

The Devolution of the Legal Profession: a Demand Side Perspective

Ronald J. Gilson

Follow this and additional works at: <http://digitalcommons.law.umaryland.edu/mlr>



Part of the [Legal Profession Commons](#)

Recommended Citation

Ronald J. Gilson, *The Devolution of the Legal Profession: a Demand Side Perspective*, 49 Md. L. Rev. 869 (1990)

Available at: <http://digitalcommons.law.umaryland.edu/mlr/vol49/iss4/3>

This Article is brought to you for free and open access by the Academic Journals at DigitalCommons@UM Carey Law. It has been accepted for inclusion in Maryland Law Review by an authorized administrator of DigitalCommons@UM Carey Law. For more information, please contact smccarty@law.umaryland.edu.

MARYLAND LAW REVIEW

VOLUME 49

1990

NUMBER 4

© Copyright Maryland Law Review, Inc. 1990

Articles

THE DEVOLUTION OF THE LEGAL PROFESSION: A DEMAND SIDE PERSPECTIVE

RONALD J. GILSON*

TABLE OF CONTENTS

INTRODUCTION	870
I. SETTING THE CONTEXT: THE PROHIBITION OF STRATEGIC LITIGATION	873
II. THE TRADITIONAL APPROACH: <i>Ex Post</i> Direct Enforcement	877
A. <i>An Objective Approach: The Inevitability of Underinclusion</i>	879
B. <i>A Subjective Approach: Underinclusion Again</i>	880
C. <i>Summary</i>	882
III. A GATEKEEPER APPROACH: <i>Ex Ante</i> Indirect Enforcement	882
A. <i>Detecting Strategic Litigation</i>	885
B. <i>The Supply Side: Will Lawyers Want to Be Gatekeepers?</i> .	886
C. <i>The Demand Side: Will Clients Allow Lawyers to Be Gatekeepers?</i>	889

© Copyright 1990 by Ronald J. Gilson.

* Professor of Law, Stanford University. The research for this Article was supported by a grant from the John M. Olin Program in Law and Economics at Stanford Law School and by the Hoover Institution, at which I was a Visiting Scholar while much of this Article was written. The Article has its origin in remarks I delivered at the American Bar Foundation's Conference on Professionalism, Ethics, and Economic Change in the American Legal Profession, September, 1988, to which organization I am grateful for having been included. I am also grateful to William Allen, Lucian Bebchuk, Steven Bundy, Robert Gordon, Reinier Kraakman, Robert H. Mnookin, William Simon, Antone G. Singen, III, Marshall Small, and to the participants at the Harvard Law School Law and Economics Workshop and the Duke Law School and Stanford Law School faculty workshops for helpful comments on an earlier draft.

1. <i>Identifying What Services Are Needed</i>	890
2. <i>Pre- and Post-Purchase Quality Uncertainty</i>	890
3. <i>Client Relationships and Law Firm Structure as a Response to Quality Uncertainty</i>	892
a. <i>The Diagnostic Function and Pre-Purchase Quality Uncertainty</i>	893
b. <i>The Lock-in Effects of Information and Post-Purchase Quality Uncertainty</i>	897
D. <i>Summary</i>	898
IV. THE DEVOLUTION OF THE LEGAL PROFESSION: WHAT HAS CHANGED?	899
A. <i>The Impact of a Reduction in Information Asymmetry</i>	900
B. <i>The New Source of Client Sophistication</i>	901
V. THE DEVOLUTION OF THE LEGAL PROFESSION: WHAT CAN WE DO ABOUT IT?	903
A. <i>Shifting from a Private to a Public Gatekeeping Regime: The 1983 Amendments to Rule 11</i>	905
B. <i>Increasing the Penalty on the Wrongdoer: Disclosure of Accountant Opinion Shopping</i>	909
C. <i>Changing the Gatekeeper: A New Role for Inside Counsel</i> .	913
CONCLUSION	916

INTRODUCTION

Economic analysis has not played a significant role in the increasingly intense debate over the decline of professionalism among lawyers.¹ Economists' lack of interest in the issue may be under-

1. This is beginning to change. Robert Mnookin's and my work is one example. See Gilson & Mnookin, *Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 STAN. L. REV. 313 (1985) [hereinafter Gilson & Mnookin, *Sharing Among Capitalists*]; Gilson & Mnookin, *Coming of Age in a Corporate Law Firm: The Economics of Associate Career Patterns*, 41 STAN. L. REV. 567 (1989). Some sociologically oriented students of the legal profession also have picked up the bug. See R. NELSON, *PARTNERS WITH POWER: THE SOCIAL TRANSFORMATION OF THE LARGE LAW FIRM* (1988); Rosen, *The Inside Counsel Movement, Professional Judgment and Organizational Representation*, 64 IND. L.J. 479 (1989); Galanter & Palay, *The Big Law Firm: Its Growth and Transformation* (1989) (unpublished manuscript) (to be fair, Palay is trained as an economist; Galanter's guilt is by association). Gordon, *The Independence of Lawyers*, 68 B.U.L. REV. 1, 52 (1988), also makes effective use of economic analysis, although he complains some. ("Yet [economic analysis] is also a notoriously limited and impoverished discourse, historically, sociologically, and philosophically illiterate, without a vocabulary for any norm but efficiency, and—though there is nothing in the least necessary about this feature—habitually given an apologetic ideological spin in practice.")

I suspect the lessening hostility toward economic analysis among non-adherents rests on the growing visibility of transaction cost economics whose paradigm—a market that is characterized by limited rationality and substantial friction and which therefore

standable. The lawyers' lament is that the legal profession is devolving into the business of law. That this concern has not captured the economists' attention may reflect only that economists do not view the label "business" as a pejorative. If becoming a business means efficiently rendering an important service in a competitive environment, then of what is there to complain?

Lawyers, more directly concerned with maintaining their professional status, would find little comfort in this explanation for the economists' inattention. From the lawyers' perspective, economists lack appreciation for what is lost in the gap between a business and a profession: the grand Brandesian vision of a public role for lawyers that contemplates a broader professional obligation than to act only in the client's (or the lawyer's) self-interest.

Both views—economists' indifference to the lawyers' public oriented vision of professionalism and the disdain students of the legal profession often display for economic analysis—are incomplete in important respects. By applying economic analysis to highlight the critical role of professionalism in the market for legal services, it is possible to demonstrate the importance of both professionalism as a concept and economics as a means to analyze it. To be sure, nothing special is gained from translating standard sociological analyses of the functions of professionalism into "economese" unless the translation results in new insights.² But such insights are in fact available here. An economic perspective suggests an important function of professionalism that has gone largely unobserved under traditional modes of analysis. Additionally, an economic perspective on professionalism helps identify the sources of the quite real pressures on the legal profession's continued ability to perform this function and the quite real limits on the profession's ability to do very much about it.

My thesis is that important elements of what have been traditionally understood as professional standards operate not as free-

requires careful attention to institutional detail—is much more compatible to those used to working in other social sciences than the perfect market paradigm of traditional law and economic analysis. For a thoughtful description of the potential for further complicating the vision of the world on which law and economics operates, see Ellickson, *Bringing Culture and Human Frailty to Rational Actors: A Critique of Classical Law and Economics*, 65 CHI.-KENT L. REV. 23 (1989).

2. Dr. Suess captures nicely the futility of interdisciplinary translation for the sake of translation alone. In a book designed to console a despondent child by showing how much worse things could really be, Suess tells us: "And how fortunate *you're* not Professor de Breeze who has spent the past thirty-two years, if you please, trying to teach Irish ducks to read Jivvanese." DR. SUESS (T. GEISEL), DID I EVER TELL YOU HOW LUCKY YOU ARE? 30 (1973) (emphasis in original).

standing statements describing appropriate behavior by lawyers, or even as paternalistic proclamations concerning lawyers' treatment of clients. Rather, important elements of professional standards serve to cast lawyers in the role of enforcers of agreements among *clients*. And if this is right, then the continued viability of these elements of professionalism depends not only on the attitude of lawyers, but, more importantly, on the attitude of clients: Will clients still *allow* lawyers to play the role of enforcer? From this perspective, the threat to professionalism comes from the demand side, not the supply side. The good news for lawyers is that economic analysis of legal professionalism provides some solace—the devolution of the profession may not be our fault. The bad news is that, for precisely the same reason, there may be very real limits on what the profession alone can do to arrest the decline.

Part I of this Article sets the context for my argument: the traditional prohibition of strategic litigation. Part II examines the traditional approach to enforcing the prohibition: *ex post* direct enforcement. We find that whether strategic litigation is defined objectively or subjectively, the inevitable outcome is an underinclusive definition and a resulting ineffective prohibition. Part III then turns to a different enforcement approach: *ex ante* indirect enforcement through the lawyer as gatekeeper. The principal focus is on the conditions necessary to the operation of a gatekeeper enforcement regime—whether lawyers can detect strategic litigation *ex ante*; whether lawyers will be willing to supply gatekeeping services (the supply side of the market for legal services); and whether clients will allow lawyers to be gatekeepers (the demand side of the market for legal services).

Having shown that conditions in the market for legal services once allowed a regime of gatekeeper enforcement of the prohibition of strategic litigation, Part IV confronts the devolution of the legal profession: What changes in the market for legal services have diminished lawyers' ability to act as gatekeepers? Part V then considers alternative approaches to shoring up a faltering gatekeeper regime: increasing the penalty on the gatekeeper as through the 1983 amendments to Federal Rule of Civil Procedure 11; increasing the penalty on the wrongdoer (the client) as through requiring increased disclosure to restrict accountant opinion shopping; and, more speculatively, changing the identity of the gatekeeper from outside to inside counsel. Finally, Part VI concludes by briefly considering the argument's impact on the potential for success of cur-

rent approaches to rekindling the spirit of professionalism.³

I. SETTING THE CONTEXT: THE PROHIBITION OF STRATEGIC LITIGATION

As a vehicle for applying economic analysis to professionalism, I will focus on the traditional professional prohibition of strategic litigation. This standard is currently expressed in Rule 3.1 of the American Bar Association's Model Rules of Professional Conduct:

3. A subtext of my argument is an effort to respond to an important comment on the devolution literature made by Robert Nelson and David Trubeck:

If we use as indicators of concern the amount of time devoted to the issue, the prestige of the people involved, the attention paid to it by leaders of the bar throughout the country, one would have to conclude that the organized bar is very concerned with the possibility that professionalism is in decline and is committed to doing something about this situation. However, if one analyzes the reports, editorials, and commentary on professionalism in some detail, the situation seems less unambiguous. In the first place, it is really hard to derive any clear and concrete notion of "professionalism" from much of the literature Secondly, while the rhetoric suggests a decline in professionalism, no clear or convincing account is given of why that might be occurring today and what forces might lie behind alleged lapses from professional norms. Third, although a number of "remedies" are offered to curb the decline in professionalism, these are so diffuse in nature as to undermine the idea that they deal with any coherent issue, and are often cosmetic in character or moralistic and exhortative.

R. Nelson & D. Trubeck, *Lawyer Professionalism and its Discontents*: From Arenas of Words to Arenas of Work 16-17 (1988) (Paper presented at the American Bar Foundation Conference on Professionalism, Ethics, and Economic Change in the Legal Profession).

I mean my story to have the beginning, middle and end, whose absence Nelson and Trubeck lament: a clear statement of the concept of professionalism I have in mind; an explanation of what went wrong; and a logically related, albeit not overly optimistic, recommendation about what we can do about it. I should also respond to an expected, but nonetheless valid criticism of this effort. My account of lawyers as gatekeepers is at best a stylized history; I offer no reliable data, historical or otherwise, that this enforcement regime ever flourished. In this respect, the story told here shares with the devolution literature a common thread that also was criticized by Nelson and Trubeck: "[N]o evidence has been marshalled to show there is more 'unprofessional' conduct today than in the past . . ." *Id.* at 19-20; *accord* Rotunda, *Lawyers and Professionalism: A Commentary on the Report of the American Bar Association Commission on Professionalism*, 18 *LOY. U. CHI. L.J.* 1149, 1151 (1987) ("The charge of decline is serious, and deserves to be supported by more than anecdotal analysis.") Nonetheless, a value exists in providing an internally complete and consistent account of one aspect of professionalism. By specifying the model clearly enough, it at least allows the empirical questions to be framed in a coherent and investigable way. *Cf.* E. Freidson, *Professionalism as Model and Ideology* 4 (Paper presented at the annual meetings of the American Association of Law Schools, Miami Beach, Jan. 10, 1988) ("[A]n analytical model does not purport to represent empirical reality, but it does claim to create a systematic way of thinking about that reality by picking out what is most consequential or important about it and by showing how an institution can *work*. It does not describe reality so much as create a conceptual yardstick against which the empirical world can be measured." (emphasis in the original)).

“A lawyer shall not bring or defend a proceeding, or assert a position or controvert an issue therein, unless there is a basis for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law.”⁴ The same concept was reflected, somewhat more explicitly, in the Model Rule’s predecessor. Disciplinary Rule 7-102(A)(1) of the American Bar Association’s Code of Professional Responsibility provides that a lawyer may not “file a suit, assert a position, conduct a defense, delay a trial or take other action on behalf of his client when he knows or when it is obvious that such action would serve merely to harass or maliciously injure another.”⁵

As commonly understood, these rules present a good example of the internal tension between the two roles for lawyers that, in uneasy conjunction, comprise the traditional concept of professionalism. On the one hand, professionalism is synonymous with client advocacy. It is the lawyer’s complete commitment to achieving what the client wants that defines a true professional.⁶ On the other hand, the lawyer’s client advocacy role is limited by her public interest role. For example, in Model Rule 3.1 the very essence of the lawyer’s obligation when a client wishes to assert a frivolous claim or defense is *not* to do what the client wants.⁷ Efforts to ameliorate the inherent tension between the lawyer’s client advocacy and public interest roles—between the obligation of zealous representation and the prohibition of strategic litigation—constitute an important part of the traditional legal profession literature.

4. MODEL RULES OF PROFESSIONAL CONDUCT Rule 3.1 (1983). The January 1980 draft of this element of the Model Rules was more forceful: “[A] lawyer shall bring or defend a proceeding, or assert or controvert an issue therein, only when a lawyer acting in good faith would conclude that there is a reasonable basis for doing so.” See S. GILLERS & N. DORSEN, REGULATION OF LAWYERS: PROBLEMS OF LAW AND ETHICS 523 (2d ed. 1989) (quoting MODEL RULES OF PROFESSIONAL CONDUCT Rule 3.3(b)).

5. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(A)(1) (1969). Earlier versions of the same prohibition appear in § 14 of the 1887 ALABAMA LAWYERS CODE OF ETHICS (“An attorney must decline in a civil cause to conduct a prosecution, when satisfied that the purpose is merely to harass or injure the opposite party, or to work oppression and wrong”) and in Canon 30 of the 1908 American Bar Association’s CANONS OF PROFESSIONAL ETHICS (“The lawyer must decline to conduct a civil case or make a defense when convinced that it is intended merely to harass or to injure the opposite party or to work oppression or wrong”).

6. See, e.g., MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 7-1 (1980) (“The duty of a lawyer, both to his client and to the legal system, is to represent his client zealously within the bounds of the law”) For a different approach to reaching the same outcome, see Fried, *The Lawyer as Friend: The Moral Foundation of the Lawyer-Client Relation*, 85 YALE L.J. 1060 (1976).

7. See *supra* text accompanying note 4.

From my perspective, the standard of conduct reflected in Model Rule 3.1 suggests a quite different function for this element of professionalism, one that eliminates the apparent conflict between the profession's two traditional faces. From this perspective, the limits stated in Model Rule 3.1 serve to facilitate, not frustrate, the client's best interests. Rather than stating the circumstances in which a lawyer's public interest role requires the lawyer to prevent the client from achieving his immediate desire, the limits are actually those specified by the client to achieve his real goal.

The manner in which the denial of a client's immediate desire facilitates achieving his real goal can be seen by shifting backward the point in time when the client's interests are evaluated. Rather than focusing on what the client wants at the time he seeks to file the strategic litigation, consider instead what he would want at the time the rules governing such litigation are chosen.

Imagine that all the potential clients in the world are assembled behind a Rawlsian veil of ignorance⁸ to select the rules that would govern the initiation and conduct of litigation. In the Rawlsian construct, potential clients would not know—actually or probabilistically—whether they would turn out to be plaintiffs or defendants, nor whether they would have substantial resources with which to conduct any litigation. The purpose of this construct is to harness self-interest in the service of selecting socially optimal rules. Because of the veil of ignorance, a potential client can select a rule that benefits himself only by selecting a rule that maximizes the position of all clients as a group.⁹

Now suppose the assembly is posed the following question: Should a party be allowed to use litigation not to vindicate a substantive legal right, but as a strategic device to secure a business advantage by imposing costs on the other party?¹⁰ Unfortunately, examples of such strategic uses of litigation are commonplace. A leading takeover lawyer advises that a target company's first response to a hostile takeover bid should be to sue the bidder.¹¹ The point is not that the bidder has necessarily violated any legal rule, but that filing suit, whatever the grounds, will build the morale of

8. See J. RAWLS, *A THEORY OF JUSTICE* 12, 136-42 (1971).

9. See *id.* at 140.

10. This definition of strategic litigation is consistent with the more formal development of the concept in Cooter & Rubinfeld, *Economic Analysis of Legal Disputes and Their Resolution*, 27 J. ECON. LITERATURE 1067, 1083-84 (1989) (action strategic when it affects only the other parties' costs and not the strategic action's likelihood of success or size of recovery).

11. Wachtell, *Special Tender Offer Litigation Tactics*, 32 BUS. LAW. 1433, 1437-38 (1977).

the target company's employees, can signal the target's intention to vigorously resist, and may chill the arbitrage thought central to the bidder's success.¹² Only then does the author consider the possible legal bases for suit.¹³ Similarly, a trade secret suit is frequently filed when employees of a high technology company leave to start a new company, often before the complaining former employer even knows what product the employees' company will produce. The lawsuit may turn out to be groundless, but it may nonetheless succeed in creating enough uncertainty to chill the new business's access to venture capital, and thereby doom or seriously cripple the potential competitor.¹⁴

It should be apparent that our Rawlsian assembly of clients would prohibit strategic use of litigation. Although such litigation can serve to redistribute wealth between the parties, behind the veil a client could not predict whether he would be the perpetrator of such litigation or its object. And because such litigation imposes a pure dead weight loss, prohibition would be in everyone's interest.¹⁵

The problem with such a prohibition is enforcement. Once the veil of ignorance is lifted, it often will be in the interest of a particular litigant to ignore the prohibition. The systemic costs of reintroducing strategic litigation are largely externalized—shared by all potential clients—while the particular litigant captures all the benefits of the wealth transfer resulting from its use in the particular case. The prohibition will therefore tend to break down absent an effective means of enforcement. The next two parts of this Article consider two different regimes for enforcing the Rawlsian assembly's prohibition of strategic litigation. The first—*ex post* direct enforcement by the injured party—is the traditional approach to enforcing obligations to third parties. The second, in which lawyers play the role of “gatekeepers”, serves to reduce dramatically the

12. *Id.*

13. *Id.* at 1438-39.

14. See A. Silverman, Symposium Report: Intellectual Property Law and the Venture Capital Process (May 1989) (Summary of Symposium Sponsored by the Stanford International Center for Law and Technology and the John M. Olin Program in Law and Economics reporting results of survey of 30 San Francisco law firms active in intellectual property disputes against start-up companies); cf. Gupta, *Start-Ups Face Big-Time Legal Artillery*, Wall St. J., Oct. 31, 1988, at B2, col. 2.

15. Conceivably the imposition of costs could have allocative impact as well, either positive or negative. Increased costs could reduce innovations or, less clearly, could protect investment in innovation if the original property right was not firmly fixed. See *infra* note 19.

costs of an *ex post* direct enforcement regime.¹⁶ The availability of such a gatekeeper approach—using lawyers as an *ex ante* screen to prevent, rather than punish, strategic litigation—seems to me to explain both the professional prohibition on strategic litigation and the limited role of direct enforcement in this area.

II. THE TRADITIONAL APPROACH: *EX POST* DIRECT ENFORCEMENT

The traditional legal approach to enforcing obligations is *ex post* direct enforcement. The party injured by the breach of an obligation can sue the party that committed the breach for the damages suffered. In the context of strategic litigation, an *ex post* direct enforcement approach gives the object of such litigation a cause of action against the perpetrator—we might call it a cause of action for malicious prosecution.¹⁷

The central problem in designing a system of *ex post* direct enforcement is the accuracy with which you can determine after the fact that the prohibition against strategic litigation has in actuality been breached. The difficulty is defining strategic litigation in a fashion that minimizes the costs associated with the definition being either under or overinclusive.¹⁸ The definition is underinclusive when some litigation that is in fact strategic escapes the prohibition. The costs of underinclusion are straightforward: because some strategic litigants will get away with it, a larger number will try.¹⁹

The costs of overinclusion are less obvious. A definition of

16. See Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J. L. ECON. & ORG. 53 (1986).

17. See *infra* notes 22-23 (discussion of the elements of the tort of malicious prosecution).

18. See Ehrlich & Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974) (general development of the concept of over and underinclusive legal rules).

19. The specific costs imposed depend on the purpose for which strategic litigation is used in a particular setting. For example, if strategic litigation is used to create market entry barriers (for example, through ultimately meritless claims that a new product is no more than an unauthorized copy of a competitor's existing product) then the costs are the loss of competition for the benefit of consumers.

More specifically, when the probability of getting caught is less than one, and damages if one is caught are limited to the injury caused, it will be to the advantage of a risk neutral litigant to pursue the strategic litigation so long as the strategic gains exceed the expected value of the damages. A careful definition tries to ameliorate the problem by increasing the probability that a strategic litigant is caught. A different approach to underinclusion is to alter instead the amount of the damages. If the damages awarded exceed the actual damages suffered, then the cost of getting caught goes up even if the likelihood of getting caught does not. Thus, the potential for punitive damages would also be a response to an underinclusive definition. See Cooter, *Punitive Damages for Deterrence: When and How Much?*, 40 ALA. L. REV. 1143 (1989).

strategic litigation is overinclusive when some litigation that in fact is *not* strategic will be erroneously found to fall within it. An overinclusive definition has the costly effect of diluting substantive property rights. Litigation is one way in which a person protects his property rights. When access to that form of protection is constrained—here by the risk that nonstrategic litigation mistakenly will be swept up in the definition—the value of the property right itself is reduced. This point can be illustrated by a situation referred to earlier as an example of strategic litigation: a trade secret suit by a high technology employer against former employees who form a competing company. In the earlier example, the employer brought suit only to prevent lawful competition.

Now consider the former employer's situation from a different perspective. Suppose a high technology company hires an engineer with the understanding that it will pay the engineer a fixed salary regardless of whether the engineer makes a discovery, but if a discovery occurs, the company will get the benefit.²⁰ Without an effective means to enforce that understanding, the arrangement is not stable. If the engineer actually makes a discovery, she has an obvious incentive to leave the company and exploit the discovery herself, with the result that the original understanding deteriorates into an option in favor of the engineer. Litigation is thus an important means by which the company can protect against the engineer's misappropriation of its property right in the discovery. Increased cost for such protection, because of the risk that such litigation will be erroneously found to be strategic, diminishes the value of the property right the company acquires and, therefore, diminishes the incentive to invest in innovating—to hire the engineer—in the first place.

The task is thus to define strategic litigation in a fashion that minimizes the cost of under and overinclusiveness. Two approaches come to mind. The first, an objective approach, attempts precision of application by looking to the extent of legal support for the allegedly strategic litigation as a proxy for inquiring into the plaintiff's subjective intent. The second approach takes precisely the opposite tack, eschewing analysis of the objective characteristics of the plaintiff's behavior—whether there was sufficient legal support for the claim asserted—in favor of directly examining the plaintiff's subjec-

20. The logic of the arrangement reflects the company's ability to pool the risk that particular engineers will never make a discovery. Assuming that individual engineers are risk averse and that, because of pooling, the company is risk neutral, there is gain from shifting the risk of nondiscovery from an individual engineer to the company.

tive intent: Did the plaintiff intend the litigation as strategic? Unfortunately, both approaches share a common failing: the resulting definition in both approaches will be inevitably underinclusive, with the further result that *ex post* enforcement of the prohibition of strategic litigation will be inevitably ineffective.

A. An Objective Approach: The Inevitability of Underinclusion

An objective approach to defining strategic litigation looks to the extent of legal support for the challenged action as a readily observable signal of whether the plaintiff had the unobservable nasty intent: to inflict costs on the defendant without regard to the legal basis for the claim. The idea is that so long as there is an appropriate level of legal support for the claim, a legitimate basis for it is said to exist even if the cost of defense also gives the plaintiff a nonlegal strategic benefit. The hoped for advantage of an objective approach is precision of coverage; specifying the amount of legal support required is less likely to be applied incorrectly than specifying the prohibited intent and then determining whether it was present.

The question posed by an objective approach is how much is enough? How little legal support will brand an action as strategic? Virtually any specification of the support necessary to avoid the label strategic is inevitably somewhat overinclusive. The resulting problem is that the magnitude of the costs of overinclusiveness will push an objective definition toward underinclusion.

Suppose the plaintiff's lawyer believes that some support for her client's position exists, but that, on balance, the plaintiff will lose. An objective approach would require the plaintiff to show that, *ex ante*, he had the requisite probability of success. But regardless of how low the probability is set, so long as there is any legal support for the plaintiff's position, a possibility remains that the action is not strategic. If deterring genuinely nonstrategic actions that nonetheless lack the specified level of legal support is costly, then the probability chosen is undesirably overinclusive.

If the goal is to avoid the costs of an overinclusive definition of strategic litigation, a simple answer to how little legal support brands an action as strategic might be none: an action is strategic only if *no* legal support for it exists. But even a "no support" standard may be overinclusive. Suppose the only existing precedent is contrary to the plaintiff's position. If the plaintiff loses the case, can he defend against the defendant's subsequent action for pursuing strategic litigation on the ground that he tried to persuade the court

to overturn existing precedent? If he cannot, then the standard remains seriously overinclusive because it could deter a party from arguing for a change in existing law, the very engine that is claimed to drive the common law's progress toward efficiency.²¹

The upshot is that because an overinclusive definition of strategic litigation can impose substantial costs, and because an objective approach to defining strategic litigation is inevitably overinclusive, such an approach would tend toward an underinclusive "straight face" standard. That is, if the plaintiff's lawyer can stand before the court and recite the argument without smiling, the litigation is not strategic.²² If such a standard prevails, it is apparent that fear of a direct action for strategic litigation will have little deterrent effect on a plaintiff contemplating strategic litigation. To be sure, some outrageous conduct may still be caught, but that is not the object of the exercise. The Rawlsian assembly had in mind prohibiting a broader range of activity.

B. A Subjective Approach: Underinclusion Again

The externalities that drive an objectively based definition toward underinclusion—dilution of property rights and restriction of the process of common-law development—result from using a measure of existing legal support as a signal of strategic intent. An alternative approach frames the definition directly in terms of the underlying subjective characteristic: Did the plaintiff intend the litigation as strategic?

Although an intent standard does not trigger the external costs that flow from an objective approach, the difficulties peculiar to a subjective approach also push, in the end, toward underinclusion.

21. See, e.g., Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65, 81 (1977); Rubin, *Why Is the Common Law Efficient?*, 6 J. LEGAL STUD. 51, 61 (1977).

22. The commentary to Model Rule 3.1 suggests this result for lawyers:

The filing of an action or defense or similar action taken for a client is not frivolous . . . even though the lawyer believes that the client's position ultimately will not prevail. The action is frivolous, however, . . . if the lawyer is unable to make a good faith argument on the merits of the action taken or to support the action taken by a good faith argument for an extension, modification or reversal of existing law.

MODEL RULES OF PROFESSIONAL CONDUCT Rule 3.1 comment (1983).

The same result appears with respect to the elements of a cause of action for malicious prosecution. In this setting, the objective approach is reflected in the requirement that the plaintiff prove that there was no "probable cause" for filing the original lawsuit. The probable cause requirement apparently is satisfied quite easily. See Wade, *On Frivolous Litigation: A Study of Tort Liability and Procedural Sanctions*, 14 HOFSTRA L. REV. 433, 444-45 (1986).

These difficulties, however, result from a very different problem of definition. The problem with a subjective approach is error. Because of the difficulty of fact finding, a subjective approach can be simultaneously over and underinclusive, with costs resulting from error in either direction. But because a strategic plaintiff will have had the opportunity to shape the facts in a favorable manner, the dominant result is, again, underinclusiveness.

The overinclusive aspects of a subjective definition of strategic litigation result simply from the potential for the trier of fact to make a mistake. The jury will decide, based on the testimony presented, whether the plaintiff had the prohibited intent. But the process of determining subjective intent is especially prone to error. Leaving aside for the moment the incentives of both parties to actively shape the fact finding process in their favor, an after-the-fact determination of what one party had in mind when it took an earlier action is made difficult by the familiar process by which one's beliefs about one's past acts are influenced by one's present circumstances. Even if that error is randomly distributed between over and underinclusion, so long as the plaintiff whose litigation is challenged as strategic is risk averse, the potential for any overinclusion—the potential that the litigation will mistakenly be determined strategic and damages awarded—will deter some beneficial conduct. To avoid that result, the definition will tend toward underinclusion.²³

The more serious problem, however, is that, in the context of a definition of strategic litigation, the fact finding process itself is inherently biased toward underinclusion. A plaintiff who is considering filing a suit for strategic purposes has the opportunity to plan—to structure his action to create a record that supports a non-strategic explanation. Whatever criteria are developed by courts as indicia of the prohibited intent can be incorporated into the plaintiff's planning process and more or less avoided.²⁴ To be sure, some behavior will be so blatant that it cannot be camouflaged even with the benefit of planning and some plaintiffs (and their lawyers) will be so unsophisticated that they neglect to fashion a favorable

23. The subjective component of the elements of a cause of action for malicious prosecution—that the plaintiff prove that the original action was filed with malice—reflects this influence. See *RESTATEMENT (SECOND) OF TORTS* § 676 (1981); Wade, *supra* note 22, at 448-50.

24. The ability to shape one's conduct in light of the criteria used to evaluate subjective intent is not symmetric among the parties. Because the criteria would focus on the behavior of the party initiating the allegedly strategic litigation, the initiating party can plan its conduct with the criteria in mind. The object of the strategic litigation, in contrast, has no opportunity to alter its behavior until the suit is filed.

record. As with the narrow swath of an objective definition, however, the Rawlsian assembly had in mind prohibiting a broader range of activity.

C. Summary

Analysis of either an objective or subjective definition of strategic litigation leads to the conclusion that a regime of *ex post* direct enforcement is unlikely to achieve the goal of significantly deterring the opportunistic pursuit of strategic litigation.²⁵ Even though clients would agree unanimously to prohibit strategic litigation when they were shielded from self-interest by the veil of ignorance, once the veil is lifted individual clients would be free to seek the wealth transfer attainable by behaving strategically with respect to particular litigation. The puzzle is that, at least over much of our history, clients, especially commercial clients, do not seem to have behaved this way. The task, then, is to identify what institution may have served to enforce the Rawlsian assembly's prohibition of strategic litigation when the traditional regime of *ex post* direct enforcement was not up to the challenge.²⁶

III. A GATEKEEPER APPROACH: *EX ANTE* INDIRECT ENFORCEMENT

Ex post direct enforcement fails because it cannot define strategic litigation with precision. An objective approach identifies strategic litigation through the presence of an observable signal, but the noisiness of the signal causes significant externalities that are avoided by an underinclusive definition. A subjective approach looks directly to whether the original plaintiff had a strategic intent, but this approach is also imprecise. By the time enforcement takes place, a carefully constructed record and the more general difficulty of reconstructing the original plaintiff's intent at the time the alleg-

25. This is certainly the conventional wisdom with respect to the tort of malicious prosecution. The following evaluation is typical: "The courts have placed stringent restrictions upon this tort action. In some states, the restrictions are so stringent as to render the cause of action essentially unavailable." Wade, *supra* note 22, at 438.

26. M. Galanter & J. Rogers, *The Transformation of American Disputing: Some Preliminary Observations* (June 1988) (unpublished manuscript), provide suggestive data concerning the timing of the phenomenon. From 1960 to 1986, filings of contract cases in federal court increased some 250% and commercial arbitration filings rose from approximately 800 to approximately 7,600 over the same period. *Id.* at 15-18. Galanter and Rogers examine a number of possible explanations for their empirical observation that "'[s]omething happened' in American business in the 1970s, and something happened in business disputing around the same period." *Id.* at 25. My goal here is to focus on the role of the legal profession in this phenomenon.

edly strategic suit was filed, combine to make strategic litigation difficult to identify. With both approaches, the ultimate outcome is an underinclusive definition and too little enforcement.

An alternative approach to enforcing the prohibition of strategic litigation is what Reinier Kraakman has called a "gatekeeper" regime.²⁷ In Kraakman's analysis, a gatekeeper is a private party who can prevent another party's misconduct by withholding his cooperation from the would-be wrongdoer. In other words, the misconduct cannot occur without the gatekeeper's participation. Securities lawyers provide a straightforward example. A legal opinion is typically necessary to complete a placement of securities under the private offering exemption from registration under the Securities Act of 1933. Securing such an opinion is the gate through which a party seeking to avoid registration must pass. The securities lawyer, as gatekeeper, can prevent regulatory evasion by refusing to provide the necessary opinion when the requirements of the exemption are not met.²⁸

A well-functioning gatekeeper regime is an elegant enforcement strategy. Wrongdoing is prevented, rather than punished after the fact, without the substantial administrative costs of a formal enforcement proceeding.²⁹ However, the conditions necessary to support a successful gatekeeper regime are formidable. First, there must be a gatekeeper and a gate—some service which the wrongdoer must have to accomplish his goal and someone in a position to decline to provide that service to those who would misuse it. Second, the gatekeeper must be able to detect with some precision when his service will be misused, lest the problem of under and overinclusion that plagued *ex post* enforcement be replicated in this

27. See generally Kraakman, *supra* note 16.

28. Kraakman's primary concern is with what he calls "public" gatekeepers—those whose pivotal position and incentive to act result from a legislatively imposed regulatory scheme. *Id.* at 61-62. My concern here is with "market" gatekeepers whose position and incentive result from market forces. In the text's example of a securities lawyer in a private placement transaction, whether the lawyer is a market or a public gatekeeper depends on whether the legal opinion is required by law or by the purchaser of the offered securities.

29. Kraakman identifies three kinds of costs associated with a gatekeeper enforcement regime: administrative, private, and tertiary. *Id.* at 75. Administrative costs are simply the costs associated with making the enforcement regime work. Because in a market regime, enforcement is a byproduct of market demand, there are no administrative costs properly allocable to the enforcement element of the activity. Private costs are the costs of actions taken by the gatekeeper to avoid making a mistake. Again, when a market regime is involved, these are unimportant because they are demanded by the market rather than imposed by regulation. Tertiary costs are the costs that the gatekeeper's efforts impose on honest purchasers of the gatekeeping service. *Id.*

enforcement strategy. Third, supply and demand conditions in the market for the service that functions as a gate must support an enforcement regime: the gatekeeper must be willing to play that role and consumers of that service must be willing to accept it.

Despite this litany of conditions, a gatekeeper regime holds out the promise of effectively enforcing the prohibition against strategic litigation. There are both an obvious gate and an obvious gatekeeper. To commence litigation that has any chance of success, a professionally prepared complaint must be filed with a court. To prepare that complaint, a lawyer must be retained. If the remaining two conditions are satisfied—if the lawyer can detect with reasonable precision when the proposed litigation is strategic, and if the supply and demand conditions in the market for legal services allow the lawyer to play a gatekeeper role—gatekeeping can provide an effective enforcement regime.

Understanding that lawyers can play a gatekeeper role to prevent strategic litigation has an analytic advantage as well. One goal of my effort is to highlight the economic value of some of lawyers' traditional professional obligations. A central feature of the Brandesian vision of a lawyer's professional role is the lawyer's obligation to refuse to participate when a client proposes inappropriate action. An oft-cited comment by Elihu Root captures the thought: "About half of the practice of a decent lawyer is telling would-be clients that they are damned fools and should stop."³⁰ Talcott Parsons put the same point more formally: The lawyer functions "as a kind of buffer between the illegitimate desires of his client and the social interest."³¹

In the setting of enforcing the prohibition against strategic litigation, then, gatekeeping provides a broader functional account of an important element of the lawyer's traditional professional credo. The remainder of this Part considers whether lawyers can reliably detect strategic litigation and identifies the conditions in the market for legal services necessary for lawyers to serve as effective gatekeepers. Put more traditionally, we examine whether market conditions allow lawyers to discharge the Brandesian vision of their professional responsibility.

30. S. GILLERS & N. DORSEN, *supra* note 4, at 521.

31. T. PARSONS, *A Sociologist Looks at the Legal Profession*, in *ESSAYS ON SOCIOLOGICAL THEORY* 370, 384 (1954).

A. *Detecting Strategic Litigation*

A lawyer cannot be an effective gatekeeper unless he can reliably detect whether his client's motive in pursuing litigation is strategic. In a gatekeeper regime, this condition serves the same function as the definition of strategic litigation in an *ex post* enforcement regime. An advantage of a gatekeeper regime is that the problem that causes an *ex post* enforcement regime to founder is soluble.

The comparative facility with which a lawyer should be able to detect a would-be plaintiff's strategic motive results from the inherent nature of the task the lawyer is asked to undertake. To successfully frame and pursue a complaint,³² a lawyer needs to understand in great detail the factual underpinnings of his client's position. Put generically, the lawyer must understand the client's starting position, what the intended defendant did wrong, the injury suffered, and the nature of the relief that might be sought.

Returning to an earlier hypothetical, suppose a high-tech employer wants to prevent former employees from establishing a competing venture. During the factual investigation preceding the drafting of the complaint, the lawyer must learn, for example, the terms of the proposed defendants' former employment to determine whether a contractual claim exists, the nature of both the employer's and the new venture's business to determine whether the new venture might have misappropriated the employer's trade secrets or engaged in unfair methods of competition, and the competitive position of both parties to determine whether damages would be adequate and, if not, whether the balance of hardships would support injunctive relief. Once the initial factual investigation is completed, the lawyer must evaluate the likely cost of the litigation and its probability of success, if only to adequately inform the client of the nature of the risk-reward characteristic of a possible suit.

Against this factual background, the lawyer should have little difficulty determining the client's true motivation in pursuing the litigation. For my purposes, litigation is strategic when pursued not to vindicate a substantive legal right, but as a device to secure a business advantage by imposing costs on the other party.³³ The client's strategic motive will be apparent to a lawyer when it is a nonle-

32. Even if its only purpose is strategic, a complaint must be sufficient to survive a motion to dismiss. To impose significant costs on the defendant, the plaintiff must be able to reach the discovery stage.

33. See *supra* note 10 and accompanying text.

gal business advantage, rather than the litigation's likelihood of success, that justifies the expense of pursuing the litigation.

Of course, lawyer detection is not perfect. Unlike the case with *ex post* enforcement, however, there is no reason to think that the direction of the error will be predictably under or overinclusive. Neither of the factors that resulted in underinclusive definitions in an *ex post* enforcement regime—externalities in the case of an objective definition and the opportunity to plan in the case of a subjective definition—are associated with lawyer detection in a gatekeeper regime. To be sure, clients may have an incentive to behave strategically with respect to their lawyers as well. If clients could successfully hide the strategic character of proposed litigation from their lawyers with sufficient frequency, then lawyer detection in a gatekeeper regime would be predictably underinclusive. Although such camouflage is possible, I think it generally unlikely to succeed in the face of a professionally skeptical lawyer.³⁴

In sum, lawyers can satisfy the detection condition essential to effective gatekeeper enforcement of the prohibition of strategic litigation. However, that leaves the two remaining, more difficult conditions: Will lawyers want to be gatekeepers; and will clients allow them that role?

B. The Supply Side: Will Lawyers Want to Be Gatekeepers?

Whether lawyers will want to supply gatekeeping services is a trickier question than may at first appear. A typical market analysis would suggest that supply follows demand; if clients want gatekeeping services, gatekeepers will appear. The difficulty here is that the need for effective enforcement arises only because, once the veil of ignorance is lifted, clients *want* to engage in strategic litigation. The demand is for litigators, not gatekeepers. Thus, if lawyers are to be gatekeepers, it must be because gatekeeping is, in some sense, a consumption good for lawyers. Faced with a choice between income—fees from pursuing strategic litigation on behalf of a client—and virtue, a gatekeeper enforcement regime requires that lawyers choose virtue.³⁵

34. It is not yet a response at this stage to argue that lawyers' self-interest—to put it crassly, the more litigation filed for clients, the higher lawyers' earnings—will lead them to ignore their clients' strategic motivation. We consider in the next section whether lawyers will choose to play a gatekeeper role. For now, the question is only whether they are capable of detecting strategic motivation if they are so inclined.

35. One can imagine the development of a reputational model in which particular lawyers openly specialize as gatekeepers because their retention allows a client to credi-

Why, then, might lawyers voluntarily trade income for virtue? That the rewards of labor include more than monetary income is a familiar proposition in labor economics. For example, it is commonly argued that wages vary across jobs to reflect, among other things, job safety and other working conditions.³⁶ It requires no conceptual leap to assume that lawyers would accept lower income if, at the margin, they value the sense that their labors contribute something to the social good more highly than they value another dollar of income.³⁷

Oddly, skepticism about the existence of this kind of dollar-virtue tradeoff comes not from economists, but from students of the sociology of professionalism who have come to view professionalism as a self-interested rationalization of standards of conduct that benefit only the profession.³⁸ Yet, history discloses a pattern of lawyer behavior consistent with a utility function more complicated than simply income maximization. My colleague Robert Gordon puts the matter nicely:

Face it; the key ingredient [for professional independence] is willingness to forgo individual or individual-share-of-group income. I know that to many it will seem incredible that lawyers in a position to make a lot of money would sacrifice it to other goods. "If that's what it takes," they will say, "forget it." All I can do is point out that historically lawyers have sacrificed income repeatedly.³⁹

bly signal that his claim is real. This concept is part of an inquiry Robert Mnookin and I are pursuing into what might be called the positive role of lawyers in conflict resolution. The idea is that lawyers can play the ameliorating role of repeat players in a setting—litigation—in which their clients are almost by definition one-time players.

36. To choose a familiar example, law professors choose to work for considerably less money than their talents presumably would command in law practice.

37. Of course, the phrase "at the margin" says nothing about how much income the lawyer must have before any trade off occurs, nor how the marginal rate of transformation changes across income levels and over time. See *infra* note 39.

38. R. ABEL, *AMERICAN LAWYERS* (1989), both exemplifies and surveys this literature.

39. Gordon, *supra* note 1, at 40; see R. Gordon & W. Simon, *The Redemption of Professionalism* 12 (Paper presented at the American Bar Foundation Conference on Professionalism, Ethics, and Economic Change in the Legal Profession, Nov. 1989) ("[W]e ought to consider that an important part of the explanation for the emergence of professional rhetoric and institutions may lie in a sincere (and to some extent, normatively plausible) aspiration for autonomy, solidarity, and responsibility in the workplace.").

As anecdotal evidence of both the fact that lawyers' utility functions do trade off between income and virtue, and that, as to this tradeoff, the shape of individual lawyers' indifference curves differ, consider the enormous variance among firms with respect to investment in pro bono work. Some firms, like San Francisco's Morrison & Foerster, appear to pride themselves on forgoing a great deal of income for virtue, while other

It is a different question, to be sure, why lawyers value the opportunity to act philanthropically, why their utility function includes furthering the social good. For present purposes, it is enough to repeat previously offered explanations that ring true when measured against our collective experience. The first is simply self-selection. Many lawyers "go into law precisely because they are looking for a working milieu different from what they perceive to be that of business, organized (so they hope) around the 'professional' values of craft excellence, intellectually interesting work, collegial esteem, and public service rather than the commercial value of profit seeking."⁴⁰ The second, unfortunately from the perspective of an academic in importance as well as in order, is socialization. When law schools get it right, students are taught to internalize the notion that being a good lawyer requires balancing our private interest against the public good in a manner that does not always tilt the scale in the lawyer's favor.⁴¹

Whatever the reasons why lawyers value serving the public interest, the critical question that remains is why clients allow them to do so. What gives lawyers the market power to say no to clients who

firms have quite different inclinations. There is also reason to think that the shape of lawyers' indifference curves changes over time in a cyclical fashion, a fact consistent with at least my perception that pro bono work by law firms was a more important concern 15 years ago. Morrison & Foerster also provides an example of this phenomenon, in recent years experiencing significant internal objections to prior levels of pro bono commitment. Cooper & Jensen, *MoFo Gains with Pain and Glory*, Nat'l L.J., Jan. 15, 1990, at 1, col. 1. For an interesting effort to develop a model of cyclical shifts between public and private activities, see A. HIRSCHMAN, *SHIFTING INVOLVEMENTS: PRIVATE INTEREST AND PUBLIC ACTION* (1982).

40. Gordon, *supra* note 1, at 32.

41. In the Progressive-Functionalist model of the professional role, the most important determinants of the professional's behavior are not self-interest and coercively enforced rules but the goals of perfecting and applying her discipline and, through that discipline, serving clients and society. This orientation is altruistic and idealistic, but it is not a matter of saintliness or self-sacrifice; it merely reflects the fact that the professional has been led to define her own goals in ways that mesh with those of the occupational group and the larger society.

Simon, *Babbitt v. Brandeis: The Decline of the Professional Ideal*, 37 STAN. L. REV. 565, 568 (1985); see Gordon, *Corporate Law Practice as a Public Calling*, 49 MD. L. REV. 255 (1990). Bill Simon's article is, in part, a harsh (unduly so I have always thought) critique of my and Robert Mnookin's effort to explain the economic organization of law firms using the tools of transaction cost and financial economics. Gilson & Mnookin, *Sharing Among Capitalists*, *supra* note 1. A portion of the criticism was that this mode of analysis undervalued the importance of the Brandesian conception of professionalism. We had not thought so. Indeed, part of the motivation for my effort here is to understand the importance of professionalism to those *outside* the profession. In so doing, I suppose I am signing on to Bob Gordon's and Bill Simon's efforts at what might be called the Stanford Neo-Radical Rehabilitation of the Professionalism Project Project.

want to pursue strategic litigation? Perfect socialization is one answer; if all lawyers automatically declined to pursue strategic litigation the profession would be a self-enforcing cabal. A more plausible explanation recognizes that entropy operates on cabals too. What prevents clients from finding those lawyers who will provide the desired service? That question brings us, finally, to the most interesting part of the story: the nature of the demand side of the market for legal services.

C. The Demand Side: Will Clients Allow Lawyers to Be Gatekeepers?

The most distinctive characteristic of the demand side of the market for legal services is pervasive information asymmetry concerning product quality.⁴² In three critical respects, clients have difficulty evaluating either the legal services they seek to purchase or those they have already purchased. First, prospective clients will have difficulty identifying what service they actually need. In the market for legal services, selecting the category of service to be purchased requires technical skills. Second, even if the appropriate category of service can be identified, the problem of quality uncertainty remains. Like the prospective purchaser of many consumer products, a prospective client will have difficulty determining the quality of the lawyers competing for the opportunity to provide service. Finally, a third characteristic of the information structure of the market for legal services distinguishes it from traditional product markets. In contrast to the consumer's experience in traditional product markets, the quality of legal services may not be revealed even *after* purchase. The result is that familiar strategies for dealing with pre-purchase quality uncertainty developed in other markets will be much less effective in the market for legal services.

My thesis is that development of the full service corporate law firm and the long-term relationships such firms reportedly enjoyed with their clients can be usefully understood as market responses to the peculiar fact that legal services are subject to both pre-purchase and post-purchase quality uncertainty. In turn, this solution to the problem of information asymmetry in the market for legal services has given lawyers the power to act as gatekeepers despite the client's real preference, at the time a lawyer is hired, for a different kind of service.

42. To my knowledge, Arrow, *Uncertainty and the Welfare Economics of Medical Care*, 53 AM. ECON. REV. 941 (1963), first stresses the centrality of information asymmetry in analyzing the market for professional services.

1. *Identifying What Services Are Needed.*—Prospective clients enter the market for legal services when they find themselves in circumstances that they recognize call for legal services. Suppose a potential client decides to start a business. The client knows she probably needs a lawyer. However, unless she is herself sophisticated concerning legal matters, she may not know what category of legal service she needs, nor the appropriate quantity and quality. Thus, one of the services a lawyer renders is diagnostic—advising the client what needs doing and how it initially should be accomplished.

Only after the diagnosis is made does the prospective client begin the next stage in the purchasing process. Having identified what she needs, the task is to select, on the basis of price and quality, a supplier of services from among those competing for the opportunity.

2. *Pre- and Post-Purchase Quality Uncertainty.*—An economist's model of a competitive market assumes that consumers can tell the quality of a product before they purchase it. Without that assumption, competition between heterogeneous products is impossible. A prospective purchaser would be unable to make comparisons between products, even if comparative prices were known. Producers then would have no incentive to incur the expense of providing a better product because consumers would never know which product was better.⁴³ Interestingly, the assumption that consumers can accurately assess product quality before they purchase the product is certainly more often wrong than right.⁴⁴ Few consumers can tell from personal examination the comparative quality of the television or automobile they purchase. Competition works because market participants have devised ways to overcome the consumers' pre-purchase difficulty in evaluating product quality.

In general, the economics literature identifies three familiar market responses to pre-purchase quality uncertainty: information collection, warranties, and reputation. What is critical for our purpose is that all share a central characteristic that makes them much

43. This is the standard rendition of the conditions that lead to a lemon's market. In a market in which quality is unobservable, only the lowest quality of goods will be produced. See generally Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970).

44. See Scitovsky, *The Benefits of Asymmetric Markets*, 4 J. ECON. PERSP. 135, 138-42 (1990) (pervasiveness of seller-favored informationally asymmetric markets).

less effective in responding to the problem of quality uncertainty in the market for legal services.

One information barrier confronting a prospective purchaser is the expense of gathering the data necessary to evaluate product quality, especially if the purchaser is buying only one item and if quality evaluation requires special expertise. A familiar market response to the high cost of pre-purchase collection of information concerning product quality is collectivizing the evaluation process so that the cost of obtaining the information and expertise necessary to evaluate product quality prior to purchase is shared among many consumers.⁴⁵ Publications such as *Consumer Reports* or testing programs such as Underwriter's Laboratories are examples of this response.

A second type of market response to pre-purchase quality uncertainty builds on the provider's incentive to resolve the prospective purchaser's uncertainty by disclosing the real quality of the product. The problem is that a purchaser may not believe the disclosure because the provider also has an incentive to overstate his product's quality. A familiar solution is to couple disclosure of quality with provision of a warranty that allows a prospective purchaser to treat the information disclosed as credible.⁴⁶

Finally, the provider can seek to overcome the prospective purchaser's quality uncertainty by building a reputation for producing quality products. This can be accomplished by making expenditures, such as advertising the quality of the product, that would become worthless if purchasers later discovered that the product was of poorer quality than advertised.⁴⁷

All of these responses to pre-purchase quality uncertainty share a common characteristic. They require that the actual quality of the product be revealed at least after purchase. *Consumer Reports* purchases the product and then discovers its actual quality. A warranty is useless if the purchaser cannot tell whether it has been breached. And the logic of the reputation approach requires that the purchaser ultimately learn the quality of the product so that the

45. See Gilson & Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 597-606 (1984).

46. See, e.g., *id.* at 596-97; Grossman, *The Informational Role of Warranties and Private Disclosure About Product Quality*, 24 J. L. & ECON. 461 (1981).

47. See, e.g., Barzel, *Measurement Cost and the Organization of Markets*, 25 J. L. & ECON. 27 (1982); Klein & Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981).

provider is penalized, by the loss of his firm specific investment, if product quality turns out to be lower than represented.

The peculiar characteristic of legal services is that a prospective client will have difficulty determining the quality of the services *even after they are rendered*. Because the quality of legal services is not directly observable to a lay client, the most obvious after-the-fact approach to quality evaluation is to treat the outcome of the matter with respect to which the legal services were rendered as a measure of the quality of the services.⁴⁸ For example, the client's perception of the quality of the services provided by litigation counsel would depend on how favorable was the verdict or settlement. However, the outcome of any single litigation matter also depends upon a number of other important factors, such as the quality of opposing counsel or the perceptiveness of the judge, that have nothing to do with the quality of the services provided. Only after the lawyer has represented the client in a number of matters, when the other influences on the outcome would have had the opportunity to cancel out, can the client discern the quality of the lawyer's services.

Nor is post-purchase quality easier to determine when the services are provided by a business lawyer. Even if protective contractual provisions negotiated and drafted by the lawyer were, in the abstract, of outstanding quality, they still would be of little value to the client if they were unnecessary. Yet, because some of the eventualities against which contractual protection might be appropriate are of low probability, their ultimate nonoccurrence is not a valid indicator of whether the lawyer correctly predicted the probability of their occurrence and invested an appropriate amount in protection.⁴⁹

3. *Client Relationships and Law Firm Structure as a Response to Quality Uncertainty*.—Demonstrating that standard product market responses to quality uncertainty do not work in the market for legal services is the less interesting part of the problem. The more chal-

48. See Gilson & Mnookin, *Sharing Among Capitalists*, *supra* note 1, at 360.

49. Evaluating the quality of medical care presents the same kind of problem. Often the diagnostic process is probabilistic. Observation of a set of symptoms signals the presence of a particular disease only probabilistically. Similarly, the outcome of an indicated treatment often can be expressed only probabilistically. In any single case, the fact that the diagnosis proves wrong or the treatment ineffective is consistent either with poor care (*i.e.*, the wrong diagnosis was made or treatment prescribed) or with good care (*i.e.*, the correct diagnosis was made or treatment prescribed but the particular patient ended up on the unlucky tail of the probability distribution). See Arrow, *supra* note 42, at 951-52.

lenging task is to identify what techniques do respond to the serious problems of quality uncertainty endemic to that market. From this perspective, familiar patterns of lawyer-client relations and important aspects of law firm structure can be usefully understood as responses to quality uncertainty concerning legal services.

a. The Diagnostic Function and Pre-Purchase Quality Uncertainty.—A prospective client seeking a lawyer initially has need for two skills. The first is diagnostic; the client needs a lawyer to tell her what services she requires. The second relates not to diagnosis, but to prescription. The client needs a specialized lawyer to provide the prescribed service. Having learned enough about the client to identify the legal services needed, the diagnostician is well situated to ease the client's problem of pre-purchase quality uncertainty by referring the client to a specialist. The complementarity of these services—diagnosis and referral—suggests a pattern for how they are rendered.

A proper diagnosis of the client's need for legal services requires the client and lawyer to invest in a relationship specific asset. The lawyer must learn enough about the client's general characteristics and particular predicament to evaluate the client's need for legal services. The client knowledge acquired by the lawyer is an asset because it will be useful the next time the lawyer is asked to assess the client's need for legal services. The asset is relationship specific because the lawyer's knowledge of the client's needs—valuable inside the relationship—has no value if the client selects a new lawyer.⁵⁰

The relationship specific character of the investment in the lawyer's knowledge about the client creates an important incentive to long-term lawyer-client relationships. While many lawyers may be in an equivalent position to provide diagnostic services when the prospective client first enters the market for legal services, the lawyer chosen for the initial matter has a substantial advantage the next time the client seeks a lawyer. Any lawyer seeking to compete for the engagement must acquire the information about the client necessary to the diagnostic service that the first lawyer already has. Regardless of how the cost of the new lawyer's client-related education is allocated between the client and the new lawyer, the original law-

50. For an explication of the centrality of asset specificity to understanding contractual and organizational relationships, see O. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING* 52-56 (1985).

yer can render the diagnostic service more efficiently.⁵¹

The complementarity between diagnosis of the specialized services needed and referral to a lawyer to provide these services suggests a second structural pattern. The diagnosing lawyer's referral serves to ameliorate the client's problem of pre-purchase quality uncertainty. While a client may have difficulty evaluating the quality of the lawyers who could provide the necessary services, another lawyer does not suffer from the same handicap.

Now consider the situation from the perspective of the lawyer providing the referral. He has a long-term relationship with the client. As with other legal services, however, the client will have difficulty evaluating the quality of the referral, even after it is made. The client can be predicted to measure the quality of the referral by her satisfaction with the performance of the lawyer recommended. As a result, the referring lawyer has a substantial incentive to carefully evaluate and monitor those lawyers to whom he sends his clients.⁵² The full service law firm—one that itself offers the specialized services that diagnosis may direct—provides a structure that facilitates efficient monitoring of specialized providers of legal services.⁵³

Two advantages to the client-generating lawyer result from referring the client to lawyers within his firm, rather than to independent lawyers. First, the physical proximity of shared quarters facilitates monitoring. But while physical proximity might be accomplished by contractual office sharing arrangements, a firm is necessary for the client-generating lawyer to obtain the second advantage from what lawyers now call cross-marketing, that is, payment by the specialized lawyer who will actually provide the

51. Oliver Williamson refers to this shift from market conditions characterized by many competing suppliers to market conditions characterized by one supplier having a significant advantage over other potential suppliers as the "fundamental transformation." *Id.* at 61-63. The catalyst that triggers the transformation is the investment in relationship specific assets by the customer and initial supplier. That the parties' investment in relationship specific assets causes their relationship to go from one of large number competition to bilateral monopoly suggests nothing about how the efficiency savings are allocated between the initial lawyer and the client. As long as the entire efficiency gain is not taken by either party, both will be better off.

52. In effect, the lawyer's investment in the relationship specific asset serves as a bond of the quality of the lawyer's referral that is forfeited if the quality is not delivered. See Klein & Leffler, *supra* note 47.

53. Fama & Jensen, *Agency Problems and Residual Claims*, 26 J. L. & ECON. 327, 334-35 (1983), point to another way in which law firms bond the quality of their work. Most firms have resisted the urge to incorporate, leaving partners with unlimited liability for each other's professional conduct. Voluntarily undertaking this liability for someone else's work creates an incentive to assure that everyone does good work.

service.⁵⁴ Under typical state rules of professional conduct, fees may be shared among members of a firm as provided by their partnership agreement.⁵⁵ A profit sharing formula that rewards "rain-making" by crediting a lawyer for bringing in business regardless of who within the firm actually provides the services provides for precisely such a referral fee. In contrast, fees may be shared among independent lawyers only if the allocation is based on the actual services each lawyer renders.⁵⁶ Fees paid only for a referral typically are prohibited.⁵⁷

This fine distinction between permissible income sharing among lawyers within firms and impermissible income sharing between independent lawyers is puzzling, the more so because it is

54. One could imagine an office sharing arrangement that also contemplated some income sharing. For example, the terms of the office lease might allocate payments based on a percentage of the lawyers' billings or even based on referrals among tenants. However, an office sharing arrangement with some fee sharing is a perfectly workable definition of a firm. See CALIFORNIA RULES OF PROFESSIONAL CONDUCT Rule 1-100 (B)(1) (1988) ("Law Firm" means: (a) two or more lawyers whose activities constitute the practice of law, and who share its profits, expenses, and liabilities . . .").

55. See, e.g., *id.* Rule 2-200 (limitations on a lawyer dividing fees with another lawyer apply only if the other lawyer "is not a partner of, associate of, or shareholder with" the first lawyer).

56. The restriction on fee sharing has had its ups and downs. The formulation in Canon 34 of the 1908 Canons of Professional Ethics barred division of fees unless "based upon a division of service or responsibility." In 1970, the Code of Professional Responsibility toughened the standard so that a fee could be divided only "in proportion to the services rendered and responsibility assumed by each" lawyer. MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-107(A)(2) (1980). The shift in formulation from "or" to "and" has been interpreted to prohibit division based on obtaining the client or bearing responsibility for what the other lawyer does. "Both lawyers must work on the case and in some way the fee division has to be 'in proportion' to their work." S. GILBERS & N. DORSEN, *supra* note 4, at 149. Rule 5.1 of the 1981 Model Rules of Professional Conduct both loosens and tightens the prohibition. In the absence of a client's written agreement, a fee can be divided only "in proportion to the services performed by each lawyer. . . ." MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.1(e) (1983). With the client's agreement, however, the fee can be divided among all lawyers who assume "joint responsibility for the representation;" presumably without restriction on the manner of division. *Id.* Some states have eliminated any restriction other than client consent. Rule 2-200 of the 1988 California Rules of Professional Conduct allows any division of fees, including the payment of a referral fee in return for recommending the lawyer who provides the service, if "the client has consented in writing thereto after a full disclosure has been made in writing that a division of fees will be made and the terms of such division." CALIFORNIA RULES OF PROFESSIONAL CONDUCT Rule 2-200 (1988).

57. See H. DRINKER, *LEGAL ETHICS* 186 (1953). The prohibition does not appear to be universal. 1 S. SPEISER, *ATTORNEY'S FEES* 246 (1973). In particular, California's client consent approach would allow a referral or finder's fee so long as written disclosure was made to the client and the client's written consent obtained. See *supra* note 56.

imposed by lawyer-made rules.⁵⁸ But an efficiency justification for allowing only the payment of internal referral fees *within* firms can be constructed. Both the diagnostician's selection of a lawyer to perform the services determined to be necessary and his monitoring of the lawyer providing the services are valuable to the client. The danger that the referring lawyer will send the client to an inferior lawyer just to earn a larger referral fee⁵⁹ is minimized by the referring lawyer's expectation of continuing dealings with the client. Reference to an inferior lawyer will destroy the asset which generates the referring lawyer's fee in the first place: the client relationship. Thus, a bribe by an inferior lawyer in the form of a higher referral fee will be effective only if it exceeds the present value of the client relationship to the referring lawyer.

This check on the referring lawyer's incentive to behave opportunistically by sending a client to an inferior, but high referral fee paying lawyer may be much weaker in the nonfirm setting. The primary situation at which the prohibition on external referral fees is directed is referrals of injured individuals to personal injury contingent fee lawyers.⁶⁰ Because such clients may not be sources of continued business to the referring lawyer, the referral fee predictably may exceed the present value of the continuing client relationship. In this situation, the lawyer's incentives lean toward directing the client toward the highest referral fee payer. The firm/non-firm distinction may serve as a rough guide for those settings when opportunism is or is not a significant risk.⁶¹

58. The same distinction—prohibiting referral fees between independent providers but allowing them between producers within the same organization—also is drawn in the regulation of the medical profession. See Frankford, *Creating and Dividing the Fruits of Collective Economic Activity: Referrals Among Health Care Providers*, 89 COLUM. L. REV. 1861, 1872 (1989).

59. The idea is that the worse the lawyer and the less likely that he will be able to attract clients on his own, the more valuable will be the referral and the larger will be the payment offered for the referral.

60. See 1 S. SPEISER, *supra* note 57, at 246-49; Spurr, *Referral Practices Among Lawyers: A Theoretical and Empirical Analysis*, 13 LAW & SOC. INQUIRY 87, 89 (1988).

61. The tradeoff presented by whether to prohibit referral fees is between wanting to provide an incentive to the referring lawyer to pass the client on to a more specialized lawyer on the one hand, and the concern that the referral will be made to the highest paying, rather than most talented, specialized lawyer on the other. See Pauley, *The Ethics and Economics of Kickbacks and Fee Splitting*, 10 BELL J. ECON. 344, 347 (1979). One advantage of limiting fee splitting to lawyers within the same firm is that the ongoing relationship among the referring and specialist lawyers allows a more textured method of allocating income more likely to ameliorate the conflicting incentive problems that complicate Pauley's modeling. See Gilson & Mnookin, *Sharing Among Capitalists*, *supra* note 1, at 349-52.

This analysis suggests a pattern for lawyer-client relationships and a structure for law firms. The lawyer who attracted the client would act as diagnostician and as the embodiment of the client's relationship with the firm. The client-generating lawyer would practice in a multi-specialty firm to whose lawyers the client's work would be referred. The client-generating lawyer would be compensated for attracting the client and, in turn, would have a substantial incentive to monitor the performance of the specialists actually rendering the services.⁶² The next step in the analysis is to understand how this structure gives lawyers the market power to act as gatekeepers.

b. The Lock-in Effects of Information and Post-Purchase Quality Uncertainty.—Reinforcing the lock-in effect of the lawyer's acquisition of relationship specific information concerning the client and its legal needs is the similar effect that results from the client's acquisition of relationship specific information concerning the quality of the lawyer's work. Recall that because the quality of a lawyer's work is not directly observable to a lay client, the client's recourse will be to measure quality by a proxy—the quality of the outcome of the matter with respect to which the lawyer was hired. The problem is that the outcome in any particular matter is a noisy signal of the quality

62. It is intriguing to speculate on the extent to which this analysis might generalize to the structure through which other specialized services are rendered. As medical care has become more specialized, the pattern of service has become one in which primary care physicians—pediatricians, internists and family practitioners—serve the function (in addition to rendering nonspecialized care themselves) of determining whether the patient requires specialized care and, if so, what kind. It is increasingly common for medical benefit plans, whether indemnity plans or health maintenance organizations, to require a referral from a primary care physician before specialized care will be provided. While this is generally explained as a means of cost control, it also serves, as in the market for legal services, to ameliorate the patient's pre-purchase quality uncertainty. The extent to which the latter explanation has force might be illuminated by studying the way in which fee for service primary care physicians make referrals. The analysis in the text predicts that primary care physicians both will monitor the work of the specialized physicians to whom they refer their patients and, one way or another, receive some form of benefit from the receiving physician in consideration of the referral (although direct remuneration would be prohibited by ethical standards and would amount to fraud if the specialist was paid under the Medicare-Medicaid program). See Frankford, *supra* note 58, at 1867-69.

A second approach to the problem would be to compare the income of primary care physicians in a multi-specialty group practice like a Health Maintenance Organization with similar physicians in sole practice. The hypothesis is that, all other things being equal, referring physicians in group practice earn more in direct income than similar physicians in sole practice. The difference would reflect an effective referral fee paid by the specialized physicians in the group, and not prohibited because the physicians were within the same group.

of the lawyer's services. The outcome is influenced by other factors which are beyond the lawyer's control. Only after the lawyer has represented the client in a sufficient number of matters so that, in effect, the influence of such other factors on the outcome have regressed out, will the client have an independent sense of the lawyer's actual quality.

The value of this information about the quality of the client's current lawyer provides another significant entry barrier to a competing lawyer by raising the client's cost of switching lawyers.⁶³ If a client were to consider changing firms, it would have to incur the costs of acquiring information about the quality of the competing lawyer's services. Not only would the current lawyer be able to render the service at a lower cost, because the client already had invested in learning about its quality, but the lock-in effect would be more significant the more risk averse is the client.⁶⁴

D. Summary

The analysis presented in this Part suggests that lawyers may

63. The concept of switching costs has important explanatory power in markets, like those for professional services, in which pre-purchase information concerning product quality is difficult to obtain. For example, Satterthwaite uses the concept to explain two apparent empirical anomalies in the market for primary care physicians. Standard economic theory tells us that, holding demand constant, an increase in supply results in a decrease in price. The data for primary care physicians, however, suggests just the opposite. At any point in time primary care physicians in communities that have more physicians per population unit charge more than physicians in communities that have fewer physicians. Moreover, increasing the supply of primary care physicians in a community apparently has no downward effect on physician prices. Satterthwaite, *Competition and Equilibrium as a Driving Force in the Health Services Sector*, in *MANAGING THE SERVICE ECONOMY: PROSPECTS AND PROBLEMS* 239 (R. Inman ed. 1985).

In Satterthwaite's analysis, a physician has market power—patient demand is relatively inelastic—to the extent that it is costly to her patients to find a new doctor. She can increase price to the extent of search costs. The empirical anomalies are explained by the impact of an increase in the supply of physicians on patient search costs. In a community with a small number of primary care physicians, switching costs are low because physicians have well established reputations; patients of any one physician will know people who are patients of the others from whom accurate information can be obtained. Increasing the number of physicians decreases the likelihood that physicians will develop widely shared reputations with the result that patient search costs increase. The result is greater market power for physicians over existing patients. *Id.* at 247-50; see Klemperer, *Markets with Consumer Switching Costs*, 102 Q.J. ECON. 375 (1987) (generalizing argument that switching costs create market power).

64. See Gilson & Mnookin, *Sharing Among Capitalists*, *supra* note 1, at 361-62. In the context of legal services, risk is the expected variation in the quality of legal services actually obtained. The more that is learned about a lawyer's services, the lower the variance between expected and actual quality. Thus, a new lawyer, even if he presented the same expected mean quality of services, would still present a higher risk because of lack of information concerning the variance of the outcome.

serve as effective gatekeepers in enforcing the prohibition against strategic litigation. The necessary ingredients to an effective gatekeeper enforcement regime seem to be present. Lawyers are in a position that makes them reasonably effective at detecting strategic litigation when a client seeks to pursue it.⁶⁵ Further, it is plausible that lawyers will want to act as gatekeepers even though declining to pursue strategic litigation on behalf of a client is costly. Most important, pervasive information asymmetries concerning quality in the market for legal services limit clients' ability to prevent lawyers from acting as gatekeepers. The presence of quality uncertainty encourages a particular pattern of lawyer-client relationship and law firm structure. Client relationships will be long-term because lawyer acquisition of relationship specific information concerning the client's special needs and characteristics and client acquisition of relationship specific information concerning the quality of the lawyer's services make it costly for a client to switch lawyers.⁶⁶ This cost barrier to selecting a new lawyer provides the market power that shelters the lawyer's gatekeeping function from the pressure of client demand.⁶⁷

IV. THE DEVOLUTION OF THE LEGAL PROFESSION: WHAT HAS CHANGED?

To this point I have shown that enforcement of the prohibition of strategic litigation through a gatekeeper regime is feasible. Con-

65. There is an interesting relationship between the requirement that a lawyer be able to detect strategic litigation when proposed by a client for a gatekeeper regime to function, and the information incentives toward long-term client relationships—particularly the incentive for the lawyer to invest in learning about the client—that make detection increasingly easy. The system seems to have an internal dynamic toward effectiveness: the very process that makes detection more effective serves to further raise the switching costs that provide the market power that allows the system to function over the client's objections.

66. Consistent with this account, a 1959 Conference Board survey of how 286 manufacturing firms handled their legal work reported that "three fourths of them retain outside counsel on a continuing basis. . . . Companies most frequently report that 'present outside counsel has been with us for many, many years,' or that 'we are satisfied with the performance of our outside counsel and have never given any thought to hiring another.'" 16 THE CONF. BOARD OF BUS. REC. 463, 464 (1959), cited in Galanter & Palay, *supra* note 1, at 58.

67. Gordon, *supra* note 1, and Simon, *Ethical Discretion in Lawyering*, 101 HARV. L. REV. 1083 (1988), emphasize a lawyer's power to influence a client's action through the way in which the lawyer frames the issues and characterizes the alternatives. What they have in mind seems to me a species of gatekeeping, although the character of the gate the lawyer keeps is less well defined than the prohibition of strategic litigation. If I am right that their concept of discretion and mine of gatekeeping share a common core, then they also share a common source—the market power discussed in this section.

sistent with the Brandesian concept of a professional, the lawyer's obligation to further his client's interests is limited by his obligation to the public interest, in our case by declining to participate in pursuing strategic litigation.⁶⁸ The task now is to explain what changes in the environment have made it more difficult for lawyers to act as gatekeepers. The lament that the legal profession is devolving into a business reflects the belief that the professional obligation to the public interest no longer constrains lawyers' responsiveness to clients. From my perspective, then, what distinguishes the profession of law from the business of law is the lawyer's inclination and ability to tell the client no, that is, the lawyer's inclination and ability to act as a gatekeeper.

A. The Impact of a Reduction in Information Asymmetry

A demand side explanation for the devolution of the profession focuses on those elements in the market for legal services that have served to shelter the operation of a gatekeeper regime from client demand. In the previous section, I argued that a gatekeeper regime was made possible by the pervasive quality uncertainty confronting a client in the market for legal services. In response to a potential client's substantial difficulty in evaluating either her own need for legal services or the quality of the legal services proffered or actually rendered, a pattern of practice developed that led to long-term lawyer-client relationships and full-service law firms. The result was that switching lawyers was costly to a client. That cost gave lawyers the market power to act as gatekeepers.

Now suppose there occurs a dramatic increase in the client's sophistication concerning legal services. The client could then both assess her own needs for services and evaluate the quality of those competing for her business. The result would be largely to eliminate the client's cost of switching that provides the market power necessary to the operation of a gatekeeper enforcement regime.

Recall that the client's switching costs grew out of investment in two relationship specific assets resulting from the client's pre- and post-purchase quality uncertainty: the lawyer's information about the client's particular needs and characteristics, and the client's information about the quality of the lawyer's services. If a client is sophisticated about the market for legal services and can assess her own needs, the diagnostic function is internalized. The need for the lawyer to acquire relationship specific information concerning the

68. See *supra* notes 4-8 and accompanying text.

client is eliminated and with it are eliminated the efficiency gains from a long-term lawyer-client relationship. Similarly, if the client is sophisticated about the market for legal services, the client also can select the lawyer who will render the needed service and will be capable herself of monitoring the lawyer's provision of services. Moreover, the greater the client's sophistication, the more quickly she will be able to evaluate the quality of legal services after they are rendered. For a sophisticated client, it is easier to distinguish the lawyer's influence on the outcome of a matter from the influence of other factors. Thus, the referral function also will be internalized. The outcome will be to reduce substantially the efficiency gains from a full service firm.

The result is a coherent story of the demise of gatekeeper enforcement. An increase in the client's sophistication leads to a reduction in information asymmetry. The patterns of client relationship and law firm structure that developed to ameliorate the client's quality uncertainty are no longer necessary,⁶⁹ and the switching costs that provided lawyers the market power to act as gatekeepers dissipate.⁷⁰ Lawyers lose the ability to act as gatekeepers and the profession laments its devolution.⁷¹

B. *The New Source of Client Sophistication*

One gap remains in the story. The presence of quality uncertainty in the market for legal services predicted traditional patterns of client relationships and firm structure that also provided lawyers

69. In a Harvard Law School study of thirteen large corporate legal departments, of those corporations where at one time in excess of 30% of their outside counsel expenditures had gone to a single firm, by 1983 no firm received more than 20% of total expenditures. A. Chayes, *Managing the Corporate Legal Function: The Law Department, Outside Counsel, and Legal Costs*, 13 Bus. Law Mono. (MB) § 7.01 (1988).

70. The same phenomenon impacts the internal organization of the law firm. From the firm's perspective, the result is a reduction in firm specific capital which, because it could not be removed by a departing partner, provided important elements of the glue that held law firms together. See Gilson & Mnookin, *Sharing Among Capitalists*, *supra* note 1, at 356-68.

71. The same forces also result in lawyers reducing their desire to act as gatekeepers. Recall that lawyers' supply of gatekeeping services is a function of both absolute income level and the client's ability to penalize a lawyer—by switching—who supplies gatekeeping services against the client's wishes. See *supra* note 40. With respect to absolute income levels, Galanter and Palay report that between 1976 and 1986, the median income of lawyers in large firms (more than 75 lawyers) increased 78% while inflation was up 93% and average hours billed was up 8%. Galanter & Palay, *supra* note 1, at 91 n.311 (citing Jensen, *Partners Work Harder to Stay Even*, Nat'l L.J., Aug. 10, 1987, at 12). The net outcome is a significant reduction in real income which, all other things equal, should lead to a reduction in lawyers' consumption of the gatekeeping role.

the market power to staff a gatekeeper enforcement regime. If one posits an increase in client sophistication, the same analysis predicts a dramatic change in the pattern of client relationships and firm structure. Long-term relationships give way to retention of counsel in connection with discrete specialized transactions; clients select their own specialists; and the rule becomes to hire lawyers, not firms.⁷² All that remains is to identify the source of change.

A consensus seems to exist about the identity of the culprit. As Robert Mnookin and I stated four years ago, “[g]eneral counsel for major corporations are creating a revolution and are the primary agents of change.”⁷³ Increasingly, general counsel are former partners in large corporate firms⁷⁴ who are capable of internalizing both the diagnostic and referral functions they previously performed on behalf of clients as outside counsel.⁷⁵ The critical difference is that

72. See J. HEINZ & E. LAUMANN, *CHICAGO LAWYERS: THE SOCIAL STRUCTURE OF THE BAR* 368 (1982); R. NELSON, *supra* note 1, at 8; Gilson & Mnookin, *Sharing Among Capitalists*, *supra* note 1, at 385; Rosen, *supra* note 1, at 489.

73. Gilson & Mnookin, *Sharing Among Capitalists*, *supra* note 1, at 381; see R. NELSON, *supra* note 1, at 57-58; Chayes & Chayes, *Corporate Counsel and the Elite Law Firm*, 37 *STAN. L. REV.* 277, 278 (1985); Rosen, *supra* note 1, at 483-84. One might appropriately object that my emphasis on the growth of in-house counsel staff and increased sophistication of in-house general counsel does not explain the decline in lawyer's market power, but merely pushes the inquiry down a level: What caused corporate management to initiate these changes in the character of the corporation's in-house legal staff? Answering this question requires a theory of the evolution of the corporation, rather than the corporate law firm, an inquiry that reaches far beyond my ambitions here. However, I can offer a mildly informed conjecture. I suspect that the key to the timing of the change in the character of in-house legal staffing is the observability of the problem. The potential for more effective internal representation may have existed for some time without senior corporate management becoming aware of it. For the opportunity to emerge from the background noise of a complex environment, legal fees had to reach a significant level. Only at that point would questions of the organization of the corporation's internal legal staff attract attention. M. Galanter & J. Rogers, *supra* note 26, offer some guidance as to when this process may have begun. Their data on business disputes discloses a sharp rise in corporate litigation commenced around 1970. *Id.* at 3. This suggests an explanation of, and a starting point for, the phenomenon of the changing structure of in-house corporate legal staffs.

One might still complain that the discussion still falls short of identifying the prime mover: What caused the increase in corporate litigation? Galanter and Rogers have begun consideration of this inquiry. *Id.* at 26. This moves, however, the inquiry from looking into the conditions in the market for legal services to looking into conditions in markets for the goods and services the client corporation produces, well past the boundaries of the task I have set for myself here.

74. Gilson & Mnookin, *Sharing Among Capitalists*, *supra* note 1, at 382; Machlowitz, *Lawyers Move In-House*, 75 *A.B.A. J.* 66 (1989); see, e.g., Borden, *Ben Heineman's In-House Revolution*, *AM. LAW.*, Sept. 1989, at 100.

75. The internalization of the diagnostic and referral functions by clients has interesting implications for a recent addition to the professional landscape—the national law firm. The efficiency gains from this form of organizing practice are not self-evident.

internalizing these functions eliminates the information asymmetry between client and lawyer, so that no relationship specific assets are created and no lock-in effect results. The consequence is a dramatic reduction in the switching costs facing clients and an elimination of lawyers' market power. The luxury of gatekeeping (and the good life generally) is the casualty.⁷⁶

V. THE DEVOLUTION OF THE LEGAL PROFESSION: WHAT CAN WE DO ABOUT IT?

To this point I have explained why a lawyer staffed gatekeeper regime may once have effectively policed the prohibition on strategic litigation, and surveyed the changes in the market for legal services that can plausibly account for the deterioration of that regime.

The analogy to the Big 8 (now Big 6) national accounting firms seems unpersuasive. Obvious efficiency gains result from having a single national accounting firm conduct the audit of a client with operations spread across the country. Moreover, an audit is an annual exercise for the accounting client. It is hard to imagine many legal matters so geographically dispersed, let alone ones that occur on an annual basis.

A more thoughtful explanation offered for the advantage of a national law firm is the potential for cross marketing. The idea is that a client who uses the firm in one city and is pleased with the firm's performance will select the firm's branch office when it encounters a legal problem in another city. Put in the terms I have been using, the concept is a more explicit application of the referral function, another effort to organize practice to alleviate the problem of pervasive information asymmetry that has occupied much of our discussion in this and the previous Part. If that conception is right, however, the national law firm may be an idea whose time has come and gone. A sophisticated general counsel who has internalized the diagnostic and referral functions should not see much value in cross-marketing. And if this is right, then the existing national law firms will be interesting to watch in the future. To the extent that individual branches are treated as profit centers, hard times in particular regions create centrifugal forces. If there are no efficiency gains from this organizational form to stand against those forces, the national law firm may not turn out to be a long term fixture in the organization of elite law firms.

76. Understanding how client sophistication reduces the ability of a firm to act as gatekeeper suggests that a perceived irony in the ideology of professionalism may exist only in the eyes of the observers. In their study of the Chicago Bar, Heinz and Laumann report, from their perspective, the ironic fact that the more prestige lawyers have, the less control—measured by the lawyers acting as gatekeepers—they have over their clients. J. HEINZ & E. LAUMANN, *supra* note 72, at 380. The result is seen as ironic presumably because their conception is that the more prestigious the lawyers, the more "professional" should be their conduct and the more control they should have over their clients. Once the source of the market power that allows lawyers to act as gatekeepers is understood, the relationship between prestige and market power seems to be precisely the opposite: The more prestigious the lawyers, the less influence they are likely to have over their clients. Prestigious lawyers are those who service prestigious corporate clients. *Id.* at 127. However, the more prestigious the corporate client, the more likely that it has a sophisticated general counsel, in which event the less likely there is to be any information asymmetry to give the lawyer the power to function as a gatekeeper.

Because this form of gatekeeping corresponds to an important component of a lawyer's traditional professional role,⁷⁷ the account also provides an explanation for the devolution of the legal profession whose current lament gave rise to my inquiry in the first place.

Completing the positive analysis, however, inevitably raises the normative: What can we do about it? In recent years, professional organizations have devoted substantial time and resources to revitalizing the legal profession's sense of itself without, it is fair but disappointing to say, much in the way of observable progress. What remains in this Essay is to see whether recognition that a traditional component of professionalism is best understood as a gatekeeper enforcement regime provides insights into the potential for rehabilitating the professional ideal. To this end, I will examine three general approaches to revitalizing a deteriorating gatekeeper regime. Interestingly, two of the approaches reflect recent efforts to shore up gatekeeper regimes in which the increasingly ineffective gatekeeper was a professional.

The first approach to rehabilitation ignores the wrongdoer at the expense of the gatekeeper: Simply increase the penalty on the gatekeeper. Where the regime in need of help involves a private gatekeeper, as with the prohibition of strategic litigation, increasing the penalty by definition involves adding at least an element of a public gatekeeper regime. In fact, precisely this approach was taken with respect to strategic litigation by the 1983 amendments to rule 11 of the Federal Rules of Civil Procedure.

The second approach takes exactly the opposite tack. It ignores the gatekeeper at the expense of the wrongdoer: Simply increase the penalty on the wrongdoer. Recall that the choice of an enforcement regime is comparative. One reason to prefer a gatekeeper regime is the problems often associated with the alternative of further increasing penalties on the wrongdoer.⁷⁸ When the gatekeeper regime begins to deteriorate, the alternative of increased direct penalties may come to look better. This approach was taken recently by the Securities and Exchange Commission in response to the problem of clients shopping for compliant independent public accountants.

The final approach is quite different and finds its origin in my earlier analysis of the conditions necessary to support a gatekeeper enforcement regime with respect to strategic litigation. Once again,

77. See *supra* notes 31-32 and accompanying text.

78. See Kraakman, *supra* note 16, at 56.

the concept is simple: Replace the gatekeeper. If conditions in the market for legal services have so changed that large law firms can no longer effectively act as gatekeepers, then we need to find someone who can. It is a nice irony that analysis of the conditions necessary for effective gatekeeping suggests as a replacement candidate precisely the party whose rise to prominence may have helped trigger the deterioration of the traditional gatekeeper regime in the first place: the new generation of inside general counsel. It is an equally nice irony that of the three approaches, only this may hold out very much hope for success.

A. Shifting From a Private to a Public Gatekeeping Regime: The 1983 Amendments to Rule 11

At least in formal terms, gatekeeper enforcement of the prohibition of strategic litigation was never strictly a private regime. As originally adopted in 1938, rule 11 of the Federal Rules of Civil Procedure did hold out the promise that penalties might be imposed on a lawyer who wrongfully certified that "to the best of his knowledge, information, and belief there is good ground to support [a pleading]; and that it is not interposed for delay or is signed with intent to defeat the purposes of this rule. . . ." The threat of public sanctions, however, turned out to be a mirage.

As interpreted by the courts, the imposition of sanctions under the 1938 version of rule 11 required proof of subjective bad faith on the part of the lawyer.⁷⁹ We saw in Section II.B. that defining strategic litigation by reference to state of mind results in a dramatically underinclusive prohibition.⁸⁰ Experience with the 1938 version of rule 11 bears out this analysis. From the rule's original adoption through 1976, only nineteen reported cases dealt with the imposition of sanctions under it. In only eleven cases were violations of the rule found, and in only three were sanctions actually imposed.⁸¹ As one of the drafters of the 1983 amendments to rule 11 put it: "[Y]ou can count the cases under [original] rule 11 on your fingers, and you do not need perfect hands to do it."⁸²

79. See, e.g., T. WILLGING, *THE RULE 11 SANCTIONING PROCESS* 36-37 (Fed. Jud. Cen. 1988); Schwartz, *Sanctions Under the New Federal Rule 11—A Closer Look*, 104 F.R.D. 181, 182-83 (1985); Wade, *supra* note 22, at 505.

80. See *supra* notes 23-25 and accompanying text.

81. Risinger, *Honesty in Pleading and Its Enforcement: Some "Striking" Problems with Federal Rule of Civil Procedure 11*, 61 MINN. L. REV. 1, 34-37 (1976).

82. A. MILLER, *THE AUGUST 1983 AMENDMENTS TO THE FEDERAL RULES OF CIVIL PROCEDURE* 14 (Fed. Jud. Cen. 1984); see 5 C. WRIGHT & A. MILLER, *FEDERAL PRACTICE AND PROCEDURE: CIVIL* § 1334 (1971).

That result changed, quite intentionally, with the 1983 amendments to rule 11. The public commentary in the period leading up to the amendments reflected the widespread belief that lawyers were no longer acting on their own to block the filing of strategic litigation. The Advisory Committee Note that accompanied transmittal of the 1983 amendments to the Chief Justice stated straightforwardly that the Committee's goal was to shift from a private to a public gatekeeping regime by imposing a realistic risk of sanctions when lawyers did not live up to their professional responsibilities: "The new language is intended to reduce the reluctance of courts to impose sanctions by emphasizing the responsibilities of the attorney and reenforcing those obligations by the imposition of sanctions."⁸³ And as if to underscore that it was the lawyers' *professional* responsibilities that were being publicly enforced, the new operative language of rule 11—that the lawyer certify his belief, formed after reasonable inquiry, that the pleading

is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation

—drew directly on the language of Disciplinary Rule 7-102(A) of the American Bar Association Model Code of Professional Responsibility.⁸⁴

Amended rule 11 seems to have had the effect intended by the Advisory Committee. In contrast to the dearth of reported cases over the 45 year life of the original version of rule 11,⁸⁵ the approximately 4 year period between the amended rule's adoption in 1983 and the close of 1987 saw some 688 reported rule 11 cases.⁸⁶ Consistent with the goal of more effectively policing the filing of strate-

83. *Advisory Committee Notes*, 97 F.R.D. 165, 198 (1983) (citations omitted). Reporting the results of his interviews with a sample of Federal district judges and lawyers, the author of the most comprehensive study of the operation of amended rule 11 states:

The source of support for rule 11 is in its articulation of a professional duty to examine and make a professional judgment about the legal and factual basis for an assertion of fact or law To prevent sanctions, a lawyer must take a position adverse to the client who insists on litigating a frivolous issue.

T. WILLGING, *supra* note 79, at 174-75.

84. See *supra* note 5 and accompanying text.

85. It is estimated that over the entire 45 year period, fewer than 50 reported opinions contained substantive discussion of rule 11. Nelkin, *Sanctions Under Amended Federal Rule 11—Some "Chilling" Problems in the Struggle Between Compensation and Punishment*, 74 GEO. L.J. 1313, 1315 n.18 (1986).

86. T. WILLGING, *supra* note 79, at 68. The principal substantive achievement

gic litigation, it appears that well over half the post-amendment rule 11 cases involved claims for sanctions based on the filing of an unjustified complaint.⁸⁷

Thus, the 1983 amendments to rule 11 seem to have been explicitly designed to shore up a deteriorating private gatekeeper. The goal was to shift from a private to a public gatekeeper regime through the imposition of formal sanctions on the gatekeeper. This approach has advantages. As David Wilkins has pointed out, an important result of the shift to a public gatekeeper regime with respect to strategic litigation is that discussion of the standards of professional conduct shifts from a private to a public forum: "For the first time, *judges* are actively debating the proper balance between client and systemic interests."⁸⁸ At a more practical level, an advantage should result from having the strategic character of the litigation determined by the presiding judge in that action, rather than by a different judge in a malicious prosecution action that can be initiated only after the initial litigation is resolved in favor of the defendant. The judge in the initial litigation has the benefit of immersion in context. Additionally, the not insubstantial incremental costs of a separate action are avoided.⁸⁹

Another important but less attractive result of the shift from a private to a public gatekeeper regime is a parallel, although partial shift from *ex ante* to (barely) *ex post* enforcement. This raises pre-

claimed for the amendment was shifting from a subjective to an objective measure of compliance.

87. *Id.* at 78 (Table 12).

88. D. Wilkins, *Reconstructing Professional Autonomy* 146 (Aug. 1989 draft) (emphasis in original).

89. The California Supreme Court recently voiced precisely these reasons for maintaining its restrictive interpretation of the elements of the tort of malicious prosecution:

After reviewing the competing policy considerations, we agree . . . that the most promising remedy for excessive litigation does not lie in an expansion of malicious prosecution liability. . . . While the filing of frivolous litigation is certainly improper and cannot in any way be condoned, in our view the better means of addressing the problem of unjustified litigation is through the adoption of measures facilitating the speedy resolution of the initial lawsuit and authorizing the imposition of sanctions for frivolous or delaying conduct within the first action itself, rather than through an expansion of the opportunities for initiating one or more additional rounds of malicious prosecution litigation after the first action has been concluded.

Sheldon Appel Co. v. Albert & Olike, 47 Cal. 3d 863, 873, 765 P.2d 498, 503, 254 Cal. Rptr. 336, 341 (1989). Note, *Groundless Litigation and the Malicious Prosecution Debate: A Historical Analysis*, 88 YALE L.J. 1218 (1979), argues persuasively that emphasizing sanctions in the initial proceeding in preference to a subsequent tort remedy reflects the broad historical pattern of response to strategic litigation, which was departed from in this country only because of the American disinclination to tax costs.

cisely the same definitional difficulties that I argued earlier led to an underinclusive definition. By rejecting original rule 11's subjective approach to defining strategic litigation, amended rule 11 avoids the impetus to underinclusion that results from the inherent bias in the fact finding process.⁹⁰ But by adopting an objective approach—defining strategic litigation by the degree of legal support for the claim—the amended rule is impaled on the other horn of the underinclusiveness dilemma: the fear that too rigorous a requirement of legal support will chill the development of the law also results in an underinclusive definition.

While it is impossible to measure the extent to which concern over chilling has influenced the development of standards under amended rule 11,⁹¹ the Advisory Committee Notes accompanying the amendments explicitly cautions against so applying the rule.⁹² Moreover, a significant portion of the current debate among commentators and the courts over the rule's application is focused on the concern that the standards applied not deter too much litigation.⁹³ The continued concern over chilling litigation suggests that, consistent with Section II.A.'s analysis, rule 11 standards will be intentionally underinclusive.

Despite the inevitable underinclusion, federal courts have used

90. See *supra* notes 23-25 and accompanying text.

91. Part of the problem is the cacophony of formulations that the courts have used to describe what behavior will violate rule 11. In making this point, Judge Schwarzer recently listed six different standards:

- (1) "[w]hen an attorney recklessly creates needless costs";
- (2) "[w]here . . . [the plaintiff's attorney] has made no inquiry or has made an inquiry that has revealed no information supporting a claim";
- (3) where the attorney insisted "on litigating a question in the face of controlling precedent . . . and failure to discover such overwhelming precedent suggests a lack of reasonable inquiry";
- (4) where a paper is "frivolously, legally unreasonable, or without factual foundation";
- (5) "where it is patently clear that a claim has absolutely no chance of success under the existing precedents, and where no reasonable argument can be advanced to extend, modify or reverse the law";
- (6) where there is "no support in any possible theory of law or any possible interpretation of the facts."

Schwarzer, *Rule 11 Revisited*, 101 HARV. L. REV. 1013, 1015 (1988) (citations omitted). In all events, none of the formulations appear to run a risk of being *over*inclusive.

92. "The rule is not intended to chill an attorney's enthusiasm or creativity in pursuing factual or legal theories." *Advisory Committee Notes, supra* note 83, at 199.

93. See, e.g., T. WILLGING, *supra* note 79, at 157-68; Snyder, *The Chill of Rule 11*, LITIGATION, Winter 1985, at 16. Some evidence is reported that rule 11 sanctions have been applied with more vigor against certain categories of cases that have as their common thread advocacy on behalf of the disadvantaged. Nelkin, *supra* note 85, at 1327 & n.92; Vairo, *Rule 11: A Critical Analysis*, 118 F.R.D. 189, 200-01 (1987).

the 1983 amendments to impose some *ex post* liability on lawyers and thereby breathed some life into a failing gatekeeper regime. There remains no reason, however, to believe that a public gatekeeper regime of unavoidably underinclusive design can serve as a substitute for the private regime that failed. Not only is the public regime of intentionally limited reach, but the magnitude of the penalties imposed seem unlikely to create substantial deterrence. Of the sanctions reflected in a recent sample of published opinions, almost half were under \$5,000 and over two-thirds were under \$15,000.⁹⁴ To be sure, a not insubstantial number of awards were of not insubstantial amounts, some 17% exceeding \$100,000.⁹⁵ Yet the deterrent effect of even large awards is subject to question. To the extent that the need for deterrence is greatest with respect to those lawyers representing corporate clients who no longer will countenance a gatekeeper, the award, even if of a size sufficient to deter the lawyer as nominal target, may be entirely insufficient to deter the client, the party on whom the incidence of the award likely falls. Moreover, in a market in which the client seeks a champion not a chaperon, a reputation for aggressiveness may well be worth the costs in sanctions necessary to earn it.⁹⁶

The point, of course, is not that amended rule 11 can have no beneficial impact on the filing of strategic litigation. Rather, it is only that for all of the same reasons why a private gatekeeping regime was desirable, a public gatekeeping regime remains a poor substitute, albeit better than nothing.

B. Increasing the Penalty on the Wrongdoer: Disclosure of Accountant Opinion Shopping

The independent certified public accountant is probably the oldest commercial gatekeeper. To borrow money or sell stock, a corporation must disclose its financial condition. The problem is how to do so credibly—to signal to the lender or investor that its financial statements are accurate despite the obvious incentive to present too favorable a picture. A public accountant provides that signal by serving as a gatekeeper. By certifying only those state-

94. T. WILLGING, *supra* note 79, at 80.

95. *Id.*

96. For example, responding to complaints of unethically vigorous advocacy on behalf of its clients, the chairman of Sullivan & Cromwell was reported to have responded that "[t]he complaints show Sullivan & Cromwell fights tough . . . , and 'clients like a law firm that's aggressive.'" Gray, *Legal Nightmare: Multiple Allegations of Impropriety Beset Sullivan & Cromwell*, Wall St. J., Aug. 3, 1987, at 1, col. 6.

ments that "present fairly the financial position of the corporation as of December 31, 19zz, and the results of its operations and changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a [consistent] basis,"⁹⁷ the accountant denies cooperation to those who would present inaccurate information.⁹⁸

Prior to the Securities Act of 1933⁹⁹ and the Securities Exchange Act of 1934,¹⁰⁰ public accountants functioned as private gatekeepers. A corporation's decision to employ them was voluntary and the sanction visited upon a corrupted gatekeeper was only reputational. The enactment of the core federal securities laws transformed the gatekeeper regime from private to public. A corporation that sought to sell its securities or which had a sufficient number of shareholders was required to provide certified financial statements to the Securities and Exchange Commission and to the public. Accountants who performed this certification were subject to regulation by the Commission.¹⁰¹

As Reinier Kraakman has stressed, "multiple contracting"—continued search by a determined wrongdoer for a compliant gate-

97. American Institute of Certified Public Accountants, AICPA Prof. Stand. (CCH): Auditing Sec. 509.07 (June 1989).

98. See, e.g., Benston, *The Market for Public Accounting Services: Demand, Supply and Regulation*, 2 ACCT. J. 2 (1979); Ng, *Supply and Demand for Auditing Services and the Nature of Regulations in Auditing*, in "THE ACCOUNTING ESTABLISHMENT" IN PERSPECTIVE 99 (S. Davidson ed. 1979).

99. 15 U.S.C. § 77 (1988).

100. *Id.* § 78.

101. The Commission has the authority to regulate the form and content of financial statements filed with it pursuant to the Securities Act of 1933. See *id.* §§ 77S(a), 78(m), and the Securities Exchange Act of 1934. The Commission has exercised this authority most comprehensively through the adoption of Regulation S-X, which sets forth a detailed description of the form and content of financial statements required to be filed. 17 C.F.R. § 210 (1989). It also regulates the relation between the accountant and client through the requirement of independence and regulates the accountant's professional behavior through its power to deny an accountant the privilege of practicing before the Commission. *Id.* §§ 210.2-01, 201.2(e)(1). The public gatekeeper regime created by this body of regulation has been recognized explicitly by the courts:

By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client. The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This "public watchdog" function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.

United States v. Arthur Young & Co., 465 U.S. 805, 817-18 (emphasis in original), *cert. denied*, 466 U.S. 936 (1984).

keeper—is a serious threat to gatekeeper enforcement.¹⁰² In the context of public accounting, multiple contracting appears as opinion shopping. When a corporation's existing accountant disagrees with how management proposes to account for a transaction, a new accountant will be sought with the understanding, explicit or not, that agreement with management's approach is a condition of the engagement. Not surprisingly, as the accounting profession became more competitive and as takeovers reduced the number of potential auditing clients, the pressure on accountants to be cooperative increased.¹⁰³

Although the Commission has brought enforcement actions against accountants who responded to a corporation's search for a cooperative accountant,¹⁰⁴ the focus of its efforts to protect the gatekeeper regime has been the imposition of effective penalties on the would-be wrongdoer. Because the point of the corporation's search is to find an accountant who will cooperate in hiding the real impact of a transaction, requiring disclosure both that shopping has taken place and of the accounting controversy at issue reduces the incentive to shop in the first place. Thus, for some time the Commission has required that a corporation publicly disclose the discharge of its principal public accountant and any disagreement over accounting principles that preceded the change.¹⁰⁵

In recent years, the Commission perceived that opinion shopping was becoming a greater threat to the integrity of the public accountant's gatekeeper role. The result was a series of regulatory initiatives directed at strengthening the barriers to shopping by increasing the effective penalty against the corporation—that is, by increasing substantially the required disclosure.¹⁰⁶ As finally adopted

102. Kraakman, *supra* note 16, at 72-74.

103. M. STEVENS, *THE ACCOUNTING WARS* (1985), provides a popular account of increased competition among accountants. The recent merger wave among large accounting firms—Ernst & Whinney and Arthur Young, Deloitte Haskins & Sells and Touche Ross, and Peat, Marwick, Mitchell and Main Hurdman—has generated an avalanche of newspaper accounts of changes in the market for public accountants. See, e.g., Cowan, *Rivalries, Responsibilities and Some New Risks*, N.Y. Times, Mar. 11, 1990, § 3, at 11, col. 1 (“Forget about accountants being a mild-mannered bunch of milquetoasts. When it comes to competing for clients, they are actually some of the most ruthless predators known to humankind.”).

104. See *In re* Stephen O. Wade, Ralph H. Hewton, Jr., and Clark C. Burrit, Jr., Exchange Act Release No. 21,095, [Accounting and Auditing Enforcement Releases 1982-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 73,432 (June 25, 1984).

105. See Form 8-K, 42 Fed. Reg. 4429, 4430 (1977).

106. See Securities Act Release No. 6594, Request for Comments on “Opinion Shopping,” [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,804 (July 1, 1985) (Concept Release); Disclosure Amendments to Regulation S-K and Forms 8-K and N-

in 1988, the amended regulations not only expand the range of circumstances in which disagreements between the corporation and its public accountant must be disclosed, but require new disclosures which focus explicitly on the shopping issue. If a corporation has consulted with a newly engaged auditor within approximately two years *before* the accountant's engagement concerning either the manner of accounting for an actual or hypothetical transaction or a disagreement between the corporation and its former accountant, the new accountant must disclose the issues discussed, its views on the issues, and whether it had consulted with the former accountant with respect to the issues. The corporation is then required to disclose a summary of the former accountant's views on the issues and request that the former accountant review the summary and state whether it agrees with it.¹⁰⁷ Under the new rules, the very act of finding a compliant accountant makes the goal of hiding something impossible to achieve. With respect to at least this matter, multiple contracting is no longer a threat.

In some circumstances, then, increasing the penalty on the wrongdoer can shore up a gatekeeper regime. However, it does not hold out much promise with respect to enforcement of the prohibition against strategic litigation. To be sure, the penalty against the wrongdoer can be increased in the strategic litigation setting. Rule 11 sanctions in substantial amounts¹⁰⁸ can be imposed as easily against clients as against lawyers.¹⁰⁹ It is unlikely, however, that increased rule 11 sanctions against the client in the strategic litigation setting can be as effective as increased sanctions against the client in the opinion shopping setting. Most important, the imposition of sanctions in the opinion shopping setting entirely eliminates any gain from the activity. It would be quite difficult to calculate the

SAR Regarding Changes in Accountants and Opinion Shopping, Securities Act Release No. 6719, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,139 (June 18, 1987) (proposed rules amending disclosure requirements).

107. Securities Act Release No. 6766, Disclosure Amendments to Regulation S-K, Form 8-K and Schedule 14A Regarding Changes in Accountants and Potential Opinion Shopping Situations, 6 Fed. Sec. L. Rep. (CCH) ¶ 72,431 (Apr. 7, 1988) (Final Rules); see Martin, *An Effort to Deter Opinion Shopping*, 14 J. CORP. L. 419 (1989).

108. See *supra* note 94 and accompanying text.

109. See *Business Guides Inc. v. Chromatic Communications Enters. Inc.*, 892 F.2d 802, 808-12 (9th Cir. 1989) (rejecting the position that under rule 11 a more lenient subjective standard applies to clients rather than the objective standard that applies to lawyers). This case has special interest because the law firm that represented the client against whom the sanctions were jointly awarded—Finley, Kumble, Wagner, Underberg, Manley, Myerson & Casey—is now in bankruptcy. Jenson, *New Allegations in Finley Case*, Nat'l L.J., Mar. 19, 1990, at 3, col. 1.

amount of rule 11 sanctions against a client necessary to entirely eliminate the strategic gain from having filed the litigation. The precise correspondence between gain sought and penalty imposed that makes the increased penalty work in the opinion shopping setting is absent in the setting of strategic litigation. Moreover, increasing the penalty on the wrongdoer would merely replicate the previously unsuccessful effort to deal with the problem of strategic litigation through *ex post* enforcement against the client, albeit now at a procedurally more effective time.¹¹⁰

Thus, increasing the penalty against the wrongdoer is not likely to restore a deteriorating private gatekeeper regime. Together with increasing the penalty on the lawyer, it may be better than nothing. But what relegates these efforts to the category of second best are the problems of underinclusion that inevitably accompany the associated shift from private to public gatekeeping. Consequently, it is worth considering whether the private gatekeeper regime can be revitalized without "going public." This (perhaps naively nostalgic) effort is the object of the next section.

C. *Changing the Gatekeeper: A New Role for Inside Counsel*

I have painted a quite pessimistic picture of the alternative approaches to shoring up the private gatekeeper regime for enforcing the prohibition against strategic litigation. Increasing the penalty on the gatekeeper does help some and increasing the penalty on the wrongdoer probably would not hurt. But this increased emphasis on the public aspects of gatekeeping cannot match the simple elegance of a working private gatekeeper regime whose principle cost is the exercise of the lawyers' conscience—as Robert Mnookin and I have described it in a different context, "Jiminy Cricket in a three-piece suit perched on each lawyer's shoulder."¹¹¹ Thus, before concluding that the game is over, it is worth addressing directly whether the *private* aspect of the gatekeeper regime can be resurrected.

For this purpose it is necessary to return to the sources of the market power that allowed lawyers to function as private gatekeepers in the first place. In Section III.C., I argued that the central characteristic of the market for legal services is the existence of both pre-purchase *and* post-purchase uncertainty concerning the quality of legal services. The response to the problem of pervasive quality

110. See *supra* notes 17-26 and accompanying text (*ex post* enforcement); *supra* note 89 and accompanying text (timing of inquiry).

111. Gilson & Mnookin, *Sharing Among Capitalists*, *supra* note 1, at 375.

uncertainty was a market structure—multi-specialty law firms and long-standing client relationships—that serves to provide quality assurance, but that, by making it costly to switch lawyers, also locks clients into a relationship with their lawyer.¹¹² The cost of switching provides the umbrella of market power that, I argued, sheltered the private gatekeeping regime.

Recently, the umbrella appears to have closed. Increased client sophistication reduced the information asymmetry between client and lawyer that made it costly to change lawyers. A talented general counsel can internalize the diagnostic and referral functions that previously had contributed to creating switching costs. Reduced costs of changing lawyers made private gatekeeping an increasingly difficult proposition.¹¹³

The potential to resurrect a lawyer staffed private gatekeeping regime appears from specifying more precisely just what happened to the information asymmetry when the new general counsel arrived. To be sure, the asymmetry between client and outside counsel was reduced. I do not expect that outside counsel will have the breadth of discretion in framing issues and characterizing the governing law and its goals that Robert Gordon and William Simon ascribe to lawyers¹¹⁴ when the “real” client is a senior inside counsel at, for example, the legal department being fashioned by Benjamin Heineman, Jr. at General Electric.¹¹⁵ I am far less certain, however, that the information asymmetry between client and lawyer that provides the discretion to which Gordon and Simon appeal in fact has been reduced. Suppose, instead, that the information asymmetry merely has moved in-house.¹¹⁶

The idea is that the informationally based market power wielded by a professional with respect to her client results from, and

112. See *supra* notes 42-67 and accompanying text.

113. See *supra* notes 67-75 and accompanying text.

114. See Gordon, *supra* note 1; Simon, *supra* note 67.

115. See Borden, *supra* note 74, at 100 (Former managing partner of Washington office of Sidley & Austin becomes general counsel at General Electric and promptly hires for senior in-house positions partners and managing partners from Hughes, Hubbard & Reed; Dewey, Ballentine, Bushby, Palmer & Wood; Baker & Daniels; and Wilmer, Cutler & Pickering).

116. Simply by way of example, suppose a general counsel seeks to buttress her view that a particular action line management would like to take is unlawful by securing an opinion from outside counsel. By the choice of the outside counsel to render the opinion, and by the information conveyed to the counsel, the general counsel may have substantial discretion—because of the information asymmetry between lawyer and client—to act as gatekeeper.

therefore follows, the diagnostic and referral functions.¹¹⁷ If these functions are performed by outside counsel, then market power, measured by the switching costs created, accrues to outside counsel. If, however, the diagnostic and referral functions are performed by the inside general counsel, then the associated market power accrues to the general counsel. Here, then, is my best (and only) candidate for the next generation of private gatekeeper: the inside lawyer. If we want a private gatekeeper, and the market power necessary for private gatekeeping has moved in-house, then so too must the gatekeeping function.

This is not the place to examine the very real barriers to actually internalizing the private gatekeeping function. Just as the external market for legal services evolved techniques that ameliorated the informational asymmetry between outside counsel and client, one can expect internal organizational responses designed to ameliorate the informational asymmetry between inside counsel and line management. Corporations will have their own agendas concerning the distribution of political power within the organization and the potential for an internal private gatekeeping regime will depend on the particular resolutions that evolve.¹¹⁸ Moreover, the risk is real that inside counsel may not share outside counsel's preference for acting as a gatekeeper. It is easy to imagine that the reference group of inside counsel may be other members of corporate management rather than other lawyers.

However, one interesting conclusion can be drawn. Private gatekeeping represents an important component of the traditional concept of professionalism. The reality of today's market for legal services is that the most likely location of the market power for lawyers to play this role is within the corporation. Thus, it may be that the burden of carrying the mantle of professionalism has fallen to a category of lawyers whom the legal profession has long considered the least worthy. There is a nice irony to the possibility that it may be left to the apprentice to pick up the master's burden.¹¹⁹

117. See *supra* notes 50-62 and accompanying text (diagnostic and referral functions).

118. Rosen, *supra* note 1, is a very useful beginning to the task of sorting out the determinants of the internal market power of inside corporate counsel.

119. Lucian Bebchuk has suggested to me that the burden of gatekeeping, once put down, cannot easily be picked up by anyone. Nelson argues that the content of professionalism—in his terms “professional ideology”—reflects the efforts of law firm leaders to elevate to principle the reality of their practice. R. NELSON, *supra* note 1, at 277. The process, likely grounded as firmly in cognitive dissonance as in sociological analysis, means that at precisely the time we want to socialize in-house counsel that being a professional requires that one act as a gatekeeper, outside counsel is changing the definition

CONCLUSION

The study of professionalism by lawyers and sociologists has been dominated by a myopic, albeit understandable, focus on the supply side of the traditional market for legal services.¹²⁰ Similarly, the response of the organized bar to the perceived transformation of the profession into a business—what I have called here the devolution of the legal profession—focuses on supply side responses: exhortations, more or less specific, to rekindle the Brandesian spirit in all of us.¹²¹ In contrast, my argument counsels a very different approach to professional renewal: The promise for resurrecting important elements of professionalism lies in understanding the demand, not the supply, side of the market for legal services. The traditional structure of professionalism, dominated by elite outside counsel and sheltered by information asymmetry, has been rent by changes in the market. The aspect of professionalism on which I have focused here—lawyers functioning as private gatekeepers to enforce a Rawlsian agreement among clients—remains a desirable end which seemingly cannot be duplicated by public enforcement. Changes in the market for legal services, however, strongly suggest that the segment of the profession most likely empowered to play this role is inside counsel, individuals hardly representative of the profession's traditional elite. For those concerned about the future of the professional project, the growing prominence of inside counsel within the profession, reflecting their market power, is not a threat but an opportunity, perhaps our only one. The message I offer is that a necessary condition for professionalism is market power. We had better start paying attention to those who have it.

of professionalism to exclude gatekeeping as a necessary attribute. In this circumstance, Bebchuk then asks who is left to effect the desired socialization of in-house counsel.

I have no easy answer to this troubling point, in part because at the same time that I suggest in-house counsel as the only plausible successor to the private gatekeeping role, I share Bebchuk's skepticism concerning the likelihood of the project's success. It is the case, however, that change in the content of professionalism is a gradual process—we have not yet abandoned at least the rhetoric of the Brandesian professional. Thus, a window of time may well exist in which the rhetoric of this element of professionalism survives its demise in practice and can serve as a vehicle for socializing the next generation of gatekeepers. Maybe.

120. See, e.g., Rosen, *supra* note 1, at 235 ("control over the services supplied is a basic and justifiable part of the professionalism project").

121. See, e.g., AMERICAN BAR ASSOCIATION, COMMISSION ON PROFESSIONALISM, ". . . IN THE SPIRIT OF PUBLIC SERVICE:" A BLUEPRINT FOR THE REKINDLING OF LAWYER PROFESSIONALISM (1986).