The *In Pari Delicto* Defense and Attorney Misconduct, or It Is Time to Get Rid of the "Law-Free Zone"[1]

Joseph H. Spiegel[a1]; Abigail H.G. Ohl[aa1]

I. Introduction

Under current Michigan law, corporate attorneys have a complete defense to liability for admitted malpractice in the structuring of a securities offering and for blatant improvident advice, as long as a few of the corporate client's employees committed some form of wrongdoing. That securities attorneys enjoy virtual immunity from legal malpractice brought by corporate clients sends the message that there is no value in professional advice from legal professionals. As long as one of the corporation's employees also violated the law, even a grossly negligent attorney will be shielded from liability and responsibility regardless of the harm done.

> [W]here a law firm believes the management of a corporate client is committing serious regulatory violations, the firm has an obligation to actively discuss the violative conduct, urge cessation of the activity, and withdraw from representation where the firm's legal services may contribute to the continuation of such conduct. [Defendant] Jones Day contends that it would have been futile to act on these fiduciary obligations because those controlling [the client] would not have responded. Client wrongdoing, however, cannot negate an attorney's fiduciary duty. Moreover, the evidence reveals that attorney advice influenced [the client's] conduct in a variety of ways.[2]

To put it another way: "[I]t makes little sense to allow those who committed torts to escape liability because of the financial misfortunes of their victims." [3]

The spate of recent high profile cases involving corporations ruined by employees' wrongful conduct (*e.g.*, MCI, WorldCom, HealthSouth, Enron,[4] etc.) has focused the attention of the public and the judiciary on the need to ferret out and punish not just those responsible *inside* the corporation for such egregious misconduct but also the *outside* professionals accused of facilitating the wrongdoing and/or allowing it to continue. However, corporate securities attorneys have managed to avoid most, if not all, of the attention or blame. As one commentator wrote, "[lawyers] have managed thus far to float beneath the radar screen and thus escape the

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[1] Susan P. Koniak, *Corporate Fraud: See, Lawyers*, 26 HARV. J.L. & PUB. POL'Y 195, 195 (2003).

[a1] Mr. Spiegel founded Joseph H. Spiegel, P.C., in 1987, a general practice firm emphasizing business law litigation and specializing in securities-related matters. He has lectured in the areas of Securities and Commodities Law and Federal Civil Procedure for a variety of professional associations and institutes. J.D., John Marshall Law School, 1974; B.A., Cornell College, 1968.

[aa1] Ms. Ohl has been employed part-time as an associate attorney with Joseph H. Spiegel, P.C., since 2002. J.D., University of Michigan Law School, 1997; B.A., University of Michigan, 1991.

[2] *In re Am. Cont'l Corp./Lincoln Sav. & Loan Sec. Litig.*, 794 F. Supp. 1424, 1453 (D. Ariz, 1992).

[3] *In re Segerstrom*, 247 F.3d 218, 225 (5th Cir. 2001).

[4] *In re Global Crossing, Ltd. Sec. Litig*, 322 F. Supp. 2d 319 (S.D.N.Y. 2004); *In re WorldCom, Inc. Sec. Litig.*, 308 F. Supp. 2d 338 (S.D.N.Y. 2004); *SEC v. HealthSouth Corp.,* 261 F. Supp. 2d 1298 (N.D. Ala. 2003); *In re Enron Corp. Sec., Derivative and ERISA Litig.*, 235 F. Supp. 2d 549 (S.D. Tex. 2002).

lion-sized portion of blame that should rightly be laid at their door."[5] Lawyers escape liability on several fronts: by elimination of a private right of action for civil aider and abettor liability under the federal security laws;[6] by courts' application of the *in pari delicto* doctrine;[7] by vigorously pursuing settlements before trial, as frequently occurred during the savings and loan scandals;[8] and by exerting powerful influence over the judiciary.[9] Other contributing factors to attorney avoidance of liability are the state bar authorities' lack of resources and lack of expertise in securities law and the SEC's retreat from bringing disciplinary actions against attorneys.[10] This virtual immunity from liability has provoked extensive analysis and comment[11] and, in some cases, sharp criticism from legal scholars.[12] It remains to be seen whether such federal law as the Sarbanes-Oxley Act,[13] passed in response to the epidemic of corporate securities scandals, will effect significant change in the field of attorney responsibility for corporate misconduct. Some commentators believe the Act, in its present form, cannot pierce the shield because the Act is flawed and/or insufficient.[14] The authors maintain that Sarbanes-Oxley alone poses little

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[5] Koniak, *supra* note 1.

[6] *See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).

[7] *See infra* Parts II, III.

[8] *See*, *e.g.*, *In re Am. Cont'l Corp.*, 794 F. Supp. 1424. Jones Day and its successor, Kaye Scholer, settled investor and government claims stemming from their representation of Lincoln Savings and Loan. *See* Roger C. Cramton, *Enron and The Corporate Lawyer: A Primer on Legal and Ethical Issues,* 58 BUS. LAW. 143, 143 n.3 (2002).

[9] *See*, *e.g.*, *SEC v. Nat'l Student Mktg. Corp.*, 457 F. Supp. 682, 713-17 (D.D.C. 1978), in which the court ruled that the attorneys aided and abetted the client's securities violations but nevertheless denied the SEC's request for injunctive relief. "While the attorney defendants are more likely to be [involved in future violations], that fact is countered somewhat by their professional responsibilities as attorneys and officers of the court to conform their conduct to the dictates of the law. The Court is confident that they will take appropriate steps to ensure that their professional conduct in the future comports with the law." *Id.* at 716-17.

[10] *See*, *e.g.*, Koniak, *supra* note 1, at 215-20; *see infra* note 12.

[11] *See* Cramton, *supra* note 8, at 145, 169-70, 182-83 (advocating overruling *Central Bank* as essential to addressing lawyer wrongdoing); Mark A. Sargent, *Lawyers in the Moral Maze*, 49 VILL. L. REV. 867, 871 (2004) (offering *Central Bank* as one possible explanation for the prevalence of lawyers' wrongdoing). Professor Koniak argues that "[t]he elimination of private suits for aiding and abetting dismantled one of the only working methods of regulating corporate lawyers and deterring bad conduct by members of this elite and powerful section of the bar." Koniak, *supra* note 1, at 222-23.

[12] *See* John C. Coffee, Jr., *Understanding Enron: "It's About the Gatekeepers, Stupid*," 57 BUS. LAW. 1403 (2002) [hereinafter "Coffee I"]; John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293 (2003) [hereinafter "Coffee II"]; Commentary*, Lawyer Conduct and Corporate Misconduct*, 117 HARV. L. REV. 2227 (2004) [hereinafter "Lawyer Conduct"]; Cramton, *supra* note 8; Koniak, *supra* note 1; Donald C. Langevoort, *Agency Law Inside the Corporation: Problems of Candor and Knowledge*, 71 U. CIN. L. REV. 1187 (2003); Honorable E. Norman Veasey, *Reflections on Key Issues of the Professional Responsibilities of Corporate Lawyers in the Twenty-First Century,* 12 WASH. U. J.L. & POL'Y 1 (2003).

[13] Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.). In a speech given September 20, 2004, Stephen Cutler, the SEC's Director of Enforcement, defended the effectiveness of SEC rules implementing Sarbanes-Oxley, including the requirement to "report up the ladder" evidence of material violations of securities laws. Director Cutler acknowledged that while the SEC has "stepped up [its] scrutiny of the role of lawyers in the corporate frauds," it has "more to do in this area." Cutler indicated that the SEC plans to bring actions against lawyers who assist clients with violations of federal securities laws, *inter alia*, illegal late trading or market timing arrangements and concealing evidence of fraud, in particular in the context of internal investigations. Stephen Cutler, Speech at University of California at Los Angeles School of Law, *at* http://www.sec.gov/news/speech/spch092004smc.htm (Sept. 30, 2004).

[14] *See, e.g.,* Cramton, *supra* note 8, at 145, 179-82 (noting that Sarbanes-Oxley is a sound beginning, but more, including overruling *Central Bank*, is required); Jill E. Fisch & Kenneth M. Rosen, *Is There a Role for Lawyers in Preventing Future Enrons?*, 48 VILL. L. REV. 1097, 1122-31 (2003); Koniak, *supra* note 1, at 228-31 (commenting

threat to the well-entrenched defense to liability securities attorneys currently enjoy. Meaningful reform requires the judiciary to apply comparative negligence principles and also reinstatement of a private cause of action for civil aider and abettor liability under the federal securities laws.

Like other courts, Michigan state courts have focused on whether one or a few employees' misconduct should be imputed to the corporation, thus barring recovery against the corporation's attorney under the *in pari delicto* doctrine. This is error because the imputation defense fails to create just outcomes and flies in the face of the general rule that principles of comparative negligence determine liability in tort cases. As a matter of public policy *in pari delicto* unfairly burdens the innocent corporate client with all financial costs associated with securities law violations, when, in fact, specialized legal professionals in great measure were responsible. Securities lawyers essentially underwrite risk; they are supposed to insure that the client's disclosure and securities offerings comply with the securities laws, and if the client does not abide by the advice, they must withdraw, i.e., forgo their fee. Instead of allocating liability for damage to the corporation *and* its attorney based on degree of fault, the imputation defense produces "all or nothing" outcomes, which is contrary to the theories of liability allocation in modern tort law. Letting securities attorneys "off the hook" only adds to the public's already negative perception of lawyers as unethical and condones attorneys' violation of their professional duties as gatekeepers in the specialized field of securities law.

Clear standards, regarding the applicability of *in pari delicto* to a corporation's malpractice action against its securities attorneys when there is constituent wrongdoing, cannot be gleaned from the case law, which has produced inconsistent and sometimes irrational decisions in the lower courts. The seminal decision by a Michigan court on *in pari delicto* is *Orzel*, in which the Supreme Court of Michigan barred recovery against a pharmacist who filled fraudulently obtained prescriptions on the ground that the plaintiff drug user was *in pari delicto* with the defendant.[15] The reasoning of *Orzel*, while certainly sound when the wrongdoer is an individual and a drug addict, is very difficult, if not impossible, to apply when the plaintiff is a large, complex corporation. The deterrence and public policy objectives differ dramatically when comparing responsibility for illegal drug use with responsibility for corporate injury due to constituent wrongdoing that was aided by the legal professionals.

That the *in pari delicto* doctrine is not capable of rational and fair application is evident from the courts' treatment of the adverse interest exception to the *in pari delicto* doctrine.[16] For example, in *Grant Thornton*,[17] the court rejected plaintiffs' assertion of the adverse interest exception because "plaintiffs point to no evidence that the wrongdoers were motivated by self-interest to the exclusion and knowing detriment of the interests of the corporations." This articulation of the standard of proof necessary to create a genuine issue of material fact regarding

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on SEC proposed rules implementing Sarbanes-Oxley); Lawyer Conduct, *supra* note 12, at 2243-48; Sargent, *supra* note 11, at 883-85.

[15] *Orzel v. Scott Drug Co.*, 537 N.W.2d 208 (Mich. 1995). *Orzel* relied on sections of Corpus Juris Secundum and American Jurisprudence Second to elucidate the wrongful conduct rule. *Id.* at 212-13; *See* 1A C.J.S. *Actions* §§ 68, 69 (2005); 1 AM. JUR. 2D *Actions* §§ 45, 46 (1994). Almost all of the cases compiled in these sections, however, concern individual plaintiffs and simple tort claims or crimes. As discussed *infra*, a rule that is helpful in determining responsibility when the facts and claims are uncomplicated and the plaintiff is an individual cannot rationally and justly be applied to securities legal malpractice actions when the client is a corporation, and only a few employees were wrongdoers.

[16] *See infra* Part II.

[17] *MCA Fin. Corp. v. Grant Thornton, L.L.P.*, 687 N.W.2d 850, 861 (Mich. Ct. App. 2004).

the adverse interest exception, however, is not grounded in existing law.[18] A number of federal courts have determined that the question of adverse interest is clearly a jury question and cannot be decided on a motion for summary judgment because it is so fact specific.

Forty years later, it is unfortunately still true that "[i]n our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar."[19]

II. Orzel Is The Wrong Standard for Determining When and to What Extent A Securities Lawyer Will be Held Accountable to His Client

The leading Michigan case on the *in pari delicto* doctrine is *Orzel*. The authors submit that the application of *Orzel* to the complex world of securities, disclosure requirements, corporate structuring, and mortgage and banking laws, is not rational. Far from serving the public interest, as it purports to do, the *Orzel* standard when applied to determine a securities attorney's liability for malpractice will push the legal profession further into a credibility abyss and will cause the confidence level of the investing public to continue to plummet.

Orzel is the wrong framework for evaluating claims brought by corporate clients against securities attorneys because: (1) the facts of *Orzel* render its holding unworkable for cases alleging professional malpractice when the corporate plaintiff is the client and only a few employees acted wrongfully; (2) the nature of professional duties of lawyers and auditors is markedly different from pharmacists, especially when the professional is a transactional attorney; and (3) the application of *Orzel* to a legal malpractice action brought by a complex company, which may have made multiple securities offerings and included many business operations, but of which a few employees committed wrongdoing, produces the exact public policy concerns raised in *Orzel*.

In *Orzel*, Justice Cavanagh framed the issue before the Court as follows:

> In this case, we are asked to determine whether plaintiffs can maintain a tort action where plaintiffs' asserted injuries arose out of illegal conduct *on the part of one of the plaintiffs*, the plaintiff's culpability is equal to the defendant's and the plaintiff's alleged entitlement to recovery is not provided for under the statutes claimed to have been violated by the defendant.[20]

The Court determined that such an action was not viable because it was based at least in part on the plaintiff drug user's illegal conduct, *i.e.*, presenting defendant with fraudulently obtained prescriptions and then using the prescribed medication. Different facts, underlying public policy objectives, and types of parties make the *Orzel* holding not applicable to this action. The *Orzel* wrongdoer was an individual, and one of several individual plaintiffs. Therefore, whether the *Orzel* plaintiffs engaged in wrongdoing was a straightforward inquiry; the

[18] *See infra* Part III.

[19] *United States v. Benjamin*, 328 F.2d 854, 863 (2d Cir. 1964) (Friendly, J.), *quoted in* DongJu Song, *The Laws of Securities Lawyering After Sarbanes-Oxley*, 53 DUKE L.J. 257, 257 (2003).

[20] 537 N.W.2d at 210.

Court did not need to turn to principles of agency or imputation theory to arrive at the conclusion that the plaintiffs were wrongdoers.[21]

Orzel provides little guidance, however, when the plaintiffs are large, complex corporations.[22] Unlike in *Orzel*, the wrongdoers in these types of cases are *not* parties to the action, which means that the wrongful conduct rule only applies if the wrongdoers' conduct is imputed to the plaintiffs. Imputation depends, of course, on the applicability of the adverse interest exception, which according to the majority of courts is a *fact-intensive issue* requiring a jury trial. *Orzel*, because it did not address imputation of wrongdoing to a corporation, gives no guidance on how to apply *in pari delicto* in this context.

Another important factual difference between *Orzel* and claims of securities malpractice brought by corporations is that the plaintiff in *Orzel* started abusing drugs long before presenting defendant with the fraudulently obtained prescriptions.[23] Perhaps that can be analogized to a corporation formed for an illegitimate purpose from the start, but it is not helpful in understanding the "fault" attributable to a corporation that was formed for and engaged in a variety of legitimate business purposes. Also, different public policies favor allowing securities legal malpractice actions brought by corporations to go forward versus permitting a drug addict to recover from the pharmacist who filled his fraudulently obtained prescriptions. Allowing the drug user's action to go forward sends the message that it is permissible to lay the blame on others for one's own addictive and illegal behavior. That is not keeping with society's emphasis on taking responsibility for one's own actions. Note that this same message is sent, however, if the action of the *corporation* is barred under *Orzel*; that is, securities attorneys need not take responsibility for their malfeasance as long as the corporation was unfortunate enough to have wrongdoing employees. Allowing the corporation to recover, however, sends the proper message that securities attorneys are expected to take responsibility for their actions.

The most significant distinction between *Orzel* and cases of securities legal malpractice is the different standards of professional responsibility for pharmacists versus lawyers. Pharmacists do not meet with a customer to assess his or her medical condition, determine the best medication, explain concepts or language unfamiliar to the customer, or act as a representative of the customer in dealing with others in the medical community; that is what we expect doctors to do. Securities lawyers, however, have professional obligations to do exactly that for their corporate clients.[24] They are supposed to assess their client's financial "health" and

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[21] *Orzel* relied upon sections of Corpus Juris Secundum and American Jurisprudence Second. A review of the supportive authority discloses that the vast majority of cases involved individuals and relatively simple transactions, not attribution or imputation doctrine. Some of the cases date to the 1800s. Many date from the early 1900s and involve gambling, liquor and issues of family law, not complex securities issues. *See* sources cited *supra* note 16.

[22] A corporation is a "distinct legal entity, with legal rights, obligations, powers, and privileges different from those of the natural individuals who created it, who own it, or whom it employs." *Cedric Kushner Promotions, Ltd. v. King*, 533 U.S. 158, 163 (2001) (citing *United States v. Bestfoods,* 524 U.S. 51, 61-62 (1998); *Burnet v. Clark*, 287 U.S. 410, 415 (1932*)*; 1 WILLIAM MEADE FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 7, 14 (rev. ed. 1999). *But cf. Wells v Firestone Tire & Rubber Co.*, 364 N.W.2d 670, 674 (Mich. 1985) (stating that distinct corporate entities will be recognized "unless doing so would subvert justice").

[23] There was deposition testimony that plaintiff began taking Desoxyn in 1979 or 1980, when he bought some from co-workers. 537 N.W.2d at 211. It was not until August 1981 that he fraudulently obtained prescriptions later presented to defendant pharmacist. *Id.*

[24] "[T]he responsibility of corporate lawyers runs to the corporation and the shareholders. Accordingly, if lawyers 'see the law being broken or about to be broken,' they are supposed to 'ensure that the law is being followed.'" Fisch & Rosen, *supra* note 14, at 1109 (quoting Letter from John Edwards, Senator of North Carolina, to Harvey

reevaluate it on an ongoing basis, recommend or approve only appropriate transactions and create the proper legal entities or vehicles to accomplish the recommended transactions, explain securities and other law, and represent their client before regulatory authorities and within the legal system. In addition, securities attorneys deserve heightened scrutiny of their professional conduct because of their duties to the public investor. As A.A. Sommer, Jr., a pre-eminent expert in securities law, noted thirty years ago, the securities attorney must be "acutely cognizant of his responsibility to the public who engage in securities transactions that would never have come about were it not for his professional presence."[25] Another commentator argues that securities lawyers deserve greater scrutiny because they are supposed to "ac[t] in the public interest as a representative of the law."[26] The same cannot be said of a pharmacist; if the defendant pharmacist in *Orzel* had declined to fill the plaintiff's prescriptions, it is quite possible another pharmacy would have done so.

The *Orzel* Court noted that in the absence of the wrongful conduct rule, four "unacceptable" consequences would result:

> First, by making relief potentially available for wrongdoers, courts in effect would condone and encourage illegal conduct. Second, some wrongdoers would be able to receive a profit or compensation as a result of their illegal acts. Third, and related to the two previously mentioned results, the public would view the legal system as a mockery of justice. Fourth, and finally, wrongdoers would be able to shift much of the responsibility for their illegal acts to other parties.[27]

The authors submit that the opposite has occurred and will continue to occur—that the four consequences noted above in fact will arise—when the *in pari delicto* doctrine *is applied* to bar corporations from asserting claims of professional malpractice when there is also constituent wrongdoing.

In *Grant Thornton*, the Court of Appeals reasoned that even though the individual wrongdoers were facing criminal sanctions, "we would nevertheless be condoning the corporations' involvement by allowing plaintiffs to recover losses generated by their agents' own illegal conduct."[28] This is nonsensical. First, if the individual wrongdoers have been punished; they have not "gotten away with it." Second, the judicial system cannot deter corporations, which "act" only through individual agents. Punishing the corporate agents who act wrongfully deters wrongdoing taken in the name of the corporation. If we punish the *individuals* responsible for harming the corporation, we will deter other *individuals* from acting wrongfully. What does it mean to "condone the corporations' involvement"?

The court determined that it was no more likely that the public would view the legal system as a mockery if the defendant-accountants prevailed than if the Court were to "allow the

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Pitt, Chairman, Securities Exchange Commission (June 18, 2002), reprinted in 148 Cong. Rec. S5652-53 (daily ed. June 18, 2002)).

[25] Coffee II, *supra* note 12, at 1299 (quoting A.A. Sommer, Jr., *The Emerging Responsibilities of the Securities Lawyer*, Address to the Banking, Corporation & Business Law Section, N.Y. State Bar Ass'n (Jan 24, 1974), *in* LARRY D. SODERQUIST & THEREESA GABALDON, SECURITIES REGULATION 617-19 (4th ed. 1999).

[26] Susanna M. Kim, *Dual Identities and Dueling Obligations: Preserving Independence in Corporate Representation*, 68 TENN. L. REV. 179, 251 (2001).

[27] 537 N.W.2d at 213 (citation omitted) (footnotes omitted).

[28] 687 N.W.2d at 855.

active fraudfeasors (plaintiffs) to prevail."[29] This argument is erroneous for at least two reasons. First, it is based on the Court's flawed premise that the *corporate entities* have no existence separate from the individual wrongdoers.[30] In *Grant Thornton* and cases similar to it, the wrongdoers are not bringing the action. The plaintiff is the *corporation*, and its subsidiaries, also corporations. Second, securities lawyers are entrusted with gatekeeping responsibilities. Legal doctrine that condones lawyers' violation of the law must be viewed as far more detrimental to the integrity of the legal system than permitting the corporate client harmed by its attorneys' malpractice to recover. In its analysis of the fourth factor, shifting responsibility for wrongdoing, the *Grant Thornton* court again failed to distinguish between the plaintiff corporate entities and the few corporate wrongdoers.[31]

Grant Thornton explained the necessary factual showing to prevail against the assertion of *in pari delicto* arguments as follows:

> That is, perhaps plaintiffs could potentially prevail if they could show that the wrongdoers within their organizations believed, based on defendants' affirmative advice, that the manner in which the transactions were structured and reported on the financial statements were proper. . . . Because plaintiffs cannot show that the wrongdoing occurred at defendants' urging or affirmative advice, plaintiffs stand *in pari delicto* with defendants. In short, to prevail, plaintiffs would have to show more than that defendants turned a blind eye to plaintiffs' wrongdoing, but that defendants' active wrongdoing was greater than was plaintiffs' wrongdoing.[32]

According to this *newly created* test,[33] under Michigan law, a corporation's legal malpractice claims will be barred unless the corporation can establish (1) that there was active wrongdoing on the part of defendants; (2) that this wrongdoing was greater than the plaintiffs' wrongdoing; and (3) that the plaintiff wrongdoers relied on defendants' wrongful advice. As explained in the next section, no other court has set forth and/or applied such a test.

III. Lawyers Should Not Be Shielded from Malpractice Liability by the *In Pari Delicto* Doctrine

A. <u>Introduction</u>

In pari delicto, when asserted as a defense against legal malpractice claims brought by corporations harmed by constituent wrongdoing, can create a virtually impenetrable shield against legal malpractice liability.[34] When viewed as an issue of professional ethics, permitting

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[29] *Id.*
[30] *See* sources cited *supra* note 22.
[31] 687 N.W.2d at 855.
[32] *Id.* at 854-55.
[33] There is no precedent for this test in either Michigan law or the federal case law that address attorney liability under these circumstances.
[34] This concern was echoed in *Ernst & Young LLP v. Baker O'Neal Holdings, Inc.*, No. 1:03-CV-0132-DFH, 2004 WL 771230, at *10 (S.D. Ind. Mar. 24, 2004), in which the court warned that "[t]he risk of a liberal application of *in pari delicto* is that tortfeasors preparing to defraud an entity could potentially immunize themselves from liability simply by enlisting the help of an executive in the victim-corporation."

securities lawyers "to roam in a law-free zone"[35] only worsens the public's already negative perception of lawyers as unethical, and condones attorneys' violation of their professional duties. Incorrectly applied, *in pari delicto* violates the principle of comparative negligence, cheapens the value of professional advice, and, by incorporating adverse interest analysis, does not reflect actual corporate decision-making. As it is in great measure based upon agency law principles, *in pari delicto* as applied in the corporate context blurs the traditional separation between a corporation's agents and the corporation.

B. Strict *In Pari Delicto* Doctrine Contradicts the Current Tort Liability Regime

Aside from producing unjust results, the *in pari delicto* doctrine, as a mechanism for assessing costs of securities law violations, unfairly saddles all of the economic costs of an attorney's malpractice and the resultant damage on the client, even when it is beyond dispute that the legal professionals were partially responsible. While comparative negligence dictates that liability for damage to the corporation should be allocated to the corporation *and* its attorney based on degree of fault, *in pari delicto* produces "all or nothing" outcomes.[36] And the very demise of a corporation, which the securities attorneys facilitated, virtually guarantees that the negligence, no matter how gross, will go unpunished.

One scholar on auditor liability noted the incongruity of imputation doctrine in the context of comparative negligence liability regimes:

> As a device for assigning responsibility, [imputation law] is unforgivingly binary. Imputation is on or off; it does not permit partial allocation of responsibility or losses. . . . This all-or-nothing device survives despite changes in other elements of tort law to achieve rough correspondence between degree of fault and the allocation of damages. . . . The result is that imputation is a meat-axe, not a scalpel, and most cases that are resolved through imputation will involve some apparent inequity.[37]

In the interest of creating rational and meaningful legal doctrine that can be applied to modern day corporate issues, there are other serious reasons to question use of the adverse interest exception. Donald Langevoort, a prominent corporate law scholar, argues that in this day of stock-based compensation systems, it is simplistic and ultimately unworkable to draw a "line between selfish behavior and company-serving behavior:"[38]

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[35] Koniak, *supra* note 1, at 195.

[36] In *Ameriwood Industries International Corp. v. Arthur Andersen & Co.*, 961 F. Supp. 1078, 1085 (W.D. Mich. 1997), Judge Hillman stated that "Michigan case law firmly recognizes the continuing viability of the doctrine following the advent of pure comparative negligence." *See Orzel,* 537 N.W.2d 208 (Mich. 1995); *Pantely v. Garris, Garris & Garris, P.C.*, 447 N.W.2d 864 (Mich. Ct. App. 1989). The authors, however, found no Michigan decisions applying *in pari delicto* doctrine and comparative negligence principles together, and note that the courts in *Orzel* and *Pantely* did not do so.

[37] Andrew J. Morris, *Clarifying the Imputation Doctrine: Charging Audit Clients with Responsibility for Unauthorized Audit Interference*, 2001 COLUM. BUS. L. REV. 339, 353 (2001).

[38] Langevoort, *supra* note 12, at 1217.

> To me, attribution of knowledge adds absolutely nothing of use here, and can be misleading when we allow the reification to get the better of us.
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> The stumbling block here is why the insider's motivation to benefit the company should make any difference, much less a dispositive one. The *Cenco* [*v. Seidman & Seidman*, 686 F.2d 449 (7th Cir. 1982)] line of cases speak of the irony of allowing the company to recover for an action taken to benefit it, but that idea collapses of its own weight. If there is actual benefit from the activity, then that is something to take account of at the remedies phase—either eliminating damages entirely or operating as an offset when there is a mix of benefit and harm. But the cases that give rise to litigation are always ones where the insiders caused serious damage to the company far beyond any benefit conferred, whatever their original intentions. Unjust enrichment is not a worry if we allow the suit to succeed, so long as we measure damages correctly.
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> The question always turns out to be one where the insiders tried, in part at least, to help the company but failed, and it is hard to see why this should matter.[39]

Trying to make such a distinction ignores the cognitive biases inherent in corporate decision-making.[40] For example, the "self-serving inference," which is the "tendency to see as reasonable what is mainly self-serving . . . gives reason to doubt the utility of the 'solely self-serving' motivation, because agents will usually be adept at rationalizing their actions in unselfish terms."[41]

C. *Grant Thornton* Grounded Its New Standard for Adverse Interest on Distinguishable Cases

Allard[42]was relied on in *Grant Thornton*[43] as support for not applying the adverse interest exception. However, *Allard* is not dispositive or even persuasive in favor of applying *in pari delicto* to defeat a corporation's securities malpractice claim. In *Allard*, the federal court declined to grant the auditors' motion for summary judgment on the adverse interest exception because material issues of fact existed as to whether the corporation benefited from its owner's misappropriation of funds. The court noted that:

> At trial it will not be easy for the Trustee to prove that no portion of the . . . contract proceeds inured to the benefit of [debtor corporation]. But because it is not clear . . . that it would be impossible for the Trustee to make such a showing, summary judgment can not [sic] be granted on this ground.[44]

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[39] *Id.* at 1219.

[40] *Id.*

[41] *Id*. *See also* Fisch & Rosen, *supra* note 14, at 1124 ("[T]he market for legal services leads lawyers to identify with their managerial clients, creating behavioral biases that limit the lawyer's ability to interpret management behavior as wrongful.").

[42] *Allard v. Arthur Andersen,* 924 F. Supp. 488, 495 (S.D.N.Y. 1996)

[43] *Grant Thornton*, 687 N.W.2d at 857-58.

[44] 924 F. Supp. at 495.

The court in *Grant Thornton* cited *Allard* when stating that "it is the wrongdoers' motives, not results, that are determinative."[45] But the law review article[46] cited in *Allard* as support for the courts' purported consensus on motives versus results is not good support for the proposition. The article, written almost ten years ago, focuses on the failed savings and loan crisis, not present day corporate scandals. The author relied only on two New York district court cases, both decided in 1992, for the theory that under the adverse interest exception, the focus is on the bad actors' motives versus results.[47] The author even admits that the adverse interest exception remained ill-defined: "the courts are not clear about the frame of reference to be used in assessing corporate 'benefit' and when the agent's interests become 'adverse.'"[48]

Transnation,[49] cited in *Grant Thornton* as an application of the general rule that motives, not results, are determinative of adverse interest, is easily distinguishable. First, it is an unpublished opinion that is not precedentially binding.[50] Second, it was decided on very different facts: a title insurance company sued the mortgagors, husband and wife, for common-law fraud. The court rejected the wife's defense that she was not liable for acts and representations of her husband, who as her attorney-in-fact acted outside his authority. The result in *Transnation* cannot possibly be deemed instructive when considering a corporation's claims of securities malpractice.

D. <u>Gatekeeper Theory Trumps *In Pari Delicto* Doctrine</u>

> No major corporate transaction goes forward without a lawyer's okay; no securities documents get filed without a lawyer's review; and no private placement memoranda are issued without a lawyer's input, if not a lawyer's drafting them herself.
>
> We had laws on the books that prohibited most and maybe all of the damaging conduct engaged in by companies like Enron. But it takes lawyers to bring that law to bear on transactions and corporate activities, as they are being planned and implemented. When lawyers use their skills instead to circumvent those laws, we end up here. Unless we rein in the lawyers, what use is it to write new laws or to enact reforms? As long as lawyers stand ready to interpret our laws out of existence to serve management's goals, our new laws will be as ineffective as our old ones. Take away the lawyer's law-free zone and the law-free zones lawyers build for others will shrink too.[51]

The spotlight is now focused on lawyers. In the post-Enron, post-Sarbanes-Oxley debate over the seemingly dysfunctional system of corporate governance in the United States, Congress,

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[45] 687 N.W.2d at 858.

[46] Matthew G. Dore, *Presumed Innocent? Financial Institutions, Professional Malpractice Claims, and Defenses Based on Management Misconduct*, 1995 COLUM. BUS. L. REV. 127, 161 (1995).

[47] *Id.* n.131. *See In re Crazy Eddie Securities Litigation*, 802 F. Supp. 804, 817 (E.D.N.Y. 1992); *In re Wedtech Securities Litigation*, 138 B.R. at 9; *In re Wedtech Corp.*, 81 B.R. 240, 242 (S.D.N.Y. 1987).

[48] Dore, *supra* note 46, at 161.

[49] *Transnation Title Ins. Co. v. Livingston,* No. 243509, 2004 WL 203075 (Mich. Ct. App. Feb. 3, 2004).

[50] M.C.R. 7.215(C)(1).

[51] Koniak, *supra* note 1, at 227.

the SEC, and the public at large all suspect that when sophisticated financial chicanery occurs, lawyers are typically present at the scene of the crime.

The "gatekeeper," as originally conceived and defined in the context of underwriters, is an "informational intermediary whose presence or certification makes the issuer's representations credible."[52] That securities attorneys must serve as gatekeepers due to their position between offering corporations and the public is not new, although it has been most cogently advanced in Professor Coffee's recent writings.[53] Coffee defines the elements of a gatekeeper as: "(1) independence from the client; (2) professional skepticism of the client's representations; (3) a duty to the public investor; and (4) a duty to resign when the attorney's integrity would otherwise be compromised."[54] Coffee notes that attorneys:

> have *reputational capital* and are often in a position to block or delay transactions or governmental approvals that are vital to their corporate clients. This is truest in the case of securities attorneys who could potentially block the effectiveness of a registration statement or the consummation of a merger simply by signaling their displeasure to the SEC.[55]

Competing with the gatekeeper concept, of course, is the notion that the attorney's most important role is as zealous advocate.[56] As one commentator noted, "[t]he few cases involving lawyers who assisted or opposed senior inside managers of corporations involved in illegal activities give credence to the widely held belief that a 'loyal' corporate lawyer is one who treats inside senior managers as the client."[57] Yet the securities attorney's gatekeeping responsibilities

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[52] Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 618-21 (1984) (cited in Coffee II, *supra* note 12, n.10). Professor Kraakman also defined gatekeepers as "private parties who [a]re able to prevent corporate misconduct by withholding their cooperation from wrongdoers." Coffee II, *supra* note 13, n.8 (citing Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857, 888-96 (1984); Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 54 (1986)).

[53] *See* Coffee II, *supra* note 12, at 1296 n.7 (noting the SEC's frequent use of the term "gatekeeper"); *Id.* n.16 and accompanying text (discussing the definition of the securities attorney's ethical responsibilities by A.A. Sommer, Jr., as including the elements that define a gatekeeper). *See generally* Coffee I, *supra* note 13. The ABA also has emphasized the importance of "independent participants in the corporate governance process . . . . [exercising] active and informed stewardship of the best interests of the corporation." ABA Task Force on Corporate Responsibility, *Preliminary Report of the American Bar Association Task Force on Corporate Responsibility*, 58 BUS. LAW. 189 (2002), *quoted in* Cramton, *supra* note 9, at 144; *see also id.* at 153-54.

[54] Coffee II, *supra* note 12, at 1299.

[55] *Id.* at 1298 (emphasis added).

[56] To those who argue that attorneys cannot serve as gatekeepers because their mindset as advocate may blind them to signs of wrongdoing, Coffee responds that a desire to avoid finding legal violations is not a defense: "The more we suspect that attorneys will avert their gaze, the more we need to raise the penalties to deter them from so doing." *Id.* at 1306.

[57] Peter C. Kostant, Breeding Better Watchdogs: Multidisciplinary Partnerships in Corporate Legal Practice, 84 MINN. L. REV. 1213, 1218 (2000). *See*, *e.g.*, Balla v. Gambro, 584 N.E.2d 104, 107 (Ill. 1991), aff'd sub nom. Jacobson v. Knepper & Moga, P.C., 706 N.E.2d 491, 492 (Ill. 1998), in which the Supreme Court of Illinois denied recovery to a corporate lawyer on his claim against a corporation that discharged him when he prevented its senior manager from selling lethally defective dialysis equipment. Kostant noted that "[n]owhere in its opinion did the [court] acknowledge that, in preventing this criminal and tortious activity, the attorney was loyally serving his corporate client and protecting it from a rogue agent." Kostant, supra. See also In re Silva, 636 A.2d 316, 316-317 (R.I. 1994), the Supreme Court of Rhode Island ordered a mild sanction against a lawyer who knowingly allowed his friend, the president of a mortgage company, to embezzle funds from the corporate client and from an out-of-

stem not from his duties to a particular client, but because "the lawyer acts in the public interest as a representative of the law."[58] One commentator aptly phrases the special position of lawyers as follows:

> As members of a public profession, lawyers have obligations that stem from the mere fact that they are lawyers, and these obligations are unlike those of any other profession. The legal profession serves as a link between private interests, as embodied in the client, and public interests, as represented by the law. . . . "[*T*]*he lawyer stands as a kind of buffer between the illegitimate desires of his client and the social interest*."[59]

Professor Coffee also defuses the concern over socially desirable client communications by pointing out that:

> [T]he ultimate goal of the law is to achieve law compliance, not to maximize uninhibited communications between the attorney and the client. Client confidentiality is a means to an end, not an end in itself. Thus the law has long placed some limitations on attorney-client communications (such as the crime/fraud exception).[60]

CONCLUSION

As long as corporate attorneys are "allowed to roam in a law-free zone,"[61] corporations, investors and the public at large will continue to bear the burdens, financial and otherwise, of the collapse of corporations who unfortunately relied on their attorneys' advice. That the SEC and Congress finally have begun to pay attention to this "dirty little secret" of corporate downfall is certainly a step in the right direction. But much more must be done – and it must begin with lawyers themselves. As Professor Koniak so forcefully put it:

> The law, lawyers used to say, is a jealous mistress. No mistress, jealous or not, would tolerate the total disregard that pillars of the bar now demonstrate toward the law. We are supposed to be the law's servants. It is not supposed to be the other way around. When we treat law this way, we dishonor ourselves. When the law gives lawyers license to ignore its dictates, it sows the seeds of its own destruction. This is your wake up call.[62]

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state bank. The court reasoned that attorneys were easily confused by rules governing the identity and confidentiality duty for corporate clients. *Id.* at 317.

[58] Kim, *supra* note 26, at 251.

[59] *Id.* at 250-251 (quoting Talcott Parsons, *A Sociologist Looks at the Legal Profession*, *in* ESSAYS IN SOCIOLOGICAL THEORY 370, 384 (rev. ed. 1954) (emphasis added)) (citing David Luban, *The Noblesse Oblige Tradition in the Practice of Law*, 41 VAND. L. REV. 717, 724 (1988)). *See also* David Luban, *Asking the Right Questions*, 72 TEMP. L. REV. 839, 841 (1999).

[60] Coffee II, *supra* note 12, at 1307.

[61] Koniak, *supra* note 1, at 195.

[62] *Id.* at 227.