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ORGANIZATIONAL REPRESENTATION AND THE FRONTIERS OF GATEKEEPING

WILLIAM H. SIMON*

Introduction

I spend more than half of my Professional Responsibility ("PR") survey course discussing issues distinctive to organizational clients. I do so in part to take into account the realities of practice. If we can generalize from John Heinz and Edward Laumann's Chicago study, about sixty-five percent of lawyering time is devoted to organizational clients. Yet, the PR issues involved in representing organizational clients occupy a comparatively small portion of legal doctrine, casebooks, and scholarship.

Another reason I emphasize organizational clients is that recent developments in this sphere, especially in securities and tax, have great general interest.

First, these developments represent fairly strong modifications or reinterpretations of traditional doctrine on confidentiality and disclosure. The tax rules, in particular, expand the idea of the lawyer as gatekeeper at the expense of traditional confidentiality to a more radical extent than academic critics have ever proposed, or perhaps would have even have contemplated, prior to their enactment.

Second, the securities and tax initiatives represent radical departures from the traditional institutional structure of professional regulation centered on state judiciaries and bar associations. Section 307 of the Sarbanes-Oxley Act of 2002 (hereinafter "S-Ox") represents the first federal statute in the history of the country to regulate lawyers directly and broadly. The second came two years later in the form of the tax enforcement provisions of the American Jobs Creation Act of 2004.

One way to view these developments is as manifestations of the trend toward fragmentation or contextualization of doctrine identified by David

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Wilkins and John Leubsdorf. But the securities and tax developments have more general significance as well. The securities norms are simply the most developed effort to date to take account of a longstanding and often-ignored problem that arises with any organizational client—what does it mean to be loyal to an entity that consists of multiple constituencies with potentially conflicting interests?

For their part, the new tax norms are a response to a problem that arises in many areas of both public and private law—the use of literalistic or formalistic interpretation to frustrate or evade implicit understanding or responsibility. Thus, one could see the securities and tax developments as augurs of a broader change.

At the same time, there is an interesting difference in the security and tax bar's response to the gatekeeper idea—or the concept that the lawyer's role should involve more public responsibility than it traditionally has. In the securities realm, practitioners have uniformly resisted the gatekeeper role, and they have been politically effective—though only partially—in muting reform. In the tax area, as Tanina Rostain has reported, paractitioners have been divided, and professional opposition to reform has had much less effect.

Securities

The core of the Sarbanes-Oxley Act is an "up-the-ladder" reporting requirement. In essence, it mandates that lawyers who encounter evidence that agents of their organizational clients are violating the securities laws or fiduciary duties report such violations to senior executives. Thereafter, the reporting lawyers must either (a) ascertain that any problems have been rectified or (b) make sure the board is aware of the evidence.

In principle, this is not a radical intervention, and its requirements were arguably implicit in the pre-existing Model Rule ("MR") 1.13. However, S-Ox does innovate in important respects. First, the pre-existing 1.13 requirements were highly ambiguous, perhaps deliberately so; S-Ox is comparatively specific.

Second, S-Ox subverts a strong managerialist inclination that is powerfully influential in practice and occasionally surfaces in doctrine. This tendency encourages lawyers to identify the organizational client with the managers with whom they deal directly and who make the decisions to retain them. By contrast, S-Ox encourages the lawyer to identify the corporation with its board, and particularly, the independent directors. This is a big step in the right direction, and sometimes requires difficult action on the part of lawyers.

Third, in one aspect, S-Ox departs notably from the fragmentation/contextualization view. Although S-Ox by its terms applies

only to public corporations, revisions to MR 1.13 designed to improve consistency with S-Ox have expanded these guidelines to encompass all organizational clients.

S-Ox contributes to the gatekeeping trend that has virtually eliminated the practical significance of confidentiality in the organizational context. This expansion of the gatekeeper ideal complements other doctrines. These doctrines include: first, the doctrine of *Garner v. Wolfenbarger*, 430 F. 2d 1093 (5th Cir. 1970) that allows plaintiffs in shareholder suits who satisfy certain conditions to discover privileged communications between managers and the organization's lawyers; second, the doctrine of *CFTC v. Weintraub*, 471 U.S. 343 (1985), which holds that when the corporation is in bankruptcy, the bankruptcy trustee controls the corporate privilege even with respect to communications before bankruptcy.

The third is the longstanding evidence doctrine, wherein privilege does not apply to "underlying facts." This means that a lawyer representing a corporation in connection with civil discovery or securities compliance must disclose damaging information even when learned from a confidential communication.

The cumulative effect of these doctrines is that a lawyer for an organization is virtually never in a position to honestly and credibly reassure the organization's agents that they will not be worse off for having confided individually damaging information.

Nevertheless, the securities bar continues to resist gatekeeper responsibilities on the grounds that they compromise confidentiality. We can see this in two notable campaigns of recent years.

First, the securities bar defeated the SEC's "noisy withdrawal" proposal that would have required lawyers withdrawing from representing public companies to announce that fact in an SEC filing and explain the reasons for the withdrawal, as auditors have long been required to do.

Second, the bar, in a bizarre alliance with the ACLU and the United States Chamber of Commerce, forced the DOJ to limit its practice of requiring corporations, as a condition of deferred prosecution, to waive attorney-client privilege with respect to internal investigations of wrongdoing.

In both cases, the securities bar's arguments rested on claims that compliance is impeded by gatekeeping responsibilities because such responsibilities impair managerial trust in lawyers. But the claims about managerial trust rest on a largely mythical portrayal of the power of confidentiality in the corporate context.

Tax

The IRS supplements and preempts state PR law in the tax area in

several ways. First, under regulations known as Circ. 230, the IRS regulates the support threshold a position must have before the practitioner can (1) sign a return based on it, or even (2) give written advice with respect to it. The rules vary by situation, but in all instances the requirements are higher than those prescribed by the relevant Model Rules, especially 3.1, which might be read to authorize any non-frivolous position.

Second, a variety of interventions have contributed to the dramatic curtailment of the more aggressive practices associated with the corporate tax shelters of the 1990s. They include:

• a set of rules regulating opinions given for the purposes of "penalty protection"; i.e., opinions that recipient can use to demonstrate good faith as a defense to penalties in the event it is found to have underpaid. Here the requisite threshold of validity rises to fifty percent. These rules may become less important due to the cutback in "penalty protection" in 2010 legislation;

• a requirement that lawyers who play a substantial role with respect to shelter-like "reportable transactions" maintain and produce on demand lists of clients involved in the transactions;

• a requirement, addressed to clients but important for lawyers, that "questionable tax positions" be affirmatively disclosed on the return;

• most radically, lawyers who give material advice or assistance with respect to "reportable transactions" are obliged to report the advice on their own initiative to the IRS on an "information return."

While far more radical than the securities developments, these reforms have not prompted the uniform resistance on the part of the tax bar; indeed important portions have been embraced and encouraged by prominent members of the tax bar. These members have responded to perceived weaknesses in the regulatory regime, not by trying to distinguish themselves in their willingness to exploit them, but by publicizing them in ways designed to assist and pressure the regulators to close them.

Ambiguities of Contextualization, or A Tale of Two Bars

As an abstract matter, we can imagine that both ideology and self-interest might lead business lawyers in two directions: (1) toward a champion or gladiator model that emphasizes lawyers' role in protecting client autonomy from state power; (2) toward a gatekeeper or intermediary model that emphasizes lawyers' role in mediating between private and public interests.

In the first model, we would expect lawyers to take an adversarial posture against the state and to compete for clients in terms of their relative willingness to assist in the evasion or frustration of costly regulation through aggressive planning and litigation. We would also expect them to

resist practice standards and to embrace, or at least tolerate, a race to the bottom.

In the second model, we would expect lawyers to take a collaborative posture toward the state and to compete in terms of their ability to induce regulators to trust their clients and to devise modes of compliance that achieve public goals at lower private costs. For example, regulators and private collaborators who trust the client will reward her with less costly rules, verification, and monitoring procedures. Here, we would expect to see leading lawyers supporting publicly enforced high standards as a means of avoiding a race to the bottom.

An important sector of the tax bar seems to have embraced something of an intermediary approach, while the securities bar seems to be generally ambivalent. It portrays its main function as, ultimately, compliance, but it resists direct gatekeeping responsibilities in the name of a managerialist conception of client loyalty and a largely mythical norm of confidentiality.

No doubt the contrasting trajectories are an instance of contextualization. But there remains the question of whether the particular configuration of contextualization should be understood in functional terms or in some other way. Have securities and tax played out differently because differing practical circumstances make the optimal role of a lawyer different in the two contexts? Or should we understand the differences more in historical and political terms?

A functionalist explanation might emphasize that securities enforcement does not depend entirely on an understaffed agency but benefits from the vigilance of investment bankers, investors, and an active plaintiffs' bar. Tax enforcement, on the other hand, largely depends on a woefully understaffed IRS.

A historical explanation would point out that there is a longstanding tradition within the elite tax bar that embraces the gatekeeping role, a tradition that seems to have emerged independently of public or market pressures.

A political explanation might point to a difference in the competitive situation of securities and tax lawyers. The barriers to entry in tax practice are fairly low, and in a race to the bottom, traditional qualifications may count for less than amoral aggressiveness and willingness to take risks. Elite lawyers may find it easier to support high standards if the standards neutralize the advantages of less credentialed but more aggressive competitors. By contrast, barriers to entry in securities practice are much higher, and elite practitioners have less cause to worry that low standards will permit uncredentialed upstarts to eat their lunch.

Conclusion

All these explanations seem to have merit; I don't have a view as to how they should be weighed. A point about which I am confident is that we need to attend to these developments in securities and tax both because the areas are intrinsically important and because some of the innovations in these areas represent alternative approaches to professional regulation that may turn out to have more general application.

Further Reading

Tanina Rostain, *Sheltering Lawyers: The Organized Tax Bar and the Tax Shelter Industry*, 23 YALE J. ON REG. 77 (2006).

William Simon, *After Confidentiality: Rethinking the Professional Responsibilities of the Business Lawyer*, 75 FORDHAM L. REV. 1453 (2006).

Dennis Ventry, *Cooperative Tax Regulation*, 41 CONN. L. REV. 431 (2008).