

Consequential Responsibility for Client Wrongs: Lehman Brothers and the Regulation of the Legal Profession

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Should transactional lawyers bear responsibility when their competent actions facilitate unlawful activity by their client? Or is a lawyer's only concern to act in the client's interest by providing her with the advice and support she seeks? The high profile failure of Lehman Brothers provides a unique opportunity to explore these questions in the context of the provision of a legal opinion by a magic circle law firm. A legal opinion which, although as a matter of law was accurate, was a necessary precursor to an accounting treatment by Lehman Brothers which was described by the Lehman's Bankruptcy Examiner as 'balance sheet manipulation'. The article argues that the law's existing understanding of when consequential responsibility should be imposed on those who assist another's wrongdoing provides a theory and a tool-kit whose application can be justifiably extended to the professional regulation of transactional lawyers.

INTRODUCTION

Lawyers are rarely far from controversy. Entrusted by the State as custodians of the rule of law, their public and adversarial role often brings them into conflict with popular perceptions of justice and fairness. In zealously defending and advising the unpopular and the 'guilty', the ethics of lawyers are readily problematised. In the context of adversarial trials, the legal profession and the courts have developed a series of rules to manage the problem of overly zealous lawyering. These are principally organised around the idea of the public interest in ensuring that the court is not misled. In the transactional context, there are fewer rules and significantly less scrutiny of the tension arising from a lawyer's zealous pursuit of their clients' interests and the public interests concerns which such lawyering generates. This is true even though the justifications for zealous transactional lawyering are weaker.

In the United States a variety of financial scandals have led to scrutiny of the ethics of corporate transaction lawyers,¹ whereas in the UK corporate lawyers have largely avoided public and regulatory attention.² UK corporate lawyers have

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- 1 See, for example, R. W. Gordon, 'A New Role for Lawyers? The Corporate Counselor after Enron' (2003) 35 Conn L Rev 1185.
- 2 Although *Marks & Spencer plc v Freshfields Bruckhaus Deringer* [2004] 1 WLR 2331 prompted a rare exception. See: J. Flood, 'Transnational Lawyering: Clients, Ethics and Regulation' in L. Mather and L. Levin (eds), *Lawyers in Practice: Ethical Decision Making in Context* (Chicago: University of Chicago Press, 2012); M. Herman, 'Conflict of interest costs Freshfields lawyer £59,000' *The Times* 2 August 2007 and J. Loughrey, 'Corporate Lawyers and Corporate Governance' (Cambridge: Cambridge UP, 2012).

successfully relied on the duty to their client, sophistication in the delivery of legal services, and legal professional privilege to shield themselves from criticism.³ The idea that the lawyer's primary function is to zealously advance their clients' interests has acted as an ideological justification for the alignment of the profession's commercial interests with their clients' interests and as a barrier to closer investigation of the role and responsibilities of transactional lawyers.

This article examines this rationalisation of the transaction lawyer's role in the context of the collapse of Lehman Brothers. A pivotal moment in the credit crisis, Lehman's collapse is of profound public interest. Clearly lawyers did not cause the collapse of Lehman, but Linklaters, a London headquartered corporate law firm, provided advice and a legal opinion which was an important component in enabling Lehman to implement suspect accounting practices. These accounting practices misled regulators and the capital markets in the run up to Lehman's collapse and prefigured alleged securities law violations by Lehman's management.

Linklaters's role in relation to Lehman's problematic accounting practices was to provide a legal opinion as to whether short term bank financing known as 'repo' financing, carried out through Lehman's UK subsidiary, amounted to a sale and repurchase arrangement or a secured loan under English law. Without the opinion the accounting practices and the alleged securities law violations could not have taken place. Yet, as we show in the article, the opinion was accurate and unlikely to raise ethical questions or attract any sanction under current professional regulations.

The Lehman's Repo scenario raises an interesting question: should lawyers bear any 'consequential responsibility' for unlawful client activity *facilitated* by their legal advice and counsel, *even when such advice is accurate and competently provided*? If so, is it practically possible to impose such consequential responsibility on lawyers through professional regulation and what would be the appropriate conditions of its application? The Lehman Repo scenario provides a particularly useful case-study to assist us in answering these questions because of the complex financial context and regulatory frameworks which it involves. We explore whether such complexity renders the imposition of consequential responsibility on transaction lawyers unworkable. We argue that it does not. A strong theoretical and practical case can be made for imposing limits on the zealous pursuit of client interests by holding transaction lawyers to account where their actions generate a *real, substantial and foreseeable* risk of client action that is unlawful or 'probably unlawful'. In making this argument through an examination of the Lehman repo affair, we emphasise that we do so by way of case study only. Due to the limited public record and the level of uncertainty about what actually happened, we are not in a position, nor do we attempt, to determine whether Linklaters should be criticised under our suggested framework of responsibility.⁴

3 See, for example, *United States of America v Philip Morris and British American Tobacco* [2004] EWCA Civ 330.

4 The Solicitors Regulatory Authority (SRA) has previously announced an investigation but has not responded to our requests to confirm the instigation or outcome of the investigation. An earlier version of this paper was forwarded to the relevant partner at Linklaters for comment. We received no comments.

To consider whether consequential responsibility should be imposed on transaction lawyers we set forth, in the following parts of the article, a detailed account of Lehman's problematic repo transactions and the accounting rules applicable to them. The article then considers Linklaters' legal opinion: its validity and its role in enabling Lehman to implement the suspect accounting treatment which in turn facilitated the alleged US securities law violations.

With this understanding in place, the article then explores the theoretical case for consequential responsibility. It considers approaches to consequential responsibility set forth in UK criminal and civil law rules on accessory liability. It argues that underpinning these accessory liability rules is a theory of consequential responsibility that justifies the imposition of accessory liability only where the secondary party facilitates a serious and foreseeable risk of wrongdoing by the primary party and where the regulated activity in question raises public interest concerns beyond the interests of the acting parties. We argue that this theory of consequential responsibility, coupled with the core tenets of what it means for law to be a profession, provides a basis for extending consequential responsibility to transaction lawyers through professional regulation.

The final part of the article looks at whether consequential responsibility is already recognised by UK professional regulation. It argues that the notion contained within the current regulation that lawyers should consider, indeed prioritise, the public interest could in theory form a basis for imposing consequential responsibility on transaction lawyers. However, we argue that the concept of the public interest has not been fashioned with any regard to transaction lawyering and the economic incentive structures of transaction lawyers. As a result, current regulation does not constrain overzealous transaction lawyering. We conclude with some thoughts about possible approaches and parameters for regulation.

ACCOUNTING FOR REPOS

Banks finance their activities through individual deposits from retail customers and loans from other banks and financial institutions.⁵ Much of this bank to bank finance is provided for only a few days before being refinanced from the same or a different source. This market in short term funding is known as the repo market. From an economic perspective, repo-finance involves a secured loan: a bank requires short term finance and uses existing assets as collateral to secure that finance. Whilst repo transactions may make look like, and are typically described as,⁶ secured loans, they are structured as sales and subsequent repurchases of the assets. Through a legal lens, the borrowing bank sells the assets to the lending bank and then repurchases them shortly thereafter on the agreed terms.

5 On banks' current dependence on such short term finance see 'US funds show true state of Eurozone Banks' *Financial Times* 25 August 2011.

6 See, for example, 'Bank runs left repo sector exposed' *Financial Times* 10 September 2009, observing that 'in a repo an investor can borrow cash from another party, using securities as collateral for the loan'.

Banks are typically required to account for repos as secured finance. Accounting standards aim to capture the economic not the legal effects of a transaction. The economic function of a repo is to raise short term finance using assets that the bank expects to continue to own (unless it defaults). Accounting for repos as secured loans means that the assets remain on the balance sheet of the borrower (Bank A) and that the funds provided by, and owed to, the repo counterparty (Bank B) are entered as a short term liability (ie a debt A owes to B). If the repo transaction was treated for accounting purposes as a sale, then the assets would no longer be Bank A's. A's overall assets would, however, remain unaltered as the value of the 'sold' assets would be replaced with the cash received from the counterparty bank (unless and until the bank uses that cash for some other purpose such as the repayment of another liability).

A basic example illustrates the significance of repo accounting. Consider Bank A with £200 of assets funded by £50 of equity and £150 of debt. £50 of this debt is maturing (the Maturing Loan). This loan needs to be refinanced and the repo market offers one means of obtaining that finance. Accordingly, for the purposes of this example, Bank A enters the repo market to borrow the £50 on a short term basis from Bank B. Following receipt of the 'repo cash' from Bank B it repays the Maturing Loan.

Before entering into the repo transaction the company's balance sheet would be presented as in Column 1 of Table 1. How the repo is accounted for in the balance sheet depends on whether the repo is accounted for as a sale and subsequent repurchase of the repo assets (Column 2) or a secured loan (Column 3). If accounted for as a sale, then following the repayment of the Maturing Loan, Bank A's assets and liabilities are both reduced by £50. However, if the repo transaction is accounted for as a secured loan then the accounts would be presented as they are in Column 3. Under secured loan accounting, Bank A is treated as having retained ownership of the assets which it has used as collateral for a loan. Accordingly, the accounting entry for these assets in the balance sheet is unaltered and there is an additional liability entry in the amount 'paid for the assets' ('loaned') by the repo-counterparty.

The significance of this accounting choice is seen in the bank's leverage ratio – its ratio of debt to equity, shown in the final row of Table 1. The extent to which a bank's activities are funded through shareholder equity rather than debt is a signal of the bank's creditworthiness and its ability to remain solvent if faced with unexpected difficulties. In Column 2 Bank A looks like a less risky proposition than in Column 3 as its assets have been financed by more equity and less

Table 1: Accounting Treatment of Repos

	1	2	3
Assets	200	150	200
Liabilities	150	100	150
Shareholder Equity	50	50	50
Leverage Ratio	3:1	2:1	3:1

debt than is the case in Column 3. In Column 2 the debt to equity ratio is 2:1; whereas the ratio in Column 3 is 3:1.⁷

LEHMAN'S REPO 105s AND US GAAP

The purpose of the Repo 105s

In common with other commercial or investment banks, Lehman Brothers made significant use of repo transactions. The vast majority were accounted for as secured loans.⁸ Indeed, Lehman's annual accounts explicitly stated that this was their approach to accounting for repos.⁹ However, Lehman also entered into repos accounted for as sales rather than secured loans. It did so without qualifying its disclosed accounting policy for repos. These repos were the now infamous Repo 105s.¹⁰ Importantly, the Bankruptcy Examiner's Report¹¹ into the collapse of Lehman Brothers finds that these transactions were not used to raise short term finance or for any other commercial or banking purpose, although such finance was a by-product of these repos. Rather they were used purposefully and solely to alter the presentation of Lehman's financial statements. In the words of the Bankruptcy Examiner, this was 'balance sheet manipulation'.¹²

After the 2007 credit crunch began, regulators, credit rating agencies and investors increasingly focused on leverage (the debt to equity ratio) as a proxy for the riskiness and viability of banks.¹³ To create the appearance of de-leveraging¹⁴ Lehman entered into Repo 105s immediately prior to the end

7 Note that prior to the Maturing Loan being discharged the leverage ratios would be 3:1 (sale accounting) and 4:1 (secured loan accounting). Consider instead the following hypothetical which does not involve the discharge of a separate liability: assume *Column 1* contains a repo booked as a secured loan – following the repurchase (the settling of the first repo) the bank enters into a back-to-back repo to refinance the first repo but this time books it as a sale, the effect of this transaction would be to reduce the leverage in *Column 1* of 3:1 to 2:1.

8 See Lehman Bankruptcy Examiner's Report at <http://lehmanreport.jenner.com/VOLUME%203.pdf> (Examiner's Report), 751 (last visited 18 September 2012).

9 Examiner's Report, 751 and note 2917.

10 Note that there were both repos 105s and 108s which were both accounted for as sales. This article considers only repo 105s, which were the dominant repo used to reduce leverage.

11 The Bankruptcy Examiner was appointed by the US Bankruptcy Court to investigate Lehman's affairs and financial position on 16 January 2009. On the role and duties of examiners see the US Bankruptcy Court, s 1106. For the whole report see <http://www.jenner.com/lehman> (last visited 3 June 2012).

12 The Examiner's Report observes that 'The Examiner has investigated Lehman's use of Repo 105 transactions and has concluded that the balance sheet manipulation was intentional, for deceptive appearances, [and] had a material impact on Lehman's net leverage ratio' (at 912 n 3497). The Examiner's Report records that Martin Kelly, former Lehman Global Financial Controller thought 'that the only purpose or motive for the transactions was reduction in balance sheet' [and] felt that 'there was no substance to the transactions' (at 735).

13 See 'Lehman faces questions over longer term model' *Financial Times* 9 June 2008; 'The Cost of a Wrong Turn' *Financial Times* 5 August 2008; 'The Five Lessons that Bankers Must Learn' *Financial Times* 10 August 2008. See also Examiner's Report, 735 and at 910: 'Officials from the Federal Reserve Bank Would Have Wanted to Know about Lehman's Use of Repo 105 Transactions'.

14 Note that Lehman introduced Repo 105s in 2001 after SFAS 140, discussed below, took effect in 2000. See Examiner's Report, 765.

of each quarter. The cash received was used to repay other liabilities exacerbating the artificial and temporary reduction in leverage.¹⁵ Following the quarter-end the assets sold in the Repo 105 would be repurchased and the asset and liability accounts reset to where they were prior to quarter-end. The sale accounting of these repo 105s took between \$38 billion and \$50 billion dollars of assets off Lehman's books on reporting dates in the financial years 2007 and 2008. This had a material impact on their leverage ratios.¹⁶ For example, the first quarter-end 2008 net leverage was reported 15.4x when it would have been 17.3x but for the Repo 105s.¹⁷

US GAAP: the accounting framework

Under US Securities and Exchange Commission (SEC) rules, financial statements not prepared in accordance with generally accepted accounting principles (US GAAP) are presumed to be misleading or inaccurate.¹⁸ According to SEC guidance¹⁹ 'generally accepted accounting principles' are those that have 'substantial authoritative support' and the only principles that have such support are those issued by the US Financial Accounting Standards Board (FASB). Note, however, that this SEC guidance implicitly acknowledges and defers²⁰ to the American Institutes Certified Public Accounting Rule of Conduct 203 which requires, in 'unusual circumstances' departure from US GAAP where its application would result in the financial statements being misleading.²¹

Before looking at the standards applicable to repo transactions it is first necessary to understand the principled framework and objectives of US GAAP. This framework structures the understanding and application of any Financial Accounting Standard. Eight Financial Accounting Concepts Statements provide a set of 'fundamentals on which financial accounting and reporting standards [are] based'.²² They do not by themselves 'directly solve financial and reporting problems, rather they are objectives and concepts for solving problems'²³ to which 'repeated references . . . will be necessary in establishing, interpreting and applying accounting and reporting standards'.²⁴

The two most important concept statements are SFAC 1 on the *Objectives of Financial Reporting in Business Enterprises* and SFAC 2 on the *Qualitative*

15 Examiner's Report, 733. See n 7 above considering this effect.

16 Examiner's Report, 739.

17 *ibid* 748.

18 Rule 4-01a.1. Regulation S-X promulgated under the Securities Act 1933 and the Securities and Exchange Act 1934. See R. E. Large, 'SEC Accounting Series Release No 150: A Critical Analysis' (1978) 54 *Indiana Law Journal* 317.

19 Set forth in the SEC's 'Accounting Series Release No 150: Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards' (1973).

20 Large, n 18 above, footnote 2.

21 See AICPA Rule 203 (Code of Professional Conduct) and commentary at http://www.aicpa.org/Research/Standards/CodeofConduct/Pages/et_203.aspx (last visited 13 September 2012).

22 Financial Accounting Concepts Statements (SFAC) 1, 3.

23 *ibid* 3.

24 SFAC 2, 8.

*Characteristics of Accounting Information.*²⁵ Under SFAC 1²⁶ the primary objective of financial reporting is to provide useful information for investors. SFAC 2 identifies the characteristics of accounting information that are necessary in order for the information to be useful. Under SFAC 2, the primary qualities of accounting information are relevance and reliability. ‘Relevance’ essentially re-articulates the idea of usefulness. Information is relevant if it is capable of making a difference to an investment decision. ‘Reliability’ deals with the nature and quality of the information and depends on ‘representational faithfulness’: ‘the faithfulness with which [the accounting treatment] represents what it purports to represent.’²⁷ Underpinning this concept of reliability is therefore an idea that the accounting treatment of a transaction should accurately represent the actual financial effects of the transaction. Substance trumps form: ‘the quality of reliability and, in particular, of representational faithfulness leaves no room for accounting representations that subordinate substance to form.’²⁸

Other accounting information qualities identified by SFAC 2 include: comparability and consistency; neutrality; materiality; and, to a lesser and controlled extent, conservatism. Neutrality requires that in applying an accounting standard the ‘primary concern’ of the accounting decision maker should be the relevance and reliability of the information to a user of the information, and should not be to attain a particular pre-determined result. Materiality or immateriality is defined by whether it would be ‘probable’ that a reasonable investor’s decision would have been affected had the information been included or had it been correct.

Did Repo 105s comply with the accounting rules?

Statement of Financial Accounting Standard 140

Lehman reported all of its repos as secured loans apart from the Repo 105s.²⁹ The starting point for determining an accounting treatment’s compliance with GAAP is the detailed *Statement of Financial Accounting Standards* (SFAS). For repos the applicable SFAS is SFAS 140.³⁰ Pursuant to SFAS 140 whether the transaction should be accounted for as a secured loan or a sale turns on whether the transaction involves a ‘transfer of assets’ which is deemed to have surrendered ‘effective control’ over the transferred assets. Surrendering control requires that the assets are: (i) isolated from the transferor’s bankruptcy; (ii) that the transferee has the right to pledge or sell the assets; and (iii) that the transferor does not

25 Note that the most recent statement SFAC 8, issued in 2010, amends, combines and supersedes SFAC 1 and 2. However, as the Repo 105 accounting was put in place prior to 2010 our analysis of GAAP’s principled framework considers SFAC 1 and 2.

26 SFAC 1 at [3].

27 SFAC 2 at [59].

28 *ibid* at [160].

29 See n 9 and n 10 above.

30 SFAS 140, ‘Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities’ (FASB, 2000).

‘maintain effective control over the transferred assets’ through a repurchase agreement.³¹ We address these conditions in reverse order.

Maintaining Control

Pursuant to SFAS 140 a transferor of assets maintains ‘effective control’ if:

- the repurchased assets are the same assets or ‘substantially the same assets’;
- the repurchase takes place before the maturity of the securities at a fixed price set forth in the contract;
- the repurchase agreement is entered into at the same time as the sale; and
- the transferor ‘is able’ to repurchase the assets even if there is a default by the transferee (the counterparty bank or financial institution).³²

This last somewhat counter-intuitive requirement is at the heart of Repo 105 accounting. What is required is that cash received in the repo by the transferor bank (the bank transferring the assets) must be sufficient to enable the ‘re’-purchase from third parties of the same securities. Repo counterparties (the bank or financial institution providing the finance) are unlikely to give full value for the assets transferred. Any default by the transferor bank in repurchasing the assets will leave the counterparty bank with the assets and, to be sure of being able to sell those assets to realise the original cash transferred, such a counterparty bank will want the value of the transferred assets to exceed the cash they paid the transferor bank for those assets. The extent to which the value of the assets exceeds the cash payment is referred to colloquially as a ‘haircut’. If the transferor bank takes a large ‘haircut’ then the value of the cash received by the bank will be significantly less than the cash needed to repurchase ‘substantially the same assets’ on the open market. Under SFAS 140, if the haircut is big enough then effective control is not maintained and (assuming the other conditions are satisfied) the repo should be accounted for as a sale rather than a secured loan.

What then is a large enough haircut to lose effective control over the asset? SFAS 140, somewhat foolishly perhaps, provides bright line clarity in this regard: overcollateralisation (ie assets provided by the transferor bank in excess of the cash received) of less than 102 per cent of the cash received would, in FASB’s view, provide the transferor bank with sufficient cash to be able to repurchase ‘substantially the same assets’.³³ Any overcollateralisation in excess of 102 per cent would not and, if all other criteria for sale accounting treatment were complied with, such a repo (with greater than 102 per cent overcollateralisation) should ordinarily be accounted for as a sale.

Lehman focused laser-like on this requirement. They produced a repo structure that involved 105 per cent overcollateralisation (hence Repo ‘105’) for highly liquid securities such as government bonds. Simply to raise short term repo finance there was no market need to engage in such overcollateralisation. Indeed, the Bankruptcy Examiner’s Report on Lehman observed that such

³¹ *ibid* at [9].

³² *ibid* at [47].

³³ *ibid* at [218]. Note the Statement provides that ‘judgment is needed to interpret the term substantially all’.

structures, although providing more protection to repo counterparties, were typically more expensive for Lehman than a normal repo. The high collateralisation signalled to the counterparty that the transaction was being undertaken for non-commercial purposes for which a premium could be charged.³⁴

Sale or Secured Loan? Structuring the Repo 105 around English Law

Under SFAS 140 the two additional preconditions to sale accounting treatment are: bankruptcy isolation (if the borrowing bank enters bankruptcy proceedings the assets remain the counterparty's property); and the ability of the counterparty to sell or pledge the assets. Fulfilment of these conditions depends on whether the law applicable to the repo views the transaction as a sale and repurchase (in accordance with the label given it by the bank and counterparty), or whether it would re-characterise the transaction and treat it as a secured loan.³⁵

Due to the uncertainties surrounding applicable US law, Lehman could not obtain a legal opinion from its US counsel that the Repo 105s would be treated as sales under US law.³⁶ It then turned to English law and its UK lawyers, Linklaters, and effected the Repo 105s through its London subsidiary, Lehman Brothers International Europe (LBIE).³⁷ Linklaters' legal opinion concluded that, subject to certain qualifications, in a repo governed by English law the 'Seller will have disposed of its entire proprietary interest in the Purchased Securities by way of sale'.³⁸ This opinion was issued several times between 2001 and 2007³⁹ and was pivotal to the Repo 105 accounting. Without the opinion, the Repo 105 accounting could not have taken place.⁴⁰ But was it correct?

To be treated as a sale under English law it is not sufficient to label the transaction with one's preferred designation. English law will readily re-characterise a transactional label if it does not correspond to the legal relations that the parties intend to create through the contract.⁴¹ Similarly if the legal relations that the parties purport to create are not the legal relations the parties actually intend to create, then the courts will treat the purported relations as a sham and disregard them.⁴² What matters are the legal relations that are actually intended to be created.⁴³ If the parties actually intend to enter the legal relations that amount to a sale and subsequent repurchase of the assets then, for English law, the transaction is a sale not a secured loan. This is the case even if the

34 Examiner's Report, 878–881. Also, 881 noting the comments of one Lehman employee: 'Everyone knows 105 is an off balance sheet mechanism so counterparties are looking for ridiculous levels to take them.'

35 SFAS 140 refers to a 'true sale at law' see at [27], [82] and [83]

36 Examiner's Report, 740.

37 Prior to effecting a Repo 105 Lehman's non-UK businesses would transfer assets they wanted to include in the Repo 105 to LBIE.

38 Legal Opinion of Linklaters LLP dated 31 May 2006; available at Appendix 17 of the Examiner's Report.

39 The Examiner's Report observes that 'Lehman refreshed the letter several times' (at note 3019).

40 The centrality of the opinion is discussed further at text to notes 74–81 below.

41 In *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148.

42 *Snook v London and West Riding Investments Ltd* [1967] 1 All ER 581.

43 *Welsh Development Agency v Export Finance Co Ltd* n 41 above; *Orion Finance Ltd v Crown Financial Management Ltd* [1996] 2 BCLC 78.

economic objective of the transaction is to raise money for only a short period of time and in the long run to retain ownership of the sold assets.⁴⁴

Repos and Repo 105s are carefully structured to create the economic effects of a secured loan but do so through the legal form of a sale.⁴⁵ For example, the repo agreement does not provide that the counterparty bank must transfer the same assets (in the repurchase part of the agreement), just 'equivalent assets'. This minor but important detail performs two roles. First, if the actual assets were required to be repurchased this would raise some doubt as to whether the parties in fact intended to enter into a sale. Secondly, if the repurchase obligation relates to a specific asset then arguably a beneficial interest is created in that asset from the time of the repurchase obligation if the seller would be entitled to a remedy of specific performance in relation to those assets.⁴⁶ In which case, an ownership interest is immediately created in the asset preventing it from being bankruptcy remote from the seller's estate. Whether or not specific performance would be available,⁴⁷ making the re-sale obligation apply to the equivalent assets means that there is no specific asset in relation to which an ownership interest could be created at the time of the repurchase contract, even if a performance remedy was subsequently granted.⁴⁸ Of course as a practical matter this distinction between the original assets and equivalent assets is of no consequence: in most instances the transferor bank will get its original assets back and where they do not they will receive identical financial assets. But as a legal matter the distinction between original and equivalent assets is crucial to sale treatment.

Accordingly, as repo transaction documentation is carefully structured to provide for a sale and as Lehman intended to enter into the formal legal relations set forth in the documentation, Repo 105s were indeed true sales. Although, some US courts have refused to enforce a transaction's formal legal characteristics and have re-characterised them according to the court's view of the substance of the transaction,⁴⁹ English law does not mix legal and economic consequences to attempt to identify the 'true nature'⁵⁰ or legal substance of the transaction. This is not to say that there is no scope to re-characterise commercial transactions under English law. For English law the lodestar for re-characterisation is not the

44 To determine what legal relations are intended to be created by the transaction the courts will look to the transaction documentation – *Orion Finance Ltd v Crown Financial Management Ltd* [1996] 2 BCLC 78.

45 Repo 105s relied upon industry standard documentation provided jointly by the Securities Industry and Financial Markets Association and the International Capital Markets Association in the form of a Global Master Repurchase Agreement.

46 Lewin on Trust (London: Sweet & Maxwell, 18th ed, 2007) at para 10–05.

47 Damages would usually be an appropriate remedy where equivalent assets are widely available *Co-operative Insurance Society v Argyll Stores (Holdings) Ltd* [1997] All ER 297.

48 Other examples of how the agreement generates secured loan economic effects through a legal sale and repurchase structure include: the pricing rate (interest rate) provisions, (Global Purchase Agreement, para 2(ii) referring also to para (ii)); asset income provisions (Global Master Purchase Agreement, para 5) and the margin transfer provisions (Global Purchase Agreement para 4) (hyperlinked at note 2972 of the Bankruptcy Examiner's Report).

49 See, for example, *Major's Furniture Mart, Inc. v Castle Credit Corporation, Inc.* 602 F.2d 538.

50 *ibid*, observing that: 'the question for the court then is whether . . . the true nature of the transaction [is] such that the legal rights and economic consequences of the agreement bear a greater similarity to a financing transaction or to a sale' (emphasis added).

relationship between legal form and substance or an attempt to identify the transaction's true nature, but whether the particular regulation or law being 'avoided' was, as a matter of statutory interpretation, intended to apply to a transaction that generated a set of effects, regardless of the transaction's formal legal characterisation.⁵¹

If, for example, UK accounting regulation provided, which it does not,⁵² that accounting for repos turns on whether or not a repo amounted to a 'true sale', English courts could take a purposive reading of the term 'true sale' and say that if a sale very closely resembles a secured loan in effect, that it was intended to be treated and accounted for as a secured loan by the applicable accounting regulation. However, in this instance the applicable regulation is US accounting regulation which simply refers to whether the transaction would amount to a true sale pursuant to the applicable legal regime. Crucially, Linklaters, as UK Counsel for Lehman's, was not being asked whether it would be a true sale for the purposes of SFAS 140, it was being asked whether it was a true sale under English Law. As a matter of English law, its opinion that a repo involved a legal sale and repurchase is clearly correct.

Rules versus Principles in Repo 105 Accounting

If one considers SFAS 140 in isolation and focuses on the true sale designation and the 105 per cent overcollateralisation then the argument that Repo 105 accounting was GAAP compliant is a strong one. Yet, as we noted above, the underlying framework of the Concept Statements encourages accounting decision-makers to focus on usefulness, relevance, reliability, representational faithfulness and neutrality. Is secured loan accounting representationally faithful to the substance of the Repo 105 transactions? The accounting problem here was not whether the legal label was representationally faithful to the transaction but whether the accounting of the transaction was representationally faithful to Lehman's financial position. Clearly it was not. Secured loan accounting in this case would have given a representationally faithful account of leverage, which was not the temporarily reduced leverage figure but the post-repo/post-quarter end figure. The 'real' leverage figures would clearly have been 'useful' and 'relevant' for investors. Furthermore, the accounting quality of neutrality is clearly contravened by a structure that is put in place only to produce a distorted accounting effect.

Lehman might attempt to argue that although sale accounting was representationally unfaithful, such information was neither useful nor relevant to investors as it was 'immaterial'. A figure of \$50 billion is arguably immaterial when juxtaposed next to an asset base of \$639 billion.⁵³ However, Lehman's own accounting policy was that any transaction that altered leverage by 0.1 per cent was material.⁵⁴ Repo 105 accounting altered leverage by several whole percentage points. For Lehman it was clearly material.

51 The leading case in this regard is *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51.

52 See IAS 39 *Financial Instruments: Recognition and Measurement*.

53 As of 31 May 2008 (extracted in the Examiner's Report, 889)

54 Examiner's Report, 747.

Accordingly, to determine whether Lehman's Repo 105 accounting is GAAP compliant there is a clear conflict between the rules in SFAS 140 and the principles in GAAP's Concept Statements. How does US GAAP manage this conflict?

FASB's Concept Statements stress the importance of the principled framework but defer to the SFASs in two respects. The Concept Statements acknowledge that: (a) they are not accounting standards; and (b) they are not intended to invoke section 203 of the AICPA code of conduct which, as discussed previously, requires the opt-out of the application of a FASB standard where its application would result in misleading accounting. The Concept Statements do not, therefore, represent a charter to opt-out of the application of the accounting standards. This suggests that the Concept principles may inform the application of an accounting standard but ultimately they defer to the rule. This is what Schauer refers to as an entrenched generalisation – the rule itself is the final port of call to determine its application.⁵⁵ This contrasts for Schauer with rules that are in a conversational relationship with the principles where actions cannot be rule compliant if they are not also principle compliant.

There are two reasons for thinking that SFASs operate in a conversational relationship with the Concept Statements and that the SFAS 140 rules are not entrenched generalisations. First, although the Concept Statements do not invoke Rule 203 they are clearly relevant to any decision to invoke the 203 opt-out.⁵⁶ In this regard, Repo 105 sale accounting did not simply represent the aggressive accounting of a pre-existing financial transaction that performed a commercial function within Lehman. Repo 105s were, according to the Bankruptcy Examiner, explicitly designed for the sole purpose of creating an accounting effect that directly contravened the principled framework set forth in the Concept Statements. Secondly, neither the accounting standards nor the concept statements are the final arbiter of what is presumptively misleading under GAAP. The Federal Courts are the final arbiter. US Federal Courts often take a very purposive approach to interpreting SEC rules particularly in the context of devices designed to avoid compliance with the underlying principles of the legal rules.⁵⁷

Support for a purposive interpretation of GAAP has been found in the concept of fairness. Fairness is not an accounting quality set forth in the Concept Statements, however, in two instances the concept is used in US accounting and audit regulation. First, audit certification requires that the auditors certify that unqualified financial statements 'present fairly [the financial condition of the corporation] in conformity with generally accepted accounting principles'.⁵⁸ Secondly, the Sarbanes-Oxley Act 2002 requires Chief Executive Officers to

55 F. Schauer, *Playing By The Rules: A Philosophical Examination of Rule Based Decision Making In Law and Life* (Oxford: Clarendon Press, 1991).

56 See text to notes 23–24 above.

57 See, for example, *CSX Corporation v The Children's Investment Fund Management (UK) L.L.P. et al* 08 Civ 2764 (LAK), slip op. at 1, 2 (S.D.N.Y. June 11, 2008).

58 Explaining the objective of an audit opinion in these terms see Public Company Accounting Oversight Board, AU Section 110.01.

certify that the financial statements of their corporation ‘fairly present in all material respects the financial condition and results of operations of the issuer’.⁵⁹ This notion of ‘fair presentation’ has resonated with the Courts. In 1974, a Second Circuit District Court held that ‘fairness is the touchstone for determining the adequacy of disclosure in financial statements.’⁶⁰ More recently in 2004, in *Global Crossing Ltd Securities Litigation* both the Concept Statements and the notion of fairness provided a platform for a Second District Federal Court to hold that:

Unlike other regulatory systems GAAPs ultimate goals of fairness and accuracy in reporting require more than mere technical compliance . . . GAAP . . . when viewed as a whole, provides no loopholes or shelters . . . Even assuming [compliance with] certain specific accounting standards, this would not insulate them or their accountants as a matter of law from liability under the Securities Acts because under both GAAP and the securities laws, business entities and their accountants are required to provide whatever additional information would be necessary to make the statements in their financial reports fair and accurate, and not misleading.⁶¹

In the post-Enron regulatory environment it is, therefore, highly improbable that a formalistic rule-based account of GAAP compliance would persuade a court that an accounting treatment, such as the Repo 105 sale accounting, that directly contravenes the principled framework provided by the Concept Statements and which, according to Lehman’s Bankruptcy Examiner, was designed to manipulate the balance sheet could be GAAP compliant.⁶² Early indications from the initial Lehman litigation suggest that the courts will continue to take this broader view of GAAP. In a motion to dismiss civil suits against the Lehman directors and Ernst & Young, Lehman’s auditors, a New York District Court observed, relying on the above cases, that: ‘the fact that Lehman’s accounting for the Repo 105 transactions technically complied with SFAS 140 does not mean that Lehman’s financial statements complied with GAAP’.⁶³ It seems implausible that any accounting decision-maker operating in the post-Enron context would not be aware of this view and of the clear risk that *ex-post* the Repo 105 accounting treatment could be deemed to be non-compliant with US GAAP.

59 Sarbanes-Oxley Act, s 302(3).

60 *Herzfeld v Leventhol, Kekstein, Horwath & Horwath* 378 F.Supp. 112, 121 (1974). See also *US v Ebbers* 458 F.3d 110 (2006).

61 *In re Global Crossing, Ltd Securities Litigation* 322 E.Supp. 2d 319 (2004) 340 citing SFAC 1 Objectives of Financial Reporting in Business Enterprise and SFAC 2 Qualitative Characteristics of Accounting Information.

62 Whether this observation is correct is likely to be tested by current litigation between the State of New York and Ernst and Young in relation to these accounting practices (unless it settles). This ‘no loopholes or shelters’ view of GAAP which relies on the Concept Statements is put forwarded forcefully in the State of New York’s: see *People of the State of New York v Ernst & Young LLP* Complaint [61]–[64] available at <http://www.scribd.com/doc/45747241/Cuomo-Lawsuit-Against-Ernst-Young> (last visited 11 October 2012).

63 *In Re Lehman Brothers Securities and ERISA Litigation* 08 Civ. 5523 (LAK), 30.

Securities Law Violations

In addition to GAAP compliance, US securities laws require that filings made by publicly traded companies, such as annual and quarterly reports, contain such 'further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made not misleading'.⁶⁴ Lehman professed in its filings to treat repos as secured financings, and made no qualification in this regard for its Repo 105s. More specifically, post-Enron amendments to the narrative disclosure regime required detailed discussion of off-balance sheet arrangements in the section of the Annual Report entitled Management Discussion and Analysis (MD&A).⁶⁵ However, Lehman made no disclosures in its annual or quarterly filings detailing the sale treatment of Repo 105s that fell squarely within these rules.⁶⁶ The case that Lehman breached these securities law obligations appears to be a strong one.⁶⁷

Other potential Securities Law violations by Lehman arose from oral statements made in the context of the non-disclosure of the Repo 105 sale treatment. In the leverage focused environment of the unfolding crisis,⁶⁸ Lehman's officers wished to emphasise its apparent de-leveraging and de-risking. Repo 105s were central to achieving this appearance. Research analysts wanted to understand how this deleveraging was being achieved. The objective of non-disclosure would, of course, be undermined by an accurate answer which referred to Repo 105s sale accounting. However, the very fact of non-disclosure drives further non-disclosure. Once the non-disclosure strategy has been implemented, the Rubicon has been crossed and careful questions are likely to beget further securities law violations. For example, according to the Bankruptcy Examiner's report, in response to analyst's questions on Lehman's deleveraging strategy, Erin Callan, Lehman's Chief Financial Officer from December 2007, referred only to the sale of assets and implied that deleveraging was connected to the sale of assets.⁶⁹ In the Bankruptcy Examiner's opinion these statements would support a determination that Lehman violated US securities laws, and provided a case for a colourable claim⁷⁰ for breach of fiduciary duty by Callan for exposing the company to liability for misleading investors.⁷¹ Litigation alleging these violations has been commenced.⁷²

64 Rule 12b-20 promulgated under the Securities Exchange Act 1934.

65 Regulation 303 of Regulation S-K, promulgated under the Securities Act 1933 and the Securities and Exchange Act 1934.

66 'As already discussed, the effects of the Repo 105s on leverage were material under Lehman's own accounting policies. See also *In Re Lehman Brothers Securities and ERISA Litigation* n 63 above, 31-35 holding that materiality was arguable.

67 See Examiner's Report concluding that such failures, amongst others, rendered the quarterly (10Q) and annual (10K) reports misleading (at 985-989).

68 See n 12 above.

69 As we have established above from a legal perspective this is literally true as a repo amounts to a sale of assets under English law. It seems unlikely, however, that an investor would understand the idea of a sale of assets to cover a temporary repo-style sale and repurchase.

70 A colourable claim is a claim that 'on appropriate proof would support a recovery' *In re STN Enters* 779 F2d 901 (2d Cir. 1985) 905.

71 Examiner's Report, 1018.

72 *In Re Lehman Brothers Securities and ERISA Litigation* n 63 above.

LEGAL ADVICE, OPINIONS AND CONSEQUENTIAL RESPONSIBILITY

The centrality of the opinion

For Lehman to claim that true sale accounting applied to the Repo 105s they required not merely advice on the position under English law but a formal legal opinion that under English law repos amounted to true sales. US auditing standards require that auditors demand expert legal evidence in relation to complex structures that claim to place assets beyond the control of the company.⁷³ Repo 105 true sale accounting was not, therefore, possible without a legal opinion which stated that under English law the Repo 105s involved a true sale of the assets.

A law firm's legal opinion has a function beyond informing the client about the applicable law. A legal opinion provides for the client or a third party – for example, as in the case of Repo 105s, an auditor – external and independent verification of a legal position.⁷⁴ Without it the client or the third party would not be able to act – to sign off on an accounting treatment or to rate a security. An opinion is more tangible, concrete and, for the capital markets, more meaningful than the mere provision of written or oral advice. When giving the opinion lawyers are expected to exhibit 'judge-like' qualities of independence and neutrality.⁷⁵ As the law firm as a whole signs and stands behind it, the opinion is viewed as being more independent and, therefore, more reliable than the mere provision of advice by a single partner.⁷⁶

Legal opinions are, of course, not declarative of the law but the lawyers' function in giving an opinion that is relied on by a third party is of a mixed regulatory nature.⁷⁷ This is clearly the case when regulators require legal opinions as part of a compliance process.⁷⁸ By requiring a legal opinion, a regulator delegates a form of regulatory power to lawyers. The legal opinion becomes a necessary gateway through which the parties have to walk in

73 Public Company Accounting Oversight Board, Auditing Standard (AU), s 9336, para 1.06. This provision does not explicitly mandate the provision of a legal opinion but clearly expects one when the structures are legally complex.

74 See generally, G. Yeowart, 'Guide to English opinion letters in financial transactions' (2012) 1 *Journal of International Banking and Financial Law* 7 and City of London Solicitors Society, 'A Guide to the questions to be addressed when providing opinion letters on English law in financial transactions' (2011) at <http://www.citysolicitors.org.uk/FileServer.aspx?oID=1095&lID=0> (last visited 11 May 2012).

75 S. L. Schwartz, 'The Limits of Lawyering: Legal Opinions in Structured Finance' (2005) 84 *Texas Law Review* 1, 10, 13 and 27.

76 'Opinion givers and counsel for opinion recipients should be guided by a sense of professionalism and not treat opinions simply as if they were terms in a business negotiation' ABA Committee on Legal Opinions, 'Legal Opinion Principles' in "Guidelines for the Preparation of Closing Opinions" (2002) 57 *The Business Lawyer* 875 at <http://apps.americanbar.org/buslaw/tribar/materials/20050120000001.pdf> 883 (last visited 18 September 2012).

77 Schwartz, n 75 above, 10, 13 and 27.

78 For another example of the regulatory use of legal opinions see FSA Handbook GENPRU, 2.2.159 (12).

order to act. In this sense the legal opinion function is a gatekeeper function.⁷⁹

Without a true sale opinion Lehman could not have adopted sale accounting for Repo 105s.⁸⁰ The legal opinion was, therefore, a proximate cause of Lehman's true sale accounting treatment; and therefore a (less) proximate cause of the, alleged, securities law violations by Lehman officers. This centrality of the opinion to the apparently unlawful accounting treatment and consequential securities law violations provide a real life test case through which we can explore whether transaction lawyers should and could be held accountable when their competently provided and accurate advice and actions materially contribute to the risk of their clients breaking the law.

The nexus of complicity in criminal and civil law

The moral notion that we bear some responsibility for the effect of our actions on the actions of others⁸¹ is reflected in laws that impose liability on individuals (accessories) who aid and abet certain unlawful acts. Acts which contribute to or enable unlawful actions by others may give rise to culpability even if the assisting act itself is a lawful and legitimate one. The law determines liability for the accessory by focusing on their awareness at the time the assistance was given of the probability that the act would be committed by another person and their awareness that the act would constitute a wrong.

To take an example from criminal law first. A taxi driver who drops off a robber at the jewellery store aids a robbery but lack of awareness of the intended act absolves him of criminal liability. A driver who drops the robber off at the same store with the knowledge that the robbery would, or was likely to, happen will be in greater difficulty if a robbery takes place.⁸² A friend who is aware that the robber habitually robs jewellery stores and has been asked by the robber to give him a lift to the jewellery store because he 'wants to buy an engagement ring', finds himself in more uncertain territory if a robbery takes place.

Anyone who aids, abets, counsels, or procures the commission of an offence may be tried as a principal offender.⁸³ In *R v Bryce* the court held that:

79 See J. C. Coffee, 'The Attorney As Gatekeeper: An Agenda For The SEC' (2003) 103 *Columbia LR* 1293; J. C. Coffee, 'Can Lawyers Wear Blinders? Gatekeepers and Third-Party Opinions' (2005) 84 *Texas Law Review* 59, 60.

80 The E&Y Complaint highlights the importance of the opinion as follows: 'Lehman used the Linklaters' opinion repeatedly to engage in billions of dollars worth of highly questionable transactions without disclosing the truth in its financial statements' at [21]; 'Armed with the Linklaters Letter . . . Lehman engaged in Repo 105 transactions . . .' at [22]. Note also that the complaint alleges that Lehman engaged in Repo 105 transactions that did not fall within the terms of the opinion that it apply to LBIE and UK counterparties, at [23].

81 See generally, D. Luban, *Lawyers and Justice: An Ethical Study* (Princeton NJ: Princeton UP, 1988).

82 See, for example, *Lomas* (1913) 9 Cr App R. 220.

83 Accessories and Abettors Act 1861, s 8 in relation to indictable offences. The Magistrates' Courts Act 1980, s 44 deals with summary and either way offences. Criminal liability for assisting offences is also provided for by the Serious Crimes Act 2007, ss 44–49. Note that the offences set forth the Serious Crimes Act 2007 can be committed even where the offence itself is not actually committed.

It is necessary to show firstly that the act which constitutes the aiding, abetting etc was done intentionally in the sense of deliberately and not accidentally and secondly that the accused knew it to be an act capable of assisting or encouraging the crime.⁸⁴

With regard to the *actus reus* for accessory criminal liability, the courts have understood the term ‘aiding’ to involve merely help or assistance in the commission of the criminal act.⁸⁵ Accordingly the causal connection with the aid or assistance is a relatively loose one. With regard to the *mens rea*, Lord Simon in *Lynch v Director of Public Prosecutions for Northern Ireland* observed that ‘it must be foreseen that the instrument or other object or service supplied will probably (or possibly and desiredly) be used for the commission of a crime.’⁸⁶ Other cases have required that the accessory knew that the assistance created a ‘real possibility’ or a ‘real or substantial risk’ that the offence would be committed.⁸⁷ Importantly, the aider and abettor need only be aware of the likelihood of the criminal act not its inevitability. Nor does the assister have to intend that the crime be committed only that he intends to provide the assistance.⁸⁸ Furthermore, as recent cases dealing with accessory liability for dangerous driving make clear, the assister must be aware not only of the likely acts of the assisted person but also of the ‘essential matters’ which constitute the crime that is committed as a result of the assisted person’s actions.⁸⁹

Drawing on criminal law, commentators have argued for general civil law principles of accessory or secondary liability for assisting a wrong.⁹⁰ There are, however, no such general principles in English law.⁹¹ Tort law provides for accessory liability where a person procures or induces a wrong.⁹² For tort law, there needs to be a close ‘complicity nexus’⁹³ between the third party’s actions and the wrongdoing to justify accessory liability. Hence, where the accessory’s

84 [2004] All ER (D) 255 at [42].

85 *Anyanwu v South Bank Students’ Union* [2000] IRLR 26 at [39]. The word ‘aid’, in its natural and ordinary meaning, appears to me to comprehend in this context assistance or help which may be very substantial in its scope and effect as well as assistance which is very limited’.

86 [1975] AC 653, 698.

87 *R v Bryce* n 84 above at [49]; *R v Rook* [1993] 2 ALL ER 955, 960.

88 *R v Bryce* *ibid* at [58];

89 See *R v Webster* [2006] All ER (D) 41 (Mar) relying on *Johnson v Youden* [1951] KB 544, 546; and *R v Martin* [2010] EWCA Crim 1450. This point however is not wholly clear – see *R v Bryce* n 84 above at [49] where the Court of Appeal observed: ‘it is inappropriate and unworkable to require knowledge of the essential matters constituting the offence in a situation where the offence is yet to be committed in the future or by a person of whose precise intentions the accused cannot be certain in advance.’ See also S. Cunningham, ‘Complicating Complicity: Aiding and Abetting Causing Death by Dangerous Driving’ (2011) 74 MLR 767.

90 P. Sales, ‘The Tort of Conspiracy and Civil Secondary Liability’ (1990) 49 *Cambridge Law Journal* 491.

91 Subsequent to Sales’ article the courts have rejected the invitation to set forth such general principles: *Credit Lyonnais Bank Nederland NV v Export Credits Guarantee Dept* [1998] 1 Lloyd’s Rep 19 (CA) (*Credit Lyonnais*).

92 See generally P. S. Davies, ‘Accessory Liability for Assisting Torts’ (2011) 70 *Cambridge Law Journal* 368.

93 This term was coined by D. Cooper, *Secondary Liability for Civil Wrongs* (University of Cambridge, PhD Thesis, 1996) 3.

actions merely aid rather than actively induce the commission of the wrong, tort law has been unwilling to impose accessory liability.⁹⁴

The courts have held that there are ‘obvious policy reasons’⁹⁵ for not extending assistance liability to tort, although they have been criticised for failing to articulate these reasons.⁹⁶ Three policy reasons suggest themselves. First, concern about the opening of floodgates,⁹⁷ leading to a possible explosion of tort liability for assisters. Secondly, a concern about inhibiting economic activity which could result from assister liability where products are sold which are then used to commit wrongdoing, for example, cd-burners that could be used to infringe property rights. Thirdly, the comparatively serious and public nature of crime. If a distinguishing feature of the criminalisation of wrongdoing is ‘the state’s interest in criminal wrongdoing’⁹⁸ and its broader societal impact, as distinct from – or at least in priority to – the interests of the wronged individual, then it makes sense for the state to broaden its attempt to deter such activity by imposing liability for criminal offences not only on the wrongdoer but also on the accessory. From this viewpoint, it is the societal impact of the wrong that justifies imposing responsibility on accessories in order to deter the wrong from occurring.

By way of contrast with tort law, equity accepts ‘dishonest assistance’ as a sufficient ‘complicity nexus’: a person who assists in a breach of trust or fiduciary duty may find themselves jointly and severally liable for that breach. With regard to causation, the courts have made it clear that the assistance does not have to cause the loss which results from the breach of fiduciary duty.⁹⁹ All that is required is that ‘the claimant can show that [the assisting act has] at least made the commission of the breach easier than it would otherwise have been’.¹⁰⁰ As regards the assisting person’s state of mind, in the Privy Council case of *Royal Brunei Airlines v Tan*, Lord Nicholls observes that: ‘ordinary, everyday business would become impossible if third parties were to be held liable for *unknowingly* interfering in the due performance of such personal obligations’.¹⁰¹ ‘Dishonesty’ is the ‘touchstone of liability’ but in effect it is understood as the assister’s awareness that his actions would assist in the breach of trust or duty, or circumstances which would have led to that awareness but for the defendant’s wilful blindness.¹⁰² In *Barlow Clowes International Ltd (in Liquidation) v Eurotrust International*, the Privy Council accepted that liability for dishonest assistance in this case required

94 *Credit Lyonnais* n 91 above. See also *Amtrax Consumer Electronics Plc v British Phonographic Industry* [1986] FSR 159. See generally Davies n 92 above.

95 *Credit Lyonnais*, *ibid per* Hobhouse LJ, at 46.

96 See Davies n 92 above, 368.

97 See Jonathan Sumption QC’s submissions in *Credit Lyonnais* n 91 above.

98 P. Ramsay, ‘The Responsible Subject as Citizen: Criminal Law, Democracy and the Welfare State’ (2006) 69 MLR 29, 39.

99 *Grupo Torras SA v Al-Sabah* [1999] All ER (D) 698 *per* Mance J (as he then was); *Casino Computer Limited v Sayo* [2001] EWCACiv 661.

100 S. B. Elliott and C. Mitchell, ‘Remedies for Dishonest Assistance’ (2004) 67 MLR 16, 20.

101 Emphasis in the original. *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378, 387.

102 *ibid* 389 *per* Lord Nicholls who observed in this regard that an honest person does not ‘deliberately close his eyes and ears, or deliberately not ask questions, lest he learn something he would rather not know, and then proceed regardless’. On ‘wilful blindness’ see further *Twinssectra v Yardley* [2002] 2 AC 164 *per* Lord Hoffmann at [22].

showing that the defendant had ‘solid grounds for suspicion which he consciously ignored’ that he was dealing with misappropriated funds.¹⁰³ Whether or not an assister regards their assistance as dishonest is immaterial; what matters is their ‘consciousness [or wilful blindness] of those elements of [the primary] transaction which make participation transgress ordinary standards of honest behaviour’.¹⁰⁴ The assister need not have regard to or be subjectively aware that their assistance transgresses those standards.¹⁰⁵ A lawyer who knows, suspects or is wilfully blind to the fact that they are assisting their client in the breach of a fiduciary duty is *ipso facto* dishonest under this test. To argue otherwise is to argue that assisting in a breach is normal and honest.

Phillip Sales has argued that it is the knowledge that the assistance will lead to a breach that creates a sufficient nexus between the assistance and the wrongdoing to justify the imposition of liability.¹⁰⁶ Yet whilst knowledge of the probable unlawful effects of assistance is central to the criminal law and the law of dishonest assistance, such knowledge is insufficient for accessory liability under tort law. Contrasting criminal law and dishonest assistance with tort law we see that it is the public implications of the primary actions in question which are the distinguishing considerations in the law’s willingness to recognise accessory liability. In the context of dishonest assistance it is the public interest in ensuring the trustee’s honesty and loyalty which justifies the extension of accessory liability to the person who assists in a breach of trust or duty. Fraud is a core threat to the functioning of a market economy; similarly the loyalty of the fiduciary is a central bulwark of market activity. The law’s driving concern here is not with compensating the individual who suffers as a result of fraud or disloyalty but with the foundations of an effective market economy.¹⁰⁷

In summary one finds within equity and the criminal law a theory of consequential responsibility which is applied where the state has a significant public interest in the effects and the prevention of the assisted action. Where such public interest considerations justify the imposition of accessory liability, application is structured around the assister’s awareness of the assisted actual wrongdoing or awareness of the probability that wrongdoing will occur. Knowledge is both a touchstone of liability but also law’s connection with a basic moral justification for liability: the assister should take responsibility for actions which they know (or ought to know) will, or are likely to, assist the wrongdoing.

With regard to Lehman’s Repo 105s, we are concerned with the provision of a legal opinion which enabled alleged materially misleading financial statements and alleged US securities law violations. English law would not impose civil liability for such assistance and no UK crime was committed by Lehman that could result in criminal accessory liability. However, the inquiry into consequential responsibility does not end there. The approach of criminal law and equity to

103 *Barlow Clowes International Ltd (in Liquidation) v Eurotrust International* [2006] 1 All ER 333 per Lord Hoffmann at [19] and [20].

104 *ibid* per Lord Hoffman at [16].

105 *ibid* at [16].

106 Sales, n 90 above, 508, note 58

107 On the centrality of trust to a functioning market economy see, for example, L. Guiso, L. Zingales and P. Sapienza, ‘Trusting the Stock Market’ (2008) 63 *Journal of Finance* 2557.

accessory liability reveals a legal theory of consequential responsibility which has a broader application, as does its conceptual tool-kit. A theory which justifies the imposition of responsibility on a person who assists wrongdoing by another where the assister is aware of the possible wrongdoing which they are assisting and where there are public interest concerns associated with the activity in question. A theory that, we argue below, when applied to the context of transactional legal practice makes a strong case that lawyers' consequential responsibility should not simply be left to the criminal and civil law but should be directly addressed by professional regulation.

Professional ethics justifications for consequential responsibility

Justifications for a Zealous Focus on Client Interests

The dominant idea of the role of the lawyer is that the lawyer should act zealously in the client's interests.¹⁰⁸ The idea of zeal is closely related to the legal cultural norm derived from criminal advocacy of the lawyer defending her client without fear or favour. However, a professional commitment to zealous lawyering extends beyond criminal law and process into the commercial sphere. As Lord Hunt observed in his review of legal services regulation: 'client first was bred into me'.¹⁰⁹

There are two principal justifications for requiring zeal. One is a rights-based justification: that the lawyer's role is to protect the client's rights.¹¹⁰ Moral qualms about a client's actions (past or future) play no role in how the lawyer acts. On the strongest version of this theory, lawyers are required to do everything within their power to advance the rights of the client unless it is clearly prohibited by law or professional conduct rules. Doubts about the legality/professionalism of an action are resolved in favour of the client on the basis that it is for courts and legislatures to define such limitations, not lawyers. As William Simon notes, this view has a strongly libertarian element to it with lawyers as defenders of client's rights against state encroachment.¹¹¹ It has the added advantage for lawyers of being accompanied by a principle of non-accountability: because a lawyer must act for a client and do their best by them, they accept no moral (or professional) responsibility for the consequences of having promoted their client's interests and enabling their client's actions.

The second justification is based on pluralism. Given that there are legitimate, and sometimes strongly held, differences about what is right or wrong, lawful or

108 Perhaps the seminal defence of this position is S. L. Pepper, 'The Lawyer's Amoral Ethical Role: A Defense, A Problem, and Some Possibilities' (1986) *American Bar Foundation Research Journal* 613. See, also: T. Dare, *The Counsel of Rogues? A Defence of the Standard Conception of the Lawyer's Role* (Farnham: Ashgate, 2009); J. Loughrey, n 2 above, 63; and D. Markovits, *A Modern Legal Ethics: Adversary Advocacy in a Democratic Age* (Princeton NJ: Princeton UP, 2011).

109 D. Hunt, 'The Hunt Review Of The Regulation Of Legal Services' (London: Law Society, 2009) at http://www.lawcentres.org.uk/uploads/Legal_Regulation_Report_October_2009.pdf (last visited 28 May 2012) 3.

110 *ibid.*

111 W. H. Simon, 'After Confidentiality: Rethinking The Professional Responsibilities Of The Business Lawyer' (2006) 75 *Fordham Law Review* 1543.

unlawful, lawyers should be able to advance arguments in their client's favour within widely drawn boundaries of (un)reasonableness and (il)legality because the 'system' (and not lawyers) gets to adjudicate on what is right in any given context.¹¹² Under this second justification zeal should not be restrained by anything other than the incontrovertible limits of the law itself, as to do otherwise risks interposing the lawyer's morality between the client's interests and just adjudication of their claims.

Zeal also has commercial and intellectual appeal. It helps clients advance and test their rights. Zeal provides a space within which lawyers can 'get creative'. Creative production of law (test cases) and legal devices can advance client, and, arguably, societal, interests.¹¹³ Zeal has the added benefit (for lawyer and client) of aligning the lawyer's professional ethics with the commercial interests of themselves and the client.

Zeal and Fidelity to the Rule of Law

Zeal may provide intellectual, commercial and economic benefits but its legitimacy is hotly contested. Critical commentators have, for example, argued that it assists in the avoidance of taxes,¹¹⁴ questionable responses to environmental regulation,¹¹⁵ and attempts to render torture 'lawful'.¹¹⁶ Simon observes that zeal risks detaching the practice of law from the public value of lawyering, particularly in what he refers to as a formalist legal regime – a rules-based environment in which decision makers are required to comply with the rules and not to have regard to the rules underlying and stated purpose.¹¹⁷

Formalism demands only that norms be specified, not that they serve their purposes. A formalist regime breeds not only counter-purposivist evasion but also counter-purposivist compliance – costly activity dictated by the literal terms of rules that make little contribution to their underlying purposes . . . The formalist model of lawyering has become a liability for lawyers. The wedge that formalism drives between legal norm and public purpose undermines the profession's claim that its services have public value.

But why should the laudable objectives and benefits of zeal be constrained by requiring lawyers, as Simon suggests, to have regard to regulatory objectives,

112 T. Dare, 'Mere Zeal, Hyper-Zeal and the Ethical Obligations of Lawyers' (2004) 7 *Legal Ethics* 24, 25; W.W. Bradley, 'The Jurisprudence of Enron: Professionalism as Interpretation' (2004) *Cornell Law Faculty Publications* Paper 7.

113 See, for example: M. J. Powell 'Professional Innovation: Corporate Lawyers and Private Lawmaking' (1993) 18 *Law and Social Inquiry* 423.

114 D. McBarnet, 'It's Not What You Do but the Way You Do It: Tax Evasion, Tax Avoidance, and the Boundaries of Deviance' in D. Downes (ed), *Unravelling Criminal Justice: Eleven British Studies* (London: Macmillan, 1982) 247.

115 D. Dana, 'What pressures are there in commercial firms away from a public service orientation, and how are they, or can they be, reduced? Environmental Lawyers and the Public Service Model of Lawyering' (1995) 74 *Oregon Law Review* 57.

116 Human Rights Watch, *Getting Away with Torture – The Bush Administration and Mistreatment of Detainees* at <http://www.hrw.org/en/reports/2011/07/12/getting-away-torture> (last visited 5 August 2011).

117 Simon, n 111 above, 1460–1461.

purposes or public values, or by requiring them, as we propose in this article, to consider and take responsibility for the probably unlawful client activity assisted by their zealous and competent lawyering? It is submitted that a case for constraint can be made based on the relationship between the rule of law and the profession.

Law and legal practice generate asymmetries of knowledge and power between the lawyer and the client but also between the lawyer and society. The asymmetry between lawyer and client is well documented. For example, the layman who needs to draft a will may have little idea of the crucial formalities which must be complied with in order to ensure that the will is enforceable. Without hiring another lawyer he is not in a position to know whether what his lawyer tells him to do is correct. The nature of law produces a second, arguably more fundamental, asymmetry of knowledge and power. While lawyers are central to allowing citizens to understand the regulatory context in which they operate, lawyers also have the technical skills to play with law, to enable clients to creatively avoid laws, or to manage and reduce the costs of an ex-post finding of non-compliance. They can create 'probably lawful' structures that provide 'legality arguments' that can be used, if caught, to negotiate favourable outcomes with regulators or injured parties.¹¹⁸

Accordingly, just as the client needs to trust the lawyer to draft an enforceable will, society needs to trust the legal profession to be faithful to the law, in both letter and spirit and not to abuse its capacity to play with rules in ways which undermine regulatory objectives or otherwise actively facilitate a client's unlawful actions or probably unlawful actions.¹¹⁹ If lawyers abuse this asymmetry of knowledge and power under the cover of a commitment to zealous lawyering, substantial externalities are imposed on society as regulations are avoided, undermined and breached.

Clearly therefore society is keenly interested in ensuring that lawyers do not abuse their position and role in this way. In this regard, we need to be cognisant of the pressures of a competitive legal market for corporate legal services.¹²⁰ Corporate lawyers face significant pressures to do their client's bidding. At the margin such pressure may come with the explicit or implicit client threat that 'if you do not do this for me then I know a lawyer who will'; so-called 'opinion shopping'. This leaves the lawyer faced with the catch-22 of losing a client without having any effect on the client's actions. Such pressure inevitably strains

118 D. McBarnet, 'After Enron will "whiter than White Collar Crime" still wash?' (2006) 46 *British Journal of Criminology* 1091, 1092. That transaction lawyers engage in such activities is widely assumed although poorly empirically grounded. Nevertheless the law reports themselves provide some empirical foundation for this assumption. See, for example, *Gisborne v Burton* [1988] 3 All ER 760.

119 See, for example, W. W. Bradley, 'Lawyers as Quasi-Public Actors' (2008) *Cornell Law Faculty Publications* Paper 99 and R. G. Gordon, 'Why Can't Lawyers Just Be Hired Guns?' in D. L. Rhode (ed), *Ethics in Practice: Lawyers' Roles, Responsibilities, and Regulation* (Oxford and New York: OUP, 2000) 42-55.

120 Generally on the possible distortions generated by a competitive market in corporate legal services see N. Smedley, *Review of the regulation of corporate legal work* (London: Law Society, 2009) at http://www.lawcentres.org.uk/uploads/Review_of_the_Regulation_of_Corporate_Legal_Work_03.09_.pdf (last visited 28 May 2012) see especially [2.23] and [2.24].

a lawyer's professional commitment to the rule of law. These pressures are well documented in law and other professional contexts.¹²¹

Accordingly, ensuring lawyerly *fidelity to the rule of law* provides a public interest justification for the extension of consequential responsibility to lawyers. It provides a principled basis for imposing constraints on zealous lawyering where such zeal facilitates or contributes to unlawful activity or probable unlawful activity, even where the lawyer's advice and actions themselves are accurate and competently provided. Zeal must operate *within* the parameters of such fidelity.

Zeal in Non-adversarial Contexts

Another reason for qualifying the objective of zealous lawyering and for subjecting transactional lawyers to consequential responsibility arises from attention to the different contexts within which law is practised. Theories of zeal are derived from principles of adversarial advocacy.¹²² The idea that an advocate should be fearless, should strain every sinew within the law, is a paradigm designed for the theory of the trial and criminal defence in particular. The theory of adversarial trial holds that the zealous pursuit of two opposing arguments, each tested by their opponent in front of a neutral arbiter, is the best means of ascertaining the truth.¹²³

There are analogues for the theory of the trial outside of adversarial contexts. It can be argued, for example, that a commercial lawyer should be encouraged to try every option open to its client that is not incontrovertibly illegal so that law does not fetter commercial creativity.¹²⁴ However, these analogues fail in a key respect. In transactional contexts – and particularly transactional contexts where there is no party with whom the client and their lawyer are obliged to negotiate, as was the case with the opinion given in relation to Lehman's repo 105, the additional institutional checks which are part of the adversarial case for zeal are not in place: there is neither an opponent nor a neutral arbiter scrutinising the factual and legal claims made by a lawyer for their client.¹²⁵ It follows that in the absence of such institutional checks the zeal based rationale for transactional lawyering that considers only the client's interests is much weaker.¹²⁶

121 In relation to legal opinion shopping see V. Fleisher, 'Regulatory Arbitrage' (2010) 89 *Texas Law Review* 227, 267 and McBarnet, note 118 above, 1092. In relation to accounting opinion-shopping see C. Lennox, 'Do Companies Successfully Engage in Opinion-Shopping?' (2000) 3 *Journal of Accounting and Economics* 321.

122 See, in particular, Markovits n 108 above, who stretches the envelope somewhat beyond adversarial trial.

123 J. Thibaut and W. Laurens, 'A Theory of Procedure' (1978) 66 *California Law Review* 541; D. Luban, 'The Adversary System Excuse' in *The Good Lawyer: Lawyers' Roles and Lawyers' Ethics* (Rowman & Allanheld, 1983) 83.

124 Schwartz, n 75 above; also more generally Pepper, n 108 above.

125 J. Loughrey, n 2 above, 64. It is often argued the absence of neutral oversight problem extends well beyond the transactional contexts, D.L. Rhode, *In the Interests of Justice: Reforming the Legal Profession* (Oxford and New York: OUP, 2000) 55.

126 Schwartz, n 75 above, 26.

Zeal and Corporate Clients

An additional reason for being more sceptical about the benefits of zeal in corporate contexts, particularly in the context of the regulation of financial statements, is the nature of the corporate client. As Simon notes, lawyers typically regard corporate managers as 'the client' for the purpose of taking instructions but that position is problematic where the interests of the managers and the corporation conflict.¹²⁷ The preparation of financial statements, the focus of this article, generates an acute agency problem arising from the potentially divergent interests of managers and the corporation in the presentation of those financial statements. For example, managers with performance-based remuneration may be incentivised to adopt accounting treatments that overstate profitability in order to enhance their pay. This damages the corporation in two respects: managers receive remuneration they should not have received; and second, should the market discover that the financial statements are misleading then the damage to the corporation's reputation for reliable transparency may increase its cost of capital. If the lawyer loses sight of the object of his zeal and directs it towards the interest of the human being providing the instructions, this could result in detriment to the person providing the actual instructions, namely the corporation. There is a risk therefore, that zeal can become a handmaiden of corporate agency problems.¹²⁸

Is There A Case Against Imposing Consequential Responsibility?*Can Consequential Responsibility be Applied to a Complex Financial Regulatory Environment?*

In this section we use the publicly available information about the Repo 105 legal opinion to generate a case study to explore whether it would be reasonable for a law firm giving an opinion in these stylised circumstances to have known about the possible unlawful consequences of giving it. This enables us to consider whether or not the complexity and uncertainty of the financial world renders the imposition of consequential responsibility on transactional lawyers unworkable.

Before commencing our analysis the reader should note first that hindsight bias is a problem here and, second, that this exploration involves a case study assessment constructed on a partial and incomplete public record which renders the conclusions reached here case study conclusions not real life judgments.¹²⁹

Corporate and financial regulation presents a difficult context in which to apply consequential responsibility to lawyers. One cannot simply take the criminal law's accessory liability framework outlined above and crudely ask whether the law firm is analogous to the taxi driver or the friend in the above examples.¹³⁰

127 Simon n 111 above. W. H. Simon, 'Whom (Or What) Does The Organization's Lawyer Represent?' (2002) Stanford Law School Public Law Research Paper No 30 at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=296687 (last visited 14 September 2012).

128 See Smedley, n 120 above at [2.23]–[2.24].

129 We have provided the relevant Linklaters partner with an opportunity to comment on a draft version of this paper, but have received no response.

130 See text to notes 81–82 above.

The robber in the jewellery store has robbed the store. There is without question an unlawful act and the elements of the crime are easily accessible and well known. Breaches of accounting and securities rules are rarely so clear cut. For a law firm considering giving a Repo 105 true sale opinion, uncertainty would exist not only at the level of how the opinion will be used by the client but also as to whether any foreseeable use would be unlawful. A complicity nexus modelled on the criminal law's theory of consequential responsibility would require that a law firm could have foreseen that the giving of the legal opinion would lead to a *real or substantial risk* of both: the commission of an act by the client (the accounting treatment and oral and written statements connected to the treatment); *and* that the act would not comply with the US accounting regulations and securities laws.

The difficulties of predicting a client's subsequent actions and the difficulties of determining whether a client's actions would or would not be unlawful may be significant, but they should not be overstated. A recognition that a lawyer will rarely definitely 'know' the client's intentions without any uncertainty does not mean that they will not sometimes have a strong basis for predicting their client's probable actions. Just as a good lawyer claims to be able to predict how third parties (regulators and opponents) are likely to act, so too can they reasonably be expected to predict (up to a point) how their client is likely to act.

The Repo 105 legal opinion itself suggests that Linklaters was aware that the opinion was being given to facilitate an accounting treatment. The opinion provided that whilst only Lehman could rely on the opinion it could also be shown to Lehman's auditors 'for the purpose of preparing the firm's balance sheets'.¹³¹ This alone clearly does not give rise to an inference that Linklaters were aware of how Lehman would use the Repo 105s and of the possible illegality of the sale accounting treatment under US GAAP. Nevertheless, it would be clear to a sophisticated professional adviser that a true sale opinion on a repo which needed to be shown to an auditor could well be required to obtain an accounting treatment resulting in the removal from the balance sheet of the assets subject to the repo.

One could argue that although a law firm giving the opinion was aware that the opinion would result in sale accounting and the removal of the sold assets from the balance sheet, it does not follow that it was aware, or could foresee, that the Repo 105s would be used in such a way as to render that sale accounting illegitimate. Furthermore, one could argue, that the law firm could not have foreseen that the cash from the repo would be used to pay down existing liabilities prior to the accounting record date, thereby exacerbating the illusion of decreased leverage. In relation to this latter point, note that whether or not Lehman paid down liabilities with the Repo funds does not alter the fact that using sale accounting instead of secured loan accounting alters reported leverage¹³² and, for the reasons set forth above, renders such accounting non-GAAP

131 Linklaters Legal Opinion, 31 May 2006, para 6.

132 As demonstrated above, the paying down of those liabilities increased the leverage effect as compared to simply rolling over a secured loan repo into a sale accounting repo; however, even if liabilities are not paid down sale accounting reduces (the perception of) leverage.

compliant in the absence of clear disclosures about the use of such an accounting approach and the effects of such an accounting approach on the balance sheet.

The important point would be whether the lawyer giving the true sale opinion perceived, or ought to have perceived, that providing the opinion was likely to give rise to a real risk of accounting or securities breaches. Or, to echo Lord Nicholl's words set forth above in relation to dishonest assistance, if they were not so aware, had they deliberately closed their eyes and ears to this risk. Given the salient twenty first century context of off-balance sheet accounting fraud,¹³³ it is strongly arguable that Lehman's request for a legal opinion *should* have raised concerns about how the opinion and the resulting sale accounting was to be deployed. As banks in the UK cannot,¹³⁴ and US banks do not,¹³⁵ book repos as sales, such a request of a large law firm would be very unusual. Borrowing from the criminal law's aiding and abetting toolkit, knowledge that, unusually, a bank requires a sale opinion on repos that can be shown to its auditors and, therefore, that it may attempt to book repos as sales would put a corporate law firm on notice of: a 'real or substantial' risk that the resulting accounting might be used to mislead investors; and a real or substantial risk that any misleading accounting would beget further securities laws violations.

Being put on initial notice of such risk does not necessarily mean that the opinion should not have been given. Such notice should have resulted in further robust inquiry: what was the purpose and effect of the sale accounting; how was the accounting treatment to be used; and, what was the auditor's view of the precise way in which it was going to be used by Lehman and of the legality of that treatment pursuant to applicable accounting regulation. Consultation with the client's auditors in such circumstances would be necessary to obtain clarification on the accounting treatment and the probability of it being deemed to be non-compliant. Reasonable reliance on the auditor's responses to these questions relieves the law firm of attempting to make its own assessment of the legality of actions under foreign and non-legal regulatory regimes.¹³⁶

If inquiries were made, it is important to acknowledge that the answers given by Lehman's management and its auditors may have been satisfactory and have provided a solid basis upon which a law firm would feel comfortable that illegality was not likely to result. The Bankruptcy Examiner did not find any plausible business purpose for the Repo 105s – a factor of some importance in the determination of GAAP compliance – but that does not mean that in response to questioning from their lawyers such plausible business purposes were not given by Lehman. We do not know if such reasons were sought and given, but could imagine them: for example, to ensure compliance with debt covenants in major debt contracts where those covenants did not exclude a (fully disclosed) change in accounting policy by the debtor. Ordinarily, when questions are asked and answers

133 Most recently in relation to the collapse of Enron, but also, and still within UK corporate consciousness, the collapse of Polly Peck.

134 See IAS 39 *Financial Instruments: Recognition and Measurement*.

135 Examiner's Report, 738 noting that Lehman themselves did not think that any other US investment banks used sale accounting for repos.

136 This would be consistent with the ABA Committee on Legal Opinions' Guidelines on preparing Closing Opinions n 69, III.A. See further below on auditor reliance generally,

given in such circumstances law firms are not required to second guess their client's or their advisors' answers. But equally such answers must be plausible. Such questions and answers cannot be perfunctory – readily enabling the avoidance of lawyer's consequential responsibility. Such questions and answers in a regime of consequential responsibility would also be subject to regulatory scrutiny.¹³⁷

Finally one could argue that in the context of accounting regulation, lawyers are entitled to rely on the bank's auditors doing their job without having to inquire directly about the accounting consequences of giving the true sale opinion. That is, Linklaters in this case were entitled to assume, *without further inquiry*, that the auditors would not sign off on non-GAAP compliant accounting. There are two weaknesses with this argument. First, whilst auditors are indeed the gatekeepers of the financial statements, a law firm giving the opinion could not assume that Lehman's auditors were aware of or approved of these transactions. Auditors do not audit every transaction but rather do so on a test basis only.¹³⁸ Audit processes are designed to identify material and unusual transactions; but they will not, and cannot be expected to, identify all material and unusual but undisclosed transactions. One might have expected Lehman to have disclosed the Repo 105s to its auditors¹³⁹ and to have consulted with them about the proposed treatment. However, as the history of accounting fraud can testify, such an expectation of disclosure is no guarantee that it will take place. In this regard, for Lehman's management the opinion and the ability to show it to the auditors could, in theory, have functioned merely as a back-up in case the auditor's tests spotted the (undisclosed) Repo 105s or in case of future discovery and litigation.

The second reason why the auditor's role does not absolve lawyers of responsibility for robust questioning in such a context is that the active engagement of one gatekeeper can facilitate the effective operation of another. Questions for the auditor from the law firm giving the opinion guarantees auditor awareness of the transaction and, arguably, facilitates auditor independence by interposing third party questioning of the auditor regarding the planned accounting treatment. Such questioning creates a non-privileged pre-transaction record of the auditor's views thereby reducing the probability that the auditor will acquiesce to an aggressive accounting treatment.¹⁴⁰

There is a third reason. Lawyers are well aware that clients and third parties sometimes take greater comfort than they ought to from a legal opinion. The self-serving bias of clients (or third parties such as auditors) may result in the taking of greater comfort from the opinion than is merited. Clients and third

137 Legal professional privilege does not prevent the disclosure of information under Solicitors Regulatory Authority investigations or Solicitors' Disciplinary Tribunal proceedings (Solicitors Act 1974, s 44B).

138 See, for example, *ISA 200: Objective and General Principles Governing an Audit of Financial Statements* (Auditing Practices Board, 2005); *ISA 530: Audit Sampling and Other Means of Testing* (Auditing Practices Board).

139 The Examiner's Report reveals uncertainty and disagreement about the extent to which Lehman's auditors knew about and signed off on the Repo 105's. Ernst & Young claim, for instance that their 'review applied only to the accounting basis for these transactions, not to their volume or purpose' (at 953).

140 Generally on acquiescent auditing see D. Kershaw, 'Waiting for Enron: The Unstable Equilibrium of Auditor Independence Regulation' (2006) 33 JLS 388.

parties may also simply fail to understand the limited nature of an opinion. As Arnott has observed, this is true even with sophisticated clients in the context of structured finance.¹⁴¹

Accordingly, although the Repo 105 generates significant, multi-jurisdictional complexities of law and accounting regulation, there is an arguable case that at the time the repo opinion was issued it could and should have been foreseen that issuing the opinion would create a real or substantial risk of violations of financial and securities regulation.¹⁴² In the Repo 105 example such concerns may well have been addressed and alleviated through robust questions and compelling answers, but the limited public record is silent in this regard. What this case study clearly shows us, however, is that corporate and financial law and regulation, operating in a multi-jurisdictional context, is not too complicated for a theory of consequential responsibility regulation to handle.

Does Consequential Responsibility Undermine the Lawyer's Role as Trusted Advisor?

Governance under the rule of law requires that we can understand the rules that apply to us. Without the technical skills possessed by lawyers many would struggle to do so. Lawyers are necessary to enable us to understand the rules promulgated by the State that structure our activities.¹⁴³ If this 'rule of law' function would be undermined by the application of regulation imposing consequential responsibility on lawyers then the case for it would be much weaker.

From the demand side (client's perspective), such regulation would not discourage clients from seeking advice as confidentiality and privilege would be unaffected. It should be noted that clients have the benefit of privilege to encourage the seeking of and giving of accurate legal advice.¹⁴⁴ This privilege is given in the belief that confidential advice will encourage greater adherence to law.¹⁴⁵ It is noteworthy for our purposes that the protection it provides has limits. If advice or assistance is given where there is prima facie evidence that it has been used to further a criminal purpose, fraud or 'wrongful act'¹⁴⁶ then legal professional privilege does not apply (the 'crime-fraud exception').¹⁴⁷ This is true even where the lawyer is unaware that their advice is to be used to further a wrong.¹⁴⁸

Although privilege protects the demand side of receiving advice, a blanket application of consequential responsibility to all lawyer activities could affect the

141 See D. Arnott, 'Report On The International Bar Association Symposium On Legal Risk' (2004) 4 JIBFL 1 where concerns about the way in which opinions were delivered and received feature significantly.

142 As we observe below: the question of the foreseeability of Lehman's allegedly illegal actions is distinct from the question of whether Linklaters' actions are consistent with their current professional obligations and understandings of practice, which, as we consider below, they may be.

143 Pepper, n 108 above.

144 See, for example, H. L. Ho, 'Legal Professional Privilege and the Integrity of Legal Representation' (2006) 9 *Legal Ethics* 163. The leading authority is *R v Derby Magistrates' Court, ex parte B* [1996] AC 487.

145 The justifications for privilege are more hotly contested in the academic literature, eg: Ho, *ibid*; A. Higgins, 'Legal Advice Privilege and its Relevance to Corporations' (2010) 73 MLR 371.

146 Halsbury's Laws of England, Ch 14 para 569.

147 See, for example, *R v Cox & Railton* (1884) 14 QBD 153.

148 *Banque Keyser Ullman v Skandia* [1986] 1 Lloyds Rep 336.

supply-side of lawyering and undermine the 'rule of law' function if lawyers become hesitant to give advice for fear of breaching applicable professional regulation. This concern is alleviated, however, if a theory of consequential responsibility does not apply to all lawyering activities. Here a distinction should be made between the pro-active and reactive activities of the lawyer. The theory of consequential responsibility underpinning criminal accessory liability requires an act which helps or assists with the commission of wrongdoing. The act of simply informing a person of their legal position does not help or assist wrongdoing even though the advice may be taken into account by the client in deciding to commit a wrong. Reactive advice does not facilitate or enable the client's act but simply informs them of the law's understanding of the proposed act as described by the client.

A lawyer who informs his client that if he drives, without extenuating circumstances, at 100mph in a 30mph zone he will, if caught, be prosecuted for dangerous driving, but that if he drives a 50mph he will in all likelihood get a speeding fine, does not assist the driver who is caught at 50mph in committing a speeding offence. Clearly advice might conceivably lead to wrongdoing as a result of the informed calculation of the actor – indeed the increased probability of wrongdoing for the actor who discovers that the sanctions are not as grave or as likely as he had imagined – but such information does not assist in the commission of the act.

Advice that informs a client is conceptually distinct from information that assists in the commission of an act, such as, for example, information about when the security guard takes his break. Such information assists in the 'successful' performance of the criminal act. By way of contrast legal advice about contemplated action does not assist in the performance of the act but only affects the client's probabilistic assessment of whether it is worthwhile engaging in the act. Whilst we may have qualms about advice which increases the probability of wrongful acts, it is distinct from active assistance not only conceptually but also from a moral and policy perspective: the moral agency involved in active assistance is greater whereas the rule of law motivations for permitting advice are stronger.

We accept that there is the potential for some argument about the precise boundary between reactive advice and active assistance, but the granting of the Repo 105 legal opinion is a clear example of active assistance. Advice about whether a Repo 105 amounted to a true sale is distinct from the giving of a formal legal opinion that it is a true sale. The opinion placed legal advice about the effects of a repo in a formal legal document that was a regulatory precondition to implementing the accounting treatment and that it was agreed could be shown to the auditors. The Repo 105 and the Repo 105 accounting could not have taken place without such a formal law firm opinion. It thus actively facilitated the transaction in question.

Would Consequential Responsibility Undermine Beneficial Creativity?

Would the imposition of consequential responsibility on lawyers for their client's unlawful actions chill beneficial legal creativity? Lawyers might withdraw from many positive creative activities fearing an *ex-post* finding of illegality.

One response to this concern might be that the benefits of legal creativity are outweighed by the risks of facilitating unlawful client activity. It may be that the price of excluding more detrimental creativity is the inhibition of some beneficial creativity and that that price is worth paying. Such a general claim is, however, difficult to test empirically and we do not rest our argument on that assumption.

Several more concrete considerations suggest that a regime of consequential responsibility would impose only a limited, and unproblematic, break on active and creative lawyering. First, much creative lawyering does not involve *any* risk of illegality or wrong doing. For example, a structure that attempts to obtain the benefits of fixed charges for clients does not raise any issue of wrongdoing if the structure is subsequently judicially recharacterised as a floating charge.¹⁴⁹ Whilst such a recharacterisation alters the client-lender's secured position and risk profile, there is no possible illegality resulting from the 'fixed charge' structure that could dampen legal creativity. This is also the case with much tax structuring. Tax structuring that falls clearly within the zone of tax avoidance, not evasion,¹⁵⁰ does not result in any illegality if the structure is subsequently found to be unsuccessful. It merely results in the imposition of the taxes that it was designed to avoid.¹⁵¹

Secondly, a regime of consequential responsibility is designed to address only assistance which enables activity that with a relatively high degree of probability will be unlawful. The contemporary criminal law articulation of this idea is set forth in the notion of a 'real or substantial risk', suggesting a probability significantly above 50 per cent. If one was to apply the criminal law's understanding of assistance probability to a professional consequential responsibility regime then any client activity that had a less-than-50 per cent chance of being deemed illegal would be a substantial distance from the point at which the regime would bite. However, we need to be cognisant here of the effects of hindsight bias on the behaviour of a regulated constituency. Actors who are aware that regulators will judge them with the benefit of hindsight will act in a risk averse fashion if the obligations imposed upon them are too demanding.¹⁵² Where a client's actions are found to be illegal, this knowledge of the illegality at the time of the *ex-post* assessment of the lawyer's actions will result in the regulator distorting (by overweighting) the probability of the client's actions being unlawful at the time the assistance was given – as compared to the actual probability at that time.¹⁵³ Lawyers fearful of this effect may refuse to act even where the probability of legality is significantly above 50 per cent.

If hindsight bias results in lawyers acting in an excessively risk averse fashion with regard to active client assistance then levels of creative lawyering may be

149 See generally *In re Spectrum Plus Ltd (in liquidation)* [2005] UKHL 41.

150 On tax evasion see *Commissioner of Inland Revenue v Challenge Corporation Ltd* [1986] STC 548; and Section 106A Taxes Management Act 1970.

151 See, for example, *Commissioner of Inland Revenue v Challenge Corporation Ltd* *ibid*; *W.T. Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300.

152 On the effect of hindsight bias in the corporate context see D. Kershaw, *Company Law in Context: Text and Materials* (Oxford: OUP, 2009) 313–314.

153 See generally D. Kahneman et al, *Judgment under Uncertainty: Heuristics and Biases* (Cambridge: Cambridge UP, 1982).

sub-optimal. Three considerations alleviate this concern. First, from a regulatory perspective, some risk aversion may not be a bad thing, lowering a lawyer's 'aggression threshold' and resulting in less client illegality. Secondly, a key consideration in thinking about the effects of hindsight bias is the financial remuneration of the decision-maker. A decision maker whose remuneration is moderate may be very wary of the effects of hindsight bias if such bias could result in liability far in excess of his limited return for performing the decision-making role. The fact that the lawyer receives direct, and often significant, remuneration for the provision of active lawyering counteracts the risk-aversion effect of hindsight bias. Furthermore, lawyers are capable of building the risk of violation (of the consequential responsibility regime) into the client fee structure¹⁵⁴ – that is, they may require better payment terms for more aggressive lawyering. This would increase the marginal cost for the client of such activities and again, at the margin, reduce the amount of illegal activity. Thirdly, in applying a regime of consequential responsibility regulators are capable of taking into account both the probability of illegality and the consequences of illegality in deciding whether to take informal or formal enforcement action. Where the effects of client illegality are not significant one would not expect a consequential responsibility regime to bite.

REGULATING CONSEQUENTIAL RESPONSIBILITY

Consequential responsibility in the current regulatory regime

The regulation of the UK's legal profession is in a state of transition. The Solicitors Regulatory Authority (SRA) has adopted the de-rigueur regulatory technique of outcomes focused/principles based regulation. However, to the extent to which there are 'public interest' considerations set forth in the regulations, there is no difference between the old and the new regulations under the Solicitors Code of Conduct 2007 or the SRA Handbook 2011. Both deploy high level principles with limited guidance as to application. They provide a set of Core Duties/Principles which, in addition to acting with competence,¹⁵⁵ independence,¹⁵⁶ integrity¹⁵⁷ and in the best interests of the client,¹⁵⁸ require lawyers to 'uphold the rule of law and the proper administration of justice'¹⁵⁹ as well as requiring that lawyers not to do anything that diminishes the public's trust in the profession.¹⁶⁰

The broad reference to 'upholding the rule of law' provides, in theory, a basis for insisting that lawyers take account of their professional 'fidelity to the rule of

154 We recognise that an explicit acknowledgment of this in the fee arrangements would amount to an acknowledgment of violation of a consequential responsibility regime. Clearly, however, (thinking about regulation through the lens of Holmes' 'bad man') fee arrangements could be arranged to render such a 'risk premium' opaque – for example, fixed fee instead of an hourly rate.

155 Solicitors Code of Conduct Rule 1.05 'A good standard of service'.

156 Solicitors Code of Conduct Rule 1.03; SRA Handbook, Principle 3.

157 *ibid* 1.02; SRA Handbook, Principle 2.

158 *ibid* 1.04; SRA Handbook, Principle 4.

159 *ibid* 1.01; SRA Handbook, Principle 1.

160 *ibid* 1.06; SRA Handbook Principle 6.

law' when advising and acting; and take responsibility for the foreseeably unlawful (or probably unlawful) consequences of their proactive actions. Similarly, the requirement that lawyers do not to do anything that undermines public trust provides theoretical scope to impose consequential responsibility on lawyers. Clearly where the lawyer's actions facilitate unlawful or probably unlawful activity such confidence may be undermined.

Importantly, SRA guidance on these Principles elevates these public regarding considerations above any other Principles (including the duty to act in the best interests of the client) should the Principles come into conflict.¹⁶¹ Where two or more Principles come into conflict, the Principle which takes precedence is the one which best serves the public interest in the particular circumstances, especially the public interest in the proper administration of justice.

Note that this guidance clarifies that, although the Principles themselves do not refer to the 'public interest', the required regard to 'upholding the rule of law' and 'maintenance of the public trust in the profession' is part of the lawyer's broader duty to act in the public interest. The guidance to the duty in the Solicitors Code of Conduct observes also in this regard that 'upholding the rule of law is part of the lawyer's obligation to serve society.'¹⁶²

The above guidance shows that public interest considerations for lawyers are broader in scope than simply the administration of justice. Yet the guidance clearly emphasises the importance of the public interest in the administration of justice, suggesting a bias towards court process and outcomes. Further guidance in the regulations on the rule of law principle focuses on lawyers' obligations to the courts and on not taking advantage of third parties¹⁶³ – where, for example, they are unrepresented or lack legal knowledge.¹⁶⁴ The 'public interest', 'upholding the rule of law' and 'the public's trust in the profession' are not given any transactional context in these regulations. They are concepts and principles fashioned through the problems faced and generated by the profession in the context of the representation of individual clients and their opponents – which often involve court proceedings. The image of the corporate transaction lawyer, let alone any notion of their public interest role, is missing from the SRA's regulatory picture.¹⁶⁵

The interpretation of these principles in the transactional context is, therefore, left completely up to the lawyer. The regulations provide no contextually relevant guidance on the application of very broad standards. Accordingly, for the transaction lawyer, these rules represent a somewhat extreme example of a principles-based regulatory approach, a central characteristic of which involves the delegation of regulatory power to the regulated.¹⁶⁶ Under such a delegation it

161 SRA Handbook Notes to Principles para 2. Solicitors Code of Conduct, Guidance to Rule 1 para 3.

162 Solicitors Code of Conduct 2007, Guidance to Rule 1, para 1. Also observing that 'a modern just society need a legal profession which adopts high stands of integrity and professionalism.' Note that this guidance is not present in the new Solicitors Handbook.

163 SRA Principles, Note 5.

164 SRA Handbook, Chapter 11, Indicative Behaviour 11.4 and 11.7.

165 See Loughrey, n 2 above, making a similar point.

166 On principles-based regulation see J. Black, 'Forms and Paradoxes of Principles Based Regulation' (2008) LSE Working Papers 13/2008.

would be open to Linklaters in the Lehman case study to argue that the public interest is best served by them simply providing their clients with an opinion as instructed and leaving the regulatory concerns to be dealt with by the US accounting system: the rule of law was upheld as the client is informed about the state of English law; the trust in the profession was maintained as the public expects lawyers to serve the interests of their clients.

The economics of having regard to the public interest

The old Solicitors Code of Conduct and the new SRA Handbook delegate to the transaction lawyer the task of mediating the public interest with the role of zealous advocate of the client's interest. But how likely is it that the public interest will get its due regard? In theory, the notion of the lawyer as a professional could operate as a regulatory constraint ensuring that the lawyer does not ignore the public interest concerns arising from the probable and foreseeable consequences of their client's actions. A 'profession', with a shared regulatory responsibility and reputational capital, is seen as a means of generating a micro-culture that, instilled into its members, increases the probability that members of the profession will give effective regard to public interest concerns when they act. While recent high profile events in the UK and abroad give good cause to doubt that this is the case, currently there is no empirical basis upon which one could draw a firm conclusion as to the state of professional culture in UK legal practice.¹⁶⁷

In the absence of an effective professional culture, the extent of a lawyer's regard for public interest concerns in a transactional context will in significant part be a function of the costs and benefits of taking real account of such concerns.¹⁶⁸ Assuming that the economic incentives of firms are identical to those of the partners and fee earners,¹⁶⁹ a rational choice lens suggests that zeal will crowd-out any concern for the public consequences of the client's actions which are assisted by the lawyer's actions. At the firm level, the benefits of providing legal assistance which aids the commission of unlawful activity or possibly unlawful activity is likely to significantly exceed any costs. The direct benefits for the law firm include the payments for the service and the future cash flows generated from the client relationship. Indeed, drawing on the Repo 105 example, the relationship with Lehman continued to be of considerable financial benefit to Linklaters, even following Lehman's demise.¹⁷⁰

167 See C. Parker, R. Rosen and V. L. Nielsen, 'The Two Faces of Lawyers: Professional Ethics and Business Compliance With Regulation' (2009) 22 *Georgetown Journal of Legal Ethics* 201.

168 Coffee, n 79 above.

169 cf P.A. Grout, *The Clementi Report: Potential Risks of External Ownership and Regulatory Responses: A Report to the Department of Constitutional Affairs* (CMPO Working Paper Series No 05/135, 2005) at <http://www.bris.ac.uk/compo/publications/papers/2005/wp135.pdf> (last visited 8 August 2011).

170 As of October 2009 alone legal fees paid by PwC, the UK administrators, amounted to £60.2 million, of which Linklaters are said to have received 'the lions share'. See 'Linklaters Cleared the Lehman Brothers Deals After US firms said "No"' *Evening Standard* 12 March 2010; 'Lehman's legal advice costs £60 million in the first year' *The Lawyer* 20 October 2009. It is estimated that there was a '100 strong' team of Linklaters lawyers advising the administrators.

In contrast to the benefits generated by the zealous pursuit of the client's interests, the costs for law firms for failing to give due regard to the consequences of their assistance are less significant. As outlined in the previous section, the absence of guidance on the core Principles which are relevant to a transaction context, and the resulting interpretative discretion given to law firms, renders enforcement action by the SRA conceivable but unlikely. Furthermore, although the SRA Handbook states that upholding the rule of law should take priority over the client's interests where there is a conflict, the same Handbook observes that in relation to enforcement their 'primary aim is to achieve the right outcomes for clients'. As the Repo 105 case study shows, right outcomes for clients may not always be the right outcomes for the public interest and the rule of law. The costs for the SRA of proceeding against a firm with the resources and insurance cover of major corporate law firms would also present a significant impediment. But even if an inquiry is undertaken and enforcement action is brought, it would be a brave and well-resourced regulator that imposed sanctions equivalent to the financial gains – assessed in both fee and relationship terms – of, for example, the Repo 105 legal opinion.¹⁷¹

With regard to civil secondary liability for the law firm, mere assistance will not trigger any secondary liability in the absence of inducement, procurement or 'knowing assistance' in the breach of trust or fiduciary duty. There is of course a risk of liability for incompetent service if it is negligently provided but this is a risk that applies to all legal activities and, therefore, is not a distinctive consideration in this context. And, as our case study illustrates, here we are interested in the costs and benefits of zealous and competently provided lawyering that facilitates unlawful activity. The likelihood of costs for the law firm arising from civil liability is, therefore, low.

One might argue that firms suffer reputational damage as a result of association with the enabled unlawful activity, particular when – as in the Repo 105 example – the failure of the client company is spectacular and has systemic implications. However, it is far from clear that there is any reputational damage that could act as an effective deterrent. For example, assuming that the Repo 105 accounting was unlawful and found to be unlawful in the on-going litigation against Lehman's auditor, Ernst & Young,¹⁷² one might expect there to be some damage to Linklaters's image and reputation as a result of negative press coverage and public disapproval of anyone involved with the accounting treatment. However, it is equally clear that with existing and potential clients there may a reputational benefit for Linklaters. Corporate clients and their managers want lawyers who are responsive to their needs. The Repo 105 opinion has attracted public, media and moral critique,¹⁷³ but, through the eyes of clients, even if this critique is correct,¹⁷⁴

171 As things stand the SRA cannot impose a significant fine, but they can prosecute before the Solicitors Disciplinary Tribunal, which could impose a significant fine,

172 'Cuomo sues Ernst & Young over Lehman Brothers' *New York Times* 21 December 2010. On reputational sanctions see generally: See J. Armour et al., *Regulatory Sanctions and Reputational Damage in Financial Markets* (Oxford Legal Studies Research Paper No. 62/2010, 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1678028.

173 'Lehman Brothers: Repo 105s and Other Accounting Tricks' *The Guardian* 12 March 2010.

174 In relation to which, as the case study analysis highlights, no reliable conclusion can be reached on the limited public record, upon which such critiques rely.

Linklaters did exactly what the client (management) asked them to do. Indeed, other lawyers, in response to the public critique of Linklaters, have said (arguably for their clients who are listening) that they too would have done the same.¹⁷⁵

Finally, one needs to factor into this cost-benefit analysis the pressures generated by opinion shopping clients.¹⁷⁶ In relation to an aggressive client the lawyer will be aware that even if he incurs the costs (to him) of saying 'no' to this client, the probability that the client's actions will change as a result of this refusal approaches zero because (in the absence of consequential responsibility regulation) the probability is reasonably high that another lawyer, less constrained by a professional commitment to the rule of law, will do the maths and provide the active lawyering requested. In such circumstances, the professional commitments of upstanding lawyers to upholding the rule of law are easily, and understandably, diminished.

Accordingly, in the absence of stronger regulation (and its enforcement) of consequential responsibility, the economics of lawyering mean that public interest concerns generated by transaction lawyering are unlikely to receive much of a hearing within an economically rational law firm. In the absence of any significant costs for ignoring public interest concerns, the economic alignment of lawyer and client interest makes unlawful activity arguably more not less likely; particularly where lawyers can through their involvement shield the clients from legal responsibility for that activity.¹⁷⁷ In the absence of an effective constraint resulting from professional identity and culture, lawyers may become not a means of upholding the rule of law but a means of undermining it where they can facilitate wrongdoing but deny responsibility for it.

CONCLUSION: TOWARDS EFFECTIVE REGULATION OF CONSEQUENTIAL RESPONSIBILITY

Society trusts lawyers not to abuse the asymmetries of power and knowledge that their role entails. They should not act in ways that undermine rather than uphold the rule of law. Attention to the economics of transactional lawyering shows us that the role of transactional lawyers in upholding the rule of law cannot be left to trust or to broad based principles such as those set forth in the current professional conduct rules which contain no transactional context or guidelines. In the presence of a regulated constituency with conflicting responsibilities but strong incentives to prioritise one set of interests, the discretion of the regulated constituency has to be more strongly directed by regulation. In such an environment, the benefits of more specific rules outweigh the loss of flexibility which broad principles bring.

More specific rules and guidance on a lawyer's consequential responsibility would clarify the limits of proactive lawyering. Whilst in the absence of effective enforcement by the SRA such rules would be as ineffective as the current broad

175 G. Hollander, 'Lehman exploited Linklaters opinion to tidy up balance sheet' *The Lawyer* 12 March 2010, reporting that 'David Barwise, a City based structured finance partner at White & Case, said that he believed Linklaters "acted as any UK firm would have".'

176 On opinion-shopping, see text to notes 120–121 above.

177 Coffee, n 79 above, 63–65.

principles, they would provide a clearer benchmark according to which lawyers can internalise what is expected of them and around which the SRA can build an enforcement policy that provides some counterweight to the economics of zeal. Even where an enforcement policy is unlikely to outweigh the economic benefits of zeal, it would assure the public that the regulator deems it appropriate to hold lawyers to their rule of law obligations.

Whilst some objections can be marshalled against the imposition and enforcement of such a rule, closer attention to those objections shows that they are far from compelling. Complex events and regulatory structures such as Lehman's Repo 105 accounting can be untangled to reach judgments about the importance and foreseeable effects of lawyers' actions; and neither the legal creativity that facilitates lawful client actions nor the role of a lawyer as trusted advisor would be undermined by the application of a consequential responsibility rule. The rule would simply require corporate lawyers to take responsibility for the foreseeable and probable consequences of their active lawyering where such consequences are unlawful. If their own claims of competence are to be believed, lawyers are better placed than most to make an assessment of potential illegality and probable behaviour, particularly where they themselves are central to the transaction structuring process. After all, it is this knowledge that they sell to clients every day: 'we know the law and we know how opponents and regulators are likely to act'.

In our view the SRA should amend the SRA Handbook to include a provision requiring lawyers not to assist a client where that assistance creates a foreseeable likelihood of wrongdoing by that client. Wrongfulness would be defined by reference to any breach of criminal law, civil law or regulation. The standard of awareness of probable client actions would also be key to the effectiveness of such a provision. A good starting point is provided by the standard used by the criminal law. This would require that the lawyer knew that his actions created a *real or substantial* risk of unlawful client action in the UK or in other jurisdictions where the act takes place. Care must be taken to ensure that such a standard does not interfere with the core rule of law function of lawyers: to enable clients to understand the rules that apply to them. Such a prohibition, therefore, would not apply to mere legal advice given by the lawyer about the legality of actions proposed by the client. The standard would however apply to any attempt by the lawyer to assist in the design of the client's proposed behaviour. We would also expect the regulator to take account of the consequences of breach in determining whether informal or formal enforcement action should be taken. Given the risks and costs involved it might be expected that regulators would only take enforcement action in cases of substantial detriment to clients, third parties or the public interest.¹⁷⁸

Our main point however is not to set forth a definitive regulatory response but to demonstrate the need for one and to highlight the considerations that should structure that response. Without such a response the practice of law risks disengagement from the lawyer's duty to uphold rule of law and, ultimately, jeopardises the rationale for seeing the practice of law as a profession.

178 A similar balancing exercise is already contemplated by the SRA Disciplinary Procedure Rules 2010.