice of law on behalf of a client, the triggers for application of the new whistleblower regime are the very thing Enron's attorneys did not have: actual knowledge or reasonable belief.[257] As a result, the SEC Standards and the Model Rules solution resolves a nonexistent problem—attorneys participating in corporate fraud with actual knowledge or reasonable belief—through an impossible solution—up-the-chain reporting or external reporting upon obtaining material evidence—resulting in an absence of disciplinary and enforcement actions and confirming that the attorney whistleblower is mythical.

B. The Mystery of Modern Fraud

In a piece entitled *Enron's Open Secrets* that has been viewed by some as a partial defense of Enron, Malcolm Gladwell discusses the difference between a mystery and a puzzle.[258] Gladwell suggests that most corporate frauds are mysteries—helped by legal business structures and corporate governance norms.[259] As a result, it is not that the information is not available, it is that there is a lot of information that is siloed in structures and it is difficult to analyze all the information to uncover the scheme. It is difficult to distinguish a lie from the truth in a sea of facts. Puzzles are different. If corporate fraud was a puzzle, parties would simply be eliminating the pieces—for example, not filing periodic reports, tax returns, or public records.[260] We would know something is wrong because something would be missing. In essence, modern corporate fraud involves simple lies about complicated things. When these simple lies about complicated things are combined with a culture that is light on enforcement and heavy on rule breaking for innovation's sake, it is difficult to determine what behavior will be egregious enough to be actionable.

Because the whistleblower regime does not help solve the puzzle, which is only assembled by making the necessary changes to governance to minimize the concealment of material facts and moving away from a culture that prioritizes the presence of short-term gains, it does little to prevent corporate wrongdoing. Instead of addressing corporate fraud, what the whistleblower regime does, in conjunction with other forces, is

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256. *See supra* notes 9–20 and accompanying text.
257. *See supra* notes 98–105 and accompanying text.
258. *See* Malcolm Gladwell, *Open Secrets: Enron, Intelligence, and the Perils of Too Much Information,* New Yorker (Jan. 1, 2007), https://www.newyorker.com/magazine/2007/01/08/open-secrets-3 [https://perma.cc/2AYJ-RPQZ].
259. *See id.*
260. *See id.*

train companies on how to avoid regulation and manipulate the market with or without the assistance of their attorneys. The Enron problem is addressed by remaining private, continuing to rely on structural complexity, and in extreme circumstances, avoiding legal counsel. For example, at Theranos, when Elizabeth Holmes defrauded her investors, attorneys were present at nearly every step.[261] In fact, she often used attorneys to intimidate her enemies, and attorneys served on her board.[262] Attorneys advanced nonviable defenses and failed to report known deception to the full board. But the Theranos directors had an odd devotion to Holmes. Even in the face of information on the failure of the product and of possible violations of Food and Drug Administration (FDA) regulations, they trusted Holmes's representations over the evidence presented by whistleblower employees.[263] In turn, Theranos investors, and even high-profile customers like Walgreens, relied on the reputations of those directors when choosing to invest.[264] In the culture of Theranos, attorneys who did not go with the flow were terminated and those who served Holmes as she desired were promoted.

Theranos is the example that most closely resembles Enron. It is a corporate scandal that involved attorneys at every stage but, even with the existing whistleblower regime, no attorneys have been subjected to SEC enforcement or disciplinary actions by state bar associations. Investors and regulators have also failed to name Theranos attorneys in civil litigation or administrative action, even in the face of known violations of FDA regulations and the eventual bankruptcy of Theranos. Holmes sought to revolutionize the blood testing business through a new technology that could run lab tests on just a drop of blood from a finger prick.[265] The idea, though ambitious, is scientifically impossible, yet Holmes was able to become a celebrity, receiving accolades for being the youngest female CEO and self-made billionaire.[266] Holmes obtained billions of dollars of funding in over a decade of operations, including a major contract with Walgreens, without any proof that the blood testing devices actually worked or that the company had any contracts.[267] Theranos never developed a working device and instead shipped blood samples back to its internal lab, running tests on equipment manufactured by its competitors.

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261. *See* CARREYROU, *supra* note 32, at 7. Henry Mosley, the first CFO of Theranos, was fired for refusing to inflate financials and for bringing up concerns during meetings. *Id.* at 8.

262. *See id.* at 133–35, 256–57, 271–72, 279 (profiling how Theranos's attorneys, particularly David Boies and his former partners, were used to intimidate Holmes's opposition).

263. *See, e.g.*, *id.* at 80–91.

264. *See id.*

265. *See id.* at 3–5, 16–17.

266. *See, e.g.*, *Youngest Richest Americans 2014: Elizabeth Holmes*, FORBES, https://www.forbes.com/pictures/emjl45kfml/elizabeth-holmes/#1f8b61a97af6 [https://perma.cc/WBN7-8KS2] (last visited Nov. 2, 2019).

267. CARREYROU, *supra* note 32, at 80–91.

Holmes solves the Enron attorney problem by not consulting attorneys with the expertise to tell her no, siloing information within her company, keeping in-house attorneys in the dark, and hiring attorneys to advance defenses that were colorable, only if the attorneys lacked the information she kept siloed and embargoed.[268] Holmes also surrounded herself with knowledgeable and reputable directors, and used their credibility to shield the company's failures and her fraudulent schemes.[269] Holmes arranged the company with redundant teams, then had those teams compete with each other to develop solutions faster or face being fired. There was no room to question Holmes's vision. She created a culture of competition, paranoia, and self-doubt. Employees were not permitted to communicate with each other about their tasks; they also were advised to not reveal the company name on social media sites like LinkedIn.[270] Security monitored the coming and goings of employees and tracked their computers. Holmes claimed it was to protect trade secrets.[271]

Whistleblowers are responsible for the exposure of Theranos, but those whistleblowers—who include Tyler Schultz, the grandson of former Secretary of State George Schultz, an early supporter and director of Theranos—do not include a single Theranos attorney.[272] Instead of working to ensure that Theranos complied with regulations and followed corporate governance norms, its attorneys were deployed as a weapon against naysayers. David Boies, who served on the board of directors, and his former partner, who served as GC, invested in the company and defended Holmes's trade secret and other claims in court and elsewhere. Holmes fired the first GC of Theranos, Michael Esquivel, after his attempts to work within the company to investigate wrongdoing and inform the directors of his concerns were ignored.[273] Subsequent GCs were completely loyal to Holmes. An attorney, David Taylor, was the last executive standing after regulators uncovered the scheme and forced the company to reorganize. After federal prosecutors filed charges against Holmes and her ex-boyfriend Ramesh "Sunny" Balwani, "alleging that they defrauded investors out of hundreds of millions of dollars and defrauded doctors and patients" with inaccurate tests and false promises, Theranos was forced to dissolve.[274]

The perceived difficulties in the pending case against Holmes of Theranos exist because fraud is not found in every failure. Fraud is not outcome determinative. Fraud is about the mental state of actors when they bring about a downfall. The whistleblower and gatekeeper regimes, therefore,

268. *Id.* at 20.
269. *See, e.g.*, *id.* at 4.
270. *Id.* 296–97.
271. *Id.*
272. *See* John Carreyrou, *Blood-Testing Firm Theranos to Dissolve*, WALL ST. J. (Sept. 5, 2018), https://www.wsj.com/articles/blood-testing-firm-theranos-to-dissolve-1536115130 [https://perma.cc/RRQ7-3C3Z] [hereinafter Carreyrou, *Blood-Testing Firm Theranos to Dissolve*].
273. *See* CARREYROU, *supra* note 32, at 50–51, 54.
274. Carreyrou, *Blood-Testing Firm Theranos to Dissolve*, *supra* note 272.

do not require attorneys to simply supply management with information regarding negative outcomes, they expect attorneys to read the minds and make fact-based decisions regarding the intentions of the very people who have retained them. The lack of regulatory action against the attorneys involved in these incidents may be proof that regulators and law enforcement acknowledge both the absurdity of the premise of a gatekeeper or whistleblower and the near impossibility of proving what an attorney knew at any given time about the intentions of another person.

Tesla presents another tactic deployed by corporations to resolve the Enron problem. Tesla is a market darling which, to date, has no evidence of fraud, but it is openly engaging in questionable governance behavior. At Tesla, Elon Musk has used the company to bail out his other business ventures when they have faced financial difficulty, such as the merger of SolarCity with Tesla.[275] Musk forced this merger, despite expert accounts that the acquisition was not in Tesla's best interest and without any regard for the conflicts of interest between himself and other board members with SolarCity.[276] Musk also treats Tesla as his alter ego, using his personal Twitter account to report inaccurate information to the public, resulting in fines and enforcement activity from the SEC.[277] He has tweeted about delisting Tesla and making it a private entity—a task that is impossible under the terms of his tweet. He has also defied SEC orders, continuing to use Twitter to communicate about Tesla.[278] The behavior of Musk at Tesla is illustrative of how the cult of personality, board complicity, and shareholder acceptance make it impossible for attorney intervention alone to effectuate change. Musk and Tesla are notable because the failures in governance have resulted in regulatory action and shareholder litigation. Yet, the market continues to reward Tesla with a vote of confidence through its stock valuation. Tesla shareholders also continue to endorse Musk's leadership.[279] To investors, the promise of Tesla is worth the penalties that have resulted from Musk's violations and the fallout of questionable governance practices.[280]

Musk's tweet storm, in which he expressed a desire to take the company private, is telling. In the tweet, he brags about the idea of a private entity being able to operate with minimized regulatory oversight.[281] He is of the belief that going private solves everything. Musk operates at Tesla the way he operates at partnerships and seeks to force the corporation

275. *See generally In re* Tesla Motors Stockholder Litig., No. 12711-VCS, 2018 WL 1560293, at *10 (Del. Ch. Mar. 28, 2018).

276. *Id.* at *19.

277. *See* Complaint at 1–2, SEC v. Musk, No. 1:18-cv-08865 (S.D.N.Y. Sept. 27, 2018).

278. *See* United States Securities and Exchange Commission's Motion and Memorandum of Law in Support of an Order to Show Cause at 1–2, *Musk*, No. 1:18-cv-08865.

279. *See, e.g.*, Alexandria Sage & Ross Kerber, *Tesla Shareholders Approve CEO Musk's $2.6 Billion Compensation Plan*, REUTERS (Mar. 21, 2018), https://www.reuters.com/article/us-tesla-ceo/tesla-shareholders-approve-ceo-musks-2-6-billion-compensation-plan-idUSKBN1GX0C0 [https://perma.cc/J6K6-CUFW].

280. *See, e.g.*, *id.*

281. *See* Complaint, *supra* note 277, at 12.

into the limited partnership structure. Musk desires for his complete dominance in leadership to be acceptable and for investors to have limited influence over his decision making. He believes a structural change will give him both the freedom and revenue he desires. Musk is not alone in this belief, as many in the industry feel private operation is the solution.[282] There seems to be a belief that innovation cannot be paired with following the rules—and if parties are avoiding the rules, they are probably also avoiding the lawyers.

In 2016, Musk decided to use Tesla stock to bail out SolarCity, the failing venture in his three-business pyramid that includes Tesla and SpaceX.[283] Fully aware of the conflicts of interest that existed, Musk structured the transaction by the book. He abstained from voting, obtained separate legal and investment bank counsel, and formed an independent committee to investigate pursuing the deal. After covering the bases to avoid a breach of fiduciary duty, Musk then disregarded the advice of the experts, even though it instantly doubled Tesla's debt, was deemed to be overvalued by experts, and was not the best option for a solar expansion.[284] Through coercion of other board members, exploitation of conflicts of interest, and mock procedure, Musk was able to secure a majority of shareholder votes and the full support of the board.

At the transaction's conclusion, Tesla owned what was billed by Goldman Sachs as the worst solar investment on the market.[285] Tesla doubled its debt taking it from $3 billion to $6 billion, harming its position with creditors.[286] Shareholders, directors, and officers of SolarCity, including Musk, his family, and friends, obtained a windfall and a complete return on investment in SolarCity through the sale at a price that exceeded the business valuation, avoided the consequences of a bankruptcy, and allowed them to continue management of the new wholly owned Tesla subsidiary. Though Musk's influence over institutional investors, many of whom are invested in all three Musk enterprises, and his control of his friends and supporters on the board, he was able to force Tesla into a transaction that by all accounts did harm to the company, because it collectively benefited his empire.

Tesla's behavior has not, to date, triggered a corporate fraud scandal. Musk's behavior and the SolarCity transaction is not criminal or fraudulent. They may not even equate to a civil breach of fiduciary duty, if a court finds that the recusal, retention of experts, and other measures fail to rise to a level of a breach of duty of loyalty, care, or good faith. His Twitter activity violates SEC regulations but does not rise to the level of

282. *See* Zachary Karabell, *The Case Against Elon Musk Will Chill Innovation*, WIRED (Sept. 29, 2018), https://www.wired.com/story/the-case-against-elon-musk-will-chill-innovation [https://perma.cc/2YCM-WTYW].

283. *In re* Tesla Motors Stockholder Litig., No. 12711-VCS, 2018 WL 1560293, at *19 (Del. Ch. Mar. 28, 2018).

284. Karabell, *supra* note 282.

285. *See In re Tesla*, 2018 WL 1560293, at *7.

286. *See id.* at *11 n.186.

securities fraud. Instead, it is evidence of a legal loophole for behavior that is oppressive to shareholders, economically inefficient, and allows corporate management to manipulate corporate assets for personal gain. As far as we know, there has been no whistleblowing about Tesla or Musk's behavior. An attorney who wishes to remain employed in a culture like Tesla's must stick to burying their head in the sand and only doing work in the silos in which they are hired. An attorney cannot blow the whistle on things they do not know, and they cannot have the legal certainty required when Musk's behavior fails to result in any material legal consequences.

Perhaps the attorney whistleblower regime is not intended to result in actions against attorneys and is instead meant to remind attorneys that they must not ever knowingly participate in or facilitate corporate fraud. Unfortunately, a warning shot can have consequences—mainly behavioral and market changes—particularly if nothing about the overall culture is changed. What remains post-Enron, post-Sarbanes, and even post-Dodd-Frank is a culture that: (1) continues to focus on positive quarterly and annual reports that show constant growth; (2) ignores the culture that the need for constant growth and positive report creates; and (3) leaves in place a system that allows companies to manipulate structures and transactions to get those results on paper without realizing any growth. These actions are legal and not in violation of any laws–which means that the attorney whistleblowing scheme is not triggered. A company can meet accounting standards, comply with state corporate laws, and properly report as required by the SEC and still commit fraud in plain sight using the Enron model for corporate structure. This is because, while accountants must now consider the real party at interest when making reports, audit independently, and prioritize accounting principles and standards over client relationships generally, corporate legal representation did not undergo a similar cultural change.[287] The chilling effect on the attorney-client relationship is only worthwhile if it results in changes that are, at the least, as beneficial as the damage it causes.

Depending on so many variables that rely on both human judgment and courage is an inefficient way to make real change. Instead, to achieve the results desired by the Enron-inspired changes to the role of attorneys, there must be a shift in the culture of business accompanied by appropriate changes to state definitions of entities and requirements for corporate governance. The capital markets reward positive periodic reports,[288] corporate leaders who develop a cult of personality that obfuscates the reality of return on investment, and leaders who are innovative and cutting edge.[289] Disclosure alone cannot work in the face of these incentives. No

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287. *See* Susanna M. Kim, *Dual Identities and Dueling Obligations: Preserving Independence in Corporate* Representation, 68 TENN. L. REV. 179, 182–85 (2001); Romano, *supra* note 9, at 1528–29.

288. *See* BAINBRIDGE, *supra* note 12, at 1–2.

289. *See, e.g.*, CARREYROU, *supra* note 32, at 5 (describing venture capital culture of inflating numbers; the "hockey-stick forecast").

intermediaries can stop a client who is set on committing fraud. Even the savviest attorney can be fooled by deliberate lies. But if structures are not in place that allow shielding attorneys from relevant information, then it will be possible for them to meet the higher knowledge standard for attorney whistleblowing. Such a structural change will not, however, prevent clients set on committing fraud from avoiding attorney advice altogether.

C. The Meaning of Zero

Misidentifying the real client at interest—the corporation—is one of the long-standing agency costs of the corporate form. It is an issue with all corporate agents and fiduciaries.[290] When combined with the attorney-client relationship, it creates a special mix ripe for collusion that can ultimately hurt the corporation, its investors, and even the entire economy. Before Sarbanes, state corporate laws and federal regulations provided remedies aimed at minimizing these costs but largely left the attorney-client relationship untouched.[291] The SEC Standards and the Model Rules attempt to harness the sacred nature of the attorney-client relationship to head off-market crippling corruption before it is too late and to give corporations an earlier chance to address employees who are not working in the corporation's best interest. To promote this social good, the provisions include a hammer: attorneys found in violation of Sarbanes may face fines and jail time, and an attorney violating the Model Rules may face disciplinary action. However, in the sixteen years since Sarbanes and the fifteen years since the amendment of the Model Rules, there have been no enforcement or disciplinary actions against attorneys on these grounds.[292] In comparison, the SEC has pursued thousands of Sarbanes-based actions against accountants and other corporate agents.[293] To date, more than fifteen years after implementation, there have been no SEC enforcements for attorneys who have failed to comply with the up-the-chain or external reporting requirements found in the SEC Standards.[294] There has also been no reported disciplinary action in

290. Agency costs are inherent in the corporate form because of the separation of ownership and control. *See* Douglas M. Branson et al., Business Enterprises: Legal Structures, Governance, and Policy 368 (3d ed. 2016). Corporations may only act through directors, officers, employees, agents, and fiduciaries. *Id.* Economists and legal scholars theorize that because none of the parties working on behalf of the corporation "own" the corporation, they are not always incentivized to work in the corporation's best interest. *Id.* at 348. Good corporate governance is needed to eliminate shirking, self-dealing, and fraud. *See id.* at 337, 347–48. Corporations attempt to instill a sense of ownership through stock options and other incentives, shareholders may pursue legal action for egregious violations, and regulations are designed to allow for the detection of governance failures early and for the punishment of misconduct. *See id.* at 597–600.

291. *See* Hazen, *supra* note 48, at 198–202.

292. *See supra* note 21.

293. *See id.*

294. Notably, there is a lack of pursuit of whistleblower claims for other employees as well. *See* Bainbridge, *supra* note 12, at 105–06 (as of 2004, "of 223 cases filed under the whistle-blower provisions of Sarbanes . . . all but 8 dropped," meaning 96% of cases were dropped).

states that have adopted the current versions of Rules 1.6 and 1.13 and no bounties awarded to attorneys for whistleblowing under the SEC Standards in conjunction with Dodd-Frank.

Although promising, the attorney whistleblower scheme seemed destined for failure. The triggers turn on attorney judgment—a standard that is difficult to impossible to judge in all but the most egregious attorney judgment calls without the benefit of hindsight. In addition, it is possible that the changes to the SEC Standards and the Model Rules are not necessary at all. The evidence rules, ethical rules, and preexisting SEC regulations all mandated and punished attorneys for conspiring with clients to commit crime or fraud. While the whistleblower regime has failed to result in discipline, it could be impacting the way attorneys practice law, the way clients retain legal services, and the way business is conducted.

The SEC Standards and the Model Rules provide avenues for avoiding the scheme altogether. An attorney may comply by reporting to an internal compliance committee, by merely counseling the client to engage in appropriate behavior, or by finding a colorable defense to the conduct. Attorneys can avoid the scheme in more nefarious ways by simply avoiding the acquisition of reasonable evidence—a feat that is possible under the current system for handling clients and matters that is imposed on businesses structured with multiple separate legal entities. If an attorney specializes or is retained for a particular matter, they may justifiably silo themselves to provide legally competent representation. If a client maintains a complicated web of entities and retains separate counsel for each, an attorney has no duty to investigate the conduct at other entities within the corporate family. And an attorney retained to represent generally has no obligations to investigate beyond the scope of that representation, nor does the attorney have an obligation to become an expert on nonlegal matters. So, they may bury their head in the sand.

For these reasons, preventing corporate crime and fraud is not a feat that can be accomplished by a company's attorneys alone, particularly in a market that can reward bad actors for concealing their conduct in the short term. Although attorneys have been deputized as whistleblowers, they notably have been excluded from whistleblower protections and from enforcements and ethical discipline for failure to comply with the Enron-inspired SEC Standards and Model Rules 1.6 and 1.13.[295] The lack of enforcement stems from the virtual impossibility of an attorney fulfilling the whistleblower role while providing purely legal representation.[296] The lack of enforcement against attorneys for failing to disclose misconduct is also, in part, because the downfall of Enron and the financial crisis

295. *See* 17 C.F.R. § 205.3 (2019); MODEL RULES OF PROF'L CONDUCT r. 1.6, 1.13 (AM. BAR ASS'N 2018). Attorneys who have blown the whistle were in-house attorneys, some serving in quasi-legal or nonlegal roles. Those attorneys would have whistleblower protections and obligations pre-Sarbanes as employees, officers, or parties required to sign off on periodic reports. This article is concerned with attorneys engaged in the traditional practice of law.

296. *See supra* Part II.A.

that inspired recent changes were not caused by a lack of information. Instead, the source of fraud was false and misleading information, coupled with manipulation of legal structures like special purpose entities, subprime loans, and default swaps.[297] Therefore, a solution that is only focused on receiving more information fails.[298] The regulations treat the symptoms without curing the disease, leading to the failure of the proposed attorney whistleblower regime.

The results of the Enron-inspired changes illustrate the difficulty, and perhaps the lack of regulatory motivation, for implementing these changes.[299]Attorneys have faced disciplinary action, been subjected to litigation, and denied bounties for failing to follow the procedures properly and for reporting externally to an improper source.[300] The result of the whistleblower regime is not disclosure but a series of chilling effects on the attorney-client relationship, the attorney appetite for information, and the desire to report.[301] Following the development of the regime, instead of the crackdown of corporate scandal through disclosures by newly deputized attorneys, we have more examples of corporate wrongdoing occurring in an attorney's presence that does not invoke up-the-chain or external reporting. The whistleblower regime creates a prisoner's dilemma for attorneys representing corporations that has no upside—so, instead, attorneys avoid the scenarios that trigger reporting. Attorneys can rely on specialization, the definition of the client, and the client-matter system to silo and bury their head in the sand, avoiding information outside of the scope of representation. At Theranos, attorneys did not want to harm fundraising efforts and were swayed by the representations of management that the product would work eventually. At Tesla, there are no statements by the GC in the securities investigation file related to Musk's Twitter activity, and attorneys at Tesla deferred to the judgment of external experts regarding the SolarCity merger. These decisions to maintain the client confidences, defer to the judgment of management and external attorneys, and even to keep the information at the level of the company where the violations occurred, have been found to be within the reasonable judgment of the attorney.[302] Because the attorney role is different and the very nature of this role makes the promise of an attorney whistleblower fleeting, no court or administrative agency has found attorneys to be liable for failure to report up the chain or externally.[303]

The goal of the whistleblower regime is to stop client crimes and frauds that harm shareholders and the market. The best way to adhere to traditional confidentiality and privilege norms while complying with the new whistleblower regime is to avoid information—a practice that is both det-

297. *See supra* Part III.B.
298. *See, e.g.*, Gladwell, *supra* note 258; Romano, *supra* note 9.
299. *See* HAZEN, *supra* note 48, at 412.
300. *See, e.g.*, Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767 (2018).
301. *See* BAINBRIDGE, *supra* note 12, at 116–17; *supra* Part II.A.
302. *See supra* Part II.A.
303. *See supra* Part III.A.

rimental to the attorney-client relationship and the prevention of corporate fraud. All are harmed by corporate clients who avoid the advice of counsel. Thus, the chilling effect is that the concept of an attorney whistleblower—even in the face of impossibility—has the potential to be far more damaging than the silent attorney who is aware but not participating in the scheme. What we give up in exchange for the mere possibility that an attorney may be able to ring an alarm before it is too late is not worth the information. Instead, it is better to encourage attorneys to encourage best practices, and it is better to encourage clients to seek to comply with laws instead of rewarding them financially for avoiding the law.

Sarbanes and Model Rule 1.13 provide a roadmap for how a company can retain an attorney and keep them ignorant and blissful. Companies can continue to manipulate business entities law to develop the same structures used by Enron but now with instructions for how to evade detection. Because up-the-chain and external reporting turn on attorney knowledge and are framed in the context of clients and representative matters,[304] a company can insulate an attorney from all the information, retain an attorney for a very limited purpose, or avoid hiring an attorney. Companies may manipulate business codes to ensure subsidiaries are truly separate, avoiding up-the-chain reporting. They may keep corrupt entities private, avoiding all public company reporting. Lastly, they can simply avoid either seeking legal advice altogether or seeking legal advice from licensed attorneys practicing before the SEC. If these efforts all fail, the Model Rules provide an additional catchall safety net. An attorney may simply be hired to investigate, attaching the requirements of confidentiality to all they uncover in their investigation.[305] Attorneys and their clients have a clear strategy for how to fix their malpractice problem, without properly addressing the fraud on the market problem. As a result, attorney whistleblowers and, to an extent, gatekeepers do not exist.

V. CONCLUSION

Historically, privilege and confidentiality have been considered the cornerstones of the legal profession. Open and honest communication is necessary for attorneys to provide clients with the best advice, and clients are less likely to be honest when there is a potential for their confidences to be revealed or, worse, used against them. The practice of law and the management of business are subjective. Attorneys cannot make the right judgment calls on subjective matters without a complete understanding of the facts. Any regulations that impede on the open exchange between attorneys and clients, therefore, reduces the value of the attorney-client relationship. If clients simply disclose less, change their structures to avoid the black letter requirements of Sarbanes and the Model Rules, or

304. *See supra* Part II.B.
305. *See supra* Part II.B.

avoid hiring attorneys all together, attorneys will not be exposed to the conduct regulators hoped they might report to save the market. Perhaps one or more of these scenarios is why there have been no opportunities for attorney whistleblowing.

Modern corporate fraud and the resulting market failures involve simple deception about complicated things.[306] This is because corporate fraud in its modern permutation is not based on an absence of information.[307] The systems in place to address fraud are all based on mandatory disclosure of information—either to insiders, so that they may make informed decisions, or to regulators, so that they may protect the public.[308] This over-reliance on information and disclosures results in a breakdown in the measures aimed at thwarting fraud because it depends on a prospective whistleblower having enough knowledge and understanding of the business and the fraudulent scheme to make a reliable disclosure.[309] As a result, what is successful about Sarbanes and Dodd-Frank is not the encouragement of whistleblowing and voluntary disclosure but changes to what regulators monitor and the means by which they monitor industries.[310] This hard truth manifests in how changes to the whistleblowing regime have provided the worst actors with a blueprint for defrauding the market in plain sight. By simply siloing and embargoing information from attorneys, management can continue a scheme without fear of an attorney whistleblower. Without any upside to attorney whistleblowing, attorneys rely on the Model Rules to take advantage of the silos and bury their heads in the sand, avoiding information that they may be required to report.

The attorney role is in fact different than that held by other experts, but the attorney is still a human being, subject to the same psychological phenomena that impact all rationally thinking people. The higher duty and special place in society does not strip attorneys of their human nature. While complying with the rules imposed upon them by primarily state bar associations, attorneys want to engage in enterprises that reward them financially, garner the respect of their clients and colleagues, and reflect the special role they hold in the justice system and American society. The best way to maintain clients is to become, at least minimally, captured by the client. Clients desire attorneys who are loyal to them, believe in their goals, and actively protect their interests. To continue this relationship in an environment that attempts to deputize an attorney as a

306. *See supra* Part II.B.

307. *See, e.g.*, CARREYROU, supra note 32 (chronicling Elizabeth Holmes and the failure of Theranos); ANDREW ROSS SORKIN, TOO BIG TO FAIL (2009) (chronicling the 2008 financial crisis from the perspective of regulators and business leaders).

308. *See* 17 C.F.R. § 205.3 (2019); MODEL RULES OF PROF'L CONDUCT r. 1.6, 1.13 (AM. BAR ASS'N 2018). A unicorn, like Theranos, avoids some degree of this oversight by market regulators by remaining private. But remaining private does not stop industry specific agencies like the FDA, the Environmental Protection Agency, or the National Transportation Safety Board from uncovering harmful behavior.

309. *See, e.g.*, 17 C.F.R. § 205.3.

310. *See, e.g.*, BAINBRIDGE, *supra* note 12, at 1–2.

whistleblower, the best option is to operate in the silos of specialization and avoid information that the attorney may be required to report.

It is difficult, if not impossible, to develop a system that fully encapsulates the nuances of the attorney-client relationship while mandating that attorneys violate that trust by disclosing information to protect third parties and the capital markets. Attorneys are advocates for their clients, not a secondary regulatory force. Blurring the lines and deputizing attorneys as whistleblowers frustrates the purpose of the attorney-client relationship. To provide accurate advice, it is necessary for attorneys to have all material information at their disposal. Fear that an attorney will report information to regulatory agencies will limit what clients share with their lawyers, crippling an attorney's ability to give accurate legal advice.

Sarbanes passed with the goal of reminding lawyers who the client is after an era in which corporate management appeared to uninhibitedly engage in fraud with the assistance of counsel.[311] The SEC Standards "emphasize that lawyers owe fiduciary duties to the organizations they represent, including their investors and shareholders, rather than to the [executives] whom attorneys may see the most regularly."[312] The SEC Standards and the Model Rules "require lawyers to take steps to mitigate overall damage to the organization by alerting key executives and the board of directors to material violations of the law that the lawyer discovers" in the course of representation.[313] "Instead of focusing on the attorney's role as an advocate in an adversarial setting, [the whistleblower regime] emphasizes the attorney's role as an advisor" and gatekeeper "focused on ensuring compliance with the law."[314]

The statutes, rules, and regulations developed in response to Enron in 2002 and to the financial crisis in 2010 look backward and punish bad actors and their conduct while doing little to effectuate cultural change. The attorney whistleblower regime seeks to deputize attorneys to disclose the misconduct at the point in time in which an attorney is aware and has expressed concern but before such misconduct is discovered by regulators.[315] To justify breaking privilege and confidentiality, attorneys are expected to make a determination that what they know is significant enough to cause harm to shareholders and the market—a test often not met by regulators until months and even years of investigation.[316] Often, criminal, civil, and administrative investigations result in no action against management at all or in the punishment of activities outside of the scope of what would trigger attorney whistleblowing.[317] If the attorney's reasonable judgment is incorrect and breaking privilege and confidentiality

311. *See* Pacella, *supra* note 12, at 498.
312. *Id.*
313. *Id.* (citing 148 CONG. REC. S6,524–60 (daily ed. July 10, 2002) (statement of Sen. Edwards)).
314. *Id.* at 499.
315. *See supra* Part II.B.
316. *See supra* Part II.B
317. *See supra* Part IV.A.

is not justified, they may face discipline.[318] If the attorney is correct, they may face retaliation of which the only viable remedy is to report to the highest level of the company the reason for termination, withdrawal, or dismissal from representation.[319] The requirements for recovery of a whistleblower bounty under Dodd-Frank and for whistleblower protections found elsewhere make it difficult for an attorney to see any advantage to reporting externally.

A flaw of the whistleblower regime includes its overreliance on attorney judgment of elements including reasonableness, materiality, harm, and even what constitutes evidence of wrongdoing.[320] It also includes several escape valves, which enables an attorney to comply enough to avoid discipline, but avoid being a disrupter at their law firm or company.[321] Although the attorney whistleblower does not exist, in a business culture that champions innovation and profits, the risk of a whistleblowing attorney could lead businesses to manipulate how they consume legal services using the roadmap provided by the very regulations meant to stop the next Enron. The lack of attorney discipline post-Enron, coupled with the numerous examples of corporate wrongdoing following Enron, show that while the companies have solved the Enron attorney problem, regulators have not. Attorneys continue to advise clients engaged in corporate fraud and continue to keep quiet about such conduct.

Even if attorneys possessed the information desired by regulators, often, the problem is not a lack of information. Corporate scandals are born out of ambiguity and complexity—an ambiguity that is encouraged by a focus on positive periodic reports, payment of regular dividends, and other surface indications of a company's success. The line between good governance aimed at profit maximization and criminal or fraudulent corporate behavior is difficult to discern when the people who are typically the most egregious bad actors are also the same people tasked with aggressively using all the legal tools available to produce results. A company may legally paint itself in the best light by manipulating business structures, tax laws, accounting rules, and other regulations with the assistance of attorneys and other experts and may be deemed to be in breach of their duties if they fail to do so. Management is rewarded for painting the part of the story that the market sees quarterly and annually in the best light with positive market reports, increased stock prices, and often additional personal compensation.[322] Management may face punishment in the form of removal or actions for breach of fiduciary duties if they fail to walk to the line without crossing it, making a company produce in a way that is positively reflected in the public filing story.

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318. *See supra* Part II.B.

319. *See supra* Part II.B.

320. 17 C.F.R. § 205.2 (2019); MODEL RULES OF PROF'L CONDUCT r. 1.6 cmt., 1.13 cmt. (AM. BAR ASS'N 2018).

321. *See supra* Part IV.C.

322. *See* Gladwell, *supra* note 258.

Bad actors are most successful, and cause the most harm, when they mostly comply with regulations and appear, on the surface, to follow the law, and business culture rewards management when they act in a similar fashion. The line between bad actor and forward-thinking management is blurry. Corporate scandals are born out of the fact that the information that is the focus of a particular agency or class of investors does not tell the entire story, and the culture of business does not reward optimal ethical and governance standards in the short term. Preventing crime or fraud requires removing the incentives and the tools used to commit the crime or fraud. A system that does not alter the culture cannot rely on the judgment and disclosures of experts, such as attorneys, to mitigate fraud.

While the goal is to stop client crimes and frauds that hurt shareholders and the market, the best way to adhere to traditional confidentiality and privilege norms while complying with the new whistleblower regime is to avoid information—a practice that is both detrimental to the attorney-client relationship and the prevention of corporate fraud. All are harmed by corporate clients who avoid the advice of counsel, and all are harmed by attorneys who rely on practice norms that silo information to bury their head in the sand and avoid learning material information. Thus, the chilling effect that the concept of an attorney whistleblower—even in the face of impossibility—has the potential to be far more damaging than the silent attorney who is aware but not participating in the scheme. What we give up in exchange for the mere possibility that an attorney may be able to ring an alarm before it is too late is not worth the information. Instead, it is better for attorneys to encourage best practices, and it is best when clients seek to comply with law instead of using legal structures to evade compliance.

Sarbanes and the Model Rules do not remedy the attorney conduct that gave rise to Enron, and they do nothing to turn an attorney into a whistleblower. Implementing a regime of attorney reporting does nothing to promote the cultural change necessary to motivate attorneys to temper their advocacy with investigation and questioning. In the absence of a cultural change, many feel it does exactly the opposite, promoting a culture of narrower representation and ignorance, since an attorney cannot question or report what they do not know. There are two major problems with the up-the-chain, noisy withdrawal, external reporting structure: it turns on attorney judgment, and it is based in a traditional corporate structure. As a result of these flaws, there is plenty of room for the same utilization of legal structures by business leaders who wish to manipulate the market that Skilling, Fastow, and the management at Enron used to make a run on the market for over five years. When combined with the lack of protection for the attorney whistleblower, Sarbanes fails. These changes only complicate the proper role of attorneys in preventing fraud. Sarbanes, the Model Rules, and Dodd-Frank are a compliance scheme to be evaded, not followed.