

8-19-2004

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W. Bradley Wendel

Cornell Law School, bradley-wendel@postoffice.law.cornell.edu

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Recommended Citation

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The Jurisprudence of Enron: Professionalism as Interpretation

W. Bradley Wendel^{*}

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^{*} Associate Professor of Law, Cornell Law School. Thanks to Greg Cooper, Sarah Cravens, Tim Dare, Bob Gordon, Doug Kysar, Dennis Tuchler, Richard Tur, and Rob Vischer for their perceptive and helpful comments. I am additionally grateful to conference and workshop organizers and participants for their feedback, specifically: Lonny Hoffman and the students in the University of Houston Law Center's legal scholarship colloquium for their excellent responsive papers; First International Conference on Lawyers' Ethics at the University of Exeter (U.K.) organizers Kim Economides and Julian Webb; and Kathleen Clark and Nancy Staudt for inviting my presentation at a Washington University School of Law faculty colloquium.

I. Introduction and Overview of the Argument.

After any significant corporate scandal, expect lawyers to be blamed. In the case of the collapse of Enron, there is plenty of blame to go around.¹ The board of directors failed to exercise effective oversight; some corporate officers engaged in blatant self-dealing while others overlooked obvious conflicts of interest; investors and corporate officers unduly emphasized short-term earnings at the expense of the long-term viability of businesses, partially because of the importance of equity-based compensation for senior management; in-house and retained accountants blessed the dubious accounting treatment of multiple transactions; in addition to engaging in

¹ For journalistic accounts of the Enron fiasco and the various explanations for it, see BETHANY MCLEAN & PETER ELKIND, *THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON* (2003); LOREN FOX, *ENRON: THE RISE AND FALL* (2003); MIMI SWARTZ & SHERRON WATKINS, *POWER FAILURE: THE INSIDE STORY OF THE COLLAPSE OF ENRON* (2003). For reports of official investigations, see the First, Second, and Third Interim Reports and the [Fourth and] Final Report of Neal Batson, Court-Appointed Examiner (dated Sept. 21, 2002; Jan. 21, 2003, June 30, 2003, and Nov. 4, 2003, respectively) [hereinafter “First, Second, Third, and Fourth Batson Report,” respectively]; Report of the Special Investigative Committee of the Board of Directors of Enron Corp. (Feb. 1, 2002) [hereinafter “Powers Report”]; Report of the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, U.S. Senate, *The Role of the Board of Directors in Enron’s Collapse*, 107th Cong., Report 107-70 (July 8, 2002) [hereinafter “Senate Investigations Subcommittee Report”]. All of these documents are available on-line, from various sources including the FindLaw library of Enron-related documents, <<http://news.findlaw.com/legalnews/lit/enron/#documents>> (visited 12/9/03), the e-Law repository of documents from U.S. bankruptcy court, <<http://bank.elaw.com>> (visited 12/9/03), or from Enron’s own website, <<http://www.enron.com/corp/por/supporting.html>> (visited 12/9/03). For scholarly analysis, see John C. Coffee, Jr., *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 CORNELL L. REV. 269 (2004) [hereinafter, “Coffee, *What Caused Enron*”]; E. Norman Veasey, *Corporate Governance and Ethics in a Post-Enron/Worldcom Environment*, 72 U. CIN. L. REV. 731 (2004); Symposium, *Crisis in Confidence: Corporate Governance and Professional Ethics Post-Enron*, 35 CONN. L. REV. 915 (2003); Symposium, *On Enron, Worldcom, and Their Aftermath*, 27 VT. L. REV. 817 (2003); Symposium, *Lessons from Enron: How Did Corporate and Securities Law Fail?*, 48 VILL. L. REV. 989 (2003); Symposium, *Lessons from Enron: A Symposium on Corporate Governance*, 54 MERCER L. REV. 663 (2003); Douglas G. Baird & Robert K. Rasmussen, *Four (or Five) Easy Lessons from Enron*, 55 VAND. L. REV. 1787 (2002); Symposium, *Enron: Lessons and Implications*, 8 STAN. J. L. BUS. & FIN. 1 (2002); William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275 (2002) [hereinafter, “Bratton, *Dark Side*”]; Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233 (2002); Steven L. Schwarcz, *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, 70 U. CIN. L. REV. 1309 (2002) [hereinafter, “Schwarcz, *Use and Abuse*”].

outright malfeasance, the company made some lousy business decisions, such as investing in broadband capacity when there was already an oversupply; many Wall Street analysts were too busy trying to drum up business for their investment banker employers to exercise objective judgment; Enron's auditor's independence was compromised by the massive fees it earned from the client, and from cross-selling consulting services; and investors were so besotted with "new economy" hype that they failed to use common sense when investing in companies with no obvious way of making money.² Even with this apparent surfeit of careless or malevolent actors,

² See FOX, *supra* note 1, at 193-95, 241, 269 (analysts acting as cheerleaders because of conflicts); MCLEAN & ELKIND, *supra* note 1, at 317-18, 324 (Andersen's independence compromised); Coffee, *What Caused Enron*, *supra* note 1, at 292 (explaining SEC disclosure requirements for firing auditor vs. firing consulting firm, which further compromised auditor independence); Fox, *supra* note 1, at 241-43 (credulity of investors, illustrated by hedge fund managers who saw red flags in Enron's accounting and sold its stock short); SWARTZ & WATKINS, *supra* note 1, at xi-xiii, 331 (credulity of investors, illustrated by Houston financial advisor who did not recommend Enron stock because he couldn't make sense of its financial statements and Warren Buffet's statement that he never understood how Enron made money); Baird & Rasmussen, *supra* note 1, at 1809 (investors failed to understand that Enron's business model was vulnerable to competition); FOX, *supra* note 1, at 195 (dot-com "bubble" of unjustified optimism by investors); MCLEAN & ELKIND, *supra* note 1, at 231-33, 299 (during the late 1990's bull market analysts and investors were obsessed with short-term earnings targets and prone to hype); Bratton, *Dark Side*, *supra* note 1, at 1283-84 (maximizing shareholder value has come to mean fixation on short-term numbers); Coffee, *What Caused Enron*, *supra* note 1, at 293-95 (noting that gatekeepers' reputational capital is less valuable in a market bubble); Fox, *supra* note 1, at 211-13, 229-30 (Arthur Andersen's acquiescence in SPE transactions); Powers Report, *supra* note 1, at 5, 24-25 (same); FOX, *supra* note 1, at 123-27, 151-56, 160, 228 (self-dealing by Andrew Fastow and Michael Kopper); Powers Report, *supra* note 1, at 7-9, 16, 18, 26 (same); MCLEAN & ELKIND, *supra* note 1, at 196-211 (same); *id.* at 190 (Andersen's skepticism about Enron dealing with private investment funds controlled by Fastow); Fourth Batson Report, *supra* note 1, at 58-59 (Fastow's personal dealing and failure by Lay and Skilling to inquire); FOX, *supra* note 1, at 169, 176 (Kenneth Lay's "hands-off" management style); *but see* Fourth Batson Report, *supra* note 1, at 57-58 (Lay was actively engaged in monitoring); FOX, *supra* note 1, at 158-59, 309 (inattention of board); *but see* Powers Report, *supra* note 1, at 9 (board's approval of LJM transactions was with knowledge of conflicts of interest); Senate Investigations Subcommittee Report, *supra* note 1, at 11-15 (claims of ignorance of board members not borne out by evidence, but board may have been unduly deferential to corporate officers); MCLEAN & ELKIND, *supra* note 1, at 126-27, 227-28 (Enron was obsessed with booking earnings, particularly through mark-to-market accounting, but wasn't particularly concerned about cash flow); FOX, *supra* note 1, at 281-82 (Lay conceding that certain investments had performed poorly and the company had accumulated a great deal of debt); MCLEAN & ELKIND, *supra* note 1, at xxiv (Skilling admitting that the broadband venture, which lost \$1 billion, was a bad idea); *id.* at 225-27 (bad investments and management in trading business); FOX, *supra* note 1, at 307 (investing in bandwidth trading was a terrible idea in light of overcapacity in telecommunications industry); Baird & Rasmussen, *supra* note 1, at 1798-99 (Enron was a "toxic" combination of market-making and venture capital businesses).

however, the legal profession should expect to be called upon to justify the role of lawyers in the transactions that ultimately proved to be Enron's undoing. Lawyers played a substantial role in every one of the transactions that were ultimately restated in October 2001, by advising their client, documenting the deals, and certifying their compliance with various legal requirements. When Enron announced that it was taking hundreds of millions of dollars of charges against earnings, and announced that it was reducing shareholders' equity by over a billion dollars, its trading business collapsed as counterparties refused to deal with the company on credit.³ Lawyers were the but-for cause of these restatements of earnings, and therefore of the subsequent failure of what was once the seventh largest publicly traded company in the United States, because the transactions could not have closed in their original form without the approvals of lawyers.⁴ The pressing question for the legal profession is whether they were additionally the responsible cause, in the sense of bearing moral blameworthiness for approving the transactions that ultimately had to be restated.

³ For the size of the restatements, charges against earnings, and reductions in shareholder equity, see Powers Report, *supra* note 1, at 2-3; Second Batson Report, *supra* note 1, at 6-9. For the unraveling of SPE transactions, see Schwarcz, *Use and Abuse*, *supra* note 1, at 1310-11. For the reluctance of others to trade with Enron and the resulting crisis in cash flow, see FOX, *supra* note 1, at 264, 268; SWARTZ & WATKINS, *supra* note 1, at 328-32; MCLEAN & ELKIND, *supra* note 1, at 236, 378-80; Bratton, *Dark Side*, *supra* note 1, at 1310.

⁴ See Second Batson Report, *supra* note 1, at 5 n.8 (pre-bankruptcy size of Enron); Fourth Batson Report, *supra* note 1, at 114 (attorneys provided essential role in closing transactions).

When the last scandal of this magnitude — the savings and loan crisis of the 1980’s — became widely known, a federal judge famously asked “Where were the lawyers?”⁵ Judge Sporkin’s *cri de coeur* has become a convenient shorthand used by scholars of the legal profession who believe, as I do, that lawyers have failed to take seriously their responsibility as professionals while representing wealthy corporate clients. It may be the case that lawyers have not yet been subjected to the kind of grilling at the hands of Congressional investigators that officers like Lay and Skilling had to endure,⁶ and certainly no law firm has suffered the fate of Enron’s auditor, Arthur Andersen, which was convicted of obstruction of justice for attempting to thwart an SEC investigation.⁷ Nevertheless, it is appropriate to ask the hard questions about the role of lawyers in the most recent wave of corporate scandals. This Article is not a polemic against the rotten state of lawyers’ ethics. It is probably true to some extent that “[p]erverse incentives, not declines in ethics, cause scandals.”⁸ When it comes to the

⁵ Lincoln Sav. & Loan Ass’n v. Wall, 743 F. Supp. 901, 920 (D.D.C. 1990); see also Susan P. Koniak, Testimony, *Where Were the Lawyers? Behind the Curtain Wearing Their Magic Caps*, in *Accountability Issues: Lessons Learned from Enron’s Fall* — Senate Judiciary Committee Hearing (Feb. 6, 2002) (ironically echoing Judge Sporkin’s question).

⁶ Susan P. Koniak, *When the Hurlyburly’s Done: The Bar’s Struggle with the SEC*, 103 COLUM. L. REV. 1236, 1237 (2003) (“the lawyers have, however, largely escaped responsibility for their role in this nation’s latest spate of corporate fraud”).

⁷ See BARBARA LEY TOFFLER & JENNIFER REINGOLD, *FINAL ACCOUNTING: AMBITION, GREED, AND THE FALL OF ARTHUR ANDERSEN* 221-22 (2003); MCLEAN & ELKIND, *supra* note 1, at 406-07.

⁸ Coffee, *What Caused Enron*, *supra* note 1, at 278; see also Donald C. Langevoort, *The Organizational Psychology of Hyper-Competition: Corporate Irresponsibility and the Lessons of Enron*, 70 GEO. WASH. L. REV. 968 (2002) (discussing cognitive psychological research on the production of firm cultures that tend to create a disposition on the part of managers to block out distracting concerns, like ethical issues); Bratton, *Dark Side*, *supra* note 1, at 1329-32 (arguing that the most plausible story of Enron’s fall requires understanding the workplace “tournament” culture, which created a bias toward winning and an inability to perceive reality accurately).

role of lawyers, however, it is impossible to talk about incentives — perverse or otherwise — without having a very clear jurisprudential understanding of how lawyers ought to apply and interpret complex, ambiguous legal norms to their clients’ transactions. In particular, we ought to investigate the responsibility of lawyers, acting in their capacity of representatives of clients, *vis-à-vis* the maintenance of a stable framework of legal norms. Do lawyers have any such responsibility, or may they take a merely instrumental stance toward the law, treating it as something that may be evaded or nullified through careful planning? If the technical requirements of law can be evaded to the client’s benefit and the detriment of others, is there anything in the lawyer’s role that prohibits her from assisting the client?

In this Article, I wish to defend what I call the interpretive attitude of *professionalism*.⁹ In short, professionalism is a stance toward the law which accepts

⁹ A reader may be forgiven for thinking that we need another defense of professionalism like she needs a hole in the head. Certainly the *rhetoric* of professionalism is a cliché in the self-justifying discourse of the legal profession and in academic criticism of the conduct of the bar. Professionalism is a word that has been used by so many different theorists, for so many different purposes, that it is almost devoid of meaning. For example, sociologists and economists in a debunking mode observe the tendency of the organized body of lawyers to erect barriers to entry and consolidate its control over the provision of anything that could conceivably be called legal services, in order to enjoy monopoly rents. *See, e.g.*, ELLIOTT A. KRAUSE, *DEATH OF THE GUILDS: PROFESSIONS, STATES, AND THE ADVANCE OF CAPITALISM, 1930 TO THE PRESENT* (1996); RICHARD A. POSNER, *OVERCOMING LAW* 39-60 (1996); RICHARD L. ABEL, *AMERICAN LAWYERS* 17-30 (1989). Idealistic critics of lawyers contrast professionalism with the profit motive, and castigate greedy lawyers for ruining a formerly honorable pursuit. *See, e.g.*, RUDOLPH J. GERBER, *LAWYERS, COURTS, AND PROFESSIONALISM* 23 (1989) (“Today we have lost the ability to distinguish between a calling and a station in life, to see differences between a profession and a trade. To the extent that law students and lawyers become absorbed in status and gain, law ceases to be a profession . . .”); Tom C. Clark, *Teaching Professional Ethics*, 12 *SAN DIEGO L. REV.* 249, 251 (1975) (“the primacy of service over profit is the criterion which distinguishes a profession from a business”). A more positive notion of professionalism, drawing from the work of sociologists such as Emelie Durkheim and Talcott Parsons as well as from the legal theory of Louis D. Brandeis, emphasizes the lawyer’s independence from the client and imagines the lawyer as a mediator between the client’s and the public’s interests. *See, e.g.*, Robert L. Nelson & David M. Trubek, *Arenas of Professionalism:*

that a lawyer is not *simply* an agent of her client (although the lawyer-client relationship is obviously governed by the law of agency). Rather, in carrying out her client's lawful instructions, a lawyer has an obligation to apply the law to her client's situation with due regard to the substantive meaning of legal norms, not merely their formal expression.¹⁰

In addition, a professional lawyer must respect the achievement represented by law, which is the final settlement of contested issues (both factual and normative) with a view toward enabling coordinated action in a highly complex, pluralistic society. This obligation of respect means that a lawyer must treat legal norms as preclusive of the moral and other reasons that would otherwise justify or require a different action in the circumstances.¹¹ We can call this the negative aspect of the attitude of professionalism, which has a further, positive, aspect. The positive aspect is the demand that a lawyer should take a certain attitude toward the law, manifesting her recognition that the law is worthy of being taken seriously, interpreted in good faith with due regard to its substantive meaning, and not simply seen as an obstacle standing in

The Professional Ideologies of Lawyers in Context, in *LAWYERS' IDEALS/LAWYERS' PRACTICES: TRANSFORMATIONS IN THE AMERICAN LEGAL PROFESSION* 180 (Robert L. Nelson, et al., eds., 1992); Robert W. Gordon & William H. Simon, *The Redemption of Professionalism?*, in *id.* at 215; William H. Simon, *Babbitt v. Brandeis: The Decline of the Professional Ideal*, 37 *STAN. L. REV.* 565 (1985). This latter definition approximates the conception of professionalism that I will defend here.

¹⁰ Compare the principle of dynamic statutory interpretation, which requires an interpreter to construe a text "in light of [its] present social, political, and legal context." William N. Eskridge, *Dynamic Statutory Interpretation*, 135 *U. PA. L. REV.* 1479 (1987) [hereinafter, "Eskridge, *Dynamic*"]. It is also similar to the principle of purposivism, familiar in legal ethics from the work of William Simon and David Wilkins. See David B. Wilkins, *Legal Realism for Lawyers*, 104 *HARV. L. REV.* 468, 505-15 (1990); William H. Simon, *The Ideology of Advocacy*, 1978 *WIS. L. REV.* 29, 62. Differences with these approaches will be apparent in the application of the attitude of professionalism to cases.

¹¹ For a more elaborate defense of this position, see W. Bradley Wendel, *Civil Obedience*, 104 *COLUM. L. REV.* 363 (2004).

the way of the client's goals.¹² Law is an achievement, but not one that will persist without custodians and defenders. It is the job of lawyers to maintain this institution in good working order, instead of subverting it.¹³ As Jeremy Waldron puts it, any attempt to circumvent the law should be accompanied by feelings of distaste and dishonor,¹⁴ not pride for having defeated something that is regarded as an adversary. In addition,

¹² See STEVEN J. BURTON, *JUDGING IN GOOD FAITH* 17, 35-37, and *passim* (1992); Thomas D. Morgan & Robert W. Tuttle, *Legal Representation in a Pluralist Society*, 63 *GEO. WASH. L. REV.* 984 (1995); Robert W. Gordon, *A New Role for Lawyers?: The Corporate Counselor After Enron*, 35 *CONN. L. REV.* 1185, 1200 (2003) [hereinafter, "Gordon, *New Role*"] ("[T]here is a difference between trying to game and manipulate a system as a resistance movement or alienated outsider would, and to engage in a committed and good faith struggle within the system to influence it to fulfill what a good faith interpreter would construe as its best values and purposes.").

¹³ See Robert W. Gordon, *A Collective Failure of Nerve: The Bar's Response to Kaye Scholer*, 23 *LAW & SOC. INQUIRY* 315 (1998) ("Lawyers have, I think, fallen into the habit of thinking that maintaining the integrity of the legal framework is always someone else's problem But, of course, the order of rules and norms, policies and procedures, and institutional actors and roles that make up the legal system . . . is only as effective as voluntary compliance can make it; for if people routinely start running red lights when they think no cop is watching (or hire lawyers to keep a lookout for the cops, and to exhaust the resources of traffic courts arguing the lights were green), the regime will collapse."). The obligation on the part of lawyers to maintain the institution of law can be understood as an instance of the Rawlsian natural duty to support just institutions. See JOHN RAWLS, *A THEORY OF JUSTICE* 114-17, 333-37 (1971). For a defense of the Rawlsian position, which is sometimes thought to be less plausible than it is, see Jeremy Waldron, *Special Ties and Natural Duties*, 22 *PHIL. & PUB. AFF.* 3 (1993).

¹⁴ JEREMY WALDRON, *LAW AND DISAGREEMENT* 101 (1999).

respect for the law demands that lawyers be able to provide public, reasoned justification for an interpretation of legal texts — one which is plausible in light of the underlying purposes of the statutes, rules, or cases.

Professionalism stands in opposition to the view of many lawyers that excellence in lawyering means engaging in “creative and aggressive” structuring of transactions for the benefit of clients, even though the transactions are set up to evade regulatory requirements for the protection of investors. The quoted language, “creative and aggressive,” which is often used by lawyers as a term of approbation, comes from the report issued by Enron’s long-time outside counsel, Vinson & Elkins, in response to the concerns raised by Sherron Watkins.¹⁵ The firm, investigating transactions its own lawyers had worked on, despite the glaring conflicts of interest,¹⁶ determined that the only problem with the structure and accounting treatment of the transactions was potentially one of public relations. The subtext of this response was that creativity and aggressiveness is a positive value in sophisticated business counsel. Interestingly,

¹⁵ See FOX, *supra* note 1, at 259; Jill E. Fisch & Kenneth M. Rosen, *Is There a Role for Lawyers in Preventing Future Enrons?*, 48 VILL. L. REV. 1097, 1115 (2003). Sherron Watkins was a vice-president for corporate development in the finance department of Enron at the time she wrote a letter to Kenneth Lay warning that the company might “implode in a wave of accounting scandals.” See FOX, *supra* note 1, at 247-48; Fourth Batson Report, *supra* note 1, App. C at 159-61. The complete Watkins letter is available on-line from numerous sites, including FindLaw, and is included as an appendix to her book. See Letter Purportedly From Enron Employee Sherron Watkins Sent To Enron Chairman and C.E.O. Kenneth Lay Re: Enron Accounting Practices, in SWARTZ & WATKINS, *supra* note 1, at 361-62; <<http://news.findlaw.com/hdocs/docs/enron/emplr2lay82001.pdf>> (visited 12/9/03).

¹⁶ Roger C. Cramton, *Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues*, 58 BUS. LAW. 143 (2002); Fourth Batson Report, *supra* note 1, at 50 & App. C at 161-66; Powers Report, *supra* note 1, at 176-77 (“The result of the V&E review was largely predetermined by the scope and nature of the investigation and the process employed. . . . The scope and process of the investigation appear to have been structured with less skepticism than was needed to see through these particularly complex transactions.”).

Watkins' letter itself used the word "aggressive" to describe the company's accounting, but the word had a decidedly more negative connotation for her — suggesting that Enron had used smoke and mirrors to obscure the economic substance of transactions to the point that the accounting treatment was no longer reliable.¹⁷ The concluding section of this Article will therefore be devoted to analyzing, as concisely as possible, a couple of the transactions which Enron allegedly used to manipulate its financial statements, move debt off its balance sheet to artificially prop up its credit rating, and meet ambitious short-term earnings forecasts.

It is relatively easy to say, in the abstract, that lawyers should not be "too aggressive" or should exercise judgment with due regard to the public interest, but I hope to show that these general standards of professionalism have content when applied to actual transactions that fall within the zone of professional judgment. In many of the Enron transactions, an attitude of professionalism would have required the lawyers to refuse to issue opinion letters in transactions which arguably, technically, "aggressively" complied with formal legal rules, but where the clear intent of regulators was not to permit them to occur in that form.¹⁸ In other words, a lawyer would be required to prevent the kind of abuse that is colorfully illustrated by a former Enron

¹⁷ See Powers Report, *supra* note 1, at 4-5 (stating committee's conclusion that certain related-party transactions lacked economic substance and were entered into solely for the purpose of manipulating Enron's financial statements).

¹⁸ See William W. Bratton, *Enron, Sarbanes-Oxley and Accounting: Rules Versus Principles Versus Rents*, 48 VILL. L. REV. 1023, 1044 (2003) (distinguishing regulatory arbitrage from strategic noncompliance, and defining the latter as "action under an interpretation of the law in conflict with the stated interpretation of the regulator").

employee:

Say you have a dog, but you need to create a duck on the financial statements. Fortunately, there are specific accounting rules for what constitutes a duck: yellow feet, white covering, orange beak. So you take the dog and paint its feet yellow and its fur white and you paste an orange plastic beak on its nose, and then you say to your accountants, “This is a duck! Don’t you agree that it’s a duck?” And the accountants say, “Yes, according to the rules, this is a duck.” Everybody knows that it’s a dog, not a duck, but that doesn’t matter, because you’ve met the rules for calling it a duck.¹⁹

It is not surprising that the rules of financial accounting would have criteria for duck-ness, but a point often escapes non-lawyers about the nature of rule-based reasoning: No matter how clear a rule appears to be, it will always be ambiguous enough to be manipulable, unless the rule is backstopped by a more substantive legal norm, cast in the form of a standard or principle that is to be applied using the informed judgment of a decisionmaker.²⁰ Professionalism, in a nutshell, instructs lawyers not to participate in the hocus-pocus of turning dogs into ducks, and is therefore a principle for regulating the exercise of interpretive judgment.

¹⁹ *Quoted in* MCLEAN & ELKIND, *supra* note 1, at 142-43.

²⁰ *See* Schwarcz, *Use and Abuse*, *supra* note 1, at 1309 (due to the complexity of structured-finance transactions, “the company’s investors must rely, to some extent, on the business judgment of management”).

This Article attempts to accomplish two somewhat disparate tasks: first, to argue for a theory of interpretation that is a function of a particular account of the nature and authority of law, and second to apply this theory to an actual lawyering dilemma, considered in enough detail to make it realistic. It will engage with jurisprudential questions at a fairly high level of abstraction, but also show how these theoretical arguments can shed light on the ethical problems that lawyers encounter in practice.²¹ Even fairly esoteric issues in legal theory, like the Hart/Dworkin debate, can have significant practical implications for lawyers and critics of the profession, but abstract jurisprudential arguments are seldom brought to bear directly on complex real world problems. This fusion may appear quixotic at first, but I hope the Article supports my hypothesis that by considering jurisprudential issues in the context of actual cases we can make progress understanding both the theory of legal ethics and the kinds of ethical dilemmas encountered in practice by sophisticated transactional lawyers.

A schematic overview of the Article is as follows: The argument begins in Section II by considering the attitude of professionalism in contrast with the prevalent

²¹ Cf. Robert W. Gordon & William H. Simon, *The Redemption of Professionalism?*, in *LAWYERS' IDEALS/LAWYERS' PRACTICES: TRANSFORMATIONS IN THE AMERICAN LEGAL PROFESSION* 238 (Robert L. Nelson, et al., eds., 1992) ("The task of applying jurisprudence to the lawyering role is relatively undeveloped and should be on the agenda of teachers of professional responsibility."); BURTON, *supra* note ____, at xv-xvi (setting out a theory of adjudication that is practical, in the sense that it does not take a third-party observer's perspective on judging, but says something about how a judge should actually decide cases).

view that lawyers may take a purely instrumental attitude toward law, treating it as merely an obstacle or an inconvenience to be planned around, rather than a source of normativity that is legitimate. The jurisprudential heavy lifting comes in Section III, which considers conceptual arguments about the nature of law and the relationship between legal and moral norms, as well as the problem of objectivity in legal interpretation. Section IV makes these abstract arguments more concrete, by making the descriptive point that analogues to the professional attitude are very much a feature of legal reasoning, and by giving a normative argument that the stance of professionalism ought to be a part of legal reasoning. Finally, Section V applies this theory of lawyers' ethics to some of the transactions that played a role in the collapse of Enron, showing the ways in which we can criticize the lawyers for having engaged in faulty legal reasoning.

II. Professionalism vs. the Holmesian Bad Man Stance.

The principal target of my argument is the position that lawyers are permitted to take a "Holmesian bad man" interpretive attitude toward legal norms, regarding them as obstacles to be planned around, or even costs to be incurred in the course of pursuing one's client's projects.²² Holmes defined the law in terms only of a prediction about how legal officials might decide particular cases, which he illustrated through the metaphor of a "bad man" who is interested only in avoiding legal penalties that might

²² See Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 459-62 (1897).

attach to his conduct. The problem with the perspective of the bad man is not that it is descriptively inaccurate — surely many people, including lawyers, do care about the law only insofar as it might impose sanctions on them — but that it is jurisprudentially unsatisfying. The bad man’s perspective is only one of many standpoints that one may adopt toward the law,²³ and it is far from self-evident that it is the best perspective to employ when describing the relationship between lawyers and the law. The choice of an interpretive standpoint is a normative one, and there must be an argument for why one *ought* to adopt the perspective of the bad man, if that perspective is to do any justifying work in jurisprudence. As Ronald Dworkin rightly observes, a participant in a social practice does not regard the practice and its constitutive rules as simply given, but assumes it has some value, in the sense of serving some interest or purpose.²⁴ The focus of a theory of lawyering must therefore be on the purpose of the legal system and, correspondingly, the point of having officially licensed and regulated lawyers who represent clients in connection with matters requiring legal advice, judgment, and skill.²⁵

²³ See William Twining, *The Bad Man Revisited*, 58 CORNELL L. REV. 275 (1973).

²⁴ RONALD DWORKIN, *LAW’S EMPIRE* 47 (1986). Dworkin uses the term “*the* interpretive attitude” to describe the standpoint of participants in a practice who seek to impose some meaning on the practice, and to see it in its best light. *Id.* at 46-48. In this Article I will make a more general reference to plural interpretive attitudes, which need not necessarily be identical with Dworkin’s constructive interpretation theory of law. The reason for making this distinction is that I believe Dworkin is right in taking seriously the perspective of participants in a social practice, or those who take what Hart calls an internal point of view toward the rules of a practice. See H.L.A. HART, *THE CONCEPT OF LAW* 56, 88-91 (2d ed. 1994). Dworkin’s use of the singular term “interpretive attitude” is too strong, however, because people governed by the rules of certain complex social practices may be able to adopt one of several reasonable stances toward the rules — e.g. attitudes of resistance, cautious acquiescence, enthusiastic embrace, and so on. The attitude one takes toward the rules is a significant jurisprudential question, and because I disagree with some aspects of Dworkin’s theory of law, it is important to note this terminological distinction.

²⁵ Cf. Cass R. Sunstein & Adrian Vermeule, *Interpretation and Institutions*, 101 MICH. L. REV. 885 (2003) (recommending that theories of interpretation take into account the institutional competence of the interpreter); Joseph Raz, *The Problem About the Nature of Law*, in *ETHICS IN THE PUBLIC DOMAIN* 195, 203-05 (1994) (arguing against taking a narrow “lawyer’s perspective,” which eliminates consideration of the lawyer’s relationship with

The argument must be “normative all the way down,” with a theory of democracy justifying a theory of the function of law, which in turn justifies a conception of the lawyer’s role.

other institutions such as courts, legislatures, administrative agencies, and various intermediate associations).

Whenever lawyers face serious criticism from regulators or academics for their role in client malfeasance, they usually defend themselves and their extremely narrow interpretive attitude by appealing to the lawyer-client relationship and their duties as fiduciaries of clients. Their duties, say the lawyers, are limited to protecting client interests by providing competent representation and keeping secrets, and most certainly do not include serving as gatekeepers or quasi-regulators of their clients' transactions.²⁶ This defense misses the point, however, that the lawyer-client relationship is itself created by the legal system and imposes duties on lawyers to the extent (and only to the extent) those duties are justified by the social function of the law. Lawyers are not judges, who are institutionally charged with the task of remaining impartial, but they are also not clients, who may be permitted to approach the law from a partisan and self-interested perspective. The role of lawyer is something of an amalgam of the judge's and client's roles, serving as a bridge between the biased

²⁶ See, e.g., Fisch & Rosen, *supra* note ____, at __; Evan Davis, *The Meaning of Professional Independence*, 103 COLUM. L. REV. 1281 (2003); Lawrence J. Fox, *The Fallout from Enron: Media Frenzy and Misguided Notions of Public Relations are no Reason to Abandon our Commitment to Our Clients*, 2003 U. ILL. L. REV. 1243-1259 (2003); James A. Cohen, *Lawyer Role, Agency Law, and the Characterization of "Officer of the Court"*, 48 BUFF. L. REV. 349 (2000); American Bar Ass'n, *Statement of Policy Regarding Responsibilities and Liabilities of Lawyers in Advising with Respect to the Compliance by Clients with Laws Administered by the Securities and Exchange Commission*, 31 BUS. LAW. 545 (1975); Comments of 79 Law Firms on Proposed SEC Rule: Implementation of Standards of Professional Conduct for Attorneys (Apr. 7, 2003), at 2, available at <www.sec.gov/rules/proposed/s74502/79lawfirms1.htm> (visited 12/18/03) ("An attorney to an issuer . . . is ethically bound to act as a legal counselor to, and at times an advocate for, that issuer, is not independent or required to be, and only in very limited circumstances provides advice that may be relied on by the investing public."). Harry Reasoner, the managing partner of Vinson & Elkins, one of Enron's principal outside law firms, defended his firm's conduct in similar terms, punting responsibility for ensuring that transactions had economic substance to Enron's accountants. "There is a misunderstanding of what outside counsel's role is," he said. "We would have no role in determining whether, or what, accounting treatment was appropriate." John Schwartz, *Enron's Many Strands: The Lawyers: Troubling Questions Ahead for Enron's Law Firm*, N.Y. TIMES (Mar. 12, 2002), at C1. For a thorough analysis of the tension between competing conceptions of the lawyers role which came to a head over the *National Student Marketing* case, see Simon Lorne, *The Corporate and Securities Adviser, The Public Interest, and Professional Ethics*, 76 MICH. L. REV. 423 (1978).

position of clients and the ideally neutral position of judges.²⁷ Lawyers are fiduciaries, but not only caretakers of their clients' interests — they are also custodians of the law in an important sense.²⁸ Thus, they have a responsibility to build the interests of third parties into their interpretation of law, even when working on behalf of private clients. Although lawyers usually become almost apoplectic at the suggestion that they have any responsibility toward the legal system or the law as such, the contrary position that lawyers can approach the law like Holmes's bad men, is impossible to justify at the level of an institution-sensitive theory of law and lawyering.

A. *Rational Instrumentalism?*

²⁷ Robert W. Gordon, *The Ideal and the Actual in the Law*, in *THE NEW HIGH PRIESTS: LAWYERS IN POST-CIVIL WAR AMERICA* 51 (Gerald W. Gawalt ed. 1984). This hybrid role has long been accepted as a description of the duties of a prosecutor. See, e.g., H. Richard Uviller, *The Neutral Prosecutor: The Obligation of Dispassion in a Passionate Pursuit*, 68 *FORDHAM L. REV.* 1695 (2000).

²⁸ German law recognizes a similar duty on the part of a lawyer to serve as a custodian of the law — *ein Pfleger des Rechts*.

Contemporary defenders of the Holmesian bad man interpretive attitude often identify with the law and economics movement.²⁹ Of course, an affinity for law and economics does not make one pro-Enron; indeed, sophisticated neoclassical economic theory may even support something like the attitude of professionalism. As Kenneth Arrow points out, contracts, markets, and transactions depend on relationships of trust and confidence.³⁰ It is impossible to draft contracts with sufficient specificity to handle every situation that could conceivably arise in the course of a commercial relationship. Thus, the parties depend on one another not to behave opportunistically. “Every contract depends for its observance on a mass of unspecified conditions which suggest that performance will be carried out in good faith without insistence on sticking literally to its wording.”³¹ In relational contracting, the parties rely on the repeated nature of their interactions to safeguard against opportunistic behavior.³² A similar dynamic limits dishonesty in small communities where the participants may encounter one another in a future commercial relationship and where information about

²⁹ See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 MICH. L. REV. 1155, 1177 n.57 (1982) (“managers do not have an ethical duty to obey economic regulatory laws just because the laws exist. They must determine the importance of those laws. The penalties Congress names for disobedience are a measure of how much it wants firms to sacrifice in order to adhere to the rules; the idea of optimal sanctions is based on the supposition that managers not only may but also should violate the rules when it is profitable to do so.”). Cynthia Williams uses the term “law-as-price” conception to label this interpretive attitude. See Cynthia A. Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 76 N.C. L. REV. 1265, 1267 (1998). The law-as-price theory is somewhat different, because it expands the Holmesian bad man predictive orientation toward law into a distinctive theory of entitlement. According to law-as-price, one has a *right* to violate the law which can be obtained simply by “purchasing” the associated penalty, or willingly incurring a risk of the penalty. *Id.* at 1268. This difference is immaterial for the purposes of this Article, because both the Holmesian bad man predictive account of law and the law-as-price theory of entitlement are predicated on the same jurisprudential error, which I will discuss in detail here.

³⁰ Kenneth J. Arrow, *Social Responsibility and Economic Efficiency*, 21 PUB. POL’Y 303, 314 (1973).

³¹ *Id.* at 314.

³² Stuart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963).

misconduct can be inexpensively disseminated.³³ In one-shot interactions in larger and more impersonal communities, the parties must use a different mechanism to ensure against exploitation; in this case economic theory uses the concept of lawyers as reputational intermediaries to explain why a lawyer or law firm would avoid being too aggressive in structuring transactions.³⁴ The services of gatekeepers, such as transactional lawyers and auditing firms, signal to the market that the client's representations are fair and accurate. Gatekeepers can perform this function because their principal stock in trade is a reputation for probity, built up over years of "vouching" for clients by representing them in transactions. A gatekeeper firm would squander this reputation by vouching for a client whose representations were dishonest, so its association with a client is a

³³ See, e.g., Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEG. STUD. 115 (1992); David Charny, *Nonlegal Sanctions in Commercial Relationships*, 104 HARV. L. REV. 373 (1990).

³⁴ See, e.g., Coffee, *What Caused Enron*, *supra* note ____, at 279-97; Theodore Eisenberg & Jonathan R. Macey, *Was Arthur Andersen Different? An Empirical Examination of Major Accounting Firms' Audits of Large Clients*, 1 J. EMPIRICAL LEG. STUD. 263 (2004); John C. Coffee, Jr., *The Attorney As Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293 (2003); John C. Coffee, Jr., *Understanding Enron: "It's About the Gatekeepers, Stupid"*, 57 BUS. LAW. 1403 (2002); Ronald J. Gilson & Robert H. Mnookin, *Disputing Through Agents: Cooperation and Conflict Between Lawyers in Litigation*, 94 COLUM. L. REV. 509 (1994); Reinier Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53 (1986); Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239 (1984); Reinier

credible signal of the client's honesty. Because gatekeepers have less to gain from dishonesty than clients do, they have a powerful incentive to monitor the client's conduct for dishonesty, to avoid losing valuable credibility. In effect the gatekeeper becomes a quasi-regulator, ensuring that deals are reached on the basis of accurate information.

Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857 (1984).

Nevertheless, the relational-contracting and gatekeeper ideas still concede something significant to the Holmesian bad man model, namely their bleak vision of professionals as essentially self-interested, amorally pragmatic actors who take a purely instrumental approach to the law.³⁵ In the economic vision of professional ethics, the reasons for following the law (or being honest in contractual relationships) can be reduced to one simple motivation — the fear of sanctions.³⁶ Sanctions may come in the form of official, state-imposed punishments or nonlegal penalties such as the loss of business opportunities, but in any event the avoidance of sanctions is the sole reason any actor would have to refrain from exploiting other parties in a transaction or treating legal rules as inconveniences to be planned around. As Holmes so memorably put it,

³⁵ See Brian Leiter, *Holmes, Economics, and Classical Realism*, in *THE PATH OF THE LAW AND ITS INFLUENCE: THE LEGACY OF OLIVER WENDELL HOLMES, JR.* 285 (Steven J. Burton ed. 2000).

³⁶ Cf. Holmes, *supra* note ____, at 462 (“The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it — and nothing else.”). The instrumental attitude toward law may be characterized, in jurisprudential terms, as reducing conduct rules to decision rules. See Meir Dan-Cohen, *Decision Rules and Conduct Rules: On Acoustic Separation in Criminal Law*, 97 HARV. L. REV. 625 (1984). Rules are analytically separable into two categories: conduct rules which are addressed to individuals and which permit or forbid certain actions, and decision rules which are addressed to officials and regulate the act of passing judgment. Although these categories are conceptually distinct, it is possible to run them together in practice, and conceive of conduct rules as being entirely a function of decision rules. See *id.* at 632. The Holmesian bad man attitude focuses interpretation solely on decision rules — i.e. when will a judge determine that I have violated the law? The attitude prescribed by professionalism focuses interpretation on conduct rules — i.e. what does the law require?

this attitude toward the law “stinks in the nostrils of those who think it advantageous to get as much ethics into the law as they can.”³⁷ His mocking tone shows his disdain for anyone who regards the law as legitimate, and therefore a reason for acting.

Economic theory has no place for actors who are guided by legal norms because they regard them as having moral force.

³⁷ *Id.*

But what would be the normative argument for taking a purely instrumental stance toward the law? It cannot be the observation that the world is full of Holmesian bad men, which would be a simplistic version of G.E. Moore's naturalistic fallacy.³⁸ The most promising candidate for an argument in favor of instrumentalism relies on libertarian premises — the fundamental moral significance of human freedom, and the concomitant requirements that any restrictions on liberty imposed by the state be justified by reasons shared by the object of coercion, general, knowable in advance of acting, and no broader than necessary to accomplish their purpose. Indeed, a deep insight of modern legal ethics theory, characteristic of the work of William Simon and Robert Gordon, is the extent to which the prevailing attitudes of practicing lawyers toward the law are reflective of the assumption that the purpose of the legal system is to delineate a sphere of individual autonomy which is protected against interference by other individuals or the state.³⁹ But Simon and Gordon have not only recognized this foundation — they, along with David Luban and others, have completely demolished it.⁴⁰ In brief, their arguments are that the autonomy of the client is not some kind of moral trump card over the lawyer's own moral agency, which would require reasoning about the permissibility of the client's ends quite apart from considerations of the

³⁸ G.E. MOORE, *PRINCIPIA ETHICA* 13 (1903).

³⁹ See WILLIAM SIMON, *THE PRACTICE OF JUSTICE* 27 (1998) (calling this the "Libertarian Premise"); Robert W. Gordon, *Why Lawyers Can't Just Be Hired Guns*, in *ETHICS IN PRACTICE: LAWYERS' ROLES, RESPONSIBILITIES, AND REGULATION* 42, 47 (Deborah L. Rhode ed. 2000) (describing "libertarian-positivist view") [hereinafter, "Gordon, *Hired Guns*"]. For the best known defense of the minimal state, grounded in the value of autonomy, see ROBERT NOZICK, *ANARCHY, STATE, AND UTOPIA* (1974).

⁴⁰ See DAVID LUBAN, *LAWYERS AND JUSTICE* 167-69 (1988); David Luban, *The Lysistratian Prerogative: A Response to Stephen Pepper*, 1986 *AM. B. FOUND. RES. J.* 637 (1986).

client's autonomy; that citizens are not entitled to autonomy as such, but only to a just measure of autonomy that is compatible with the rights of others; that liberty is only one value among others that a decent legal system would seek to protect; that lawyers participate to such a great extent in interpreting and applying the law that legal restrictions on client autonomy can hardly be said to be impartial and general; and that even if autonomy were the most important thing, its exercise depends on a stable framework of legal norms and institutions, which is undercut by instrumentalist approaches to the law.

The other principal argument for taking an instrumental stance toward the law trades on overgeneralization from the paradigm of adversarial litigation. The most shopworn aphorism in legal ethics is that a lawyer's primary duty is to "represent a client zealously within the bounds of the law."⁴¹ Lawyers who seize on this maxim as a justification for interpreting the law as Holmesian bad men often elide the distinction between acting as an advocate in litigation and acting as a counselor or transactional engineer. Ask a securities lawyer why she opposes a requirement to report out evidence of client fraud, and she is likely to mention the principle of zealous representation, seemingly without awareness that this phrase, as originally stated in the Model Rules, applied only to representation in litigation. For good reason, however, a lawyer's attitude toward the law must vary according to the context in which she is

⁴¹ MODEL CODE OF PROFESSIONAL RESPONSIBILITY, Canon 7 (1981).

representing a client.⁴² A well prepared adversary and a fully informed tribunal are institutional features that are capable of countering excessive adversarial zeal in litigation and ensuring that legal norms are applied in an impartial manner. In litigation, the judge serves as the custodian of the law, and as long as she is adequately informed and not misled, the parties' lawyers are justified in leaving to the judge the responsibility for taking care of the law. Without an impartial referee, orderly procedures, rules for obtaining, introducing, and excluding evidence, and a competent opposing party, however, transactional lawyering is so different from adversarial litigation that one wonders why anyone has ever thought to analogize the role of lawyer from one context

⁴² The Model Code, which was frequently criticized for assimilating all lawyering activities to adversarial litigation, actually recognizes quite plainly the importance of context. "Where the bounds of law are uncertain, the action of a lawyer may depend on whether he is serving as advocate or adviser." *Id.*, EC 7-3. Taking a narrow, technical, or instrumental attitude toward the law is appropriate only (if at all) in adversarial litigation, and only where the lawyer has a good faith belief that her interpretation of the law is supported by existing norms or by a reasonable argument for extension, modification, or reversal of existing law. *Id.*, EC 7-4. In adversarial litigation, this highly partisan stance toward the law may be justified by the effect on the tribunal of opposing partisan presentations: "[T]he advocate, by his zealous preparation and presentation of facts and law, enables the tribunal to come to the hearing with an open and neutral mind and to render impartial judgments." *Id.*, EC 7-19. The attorney as adviser, however, is bound to render a professional opinion as to the applicability of law, interpreted from the point of view of an impartial tribunal. *Id.*, EC 7-5. The modern law governing lawyers preserves these distinctions. Compare MODEL RULES OF PROF'L CONDUCT, Rule 2.1 (2002) [hereinafter, "MODEL RULES"] (attorney as adviser must use independent professional judgment and render candid advice) with *id.*, Rule 3.1 (lawyer representing client in litigated matter may assert any nonfrivolous legal argument).

to the other.⁴³ Whatever psychological enthusiasm a lawyer might feel for her client's cause, the kind of zealous representation a lawyer may provide in counseling and transactional practice is circumscribed by a heightened obligation not to treat the law instrumentally. In effect, the legal system has delegated the judge's caretaker function to the lawyer in cases where the lawyer's interpretation of the law is not subject to review by an impartial referee.

⁴³ See LUBAN, *supra* note ____, at 56-66.

The arguments in this Article are an attempt to provide a secure jurisprudential foundation for this “caretaker” theory of the authority of law and of legal interpretation — a model of lawyering which treats legal norms seriously as reasons in a lawyer’s practical deliberation. I have called this the authority conception of legal ethics.⁴⁴ In this view, legal rules are not only legitimate reasons for action but preclude recourse to ordinary first-order moral reasons, including the value of client autonomy. The reason for this preclusion is that the need for law arises from recognition of deep and persistent disagreement, resulting from a plurality of worthwhile human goods, values and forms of life; empirical uncertainty; divergent evaluative standpoints; and what Hume called the circumstances of justice — moderate scarcity and limited benevolence.⁴⁵ On many moral or political questions of significance, we can expect disagreement in good faith that cannot be resolved by reasoning alone; in addition, the participants in the debate recognize that something must be done, one way or the other, about the issue. When these conditions obtain, the parties to the normative disagreement share a desire for an at least provisional settlement of the issue, enabling coordinated activity notwithstanding the intractable dispute. Individuals turn to an impartial, third-party mechanism — the law — because they share the desire for peaceful cooperation and

⁴⁴ See Wendel, *supra* note ____, at 364.

⁴⁵ See WILLIAM A. GALSTON, LIBERAL PLURALISM 5-6, 28-35 (2002); AMY GUTMANN & DENNIS THOMPSON, DEMOCRACY AND DISAGREEMENT 21-23 (1996); ALASDAIR MACINTYRE, AFTER VIRTUE 6-11 (2d ed. 1994); NICHOLAS RESCHER, PLURALISM: AGAINST THE DEMAND FOR CONSENSUS 76-78 (1993); Isaiah Berlin, *The Pursuit of the Ideal*, in THE CROOKED TIMBER OF HUMANITY 1 (1990); STUART HAMPSHIRE, INNOCENCE AND EXPERIENCE 30-33(1989); Thomas Nagel, *The Fragmentation of Value*, in MORTAL QUESTIONS 128 (1979); Thomas D. Morgan & Robert W. Tuttle, *Legal Representation in a Pluralist Society*, 63 GEO. WASH. L. REV. 985 (1995); WALDRON, *supra* note ____, at 175-79.

settlement.⁴⁶ Because the law permits them to do better at realizing this interest than they would on their own, and because it is adopted through procedures that meet a threshold standard of fairness and respect for the parties to the normative disputes, the law has authority in the domain of the disagreement and precludes practical reasoning on the basis of the reasons that were relevant to the underlying controversy.⁴⁷ This is essentially the argument for the negative aspect of professionalism, which preempts recourse to reasons that would otherwise require a different action in the circumstances, where a legal norm is in force. The positive aspect of professionalism flows from the same conception of the authority of law, and requires lawyers to interpret legal norms in such a way that the law can continue to perform its coordination and settlement functions.

⁴⁶ See HENRY M. HART, JR. & ALBERT M. SACKS, *THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW* 1-4 (William N. Eskridge, Jr. & Philip P. Frickey eds. 1994); LARRY ALEXANDER & EMILY SHERWIN, *THE RULE OF RULES: MORALITY, RULES, AND THE DILEMMAS OF LAW* 11-15 (2001); Larry Alexander & Frederick Schauer, *On Extrajudicial Constitutional Interpretation*, 110 HARV. L. REV. 1359 (1997).

⁴⁷ This conception of the authority of law is derived from Joseph Raz's normal justification thesis. See JOSEPH RAZ, *THE MORALITY OF FREEDOM* 53 (1986); Joseph Raz, *Introduction*, in *AUTHORITY* 1, 12-13 (Joseph Raz ed. 1990). It is substantially influenced by Jeremy Waldron's use of the Razian normal justification thesis (NJT). See WALDRON, *supra* note ___, at 95-96. Both are discussed in considerably more detail in Wendel, *supra* note ___. I am making stronger claims for the force of the NJT than Raz would accept, but I believe they are consistent with Waldron's expansive use of Raz's conception of authority.

Before working through the defense of this position in detail, it may be helpful to take a preliminary look at some examples of how one's interpretive attitude would make a difference to judicial decisions or the advice given to clients. (The final section of the Article will review a longer example involving the Enron transactions.) As the examples should make clear, the approach to legal interpretation that flows from the authority conception of legal ethics is different from both textualism and some of its more loosely structured competitors.⁴⁸ Legal texts alone cannot achieve the settlement that is the function of law, because they are never self-interpreting. Texts must be interpreted in light of their evident purpose, the background against which they were enacted, and the interpretive understandings of the relevant community of lawyers and judges. The most important features of this style of interpretation is the preclusion of the policy preferences or first-order moral beliefs of interpreters, and the resistance to the manipulation of the form of legal norms to defeat their substance. Professionalism, as defended here, does not instruct lawyers to act in the public interest, which may be internally incoherent and normatively contested, but by what the public has come up with as its laws, through the process of legislation, administrative rulemaking, and

⁴⁸ For some of the most important contributions to this debate, see John Manning, *Constitutional Structure and Statutory Formalism*, 66 U. CHI. L. REV. 685 (1999); Adrian Vermeule, *Legislative History and the Limits of Judicial Competence: The Untold Story of Holy Trinity Church*, 50 STAN. L. REV. 1833 (1998); Richard J. Pierce, Jr., *The Supreme Court's New Hypertextualism: An Invitation to Cacophony and Incoherence in the Administrative State*, 95 COLUM. L. REV. 749 (1995); Frank H. Easterbrook, *Text, History, and Structure in Statutory Interpretation*, 17 HARV. J.L. & PUB. POL'Y 61 (1994); Daniel A. Farber, *The Inevitability of Practical Reason: Statutes, Formalism, and the Rule of Law*, 45 VAND. L. REV. 533 (1992) [hereinafter, "Farber, *Inevitability*"]; Stephen Breyer, *On the Uses of Legislative History in Interpreting Statutes*, 65 S. CAL. L. REV. 845 (1992); William N. Eskridge, Jr., *The New Textualism*, 37 UCLA L. REV. 621 (1990); William N. Eskridge, Jr. & Philip P. Frickey, *Statutory Interpretation as Practical Reasoning*, 42 STAN. L. REV. 321 (1990); Frederick Schauer, *Statutory Construction and the Coordinating Function of Plain Meaning*, 1990 SUP. CT. REV. 231 [hereinafter, "Schauer, *Statutory Construction*"]; Cass R. Sunstein, *Interpreting Statutes in the Regulatory State*, 103 HARV. L. REV. 405 (1989); Daniel A. Farber, *Statutory Interpretation and Legislative Supremacy*, 78 GEO. L.J. 281 (1989); Frank H. Easterbrook, *Statutes' Domains*, 50 U. CHI. L. REV. 533 (1983).

adjudication. Professionalism is grounded in fidelity to a society's laws, but it is critical that law not be understood narrowly or formalistically. Rather, the law must be interpreted in a way that ensures it will continue to have the capacity to coordinate social action against a background of persistent first-order normative disagreement.

B. Some Examples.

The conception of professionalism I have been defending makes reference to “substantive meanings” of legal norms, as opposed to their mere formal expression. One natural objection to this position is that legal norms do not have a substantive meaning apart from their textual form. The following two examples of ethical dilemmas in lawyering are designed to show that even the simplest legal norms, either statutes or cases, depend for their meaning on interpretive understandings that are not captured in texts themselves. If a reader is persuaded that these non-textual conventions and practices of legal reasoning are actually relevant to determining the relevant law, then the only remaining step in the argument for professionalism is to establish the wrongfulness of ignoring them.

The Miserly Railroad. The Northern Atlantic Railroad has asked its general counsel whether it is required to make an expensive modification to its locomotives. It is concerned that a new federal statute may mandate retrofitting the locomotives with

an automatic coupling device.⁴⁹ The relevant statutory language reads:

On and after the first day of January, nineteen hundred and ninety-eight, it shall be unlawful for any such common carrier to haul or permit to be hauled or used on its line any car used in moving interstate traffic not equipped with couplers coupling automatically by impact, and which can be uncoupled without the necessity of men going between the ends of the cars.

⁴⁹ This problem is based on *Johnson v. Southern Pacific*, 196 U.S. 1 (1904), reversing 117 F. 462 (8th Cir. 1902), two casebook classics illustrating issues in statutory interpretation, but I freely embellished many of the facts.

The railroad's vice-president for engineering told the general counsel that for technical reasons, it is much more difficult to equip locomotives, as opposed to ordinary cars, with automatic coupling devices. She pointed out that the statute requires automatic couplers on "cars," which in the ordinary parlance of railroad workers would not be understood to include locomotives. (She actually overheard a snippet of dialogue in which one employee at a switching yard asked, "are there any cars on that track?" and was told, "nope, just a locomotive.") Moreover, the examples used to illustrate the definition of "car" in the Oxford English Dictionary all referred to conveyances that are pulled by a locomotive: passenger car, sleeping car, coal car, freight car, and so on. Her argument was supported by the use in the statute of the verb "haul," of which "car" is an object — locomotives are not hauled; they do the hauling. The general counsel also remembered reading in law school a case involving the theft of an airplane, in which the Supreme Court noted that the operative term "vehicle" did not "evoke in the common mind" the image of an airplane.⁵⁰ What advice should the general counsel give to the railroad regarding compliance with the statute?

⁵⁰ *McBoyle v. United States*, 283 U.S. 25 (1931) (interpreting a statute criminalizing "transporting in interstate commerce a motor vehicle, knowing the same to have been stolen").

Fine Print on the Ticket.⁵¹ Festival Cruise Lines hired an outside law firm to review its standard ticket contract, and recommend changes if necessary. One provision caught the eye of a junior associate in the firm who had been assigned to review the contract:

It is agreed by and between the Guest and Festival that all disputes and matters whatsoever arising under, in connection with or incident to this Contract or the Guest's cruise, including travel to and from the vessel, shall be litigated, if at all, before the United States District Court for the Southern District of Florida in Miami, or as to those lawsuits to which the Federal Courts of the United States lack subject matter jurisdiction, before a court located in Miami-Dade County, Florida, U.S.A. to the exclusion of the Courts of any other county, state or country.⁵²

⁵¹ The facts of this problem are taken from *Carnival Cruise Lines v. Shute*, 499 U.S. 585 (1991). The issue of lawyers' ethical responsibility for drafting adhesion contracts has been widely discussed. See, e.g., Henry Ordower, *Toward a Multiple Party Representation Model: Moderating Power Disparity*, 64 OHIO ST. L.J. 1263 (2003); William T. Vukowich, *Lawyers and the Standard Form Contract System: A Model Rule That Should Have Been*, 6 GEO. J. LEGAL ETHICS 799 (1993). See also Robert A. Hillman & Jeffrey J. Rachlinski, *Standard Form Contracting in the Electronic Age*, 77 NYU L. REV. 429 (2002) (not focusing on lawyers, but providing an interesting overview of technological innovations in standard-form contracts, such as shrink-wrap and "click-wrap" licenses).

⁵² This language is currently in use by Carnival Cruise Lines in its standard form ticket contract. <http://www.carnival.com/CMS/Static_Templates/ticket_contract.aspx> (visited 6/19/04).

Having had many depressing experiences with standard-form leases as a graduate student,⁵³ the associate questioned the propriety of including the forum-selection clause in the cruise contract. He was troubled by uncertainty in the law. On the one hand, the Supreme Court had upheld forum-selection clauses when negotiated between two sophisticated business parties, specifically in the maritime context.⁵⁴ On the other hand, appellate courts had refused to enforce certain terms in standard-form contracts where one party had an absence of meaningful choice as to whether to accept a contract term that is unreasonably favorable to the other party.⁵⁵ He also knew that many passengers would be coming from homes far away from Miami, and would face considerable inconvenience and expense if they were required to litigate in South Florida. Although the language of the contract was clear, it was buried in the fine print on the back of the ticket, which passengers never read. The associate therefore worried that including the contract term might constitute “conduct involving dishonesty, fraud, deceit or misrepresentation,”⁵⁶ but his supervisor told him that the client insisted on retaining the forum-selection clause, unless it was plainly illegal. The associate concluded that there was no plain illegality, reasoned that his supervisor’s instructions were a “reasonable resolution of an arguable question of professional duty,”⁵⁷ and said nothing more. Should he have acquiesced in the inclusion of the contract term?

⁵³ See Daniel E. Wenner, *Renting in Collegetown*, 84 CORNELL L. REV. 543 (1999).

⁵⁴ *The Bremen v. Zapata Off-Shore*, 407 U.S. 1 (1972).

⁵⁵ *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965).

⁵⁶ MODEL RULES, *supra* note ____, Rule 8.4(c).

⁵⁷ *Id.*, Rule 5.2(b).

In both of these cases, the content of the law on point is facially uncertain, if law is understood as a property of legal texts alone. In the railroad case, the apparent uncertainty is the result of linguistic ambiguity (does the term “car” encompass locomotives?); in the forum-selection clause case, it is the result of conflicting precedents or competing analogies (“is the cruise case more like a different kind of maritime activity or a different kind of consumer sales contract?”). I suspect, however, that readers have already concluded that these cases do not actually involve any serious uncertainty.⁵⁸ The railroad must equip the locomotives with automatic couplers, and the cruise line is free to include the forum-selection clause in the contract. What justifies these conclusions? The answer to any question of legal interpretation is ultimately provided by the conventions and practices of legal reasoning, which form the basis for the exercise of informed, sound “situation sense,” prudence, practical

⁵⁸ Cf. Frederick Schauer, *Easy Cases*, 58 S. CAL. L. REV. 399 (1985) (arguing that doctrinal, factual, and linguistic factors may make a particular outcome easy for competent lawyers to predict).

reasoning, or *judgment*.⁵⁹

⁵⁹ “Situation sense” is a term favored by Karl Llewellyn. See KARL LLEWELLYN, *THE COMMON LAW TRADITION: DECIDING APPEALS* 60-61, 268-85 (1960). Anthony Kronman uses the Aristotelian terms prudence (as a translation of *phronesis*) and practical wisdom to convey a similar notion. See ANTHONY T. KRONMAN, *THE LOST LAWYER* (1993); Anthony T. Kronman, *Alexander Bickel’s Philosophy of Prudence*, 94 *YALE L.J.* 1985). Modern commentators on statutory interpretation favor the term “practical reason.” See, e.g., Farber, *Inevitability*, *supra* note ____; Eskridge & Frickey, *supra* note ____; see also BURTON, *supra* note ____, at 6 n.9 (citing sources). One might even use the term “pragmatism,” as popularized by Richard Posner, among others. See, e.g., Richard Posner, *Pragmatic Adjudication*, in *THE REVIVAL OF PRAGMATISM* 235 (Morris Dickstein ed. 1998). I will use the term judgment throughout the Article, but it should be understood that I am appealing to this vigorous tradition of legal theory, whatever label a particular writer chooses. And I intend as well to appeal (without elaboration, because of the constraints of space and relevance) to the work of critics within moral philosophy who seek to establish objective truths of ethics while making room for contextual judgment. See, e.g., HILARY PUTNAM, *ETHICS WITHOUT ONTOLOGY* (2004).

Legal reasoning begins with the text of statutes and the holdings of cases, to be sure, but does not end there. Indeed, a judge or lawyer might commit the vice of “hypertextualism” by pretending that the language of a statute, dictionary definitions, and rules of syntax are sufficiently determinate to produce an objective interpretation of a text.⁶⁰ Although the statute in the railroad case uses the word “car,” the legislature may have intended to require coupling devices on locomotives as well (perhaps after hearing testimony about the frequency of locomotive-car coupling accidents), and only a myopic fixation on the literal language of the statute would cause an interpreter to miss this apparent meaning of the text. Moreover, statutory language, definitions of words, canons of construction, and so on, might create as much interpretive freedom as more expansive methods like purposivism or intentionalism, thereby permitting the interpreter to impose her own policy preferences on the text, under the guise of rendering an objective reading. Similarly, in common-law reasoning, the facts and arguments set out in a given judicial opinion are highly manipulable when considered in isolation. Fortunately, in both of these styles of legal reasoning, there are second-level principles that have developed in any given domain of law that stabilize and regulate interpretation.⁶¹

1. *Statutory Analysis.*

⁶⁰ Pierce, *supra* note ____, at 750-52.

⁶¹ See, e.g., MELVIN ARON EISENBERG, *THE NATURE OF THE COMMON LAW* (1988); Owen M. Fiss, *Objectivity and Interpretation*, 34 *STAN. L. REV.* 739 (1982).

Consider first an example of statutory interpretation — the railroad case. The word “car” in isolation does not answer the question whether the railroad is required to equip its locomotives with automatic couplers; if anything, it suggests a counterintuitive negative response. Starting with the text of the statute does tell us something; under this particular statute the railroad is not required to equip cars with air brakes, doors that can be opened from the inside, or some other useful safety feature. But the text still leaves interpretive puzzles. What about the absence of the term “locomotive”? Congress could easily have drafted the provision to read “any car or locomotive . . . not equipped with couplers coupling automatically by impact.” Under the canon of construction known as *expressio unius est exclusio alterius*,⁶² an interpreter should infer from the inclusion of the term “car” and the absence of the term “locomotive” that Congress intended the statute not to apply to locomotives. Of course, as Karl Llewellyn demonstrated in one of the best known critiques of formalism, every canon of statutory construction has an opposing canon, which should be used “when the context dictates.”⁶³ In this case, if the context so dictates, one could argue that locomotives

⁶² 2A NORMAN J. SINGER, SUTHERLAND STATUTORY CONSTRUCTION § 47.23, at 216-17 (5th ed. 1992). This was one of the arguments made by the court of appeals in this case. *See* 117 F. at ____.

⁶³ Karl N. Llewellyn, *Remarks on the Theory of Appellate Decision and the Rules or Canons About How Statutes Are to Be Construed*, 3 VAND. L. REV. 395, 401-06 (1950). A notorious example of a court disregarding the *expressio unius* canon is *Holy Trinity Church v. United States*, 143 U.S. 457 (1892), in which a statute making it a crime to assist “the importation or migration of any alien” contained exceptions for certain categories of workers, such as lecturers, actors, and domestic servants, but said nothing about “brain toilers” and “ministers of the gospel.” The Court nevertheless held the statute inapplicable to an elite New York City church which had arranged for the entry of its new rector from England.

should be included from the opposing canon that the statute may comprehend cases beyond those specifically mentioned in the text, particularly if it is apparent that the statute has a purpose (such as protecting the safety of railroad workers) that would be advanced by requiring couplers on locomotives.⁶⁴ And these are only principles of interpretation based on the language of a statute. There are also policy-based aids to construction, such as the rule of lenity, which provides that an ambiguous criminal statute should be read narrowly.⁶⁵ The case mentioned by the railroad's vice-president, involving the theft of an airplane, can arguably be justified on this basis. Furthermore, we can ascribe a variety of hypothetical intentions to Congress (in the absence of clear legislative history).⁶⁶ Perhaps Congress wanted to improve safety for railroad workers,

⁶⁴ In reversing the Eighth Circuit, the Supreme Court relied heavily on Congressional intention and the purpose of the statute. See 196 U.S. at ____.

⁶⁵ 3 SINGER, *supra* note ____ § 59.03, at 102-05. The court of appeals also relied on the rule of lenity. 117 F. at ____.

⁶⁶ Interpretation by ascription-of-intention is a disfavored methodology in modern jurisprudence, owing to powerful critiques by Dworkin and others. See DWORKIN, *supra* note ____, at 313-27; WALDRON, *supra* note ____, at 124-29; ANTONIN SCALIA, A MATTER OF INTERPRETATION 29-32 (1997); Eskridge & Frickey, *supra* note ____, at 325-32; Easterbrook, *supra* note ____; Stephen F. Williams, *Restoring Context, Distorting Text: Legislative History and the Problem of Age*, 66 GEO. WASH. L. REV. 1366 (1998). Briefly, the problems with imputing intentions to a multi-member representative body are that there is no speaker or actor to whom to ascribe an actual unitary intention, and that constructing a fictional unitary intention by combining the intentions of individual legislators is doomed to failure because of theoretical difficulties involved in identifying and cumulating the mental states of dozens, if not hundreds of legislators. Each legislator may had a variety of mental states with respect to the proposed legislation — enthusiastic support, cautious assent, isolated qualms, serious reservations, or utter indifference. Legislators also may be moved by motives of rent-seeking, party loyalty, or logrolling, without regard to the content of the provision under consideration. See DANIEL A. FARBER & PHILIP P. FRICKEY, *LAW AND PUBLIC CHOICE* (1991). Specifically with respect to intention regarding interpretation, a legislator may hope that an interpreter would read the text in a particular way, even though she fully expected a different interpretation to gain acceptance. Even if we could identify the intentions of individuals, the actual text voted on by the majority may represent the intention of none of the individuals, because of the way preferences are registered in an assembly. Attempting to divine collective intention from legislative history is no less problematic, because of the manipulability of legislative history and the multiplicity of interpretations that can be supported by the relevant history documents such as committee reports and remarks made on the floor by supporters and opponents of the bill. Interpreting statutes by selecting bits and pieces of legislative history has often been criticized as tantamount to “looking over a crowd and picking out your friends.” See Patricia Wald, *Some Observations on the Use of Legislative History in the 1981 Supreme Court Term*, 68 IOWA L. REV. 195, 214 (1983); *Conroy v. Aniskoff*, 507 U.S. 511, 519 (1993) (Scalia, J., concurring).

even though it would impose high costs on the railroads, in which case couplers should be required on locomotives. On the other hand, the statute may have represented a compromise between workplace-safety advocates and the railroad industry, in which case it fairly should be read as requiring couplers only on non-locomotive cars.⁶⁷

As in most legal cases, it is possible to line up arguments in favor of both positions in the railroad case. This is the point at which analysis of statutory interpretation often resorts to metaphors of weighing and balancing to capture the process of exercising judgment. The trouble with these tropes is that the process of comparison they suggest creates an illusion of precision which in turn encourages

⁶⁷ The scheme which limited couplers to non-locomotive cars might be an example of what Dworkin would call a “checkerboard” statute, which seems to resolve the dispute in an arbitrary or unprincipled way. *See* DWORKIN, *supra* note ___, at 178-84. Dworkin believes he is tapping into a generally shared intuition that checkerboard statutes are objectionable because we would prefer *ex ante* that our preferred legal norm be either adopted or rejected, but not compromised. “Even if I thought strict liability for accidents wrong in principle, I would prefer that manufacturers of both washing machines and automobiles be held to that standard than that only one of them be.” *Id.* at 182. But leaving aside obvious checkerboards like a statute that made abortion legal on Mondays but illegal on Tuesdays, it is not clear that all legislative compromises like Dworkin’s product liability statute are unprincipled. There may be good reasons for imposing strict liability on automobile manufacturers but not washing machine manufacturers. (Perhaps washing machines are easier for users to inspect, or the expected cost of accidents is not as high, as compared with automobiles.) In the railroad case, if for some reason it is significantly more expensive to install couplers on locomotives, or if the operation of automatic couplers on locomotives creates some new danger that would not be present if they were used only on non-locomotive cars, the exclusion of locomotives from the coupler requirement would not be a checkerboard statute in Dworkin’s sense.

unrealistic expectations about the objectivity of judging. To put it another way, judgment sometimes functions as a black box in legal theory — one result or another mysteriously pops out of the decision-making machinery, but the process itself is opaque to observation and criticism from a third-person point of view. Sophisticated legal theorists do not use judgment in this way, however. In every serious account of legal interpretation, the interpreter’s judgment is constrained by something external to the interpreter, which is available for public observation and criticism. This external constraint of public justifiability secures the objectivity of judgment against the critique that the interpreter is simply imposing her own policy preferences on the law.

For example, Ronald Dworkin is the most enthusiastic proponent of a thoroughgoing interpretive approach to law, and he is quite clear that his hypothetical interpreter, the superhuman judge Hercules, must exercise judgment with respect to an external standard — the best justification of a legal speech-act (a judicial decision or the enactment of a statute) where “best” is understood in terms of the coherence of the principles underlying the act (i.e. as reasons explaining and justifying the act) with a political community’s ideals of integrity, fairness, and political due process.⁶⁸ Dworkin refers to this external constraint as integrity, and offers integrity as a criterion for others to judge whether Hercules has exercised his judgment correctly. Other theorists construct a framework of criteria, rebuttable presumptions, or a continuum of

⁶⁸ DWORKIN, *supra* note ____, at 337-38, 345-46.

complementary interpretive methodologies.⁶⁹ However these external checks on interpretive discretion are constructed, they are essential to ensure against not only rampant subjectivity by the interpreter, but also against reaching *ex post* evaluations of the propriety of an interpretation that would not have been as clear *ex ante*.⁷⁰

⁶⁹ See Eskridge, *Dynamic*, *supra* note ____, at 1496-97 (proposing continuum in which text controls where it provides determinate answers, but history, social and legal context, and evolutive context assume more importance as textualist interpretations become more contestible); Eskridge & Frickey, *supra* note ____, at 352-53 (proposing “funnel of abstraction” in which interpreter begins with statutory text and tests potential interpretations for historical accuracy and conformity to contemporary circumstances and values).

⁷⁰ Cf. Schwarcz, *Use and Abuse*, *supra* note 1, at 1313 (suggesting that some of the decisions of accountants and lawyers in the Enron transactions may look bad *ex post*, but at the time were defensible exercises of discretionary judgment).

To these models of judgment I would add a critical jurisprudential element: Interpretation is not a function of a single judicial or lawyerly mind, acting alone.⁷¹ Rather, it is a community-bound enterprise, in which the criteria for reasonable exercise of judgment are elaborated intersubjectively, among an interpretive community that is constituted by fidelity to law. These criteria are available to provide a justification of a decision.⁷² As Anthony Kronman correctly points out, a person characterized by good judgment “is not someone who from time to time merely makes certain strikingly appropriate oracular pronouncements.”⁷³ Rather, a person of good judgment can, if called upon to do so, provide a reasoned explanation of her decision.⁷⁴ This explanation is a public phenomenon, in the sense that the interpreter is appealing to shared community standards for evaluating the appropriateness of interpretation. In this way, the interpreter’s discretion is constrained by public norms regulating the understanding of legal texts. The meaning of these texts therefore becomes a property

⁷¹ Gerald Postema, “Protestant” Interpretation and Social Practices, 6 *LAW & PHIL.* 283 (1987).

⁷² See WILLIAM TWINING, *KARL LLEWELLYN AND THE REALIST MOVEMENT* 205 (1973) (discussing Llewellyn’s arguments in *The Common Law Tradition*); BURTON, *supra* note ___, at 19-22 (arguing that the rule of law demands that judges be able to justify their decisions on the basis of reasons about what the law is, as opposed to what they think it should be).

⁷³ Anthony T. Kronman, *Living in the Law*, 54 *U. CHI. L. REV.* 835, 848 (1987).

⁷⁴ HART & SACKS, *supra* note ___, at 143.

of the community, which confers the ultimate authority on legal norms, and the community's standards are legitimate to the extent they respect the purpose of law, which is to enable people to live peacefully together, flourish, and achieve their common ends.

A textualist might respond that I have assumed too hastily that judgment is necessary. Perhaps the plain language if the statute provides sufficient determinacy to accomplish the settlement of normative disputes that is the function of law. One might also make the argument from the authority of law by noting that legal norms are legitimate only to the extent they are enacted by fair procedures, and in the case of legislation, those procedures involve a majority vote on a particular form of words embodied in the resolution under discussion.⁷⁵ But the argument from authority shows only that “the product of legislation” is entitled to respect, not that the product of legislation is simply a text, the interpretation of which is confined to the literal language of the enactment. Even Jeremy Waldron, who makes the argument from authority powerfully, concedes that “statutes need interpretation [and] the words of the enactment (and their ‘plain meaning’) are often insufficient to determine the statute’s application.”⁷⁶ For Waldron, the important thing is that the interpretive process *begin* with the sense that there is a single, definitive proposal under discussion, and that the

⁷⁵ WALDRON, *supra* note ____, at 25, 77-82.

⁷⁶ *Id.* at 79.

meaning of the proposal should be recovered by beginning with the text of the enactment. Suppose in the railroad case that the legislature had responded to a series of lurid reports of accidents, and resulting public outcry. In the course of considering some response, it became apparent that workers were injured by attaching locomotives to cars as well as by hooking non-locomotive cars together. The course of discussion in the legislature reveals that all members of the assembly were concerned with this problem *in toto*, although the members disagreed on other points, such as whether to make new safety measures mandatory or voluntary. In that instance, is there any doubt that the word “car” should be interpreted to include locomotives? This interpretation is not undermined by the reasons for treating the enactment as authoritative, because the legislative response was aimed at settling some disagreement other than a disagreement over whether the word “car” should include locomotives. Thus, one should not assume that the functional argument for the authority of law necessarily entails a textualist interpretive methodology; in fact, it may support a broader purposivist approach to statutory meaning.⁷⁷

2. *Common-Law Reasoning.*

Judgment is also necessary in common-law reasoning because it is impossible

⁷⁷ See Lawrence M. Solan, *Private Language, Public Laws: The Central Role of Legislative Intent in Statutory Interpretation*, __ GEO. L.J. __ (2004) (“At the very least [legislative history] can help us to determine whether the difficulty in applying the statute results from an unfortunate choice of statutory language to effectuate a legislative goal that is very clear once one investigates the matter.”); William N. Eskridge, Jr., *The Circumstances of Politics and the Application of Statutes*, 100 COLUM. L. REV. 558, 566 (2000) (book review).

fully to specify meta-rules that capture the complexity of legal interpretation, when the decisionmaker must consider texts, principles, and facts, as well as subsidiary norms such as rules of legal salience (which point to aspects of the facts that are germane to the decision), considerations of weight and priority among competing norms, and the possibility of justified departures from previously sanctioned interpretations. Consider a famous example of the interplay between facts and rules in case interpretation, from Karl Llewellyn's *Bramble Bush*:

What are *the facts*? The plaintiff's name is Atkinson and the defendant's Walpole. The defendant, despite his name, is an Italian by extraction, but the plaintiff's ancestors came over with the Pilgrims. The defendant has a schnauzer-dog named Walter, red hair, and \$30,000 worth of life insurance. . . . The defendant's auto was a Buick painted pale magenta. He is married. His wife was in the back seat, an irritable, somewhat faded blonde. She was attempting back-seat driving when the accident occurred. He had turned around to make objection. In the process the car swerved and hit the plaintiff. The sun was shining; there was a rather lovely dappled sky low to the West. The time was late October on a Tuesday. The road was smooth, concrete. It had been put in by the McCarthy Road Work Company.⁷⁸

⁷⁸ KARL LLEWELLYN, *THE BRAMBLE BUSH* 46-47 (1951) (emphasis in original).

It does not take more than a couple of weeks of law school for a first-year student to learn to winnow out the relevant facts from an example like this. But what has the student learned? Surely not a system of rules that can be applied deductively (e.g. “if the dispute involves an auto accident, road conditions may be relevant but not the plaintiff’s ethnic ancestry”), because any set of rules would quickly become too complex to learn and apply. For example, the identity of the construction company may or may not be legally salient, depending on whether the case involves allegations that the design of the road contributed to poor visibility. Life insurance may matter if this is a case in which the collateral source rule is an issue. Even the ethnic background of the plaintiff and defendant might conceivably matter if the auto accident had been only the precursor to a violent argument in which insults were exchanged, and out of which the plaintiff claims infliction of emotional distress.⁷⁹ Some knowledge of the law is necessary to know which facts are relevant, but the relevance-making relationship between law and facts is not constituted by rules.⁸⁰ Instead of rule-application, this

⁷⁹ See, e.g., *Taylor v. Metzger*, 706 A.2d 685 (N.J. 1998) (recognizing cause of action for intentional infliction of emotional distress arising out of racial epithets uttered in an employment setting).

⁸⁰ Cf. BARBARA HERMAN, *THE PRACTICE OF MORAL JUDGMENT* 75 (1993) (“An agent who came to the [Kantian Categorical Imperative] procedure with no knowledge of the moral characteristics of actions would be very unlikely to describe his action in a morally appropriate way.”). See also Michael Moore, *Torture and the Balance of Evils* 23 *ISRAEL L. REV.* 280, 287-88 (1989) (arguing that moral knowledge of the domain of consequentialist calculation is needed before it is possible to proceed to consider consequences in moral reasoning). Note that Moore does not subscribe to an intuitionist view, in which knowledge of the domain of consequentialist calculation is something mysterious and ineffable; rather, he reviews numerous rigorous standards (such as the act/omission and intended/foreseeable distinctions, the preexisting peril doctrine, and Judith Jarvis Thomson’s principle of redirecting harms) which justify the boundary between permissible and impermissible use of consequences in moral reasoning. *Id.* at 299-308. Moore boils these down to the standard threefold analysis of criminal law culpability, *id.* at 308-09, but the application of these criteria still calls for the exercise of judgment, as opposed to deductive reasoning. The point is not that the student’s judgment in my example, or the ascription of responsibility in Moore’s, is incapable of being justified or theorized, but that the precise nature of reasoning process is often opaque to the person exercising judgment. See generally DONALD SCHÖN, *THE REFLECTIVE PRACTITIONER: HOW PROFESSIONALS THINK IN ACTION* (1983).

reasoning process involves the exercise of informed professional judgment, which can be justified on the basis of rules and standards, but which is always incompletely specified, or underdetermined by rules and standards. These higher-order norms are acquired and internalized through professional education and followed largely unconsciously within a given interpretive community.

My claim is that these higher-order norms are legitimate, and have authority to the exclusion of ordinary moral reasons, to the extent they enable the law to fulfill its function of optimizing people's ability to work together to achieve common projects.⁸¹ The law would fail at this end if one of two conditions obtained: (1) it were impossible for a representative of a client to discern the content of the law, or (2) it were permissible for individual legal interpreters, such as lawyers, to manipulate the formal expression of legal norms to make them mean anything at all, thereby defeating their substantive purpose. Thus, if it is apparent that the purpose of the statute in the railroad case is to prevent accidents caused by workers getting their hands caught in manual coupling mechanisms, there will be good grounds for interpreting the statute to require automatic couplers on locomotives. Naturally, a contrary purpose may be apparent — perhaps, as suggested previously, the statute was a compromise between advocates of a comprehensive reform of railroad safety regulations and those who preferred a more cautious, incremental approach. In that case, one might make a reasonable argument for not requiring the automatic couplers on locomotives. But the

⁸¹ HART & SACKS, *supra* note ____, at 146-48.

crucial term here is *reasonable*. The demand is, in any event, for a reasoned elaboration of an interpretation of legal texts. Appealing only to formal features like the statutory text is not a reasoned elaboration, absent some argument why the form alone ought to have dispositive importance in the particular case. Similarly, in the forum-selection clause case, the lawyer must be able to offer a reasoned argument for analogizing the clause in the cruise ticket to either the forum-selection clause in the cargo carriage contract (permissible) or the unconscionable contract terms in the installment-sales contract (impermissible). Professionalism does not necessarily favor one interpretation or another, but it does rule out the kind of facile analogy-drawing that might be used by a lawyer who was interested only in taking advantage of a superficial similarity between two cases.

3. *Hard Cases and Right Answers.*

Finally, to anticipate a common objection to this line of reasoning, it is important to emphasize that I am not denying the existence of “hard cases,” where the relevant legal texts and interpretive practices underdetermine the result.⁸² Hart and Sacks confidently assert that “[u]nderlying every rule and standard . . . is at least a policy and in most cases a principle [which is] available to guide judgment in resolving

⁸² See BURTON, *supra* note ____, at xii, 5-12, 47-48, 79-80. The term “hard cases” is associated with Dworkin’s debate with Hart. See Ronald Dworkin, *Hard Cases*, in *TAKING RIGHTS SERIOUSLY* 81 (1977) [hereinafter, “Dworkin, *Hard Cases*”].

uncertainties about the arrangement’s meaning.”⁸³ Although I share their belief that underlying purposes, policies, and principles are available to guide judgment, the passage quoted is made too strong by the singular nouns — a policy, a principle. Many legal rules and standards serve multiple, sometimes conflicting purposes. In addition, purpose is not the only key to a statute’s meaning — the express language of the statute may be in conflict with its purpose, and there may be other indications, such as legislative history and context, that cut against the interpretation suggested by the apparent purpose (even if there is only one). For these reasons, there are a great many cases in which competent judges or lawyers, reasoning in good faith, could reach result A or result B, and be deemed by a competent observer to have performed her job adequately.⁸⁴ An observer might disagree with B, and believe that A was the better result, but nevertheless concede that B was within the range of plausible, justifiable results.⁸⁵ For example, consider a municipal ordinance that bans vehicles in excess of

⁸³ HART & SACKS, *supra* note ____, at 148.

⁸⁴ Kent Greenawalt, *Discretion and the Judicial Decision: The Elusive Quest for the Fetters That Bind Judges*, 75 COLUM. L. REV. 359, 368-69 (1975).

⁸⁵ I do not believe it is possible to define “plausible” legal arguments in mathematical terms — e.g. whether a 10% chance, a 30% chance, and so on, is necessary before we can deem an interpretation of law plausible. Plausible is certainly more than passing the proverbial straight-face test. The standard should be understood instead in terms of an attitude or conviction on the part of the lawyer who offers the interpretation, and may be fleshed out with reference to a kind of hypothetical reasonable observer. One possible heuristic is that if a lawyer would be comfortable making the argument to the judge for whom she clerked, a professor she respects, or a colleague who is known for her good sense and judgment, the argument is plausible. If the lawyer could stand behind an interpretation, take pride in it, and offer it to a third party the lawyer respects for her sound judgment, then the interpretation is plausible.

I recognize that it can be difficult to give a rigorous logical account of the distinction between a plainly implausible legal argument (say, one with only a 1% chance of success) and a clearly plausible one (say, one with a 98% chance of success). See Sorites Paradox, in THE CAMBRIDGE DICTIONARY OF PHILOSOPHY 864 (Robert Audi ed., 2d ed. 1999); Jeremy Waldron, *Vagueness in Law and Language: Some Philosophical Issues*, 82 CAL. L. REV. 523 (1994). But law does not lend itself to bivalent logic and always demands the exercise of judgment. Further

6,000 pounds from residential streets — does the ordinance apply to monster sport-utility vehicles like the Ford Excursion and Cadillac Escalade?⁸⁶ The ordinance is intended to reduce wear and tear on municipal streets, as well as prevent accidents caused by heavy trucks driving in residential neighborhoods. Not only do large SUVs fall within the prohibition created by the literal language of the statute, but they pose many of the same dangers; they are within the “mischief” sought to be remedied by the statute, as British lawyers would say.⁸⁷ On the other hand, these ordinances were mostly enacted before the widespread craze for SUVs, particularly the gigantic subgenre of vehicles that weigh as much as commercial trucks. The drafters of the ordinances probably did not intend to target vehicles that are owned primarily for personal use. Moreover, the law is generally quite lenient on SUVs, granting their owners special tax breaks and their manufacturers exemptions from passenger car fuel

support for this assertion must await the arguments in Section _____. As a preliminary matter, even if we are uncertain whether we need three, four, five, or *n* stones to make a heap, it does not mean that there are no such things as heaps. Moore, *supra* note _____, at 332. By analogy, even if we may be unsure on the margins whether an argument is frivolous, we should not conclude that there is no such thing as a frivolous argument.

⁸⁶ See Andy Bowers, *California's SUV Ban*, SLATE (Aug. 4, 2004), <<http://slate.msn.com/id/2104755>> (visited 8/4/04).

⁸⁷ See Heydon's Case, [1584] 76 E.R. at 638.

economy standards.⁸⁸ Thus, one could plausibly argue that the most reasonable interpretation of the ordinance would not apply to SUVs.

⁸⁸ See Union of Concerned Scientists, *Tax Incentives: SUV Loophole Widens, Clean Vehicle Credits Face Uncertain Future*, <http://www.ucsusa.org/clean_vehicles/cars_and_suvs/page.cfm?pageID=1280> (visited 8/4/04).

What is critical in hard cases is that the judge argue for A or B on the basis of what might be called “internal” legal reasons, and do so in a way that is respectful of the role of law.⁸⁹ In order to respect the rule of law, these justifications must be based on reasons that could be advanced publicly in an adversarial process in which reasons are given in support of one’s position.⁹⁰ It is not necessary that all interpreters agree on the result, as long as the result is justifiable in principle on the basis of internal legal reasons. Internal legal reasons are simply those grounds (texts, principles that are fairly deemed to underlie and justify legal rules, interpretive practices, hermeneutic methods, and so on) that are properly regarded in a professional community as appropriate reasons to offer in justification of a result. In the SUV case, the arguments back and forth were offered on the basis of reasons such as the underlying policies (reducing wear and tear on streets), traditional canons of statutory construction (the mischief rule), and interpretive practices that place a single text in a broader legal context (observing the solicitude for SUVs in environmental and tax law). Perhaps it is most natural to define internal legal reasons negatively, as excluding extraneous factors such as a bribe, gratitude for a party’s support in a judicial election, information excluded by

⁸⁹ In fairness to Hart and Sacks, they recognize the problem of indeterminacy: “It may even be said that more than one answer is permissible, in the sense that if one answer had been conscientiously reached and generally accepted a reviewing court might well think it ought not to be upset, even though its own answer would have been different as an original matter.” HART & SACKS, *supra* note ___, at 149. Fairly or not, however, *The Legal Process* has become known as the *locus classicus* of the attribution-of-purpose method of statutory interpretation, and Hart and Sacks are usually understood to have relied on an assumption that a statute, case, or legal doctrine has a single purpose standing behind it. *See, e.g.*, Eskridge & Frickey, *supra* note ___, at 333-37. I do want to make clear that I do not subscribe to the interpretation of Hart and Sacks that assumes a single purpose lying behind a regime of legal rules and standards.

⁹⁰ *See* MICHAEL IGNATIEFF, *THE LESSER EVIL: POLITICAL ETHICS IN AN AGE OF TERROR* 49-53 (2004) (arguing that the rule of law does not require invariance, but does require public justification).

evidentiary rules, the flip of a coin, or what the judge ate for breakfast.⁹¹ Providing a positive definition of internal legal reasons is a major task of analytic jurisprudence, and the following Section considers how seemingly esoteric academic debates can actually have a great deal of practical significance for how lawyers understand their role in relation to the law.

⁹¹ The familiar reference to “what the judge had for breakfast” as a basis for judicial decisions is a caricature of American legal realism. Most realists believed that judicial decisions fell into predictable patterns, influenced by various social forces. Only a small faction of realists argued that the reasons for judicial decisions were completely idiosyncratic, a claim whose plausibility is undermined by the ability of lawyers to predict judicial decisions with a fair degree of reliability. *See generally* Brian Leiter, *American Legal Realism*, in *THE BLACKWELL GUIDE TO PHILOSOPHY OF LAW AND LEGAL THEORY* (Martin Golding ed. 2004).

Before moving on to that discussion, however, it is necessary to consider a seeming inconsistency between the demands of professionalism in litigation, on the one hand, and transactional and counseling contexts, on the other. In an easy case, a lawyer is not justified in urging a court to adopt a spurious interpretation of law; neither is she permitted to structure a transaction in order to take advantage of an illegitimate construction of applicable legal rules. The law governing lawyers — both the state bar disciplinary rules and the law of civil procedure — prohibits advancing frivolous legal arguments.⁹² In a hard case, however, it appears to be an implication of professionalism that a lawyer may advocate for an interpretation in litigation that she would be prohibited from adopting as the basis for legal advice to a client or the structure of a transaction. This contextual distinction does exist in the law of lawyering, most notably in the Securities and Exchange Commission’s regulations implementing the Sarbanes-Oxley act, which require lawyers in some cases to report information “up the ladder” within a corporation where they reasonably believe their client is committing certain wrongful acts, but do not require reporting up where the lawyer is representing the client in litigation over the wrongful act.⁹³ The distinction may nevertheless be incoherent if it amounts to a requirement that the lawyer assert, in litigation, an interpretation of the law that she would be prohibited from relying upon in transactional

⁹² See MODEL RULES, *supra* note ____, Rule 3.1; RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 110 (2000); FED. R. CIV. P. 11.

⁹³ Compare 17 C.F.R. § 205.3(b)(2)-(3) (duty to report where representing issuer in non-litigation context) with 17 C.F.R. § 205.3(b)(7)(ii) (no duty to report up where lawyer retained “[t]o assert, consistent with his or her professional obligations, a colorable defense on behalf of the issuer . . . in any investigation or judicial or administrative proceeding relating to such evidence of a material violation”).

representation.⁹⁴

⁹⁴ Thanks to Dennis Tuchler for raising this problem with me in correspondence.

It is important to note that the distinction between the transactional and litigation contexts is not some kind of ontological or epistemological claim that the law is actually different in these contexts or it may more easily be recovered in one setting than the other. The applicable law and the process of interpretation are the same in both settings. The difference is, in hard cases, the responsibility to serve as a custodian of the law is primarily the judge's, with limited coordinate duties on lawyers not to advance frivolous legal arguments, fail to disclose adverse legal authority missed by the adversary, falsify evidence, or permit perjury to taint the record.⁹⁵ The lawyer is justified in advancing an aggressive or novel interpretation of law in litigation, as long as there is some good faith basis for the argument, because the judge is always in a position to reject it. Transactional and planning situations are distinctive precisely for the lack of an impartial referee to push back on the lawyer's client-centered construction of the law. The lawyer is the sole legal interpreter and is therefore, in effect, a law-giver from the client's point of view. As such, the lawyer has the power to shape the law for good or for ill. As Spider-Man would observe, with great power comes great responsibility, for if the lawyer does not in some sense internalize the judicial virtues of impartiality and objectivity, the law will be distorted by partisan zeal in a context where no neutral third party can check this tendency. In litigation, the lawyer's partisan stance and greater flexibility to advance aggressive or novel interpretations of legal rules creates flexibility and adaptivity in the law. If similar interpretive license were permitted in transactional work, however, the legal system would lose some of the virtues identified with the rule

⁹⁵ For these litigation-related duties, see MODEL RULES, *supra* note ____, Rules 3.1 (frivolous legal arguments), 3.3(a)(1), (3) (perjury), 3.3(a)(2) (adverse legal authority), 3.4(b) (falsifying evidence).

of law, such as stability, predictability, and certainty. Legal theory must always balance the need for growth and change with the values of stability and resistance to manipulation. The distinction between transactional and litigation-related representation is one way to strike this balance.

III. Arguments for Professionalism.

A. Identification and Interpretation of Legal Norms.

I have been defending the view that the social function of law is the settlement of uncertainty and normative conflict, and this requires a system of legal norms that can be identified without reference to the truth of moral beliefs. This is an argument about the nature of *law*. Even if one accepts this account of the nature of law, however, there can be further controversy over *the law* in a given case.⁹⁶ The law on a particular issue must be sufficiently determinate that the matter may be resolved by reference to the law, rather than any of the reasons that were at stake in the underlying normative disagreement. The question of the identity of the law, as opposed to the nature of law, is case-specific and interpretive. It can be stated concisely in one of the following ways:

⁹⁶ See H.L.A. Hart, *Postscript*, in HART, *supra* note ____, at 237, 247-48 [hereinafter, “Hart, *Postscript*”], for this distinction, which he accuses Dworkin of blurring. Waldron explicitly connects the problem of interpretation with the authority of law: “If enacted law is to settle at least some cases at the level of particularity at which they present themselves, a rule of recognition will need to provide a basis for specifying not only which proposal, but *which version* of a given proposal, has been enacted.” WALDRON, *supra* note ____, at 39.

“What does it mean to say that a proposition of law is true?”⁹⁷ or “With respect to some action, is it legally permitted?” The controversy about the law can also be understood in terms of criteria for the objectivity of legal decisions. If a judge decides that there is a constitutional right to same-sex marriage, or to obtain an abortion, or to use marijuana for the purpose of alleviating pain, the question naturally arises whether the decision is just the judge’s subjective belief about what the law ought to be, or whether it is in fact an accurate report on what the law is, or at least a defensible judgment where the legal issue could have more than one plausible resolution.⁹⁸ Most attempts to understand the nature of objectivity in legal reasoning have addressed themselves to the predicament of a judge who must decide a case, or a critic of a judicial decision.⁹⁹ If with respect to an interpretive question in law, there is an objective or determinate right answer, range of plausible right answers, or at least a wrong answer, then it is possible to criticize the judge from the standpoint of law, for making a mistake. If there is no such thing as objectivity or determinacy in law, however, the law

⁹⁷ See DENNIS PATTERSON, *LAW & TRUTH* 3 (1996).

⁹⁸ See Fiss, *supra* note ____, at 742.

⁹⁹ The most helpful discussions include KENT GREENAWALT, *LAW AND OBJECTIVITY* (1992); Gerald J. Postema, *Objectivity Fit for Law*, in *OBJECTIVITY IN LAW AND MORALS* 99 (Brian Leiter ed. 2001); Andrei Marmor, *Three Concepts of Objectivity*, in *POSITIVE LAW AND OBJECTIVE VALUES* 112 (2001); Jules L. Coleman & Brian Leiter, *Determinacy, Objectivity, and Authority*, in *LAW AND INTERPRETATION* 203 (Andrei Marmor ed. 1995); JOHN RAWLS, *POLITICAL LIBERALISM* 110-16 (1993) [hereinafter, “RAWLS, LIBERALISM”].

does not provide a standpoint for criticizing the judge.

Lawyers, too, must worry about whether legal interpretation can be objective or determinate, because when they act in a representative capacity, they enable or limit their clients' enjoyment of legal entitlements.¹⁰⁰ If a client has a legal right to disinherit his son for opposing the war in Vietnam,¹⁰¹ but his lawyer refuses to draft a will with this effect because of her moral disagreement with the client's desire, the lawyer has blocked the client's enjoyment of a right that the legal system would recognize if asserted — namely, the right to cut his son out of his inheritance. The client may be able to find another lawyer to draft the will, but regardless of whether the client eventually gets his wish, one could ask whether the original lawyer acted wrongly *vis-à-vis* the client's legal entitlement. The first step in that analysis would be to ascertain the content of the law of wills. Apparently in Louisiana a parent can disinherit a child only for one of ten enumerated "just causes," which must be set forth specifically in the will.¹⁰² Unless the hypothetical occurred in Louisiana, however, the testator's freedom is virtually unrestricted, except by pretermitted heir statutes, which require the intent to

¹⁰⁰ EISENBERG, *supra* note ____, at 10 ("in the vast majority of cases where law becomes important to private actors, as a practical matter the institution that determines the law is not the courts, but the legal profession").

¹⁰¹ Richard Wasserstrom, *Lawyers as Professionals: Some Moral Issues*, 5 HUM. RTS. 1, 7-8 (1975) (using this example to illustrate the tension between legal entitlements and ordinary moral reasons).

¹⁰² See Max Nathan, Jr., *An Assault on the Citadel: A Rejection of Forced Heirship*, 52 TUL. L. REV. 5, 12 (1977). None of the grounds stated would encompass Wasserstrom's hypothetical — they cover situations such as the child "rais[ing] his hand to strike a parent" or an adult child failing to communicate with a parent, without just cause, for two years. See LA. CIV. CODE art. 1621.

disinherit the son to be expressly stated in the will.¹⁰³ In one of those states, the lawyer may believe her refusal to cooperate with the client to be morally justified, and she may further believe that her moral obligation not to assist the client outweighs her moral obligation to obey the law, but as long as she is a competent lawyer she will not deny that the governing law would have permitted the client to disinherit his son.

¹⁰³ See WILLIAM M. MCGOVERN, JR., WILLS, TRUSTS AND ESTATES § 3.6 (1988).

This is obviously an exceptionally simple example,¹⁰⁴ but it illustrates what is at stake for lawyers in the attempt to characterize objectivity in legal interpretation: If the objectively correct interpretation of an applicable legal norms is that the client has a right to do X, then the lawyer in an existing lawyer-client relationship must justify her refusal to assist the client in doing X in moral terms. On the other hand, if one cannot say objectively that legal norms permit the client to do X, then the lawyer has no burden to justify her refusal morally — she can appeal instead to an interpretation of the law. Notice that the will example assumes the lawyer is motivated not to assist her client. The possibility that law is indeterminate creates a different, but equally serious ethical problem if the lawyer is motivated to do anything at all for her (presumably high-paying) client. If one cannot say objectively that the client is *not* legally entitled to do Y, and Y is a socially harmful thing to do, then the client doing Y may cause a significant amount of harm with the assistance of a lawyer, and there is no legal standpoint from which we

¹⁰⁴ Simple examples are sometimes useful to argue against the view that *all* legal texts present serious problems of indeterminacy. See BURTON, *supra* note ____, at 9-10 nn.20-21 (citing extensive collection of Critical Legal Studies sources urging that indeterminacy is a pervasive and unavoidable aspect of legal interpretation). Although it is possible to overgeneralize from easy cases, it is nevertheless worth noting that there is a practically infinite number of examples that can be offered of uncontroversial interpretation of legal norms. See, e.g., Lawrence B. Solum, *On the Indeterminacy Crisis: Critiquing Critical Dogma*, 54 U. CHI. L. REV. 462 (1987). The strongest form of the indeterminacy claim — that “doctrinal inconsistency necessarily undermines the force of any conventional legal argument” — is fairly straightforwardly refuted by stating propositions such as, “the first paragraph of this essay does not slander Gore Vidal.” *Id.* at 471-72. Cf. PUTNAM, *supra* note ____, at 116-19 (arguing against the view that interpretation is called for in every case).

can criticize the lawyer for helping the client do Y. The latter scenario is the conceptual problem at the heart of the Enron collapse — we may or may not have good grounds to criticize the lawyers, from the standpoint of legal interpretation, for their role in setting up the questionable transactions.

In order to determine whether the Enron lawyers are subject to criticism from the point of view of the law, we must first determine what the law is with respect to these transactions. Unlike a simple example like the railroad hypothetical, ascertaining the law in this case is not a matter of reading unambiguous statutory language and applying the rule it announces to a case within the core of the statute's plain meaning.¹⁰⁵ Finding the relevant rule is a much more complicated interpretive exercise in most cases, because of familiar problems with the use of verbally formulated rules to guide conduct. In Hart's well known formulation, legal rules have an "open texture."¹⁰⁶ Rules do not determine the scope of their own application, but there must always be something (another rule perhaps, or a conventional practice in the relevant community) which picks out the instances of some phenomenon which fall under the rule.¹⁰⁷ It is

¹⁰⁵ For the terminology of "core" meaning, see H.L.A. Hart, *Positivism and the Separation of Law and Morals*, 71 HARV. L. REV. 593, 607 (1958) ("If we are to communicate with each other at all, and if, as in the most elementary form of law, we are to express our intentions that a certain type of behavior be regulated by rules, then the general words we use . . . must have some standard instance in which no doubts are felt about its application.").

¹⁰⁶ HART, *supra* note ____, at 124-36.

¹⁰⁷ *Id.* at 126. Another way to make this point is to distinguish between two categories of rules: conduct rules, which are addressed to citizens and permit or forbid certain acts, and decision rules, which are addressed to officials and regulate what these officials do when they apply or interpret the law. See Dan-Cohen, *supra* note ____, at 627. As Dan-Cohen argues, "[t]he proper relationship between decision rules and their corresponding conduct

tempting to respond that a legal judgment is objectively true if it corresponds with something “out there,” like “what the law really is” in a particular case. In general, correspondence theories of truth are widely believed to be fatally flawed, for a number of reasons, one of which is particularly relevant to the attempt to use correspondence as a criterion for legal objectivity.¹⁰⁸ Suppose we wish to know whether the sentence “the cat is on the mat” is true. The correspondence theory of truth says it is true if the sentence p (“the cat is on the mat”) corresponds to a state of affairs in the world W (cat on mat), in some kind of appropriate correspondence-relationship C , whatever that may be.

Schematically, we can represent this truth condition as pCW . Now, have we got it right? Does p correspond to W in the right way? This is to ask the question whether pCW itself is true, which suggests there may be some property of the world W' to which pCW may or may not correspond. So pCW is true if $pCWCW'$. Then it is open for us to ask whether $pCWCW'$ is true. We are thus faced with an infinite regress, in which there is no foundational fact-and-correspondence relationship about which we cannot in principle ask whether it is true. Something else must serve as criteria of truth, such as correspondence with other beliefs, or a normative community practice of manifesting agreement with the speaker who utters “there is a cat on the mat” under certain

rules is not a logical or analytic matter.” *Id.* at 629. Rather, one must make a normative argument about the kinds of decisions rules we want, in light of the relevant policies and values. The position advanced in the following textual discussion differs from Dan-Cohen’s model of the relationship between decision rules and conduct rules in that it does not concede the existence, as a logical matter, of a rule that can be both a conduct rule and a decision rule. *Cf. id.* at 631.

¹⁰⁸ This discussion is drawn from SIMON BLACKBURN, *SPREADING THE WORD: GROUNDINGS IN THE PHILOSOPHY OF LANGUAGE* 224-29 (1984).

conditions.¹⁰⁹

In legal reasoning, if there is any vagueness, open-texture, or uncertainty in the law, however, it is an open question whether the judgment corresponds to the law as it is. The sentence “the judgment corresponds to the law” is itself contestable, and the attempt to specify truth conditions for that sentence leads us down the same path of infinite regress. In other words, the correspondence relationship is impossible to pin down *using only the concept of correspondence*. Something else is needed to give genuine content to the notion of a truth-making relationship between an interpretation, on the one hand, and legal texts, practices, and conventions, on the other. Figuring out the nature of that “something else” has been a major preoccupation of analytic jurisprudence. It is certainly an issue that arises in connection with the argument for professionalism, because a lawyer who adheres to the Holmesian bad man position would deny the status of “law” to the considerations I claim should be relevant to legal interpretation by transactional lawyers.

¹⁰⁹ See ALEXANDER & SHERWIN, *supra* note ____, at 113-14.

In jurisprudential terms, the problem can be stated in terms of Hart's concept of a rule of recognition. In Hart's account, a legal system is "mature" rather than "primitive" to the extent it is characterized by a union of primary and secondary rules.¹¹⁰ Primary rules impose obligations, create rights or permissions, and in other ways guide the day-to-day activities of citizens. Secondary rules, by contrast, are rules respecting what can be done with primary rules — they provide for orderly, formal change in primary rules, permit adjudication of disputes that arise under primary rules, and so on. The most important of these secondary rules, which is essential to the concept of a legal system, is a rule which provides binding criteria for legal officials who must identify primary rules in order to interpret and apply the law. This is the rule of recognition.¹¹¹ The structure described by Hart gives rise to a paradox, however, because the rule of recognition cannot depend for its validity on any other rule; otherwise the infinite regress problem would recur.¹¹² His ingenious solution is to deny that there are legal rules or other norms that require officials to follow the rule of recognition. The rule of recognition, instead, comes into existence because it is practiced, in the sense that officials regard it as a standard for critically evaluating their own and others' conduct.¹¹³ The convergence by officials on a standard for identifying legal norms, and the internal

¹¹⁰ HART, *supra* note ___, at 91-94. Hart's term "primitive" is perhaps unfortunate, but he uses it primarily as a thought experiment, not a characterization of any actual human society. A primitive legal system, as Hart uses the term, would be a small, closely knit community in which people knew each other and shared a thick set of values, so that they could effectively govern themselves by simple methods of social control.

¹¹¹ *Id.* at 100.

¹¹² Scott J. Shapiro, *On Hart's Way Out*, in HART'S POSTSCRIPT: ESSAYS ON THE POSTSCRIPT TO THE CONCEPT OF LAW 149, 150-53 (Jules Coleman ed. 2001) [hereinafter, "Shapiro, *Hart's Way Out*"].

¹¹³ *Id.* at 154; HART, *supra* note ___, at 116-17; Ronald Dworkin, *The Model of Rules II*, in TAKING

attitude that officials take toward the rule as a reason for action, are the criteria for legality, not any further rule whose credentials as a legal rule would themselves stand in need of certification by the rule of recognition.

RIGHTS SERIOUSLY 46, 49 (1977) [hereinafter, "Dworkin, *Model II*"].

Because it is a product of conventional behavior by officials and the attitude of acceptance of the rule as a guide to conduct, the rule of recognition need not be formally expressed as a rule, or written down in any authoritative legal document.¹¹⁴ Thus, one might wonder whether legal judgments can be objective, if they have no foundation other than social practices. Specifically in regard to this Article, one might wonder whether the interpretive stance of professionalism is validated as a legal standard by the applicable rule of recognition, whether it is just my subjective policy preference or, as a third possibility, whether it is an objectively binding principle of legal interpretation that is not validated by the rule of recognition. It is important at this juncture not to overstate the requirements for a judgment to be objective. Even a strong conception of objectivity need not require something like Platonic forms or correspondence with the fabric of the universe to underwrite the truth of a proposition. Rather, objectivity in law need be only moderately domain-specific, meaning that the characteristics of as an objective judgment in the natural sciences will differ in some respects from that which makes a judgment objective in art criticism, basketball officiating, or faculty hiring decisions.¹¹⁵ An objective judgment in any endeavor must have certain characteristics: (1) independence from the subjectivity of the judging subject, openness to the subject matter, and willingness to base judgments on the subject itself, not personal idiosyncracies; (2) amenability to evaluation of the correctness of judgments, or standards for assessing judgments; and (3) invariance

¹¹⁴ HART, *supra* note ____, at 101-03,

¹¹⁵ *See* Postema, *supra* note ____, at 100.

across judging subjects.¹¹⁶ A decision to follow norm that is capable of serving as a Hartian rule of recognition satisfies these criteria — in Hart’s words a political official “manifests acceptance” of the rule of recognition,¹¹⁷ acknowledging that whether a norm counts as a rule of recognition is independent of the subjectivity of the official. The official also acknowledges that the rule of recognition is a product of the shared acceptance of the norm, which indicates acceptance of standards for evaluating the correctness of this judgment. Finally, there must be a high degree of invariance in officials’ acceptance of the norm, or there would be a general collapse in the efficacy of the legal system.¹¹⁸ As Hart recognized, there may be some disagreement at the margins of a rule of recognition, but as long as there is a “normally concordant” practice of identifying law with reference to certain criteria, one exists.¹¹⁹

¹¹⁶ *Id.* at 105-09; *see also* Fiss, *supra* note ____, at 744 (objectivity implies that an interpretation can be measured against a set of norms that transcend the judging subject); RAWLS, LIBERALISM, *supra* note ____, at 110-12.

¹¹⁷ HART, *supra* note ____, at 102.

¹¹⁸ *Id.* at 103-04.

¹¹⁹ *Id.* at 109-10.

For Hart, whether a rule of recognition exists is an empirical question.¹²⁰ The content of the rule of recognition is an empirical question as well.¹²¹ One can ascertain the existence and content of a rule of recognition by reading cases, doing legal sociology, or some other method appropriate to discovering facts about a community's practices. The argument in this Section might be restated in these terms, as a claim that the prescribed attitude of professionalism is in fact law, and that this fact can be proven by studying the interpretive practices of lawyers and judges in a number of related areas. In a different vein, one might make a critical or normative argument about the rule of recognition — namely, that it ought to recognize a principle or standard as a part of the law. The normative argument in this case would maintain that the legal system would be better if the attitude of professionalism were a feature of the law, not an aspiration for lawyers or an obligation of ordinary morality.

B. Descriptive Arguments: The Case of Tax Shelters.

¹²⁰ *Id.* at 110. Dworkin criticizes Hart for arguing that social rules are constituted by behavior while admitting that rules can be uncertain at the margins. Dworkin, *Model II*, *supra* note ____, at 54. The Hartian distinction between the core and penumbra of rules can explain this apparent anomaly, because the core of a rule of recognition will exist as long as it works most of the time, with only a few marginal uncertainties.

¹²¹ *Id.* at 150 (“Which form of omnipotence . . . our Parliament enjoys is an empirical question concerning the rule which is accepted as the ultimate criterion in identifying the law.”).

Interpretive practices by judges, lawyers, legislators, and scholars frequently make reference to *principles* to justify a conclusion that X is a true proposition of law. In contrast with rules, which have a binary, all-or-nothing character,¹²² principles are characterized by being reasons in support of a judge's decision, but not conclusive reasons in the way that rules are. Two principles can conflict, and one can outweigh another, while both remain parts of the legal system; by contrast, when two rules conflict, one of the rules must persist while the other is abandoned.¹²³ Principles in the Dworkinian sense are not the kind of extra-legal moral arguments that one might make to criticize the law for being wrongheaded; rather, they exist within the law and can serve as a link in the chain of an internal justificatory argument.¹²⁴ Because they are part of the law, lawyers can no more ignore these principles than they can omit express statutory or common-law rules from their reasoning process.¹²⁵ In addition, lawyers appeal to extra-legal norms constraining their interpretive activities. These are not Dworkinian principles in the sense of being part of the law itself, but are an aspect of an

¹²² Ronald Dworkin, *The Model of Rules I*, in TAKING RIGHTS SERIOUSLY 14, 24 (1977) [hereinafter "Dworkin, *Model I*"].

¹²³ *Id.* at 26-27. In his response to Dworkin contained in the Postscript to *The Concept of Law*, Hart refers to this feature of principles as their "non-conclusive" character. Hart, *Postscript*, *supra* note ____, at 261. He argues that Dworkin exaggerates this distinction between rules and principles, and that there are many instances in which two legal rules conflict and one is held to outweigh the other. Hart also points out that in cases where a principle conflicts with a rule and the principle prevails, the rule is not abandoned. *Id.* at 262.

¹²⁴ Dworkin, *Model I*, *supra* note ____, at 35, 44; Dworkin, *Hard Cases*, *supra* note ____, at 85, 115. Hart contended that judges exercise law-making power in cases that lay far out in the penumbra of rules. See HART, *supra* note ____, at 135, 145.

¹²⁵ Dworkin argues that principles do not have the same pedigree as judicial decisions and statutes — rather, they are a product of a "sense of appropriateness developed in the profession." Dworkin, *Model I*, *supra* note ____, at 40. Hart responds that there is no reason why principles cannot be identified by pedigree criteria, "in that they have been consistently invoked by courts in ranges of different cases as providing reasons for decision." Hart, *Postscript*, *supra* note ____, at 265.

attitude of respect adopted toward the law and legal interpretation. “[I]n most contexts lawyers can fairly readily tell the difference between making good-faith efforts to comply with a plausible interpretation of the purposes of a legal regime, and using every ingenuity of his or her trade to resist or evade compliance.”¹²⁶ Indeed, these extra-legal norms regulating interpretation must be outside the domain of substantive legal rules and principles, because any substantive legal norm, whether a rule or a principle, will stand in need of interpretation and the process of interpretation must be constrained by some sort of regulative norms. These extra-legal regulative norms are what I have been calling attitudes or stances taken by officials, and quasi-officials such as lawyers, toward the law.

The opposing argument from the Holmesian bad man perspective is that a lawyer need not counsel and assist the client within the bounds of law as defined by “good faith efforts” and “plausible” interpretations — rather, the lawyer need only respect “arguable” or “non-frivolous” constructions of legal norms.¹²⁷ Which of these interpretive stances is the right one to take toward legal norms? One way to answer this question is to see whether *courts* require clients to arrange their affairs to comply

¹²⁶ Gordon, *Hired Guns*, *supra* note ____, at 48.

¹²⁷ See Gordon, *New Role*, *supra* note ____, at 1194-97. David Luban argues that Holmes invented his image of the lawyer advising a “bad man” client in order to make a jurisprudential point about the separability of law and morality. See David Luban, *The Bad Man and the Good Lawyer: A Centennial Essay on Holmes’s The Path of the Law*, 72 NYU L. REV. 1547, 1562 (1997). Holmes can therefore be understood as making the same point as Dworkin — if a norm is not part of the legal system, a judicial decision based on that norm is not legitimate from the point of view of a client who is bound by it. Dworkin’s response, of course, is very different from Holmes’s, for instead of insisting on a bright-line separation of law and morality, Dworkin enthusiastically incorporates morality into law.

with the law interpreted in light of substantive principles, values, and social interests. Once we frame the question in these terms, we can derive support for the attitude of professionalism from a number of analogous areas of law. Although there are numerous examples that could be offered, including the law of frivolous litigation¹²⁸ and the implicit norms of good faith dealing observed in various commercial communities,¹²⁹ I will concentrate on the economic substance doctrine in the law of taxation.

¹²⁸ See, e.g., William Schwarzer, *Sanctions Under the New Federal Rule 11 — A Closer Look*, 104 F.R.D. 181 (1985).

¹²⁹ See *supra* notes ___ - ___, and accompanying text.

One of the recurring problems in the law of taxation is that the tax laws may be defeated through manipulation, that is, by structuring transactions in a way that creates artificial tax consequences.¹³⁰ The difficult analytical question is obviously how to define “manipulation” or “artificial,” and this question only arises because it is possible for a transaction to comply with formal legal norms while somehow failing to satisfy the substantive standards or principles that those formal norms attempt to express. The difficulty is perhaps particularly acute in tax law, which supposedly does not concern itself with whether the taxpayers intent in entering into a transaction was to avoid taxes,¹³¹ but it must be faced in any complex regulatory arena in which a client may seek the assistance of a lawyer to avoid a legal prohibition or penalty through careful planning. The danger of manipulation results from the familiar dichotomy between form and substance, or rules and standards, in legal norms.¹³² Briefly, the distinction depends on the conceptual possibility of divergence between the action mandated (or prohibited) by a rule and the action mandated (or prohibited) by the rule’s background justification.¹³³ A legal norm in the form of a rule permitting only people age 16 or older

¹³⁰ Isenbergh, *supra* note ___, at 863; David A. Weisbach, *Formalism in the Tax Law*, 66 U. CHI. L. REV. 860, 860 (1999) (“taxpayers have been able to manipulate the rules endlessly to produce results clearly not intended by the drafters”); David P. Hariton, *Sorting Out the Tangle of Economic Substance*, 52 TAX LAW. 235, 236 (1999) (noting that tax lawyers have tried to device rules so that “business transactions do not permit some taxpayers to avoid tax at the expense of others in a way that was not intended by the political system”).

¹³¹ Alan Gunn, *Tax Avoidance*, 76 MICH. L. REV. 733, 735 (1978).

¹³² See, e.g., Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992); Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976); Weisbach, *supra* note ___.

¹³³ See FREDERICK SCHAUER, *PLAYING BY THE RULES: A PHILOSOPHICAL EXAMINATION OF RULE-BASED DECISIONMAKING IN LAW AND IN LIFE* 53-55 (1991) [hereinafter “SCHAUER, *PLAYING BY THE RULES*”]. The terminology of background justification, and the driver’s license example, are from a contemporaneous article by Schauer. See Schauer, *Rule of Law*, *supra* note ___, at 648-49; see also Schauer, *Statutory Construction*, *supra* note

to obtain a driver's license is plainly justified by reasons of public safety, but the is both overinclusive and underinclusive with respect to this background justification. The rule may prevent mature, careful 15 year-olds from driving (overinclusiveness) as well as permitting reckless, dangerous 20 year-olds to obtain a license (underinclusiveness). One response to this problem is to permit a decisionmaker to rely directly on the background justification, by casting the norm in the form of a standard. In our example, the relevant norm expressed as a standard might be that only competent, mature drivers may obtain a license.

____, at 236. Significantly, the phenomenon of divergence between the result mandated by a general rule and what would be required after full attention to all the relevant features of a situation is not limited to following legal rules. A similar dynamic exists in moral philosophy; indeed, a well known criticism of Kantian ethics is that the emphasis by Kant on moral rules distorts the nature of moral judgment by directing an agent to ignore morally relevant details of a problem. See HERMAN, *supra* note ____, at 74-75.

The distinction between rules and standards creates two sets of mirror-image risks facing the regulator. Expressing a norm in a standard-like way entails the loss of benefits associated with rules, such as ease of application, error reduction, constraint on the decisionmaker's discretion (and therefore power), and especially values of *ex ante* predictability and certainty of application.¹³⁴ By contrast, expressing the norm in a rule-like way entails the loss of the benefits associated with standards, such as sensitivity to the fit between the outcome of the legal decision and the background justification of the norm, and greater *ex post* contextualization and particularization of the result, resulting in a more just result as between the parties. In tax law, rules are generally favored for the additional reason that many transactions are structured carefully in order to capture tax benefits, even if the tax treatment of the given transaction was never foreseen or intended.¹³⁵ Given the sensitivity of transactional structure to tax consequences, there seems to be a heightened need for predictability in tax law as opposed to, say, tort law, where many actors are less likely to be influenced by the precise form of legal norms. Still, there must be limits on the extent to which the formal (or rule-based) treatment of a transaction can diverge from the substantive (or standard-based) approach — too great a divergence and the system will be unfair as

¹³⁴ SCHAUER, PLAYING BY THE RULES, *supra* note ____, at 135-66; Antonin Scalia, *The Rule of Law as a Law of Rules*, 56 U. CHI. L. REV. 1175 (1989).

¹³⁵ *See, e.g.,* *Yosha v. Commissioner*, 861 F.2d 494, 498 (7th Cir. 1988) (Posner, J.) (“There is no rule against taking advantage of opportunities created by Congress or the Treasury Department for beating taxes. . . . Many transactions are largely or even entirely motivated by the desire to obtain a tax advantage.”); Hariton, *supra* note ____, at 237 (noting the general presumption that the taxpayer “should not be denied beneficial tax results which she stumbles upon, or even seeks out, in the course of her legitimate business dealings, even if those results are obviously unanticipated, unintended, or downright undesirable”).

between similarly situated taxpayers.¹³⁶ There is accordingly great pressure to differentiate between real transactions, undertaken in the ordinary course of a taxpayer's business for legitimate business purposes, and the artificial transactions, with all their Rube Goldberg complexity, set up with no purpose other than to generate tax benefits.

¹³⁶ Hariton, *supra* note ____, at 236

One way to distinguish between real and artificial transactions and their tax consequences is to rely on the informed judgment of members of the relevant professional community. As Mark Gergen observes, “[g]ood tax lawyers know when they are pushing hard at the edge of the envelope.”¹³⁷ After observing the difficulty in arriving at determinate standards of tax motive and economic substance, which would enable courts to deny a positive result to a taxpayer who had complied formally with the rules, he falls back on professional judgment to formulate a “disclaimer” that could be attached to any analysis of form and substance in tax law:

A determination that an action is tax motivated or insubstantial is neither a necessary nor a sufficient condition for denying a positive tax result to which the actor claims he is entitled under tax law. There may be other grounds for rejecting the actor’s position. These standards do not displace other forms of reasoning. Further, some tax motivated or insubstantial actions are respected. As for which are respected and which are not, that is difficult to say. Do not always expect to find a rule or principle to sort them out. In a novel case the best guide may well be professional common knowledge.¹³⁸

¹³⁷ Mark P. Gergen, *The Common Knowledge of Tax Abuse*, 54 SMU L. REV. 131, 136 (2001).

¹³⁸ *Id.* at 138.

Similarly, tax lawyer Peter Canellos claims that everyone in the relevant community knows the difference between creative tax planning and bogus tax shelters, even though shelters are designed to mimic real transactions.¹³⁹ In tax sheltering, “promoters attempt to apply a patina of substance to a transaction that is formal and unreal,” while legitimate tax practitioners plan real business transactions with a business purpose, in light of the possibility of obtaining tax advantages.”¹⁴⁰ As Canellos recognizes, all of these terms are subject to a challenge that they be defined more precisely — what makes a transaction real or unreal? what is the difference between a patina of substance and creative structuring? The answers cannot be given by ever more elaborate rules, however. Professional judgment is an irreducible aspect of the analysis, even though it may be possible to set out some standards or criteria that are germane to the exercise of judgment.¹⁴¹

¹³⁹ Peter C. Canellos, *A Tax Practitioner’s Perspective on Substance, Form and Business Purpose in Structuring Business Transactions and in Tax Shelters*, 54 SMU L. REV. 47, 51-52 (2001) (“experienced tax professionals can usually readily distinguish tax shelters from real transactions”).

¹⁴⁰ *Id.* at 50.

¹⁴¹ *Id.* at 53-54 (“Although in theory the line between a tax shelter and an aggressively structured real transaction may appear difficult to draw, in actuality the distinction is rather easy to establish when the transaction involves most of the tax shelter elements described above.”).

Appeals to professional judgment lead to a predictable reaction — charges of unprincipled decisionmaking, arbitrariness, non-transparency, and a departure from the ideal of objectivity in law.¹⁴² Critics are apt to cite, disparagingly, Justice Stewart’s comment about hard-core pornography, that he cannot define it, but he knows it when he sees it.¹⁴³ But recall the previous discussion of judgment and objectivity. A judgment in this domain (e.g. “that is a tax shelter, not a legitimate transaction”) can be objective as long as the decisionmaker is willing to base judgments on the subject itself, not personal idiosyncracies; is willing to be open to evaluation of the correctness of her judgment; and makes a decision that exhibits some degree of invariance across judging subjects.¹⁴⁴ This kind of limited domain-specific objectivity can be secured by constraining all-things-considered contextual judgments with more specific criteria which are developed over a series of analogous cases. In the tax example, the taxpayer will not be denied tax benefits as long as the transaction has a legitimate business purpose. This standard can be defined further based on criteria such as:

- the way the transaction was marketed and sold — i.e. whether it was pitched by specialized tax professionals and marketed to the tax or finance department of a corporation, or was it developed by outside investment advisors or internal

¹⁴² In the tax context see Isenbergh, *supra* note ____, at 882 (“It is not uncommon for professors to regard — and teach — the process of legal interpretation as a vehicle for their own aesthetic preferences”); *ACM Partnership v. Commissioner*, 157 F.3d 231, 265 (3d Cir. 1998) (McKee, J., dissenting) (I can’t help but suspect that the majority’s conclusion . . . is, in its essence, something akin to a ‘smell test.’”). In legal theory generally, see Farber, *Inevitability*, *supra* note ____, at 541-47 (summarizing critiques).

¹⁴³ *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (Stewart, J., concurring). For an interesting, sympathetic interpretation of Justice Stewart’s reasoning, see Paul Gewirtz, *On “I Know It When I See It”*, 105 *YALE L.J.* 1023 (1996). Gewirtz’s essay is a defense of what he calls nonrational elements of judicial reasoning, such as judgment and character, and I think he is correct that these qualities can be described as excellences or virtues. *See id.* at 1033.

¹⁴⁴ Postema, *supra* note ____, at 105-09.

operations departments and marketed in terms of business or financing opportunities, not tax savings;

- the involvement of real or extraneous parties — i.e. whether it included real buyers and sellers, with financing at market rates, or accommodation parties such as foreign subsidiaries or partnerships;
- the use of a series of highly choreographed steps; and
- whether the workings of the transaction are concealed (and thus reliant upon the audit lottery) or publicly disclosed.¹⁴⁵

Assuming that these evaluative criteria are generally shared within the relevant community, the judgment of legitimate business purpose is sufficiently objective.

It is my belief that criteria similar to those for economic substance in taxation could be developed in any area of practice, in consultation with specialists in the substantive law, and it is my contention that the professionalism demands that lawyers understand their counseling and advising role as mandating the use of criteria such as these. My principal aim in this Article is not to generate specific criteria, like the ones above for identifying abusive tax planning, but to lay the jurisprudential groundwork for the prescription that lawyers ought to think about their roles in this way. The task of developing criteria for the exercise of judgment would then be a task for conscientious lawyers in various areas of practice. Up to this point, however, the arguments have been descriptive only, insofar as they have shown that in at least one area of law, it is possible to conceptualize practice in accordance with the professionalism. The task for

¹⁴⁵ Canellos, *supra* note ____, at 51-55

the following subsection is to demonstrate that this style of practice is mandatory.

I am hedging here a bit with the term “relevant” community. Canellos’s article on tax shelters identifies two vastly different communities of practitioners — the tax bar and the tax shelter bar.¹⁴⁶ “Real” tax practitioners structure transactions that are otherwise legitimate in a way that maximizes tax advantages; they are concerned with their reputation and status, and often become involved with high-profile organizations such as the tax sections of the ABA and the New York State Bar Association, which are dedicated to improving the tax law. They consider exercising professional judgment as a stock in trade. (This description, particularly the elitism and emphasis on the exercise of judgment, calls to mind Anthony Kronman’s lawyer-statesman.¹⁴⁷) Tax shelter practitioners, on the other hand, set up artificially contrived deals, care little about their reputation for probity and judgment, and provide legal opinions as a fig leaf for sheltering transactions that are widely derided as flimflam by real practitioners. So which of these is the relevant community? If we specific real tax practitioners and then derive evaluative criteria from their shared norms, are we not engaging in circular reasoning? The shared norms of the tax shelter bar and the criteria they would generate for identifying abusive transactions would presumably look very different from those listed above. But why follow the interpretive principles of the tax bar, not the tax shelter bar? Or, why regard oneself as a member of the interpretive community that is

¹⁴⁶ See *id.* at 55-57; see also Joseph Bankman, *The Business Purpose Doctrine and the Sociology of Tax*, 54 SMU L. REV. 149, 150 (2001) (elaborating on Canellos’s sociological analysis of the two tax bars).

¹⁴⁷ See ANTHONY T. KRONMAN, *THE LOST LAWYER* (1993).

constituted by fidelity to those norms? In theory, a lawyer may decide to remove herself from the tax bar and join the tax shelter bar, which recognizes a different set of standards of interpretation.¹⁴⁸ Even if the authority of a community's disciplining rules do not depend on assent to those norms,¹⁴⁹ it seems open to practitioners to opt out of the community and opt into a different community, with a different set of disciplining rules.¹⁵⁰

¹⁴⁸ See ARTHUR ISAK APPLBAUM, *ETHICS FOR ADVERSARIES* 45-60 (1999) (discussing the possibility that even if the role of doctor were constituted with certain obligations, a practitioner might opt to become a "schmoctor" with different obligations, and that the concept of a role cannot prevent this kind of maneuver); Katharine T. Bartlett, *Feminist Legal Methods*, 103 HARV. L. REV. 829, 855 (1990) (arguing that there are multiple, overlapping communities to which one may belong, and that privileging the dominant community tends to preserve the status quo).

¹⁴⁹ Fiss, *supra* note ____, at 746.

¹⁵⁰ Social pressures may prevent a lawyer from opting in to a community that is perceived to be abusive, from the standpoint of the interests of elite practitioners. This can be a good thing or it can be a bad thing. It is a good thing if the prospect of incurring shame or even being ostracized motivates a lawyer to maintain respect for the law and not assist clients in evading it. It is a bad thing, however, if social norms compel the lawyer's membership in a community that is not dedicated to respecting the law.

A different way to frame this objection might be to claim that the requirement of professionalism in interpretation only gains authority by bootstrapping. That is, my claim is that the obligation imposed by the attitude of professionalism is a function of the relevant interpretive community and the standards it recognizes for evaluating the correctness of legal judgments (i.e. “although purely formal norms seem to permit X, the law as correctly interpreted prohibits X”). At the same time, I seem to be claiming that a lawyer ought to associate himself with the interpretive community that recognizes the attitude of professionalism and shun other communities that do not. What is the source of this meta-obligation? If the response were, “the obligation of professionalism,” that would indeed be bootstrapping. But the correct response is given instead in terms of the social function of law: A relatively stable, determinate framework of legal rights and obligations is necessary to permit ordered cooperation among people who disagree on just about everything except the need to reach settlement of disagreements. If lawyers were permitted to adopt a Holmesian bad man interpretive attitude (or to opt into a community which recognized that attitude as a proper interpretation of the relevant law), then the law would end up having no boundaries at all, no constraining capacity, and therefore no ability to create authoritative settlement. This conclusion may sound unduly apocalyptic, but experience with practices such as tax sheltering shows that lawyers can always plan around formal legal norms, given sufficient resources and creativity. Purely formal constraints such as legislation, rulemaking, and enhanced enforcement will never be sufficient to eliminate

abuses because lawyers are involved in constructing the bounds of the law.¹⁵¹ As Robert Gordon rightly observes, there are resources for strategic manipulation within any set of adjudicative or administrative rules and procedures.¹⁵² As a result, the effectiveness of the law depends on constraints that are exogenous to formal legal norms. The following Subsection develops this argument further.

¹⁵¹ Cf. Susan P. Koniak & George M. Cohen, *In Hell There Will Be Lawyers Without Clients or Law*, in *ETHICS IN PRACTICE: LAWYERS' ROLES, RESPONSIBILITIES, AND REGULATION* 177, 180 (Deborah L. Rhode ed. 2000) (“Good lawyers understand that the ethical practice of law involves lawyers simultaneously shaping legal boundaries and recognizing the real limits to this manipulation.”).

¹⁵² Gordon, *Hired Guns*, *supra* note ____, at 45.

Before moving on, however, it is necessary to consider one final objection.¹⁵³ I have been talking about “the community” and its interpretive practices as if it were a thing to which an intention can be straightforwardly ascribed. In one sense, this is just a convenient fiction — communities don’t have practices or disciplining rules, community *members* follow these norms. The community’s standards can be located by observing convergent behavior by community members,¹⁵⁴ but the community itself is not an intentional being. On the other hand we speak quite naturally of collective intentions and norms and attribute these mental states to a group.¹⁵⁵ In this case, we mean literally that the group intends something and are no longer using collective intention as a metaphor. Moreover, we do so even in the absence of some formal procedure, such as taking a poll, which we could use to discern the intentions of individuals and aggregate them into a collective intention. Without formal procedures we may reach a premature and incorrect conclusion about the group’s intention,¹⁵⁶ so an ascription of group intention must be regarded as potentially revisable, but talking as though the group has an intention is not incoherent. In the example here, it may turn out that the elite tax bar is more tolerant of tax shelters than its more outspoken members would admit. This, however, is an empirical challenge to the norms of a particular group, not a conceptual impediment to the general practice of imputing intentions to a collective

¹⁵³ I am indebted to Dennis Tuchler for pressing me to consider this problem.

¹⁵⁴ HART, *supra* note ____, at 108-09.

¹⁵⁵ Solan, *supra* note ____, at ____.

¹⁵⁶ *Id.* at ____.

body.

C. *Normative Arguments: Public Justifiability.*

Descriptive arguments cannot settle with finality the question of whether the attitude of professionalism is a part of our legal system. One could read every case and conduct exhaustive empirical sociological research and never know the answer for sure. There are two reasons for this. The first is that the rule of recognition, like any legal rule, is characterized by its open texture.¹⁵⁷ There may be a situation in which there is factual uncertainty regarding the content of the rule of recognition, and in that situation some institution will be called upon to make an unconstrained choice about the specific contours of the ultimate rule for identifying law. There are no rules requiring one result or another — as Hart puts it, “at the fringe of these very fundamental things, we should welcome the rule-sceptic.”¹⁵⁸ The second is the by-now familiar infinite regress problem. No amount of rules and meta-rules can settle an interpretive question with finality. Hart grounded the rule of recognition in social practices to avoid the regress problem, and we might take the same way out with respect to professionalism. A more promising approach, however, would be to give an extra-legal justification for it — one which is based on the nature and function of law, and therefore the reasons for

¹⁵⁷ HART, *supra* note ____, at 151.

¹⁵⁸ *Id.* at 154. As Coleman reconstructs Dworkin’s argument against Hart’s social rules thesis, “if there is substantial controversy [over the content of the rule of recognition], then there cannot be convergence of behavior sufficient to specify a social rule.” Coleman, *Negative and Positive*, *supra* note ____, at 15.

treating legal directives as authoritative.

Philosophers of law ask the conceptual question “what distinguishes law from other means of social ordering?”¹⁵⁹ for a reason — the function of law is to do a distinctive kind of work, as compared with other means of securing social order. My claim has been that the function of law is to secure the conditions necessary for cooperation and the realization of collective goods, notwithstanding deep and persistent disagreement over values, ends, conceptions of the good, and the application of moral principles to practical situations. In order to do this work, law must have certain characteristics. It is tempting to say that the law must be uncontroversial,¹⁶⁰ but in anything outside the core of the application of legal norms, common experience shows that the law is anything but uncontroversial. In any event, the requirement that the law be uncontroversial is usually interpreted as a requirement that a legal system’s rule of recognition be capable of formulation without reference to the *content* of moral principles, and this requirement does not preclude the use in legal reasoning of moral principles that have become incorporated into legal norms.¹⁶¹ Preclusion of the content of moral norms is necessary to avoid slipping back into the disagreement that required

¹⁵⁹ See FINNIS, *supra* note ____, at 14-15.

¹⁶⁰ See Coleman, *Negative and Positive*, *supra* note ____, at 9-10 (explaining that this account of legal positivism is probably Dworkin’s target in *The Model of Rules I*, but that there is another characteristic of positivism, namely its conventionalism, that is plausible).

¹⁶¹ *Id.* at 15-16.

authoritative settlement by law. But the preclusion of non-legal considerations that is the consequence of the negative aspect of professionalism requires a lawyer to exclude moral principles from her interpretive process only to the extent those principles are not recognized as part of law by the relevant interpretive community. In addition, the positive aspect of professionalism requires that a lawyer's interpretive judgment be guided, in the end, by the social function of law, which is to provide a secure framework for coordinated action. For this reason, interpretive communities have evolved, and ought to evolve, higher-order standards for differentiating artificial, abusive transactions that comply only formally with legal rules from those transactions that comply substantially with the law.

The reason to favor the interpretive principles of the tax bar, instead of the tax shelter bar, is that the former does better *vis-à-vis* the social function of the law. The choice of that community's norms is not an aesthetic response or a standardless attempt to privilege one standpoint over another. Rather, the foundational question — which community's norms? — is answered with reference to purposive or teleological standards. The analogy in moral philosophy is Aristotelian virtue ethics, in which character, virtue, and the exercise of judgment (practical wisdom, or *phronesis*) are prior to evaluations of right and wrong, and moral virtues are known to be virtues because they conduce to the final good for humans, *eudaimonia*.¹⁶² As long as there is

¹⁶² See generally ROSALIND HURSTHOUSE, ON VIRTUE ETHICS 170-91 (1999); ALASDAIR MACINTYRE, WHOSE JUSTICE? WHOSE RATIONALITY? 124-45 (1988); J.L. Ackrill, *Aristotle on Eudaimonia*, in ESSAYS ON ARISTOTLE'S ETHICS 15 (Amélie Oksenberg Rorty ed. 1980).

agreement on the final end of an activity or practice, it is possible to define virtues as those characteristics that enable one to better realize the ends of that practice.¹⁶³

Kripke's interpretation of Wittgenstein makes a similar point in a different way, noting that for utterances to be said to conform to a rule, they must not only conform to assertability conditions, but also that there is some point, within the community of language-users, of making this type of utterance under these conditions.¹⁶⁴

¹⁶³ See MACINTYRE, *AFTER VIRTUE*, *supra* note ____, at 186-96.

¹⁶⁴ See KRIPKE, *supra* note ____, at 92. See also HERMAN, *supra* note ____, at 83-84 (discussing rules of moral salience, which specify features of a situation that are relevant to the exercise of moral judgment, and noting that not just any rules count as rules of moral salience); Schauer, *Statutory Construction*, *supra* note ____, at 251 (members of linguistic communities not only share the ability to make sense of utterances, but do the same things with linguistic understandings).

Thus, the reasons for regarding the law as authoritative over some issue gives a reason for incorporating the interpretive understandings of a particular community. These principles in turn can supply criteria for differentiating legitimate from bogus interpretations of formal legal norms. The reason for treating the law as authoritative is that it does a better job than uncoordinated individual action at facilitating peaceful social interaction and cooperation against a background of persistent conflict and disagreement. In order for the law to facilitate private ordering, however, it must be relatively stable and determinate; and in order for law to be stable and determinate, the lawyers who interpret and apply the law to their clients' situations must interpret the law in a way that reflects the public meaning it would likely have if interpreted by a legal official such as a judge or administrative law judge.¹⁶⁵ This means that a lawyer cannot interpret the law applying to complex, undisclosed transactions differently, merely because the transactions are secret; the appropriate normative stance one must take toward the law assumes that the facts of the transaction are being evaluated by a competent regulator who is fully informed on the applicable facts and law.

¹⁶⁵ EISENBERG, *supra* note ____, at 11 (“Granted that it is desirable for lawyers as well as judges to be able to determine the law, it becomes critical that lawyers should be able to replicate the process of judicial reasoning.”).

I suppose a lawyer could reply that she is unconcerned with the effective functioning of the law, which is a problem for legislators, rulemakers, or judges, but not for her or her client. If those “others” were unable to make the law fully effective, so much the worse for them, but it is of no moment to the lawyer or her client. This attitude, however, would be self-defeating — even irrational in the narrow means-ends sense. Again picking up on an argument by Robert Gordon, the response to this lawyer is that she *must* be concerned about the effective functioning of the law, because without it, neither she nor her client could realize her own interests. The market economy presupposes a background of stable law, custom, and enforcement that enforces private ordering.¹⁶⁶ Even if a lawyer and client were concerned only with pursuing their own narrow self-interest, paradoxically it is only possible to behave self-interestedly within a framework of other-regarding obligations. A lawyer might evade regulatory requirements by aggressive structuring of transactions in one case, but cause long-run damage in the form of eroding the capability of the legal system to facilitate the functioning of financial markets. The lawyer cannot be indifferent to this long-term damage and still claim to be making an ethical argument about the obligations of her role, because it is in the nature of ethical arguments that they must be generalizable to relevantly similar situations. It may be true that a lawyer could game the system once without causing catastrophic damage, but this would constitute impermissible free-riding on the cooperation of others. Thus, any plausible ethical argument — i.e. one that is worthy of the respect of similarly situated others — must

¹⁶⁶ *Id.* at 49; Gordon, *New Role*, *supra* note ____, at 1198-99.

take account of the consequences of widespread manipulation of formal legal norms.

IV. *The Enron Lawyers: Creative, Aggressive, and Professional, or Creative, Aggressive, and Unprofessional?*

Enron had a problem. It had an ambitious plan for growth that required billions of dollars in cash, but it could not raise cash through conventional methods like selling stock or borrowing from banks. The reason was simple — additional borrowing would harm its credit rating and issuing additional equity would hurt the price of its stock, which would be unthinkable in a company driven by the need to constantly increase its share price.¹⁶⁷ The markets it had created, in natural gas and wholesale electricity, were maturing and profits from trading were diminishing in response to increasing competition.¹⁶⁸ Moreover, the insistence by Jeffrey Skilling that the company use mark-to-market accounting placed tremendous pressure on corporate managers to show constant revenue growth, even if that meant sacrificing cash flow.¹⁶⁹ These incentives

¹⁶⁷ Powers Report, *supra* note 1, at 36-37; Second Batson Report, *supra* note 1, at 15-22; MCLEAN & ELKIND, *supra* note 1, at 92-94, 150-51, 154-55, 161, 236-37, 296, 318; Frank Partnoy, *A Revisionist View of Enron and the Sudden Death of "May"*, 48 VILL. L. REV. 1245, 1250 (2003) ("The key factor sustaining Enron's ability to secure a low cost of capital was its investment grade credit rating . . . which the major credit rating agencies gave to Enron's debt from 1995 until November 2001."); Schwarcz, *Use and Abuse*, *supra* note ____, at 1309-10.

¹⁶⁸ Baird & Rasmussen, *supra* note 1, at 1792-94; Bratton, *Dark Side*, *supra* note 1, at 1299-1300.

¹⁶⁹ Mark-to-market accounting permits a company to book as revenue the entire estimated value of a stream of income from an asset. Cash will continue to flow in the door over the entire productive life of the asset, but all of the revenue will be realized in the quarter in which it was booked. Not only was this method highly susceptible to abuse in the form of fiddling with the estimated value of an asset, but it also amplifies the pressure from Wall Street to show continuing growth. Because realizing all the future profits when the asset is booked makes one quarter's revenue figures look good, it makes it that much harder to show growth in the subsequent quarter. *See generally* Second Batson Report, *supra* note 1, at 22-28 (mark-to-market accounting can create a "quality of earnings" problem, because earnings are recognized long before the activity generates any cash); *id.* at 29-32 (transaction to

explain the motivation for most of the convoluted transactions devised by Chief Financial Officer Andy Fastow. Fastow's innovation, if you can call it that, was to use techniques of structured financing and asset securitization to accomplish two principal goals: borrow money while keeping debt off the books, and enable Enron to book the long-term value of a deal immediately under mark-to-market accounting rules.¹⁷⁰

provide video on demand, with content supplied by Blockbuster, resulted in recognized gain of \$53 million, even though Enron did not have the technology to deliver the content, which Blockbuster in any event could not obtain from the studios); MCLEAN & ELKIND, *supra* note 1, at 39-41, 126-29; Bala G. Dharan, Testimony, in *Lessons Learned from Enron's Collapse: Auditing the Accounting Industry — Report of the House Committee on Energy and Commerce*, H.R. Doc. No. 107-83, at 87 (Feb. 6, 2002) (mark-to-market accounting, as applied to private contracts for the sale of assets that do not have readily ascertainable market values, requires a great deal of guess work and assumptions about dozens of variables); James S. Chanos, Testimony, in *id.*, at 76 (under mark-to-market accounting, if assumptions are not borne out and assets actually decline in value, the reporting company must adjust their book value downward, but in practice there is a powerful incentive to do new deals and book the value of those new deals, using questionable assumptions, to mask the effect of the previous decline in asset values); Bratton, *Dark Side*, *supra* note 1, at 1303-04 (no market sets values for over-the-counter derivatives, so values must be obtained from economic models; since Enron was at the cutting edge of creating new derivative products, generally accepted approaches to valuation did not exist); Schwarcz, *Use and Abuse*, *supra* note ____, at 1309 n.2 (quoting e-mail communication between an accounting professor at Duke's business school and the author, a highly sophisticated scholar of structured finance, which incidentally illustrates how complex these transactions can be).

¹⁷⁰ Structured finance techniques can be used for legitimate business purposes, such as enabling a company to obtain lower-cost financing, transferring risk to parties who are better able to evaluate it, and permitting the owner

Significantly, Fastow’s corporate finance department set up transactions to milk them for beneficial accounting treatment — in terms of the substantive economics of the business, they did nothing at all. This observation will be crucial to evaluating the duties of the lawyers who were employed to provide the documentation for the transactions.

of illiquid but valuable assets to use them to obtain financing. *See, e.g.*, Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133 (1994) [hereinafter, “Schwarcz, *Alchemy*”]; Dharan, *supra* note ____, at 92-93.

Many of the Fastow transactions have become well known by names such as Chewco, LJM1 and LJM2, and the Raptors. These names refer to special purpose entities (SPE's) which were set up as part of the deals. Special purpose entities are often used in the process of asset securitization, in which the owners of some asset convert a stream of income over time into something that could be repackaged as a security and sold immediately to investors in the capital markets.¹⁷¹ For example, a bank with many outstanding mortgage loans is entitled to receive monthly payments over the life of those loans, but it may wish to convert those payments into a lump sum in cash that it can use immediately. To do so, it "bundles" the mortgages and transfers them to an SPE, which issues tradable financial instruments (mortgage-backed securities), offered to investors at a discount relative to the present value of the stream of payments. The investors make money because they paid less for the securities than the income over time is worth. The bank is happy because it has converted a formerly illiquid asset into cash. The investors in these transactions are often investment banks who deal with large corporations on a regular basis, and in the case of Enron were subjected to a fair amount of bullying by Fastow.¹⁷² The banks and other institutional investors would often contribute funds directly to an SPE created for the deal, which in turn purchased the asset from its owner. In all of these transactions, the SPE is supposed to be independent of the seller of the assets, but to be deemed independent, it actually need only have 3 percent of its equity owned by a party unaffiliated with the

¹⁷¹ See generally MCLEAN & ELKIND, *supra* note 1, at 157-59.

¹⁷² MCLEAN & ELKIND, *supra* note 1, at 162-65.

seller. (If the SPE is independent, it need not be “consolidated” — i.e. reported on the financial statements of the company that transferred assets to the SPE.) Thus, if Citibank or J.P. Morgan contributed \$3 million to an SPE and Enron contributed \$97 million, Enron would be permitted to transfer assets to the SPE and book the transaction as a bona fide sale to an independent party. This situation was very much preferable, from Enron’s perspective, to a \$100 million loan from the bank, which would have had an adverse effect on Enron’s credit rating.

Although the legal and accounting requirements for transactions with unconsolidated, off-balance-sheet SPE’s are not terribly rigorous, Enron had a hard time complying even with those.¹⁷³ Or, to put it differently, Enron was not interested in consummating a genuine transfer of assets to a truly independent entity. Its motivation was rather to continue to realize the economic benefits of owning the asset, preferably as operating income as opposed to a one-time profits, but move any debt associated with the acquisition of the asset off its balance sheet.¹⁷⁴ In order to accomplish this goal, Enron officers and employees, with the assistance of accountants and lawyers, attempted to structure transactions that conformed to the letter of financial accounting rules, while aggressively pushing the boundaries of permissibility. To return to the

¹⁷³ Eventually Enron employed so many SPE’s that it was impossible to find investors with capital representing 3 percent of the valuation of all of the off-balance-sheet vehicles. See MCLEAN & ELKIND, *supra* note 1, at 166, 189; Powers Report, *supra* note 1, at 41 (“Chewco” partnership was created because Enron managers were having a hard time finding outside investors to finance buyout of JEDI joint venture).

¹⁷⁴ Second Batson Report, *supra* note 1, at 36-39 (motivation for SPE transactions); MCLEAN & ELKIND, *supra* note 1, at 368-69 (abuse of recurring vs. nonrecurring distinction); Schwarcz, *Alchemy*, *supra* note ____, at 142-43 (legitimate use of off-balance sheet financing).

image which opened this Article, the lawyers and accountants were directed to create a duck, even though the transactions (in more than one sense!) were a dog. The duck-creating rules for SPE transactions can be summarized very briefly as follows¹⁷⁵:

- The SPE must be “bankruptcy remote” from the originating company (e.g. Enron), so that the originating company’s credit risks do not affect the risks associated with owning the securities of the SPE.¹⁷⁶
- Bankruptcy remoteness depends, in turn, on the genuine transfer of the economic risks and benefits associated with the assets from the originating company to the SPE.¹⁷⁷ In other words, the transfer must be a “true sale.”¹⁷⁸

¹⁷⁵ See generally ACCOUNTING FOR TRANSFERS AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENTS OF LIABILITY — A REPLACEMENT OF FASB STATEMENT NO. 125, Statement of Financial Accounting Standards No. 140 (Financial Accounting Standards Bd. 2000). Several reports prepared under the supervision of the bankruptcy court provide useful summaries of the applicable financial accounting standards. See, e.g., Report of Harrison J. Goldin, The Court-Appointed Examiner in the Enron North America Bankruptcy Proceeding, Respecting His Investigation of the Role of Certain Entities in Transactions Pertaining to Special Purpose Entities (Nov. 14, 2003) [hereinafter, “Goldin SPE Report”] (available on-line from Enron Corp.: <<http://www.enron.com/corp/por/supporting.html>> (visited 6/29/04)). For the relevant legal standards, see STEVEN L. SCHWARCZ, STRUCTURED FINANCE: A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION (2d ed. 1993); Second Batson Report, *supra* note 1, App. C.

¹⁷⁶ Schwarcz, *Alchemy*, *supra* note ____, at 135.

¹⁷⁷ Powers Report, *supra* note 1, at 14; Second Batson Report, *supra* note 1, App. C, at 9-11 Schwarcz, *Alchemy*, *supra* note ____, at 141; Bratton, *Dark Side*, *supra* note 1, at 1306-07 (citing numerous GAAP authorities).

¹⁷⁸ Second Batson Report, *supra* note 1, at 37-38.

- If the SPE is not truly independent (i.e. bankruptcy remote) from the originating company, the assets and liabilities of the SPE must be consolidated on the financial statements of the originating company.¹⁷⁹ Fleshing out the requirement of independent ownership, financial accounting standards set a minimum of 3% for the equity that must be contributed by entities unaffiliated with the originating company.¹⁸⁰
- The independence of an SPE can be compromised by the originating company retaining control over the asset; this can be accomplished through side deals, such as loan guarantees, between the originating company and the SPE, and may be shown by the originating company's attempt to recognize gains in the value of the SPE as earnings on its own balance sheet.¹⁸¹

Notice, however, that these norms are subject to manipulation or gaming by

¹⁷⁹ Powers Report, *supra* note 1, at 38-39 (consolidation is a presumptive requirement, and the presumption can be overcome only if two conditions are met, namely independence of ownership and control of the SPE).

¹⁸⁰ Bratton, *Dark Side*, *supra* note 1, at 1306 n.118 (citing SEC and GAAP authorities for the three-percent rule, and noting that while the SEC has consistently denied that the three-percent rule is a bright-line test, it is generally understood as such by accountants).

¹⁸¹ Powers Report, *supra* note 1, at 36-37; Second Batson Report, *supra* note 1, App. C, at 12-13, 20-23; Schwarcz, *Alchemy*, *supra* note ____, at 136; Christine E. Earley, et al., *Some Thoughts on the Audit Failure at Enron, the Demise of Arthur Andersen, and the Ethical Climate of Public Accounting Firms*, 35 CONN. L. REV. 1013, 1019-20 (2003) (detailing side agreement between Enron and Michael Kopper, an Enron employee whose involvement need not be disclosed as a related-party transaction, guaranteeing loan from Barclay's Bank to Kopper, for the purpose of acquiring a three-percent interest in Chewco, an SPE run by Andy Fastow). Enron used complex financial devices, such as a transaction it called a Total Return Swap, to retain the benefits of an asset transferred to an SPE. Second Batson Report, *supra* note 1, App. C, at 16-18.

lawyers who may be motivated to comply with them only formally. A complete analysis of the appropriateness of the Enron transactions would have to give additional content to those rules by tapping into the understandings of the relevant interpretive community, which are germane to the exercise of interpretive judgment by lawyers and accountants. These principles are relevant to interpretation, and can constrain the exercise of judgment, but only if the lawyer engaged in the process of interpretation belongs to a community that is interested in maintaining a stable, publicly accessible framework for cooperative activity. A lawyer who belongs to Andy Fastow's interpretive community might be interested only in securing short-term economic benefits for her client or, worse, for an individual agent of her client. As I have argued, however, this interpretive stance cannot be given a normative justification that reaches all the way down to the bedrock of the social function of the law. If, on the other hand, a lawyer is interested in exercising judgment in a way that has plausible ethical foundations, she will probably discover that the interpretive community recognizes certain norms that differentiate artificially created ducks from real ducks — that is, distinguishing between transactions that are motivated only by the attempt to create accounting results and those that have a real economic substance. In addition to the rules for duck-ness, there are principles regulating interpretation that sort ducks from dogs dressed up as ducks, including:

- One of the benefits of SPE financing is “disintermediation,” or the reduction of transaction costs by removing intermediaries such as banks from the financing process. A transaction involving multiple intermediaries and a highly complex series of steps is unlikely to result in the transaction cost savings that usually

justifies SPE transactions.¹⁸²

¹⁸² Schwarcz, *Use and Abuse*, *supra* note 1, at 1315.

- Because SPE transactions can benefit both the originating company and investors in the SPE, one would expect a legitimate transaction to be fully disclosed in a sufficiently clear manner. One of the recurring themes of the commentary on the Enron transactions is the opacity of the disclosures.¹⁸³ An undisclosed transaction or one that is camouflaged in layers of obfuscating legalese, should alert lawyers and accountants that something is fishy.¹⁸⁴
- Additional caution is warranted when other aspects of the transaction are aggressive. For example, in the LJM transactions, Enron capitalized the SPE's with \$1.2 billion of its own common stock, in exchange for notes issued by the SPE's. This is a once-disfavored funding mechanism, and GAAP requires that Enron reduce shareholder equity in the amount of the newly issued shares, until the SPE pays down the notes.¹⁸⁵ Use of this kind of capitalization scheme, and

¹⁸³ See, e.g., Powers Report, *supra* note 1, at 192; Bratton, *Dark Side*, *supra* note 1, at 1281 (calling financial statements “famously opaque”). The reaction of James Chanos, a sophisticated Wall Street hedge fund manager, is typical: “We read the footnotes in Enron’s financial statements about these transactions over and over again, and . . . we could not decipher what impact they had on Enron’s overall financial condition.” Chanos, *supra* note ___, at 73. Indeed, the complexity of some of the SPE transactions, such as the “Raptor” hedges, made it difficult even for internal Enron managers to know how a given business unit was performing. See Baird & Rasmussen, *supra* note 1, at 1802-04.

¹⁸⁴ I take the point that some structured finance transactions can be so complex that disclosure is necessarily imperfect — either it oversimplifies the transaction or it provides so much detail that it goes over the head of most investors. See Schwarcz, *Use and Abuse*, *supra* note 1, at 1316-17. When a transaction becomes this complicated, the clarity of the disclosure language, by itself, is an insufficient indication of abuse. In a case like this, however, professionals have a heightened obligation of inquiry and should rely even more heavily on other factors to guide their interpretation of the relevant legal and accounting standards.

¹⁸⁵ Bratton, *Dark Side*, *supra* note 1, at 1314-15.

the failure of Enron to account for the transaction properly, should have put professionals on notice that other aspects of the transaction should be scrutinized carefully.

- The financial accounting system in general is intended to provide transparent, accurate, easily understood information to managers, creditors, and investors regarding the financial condition of the reporting company.¹⁸⁶ If it appears that managers are valuing complexity for its own sake, it could be a red flag warning lawyers and accountants that the transaction is intended to manipulate the numbers on the company's financial statements, rather than accomplish some economically useful end.

¹⁸⁶ Second Batson Report, *supra* note 1, at 15.

Like the disciplining rules that differentiate between legitimate structuring to capture favorable tax treatment, on the one hand, and bogus tax shelters on the other, these principles of interpretation are not binary, all-or-nothing rules. There is no algorithmic way to capture the process of reasoning from these principles to a correct application of the law to an SPE transaction. For this reason, there may be hard cases in which competent lawyers disagree over whether a given transaction is permissible, and there may be cases in which some lawyers are more aggressive than others in pushing the boundaries of the rules. This is as it should be. To emphasize, my claim is not that the appropriately constrained judgment of interpretive communities produces a single right answer in every case. Rather, the limit on lawyers' creativity, preventing it from shading over into undue aggressiveness, is the requirement of public justifiability. A lawyer must be prepared, in principle, to articulate a reason why the legal treatment (for tax, accounting, bankruptcy, etc., purposes) of a transaction is legitimate, in light of the end sought to be advanced by the regulatory regime in question. In the case of the Enron SPE transactions reviewed in the Powers and Batson reports, there is simply no plausible justification available. Fastow and his confederates had manipulated the techniques of structured financing to produce spurious accounting results which had no relationship whatsoever to the underlying economics of the transactions. Their abuse was abetted by the Holmesian bad man attitudes of lawyers and accountants, who in effect agreed with Fastow that if the rules do not explicitly say that something may not be done, it is permissible. As this Article has argued, however, interpreting the law correctly requires an approach very different from asking, "Show me where it says I

can't do that."¹⁸⁷

¹⁸⁷ Cf. Roman L. Weil, Testimony, *Fundamental Causes of the Accounting Debacle at Enron: Show Me Where It Says I Can't*, HOUSE ENERGY AND COMMERCE COMMITTEE HEARING (Feb. 6, 2002), available at <http://gsb.uchicago.edu/pdf/weil_testimony.pdf> (visited 7/16/04).