

## **ETHICS IN BUSINESS LAW**

**By Edward J. Waitzer**

### **A. The “Front Page” Test**

All but the most difficult ethical issues are usually susceptible to resolution by asking oneself whether we'd be comfortable reading about the proposed course of action on the front page of the next day's paper.

- Paul Wolfowitz (hiring his girlfriend and giving her a promotion/raise)
- undated stock options
- HP access to Directors' phone records
- accounting firms selling “black box” tax shelters

### **B. Conflicting Loyalties – “Entity Theory”**

- traditional role of lawyers as “transaction” facilitators is being tempered by a creeping “gate keeper” role
- SOX required the SEC to set minimum standards of professional conduct for those appearing and practicing before it
- initially proposed “up the ladder” requirements and “noisy withdrawal” provisions (the latter ultimately postponed)
- clear commitment to enforcement – lawyers are now routinely named as respondents or defendants in enforcement actions
  - Mark Kipnis – all the elements of a Greek tragedy – Kipnis was the foil, exemplifying modesty, humility and transparency but, despite the vast differences in his conduct, knowledge and intent, subjected by jury to the same fate
- similar dramas playing out in the U.S. subprime lending mess
- this marks a return to the advice of lawyer and statesmen, Elihu Root, who said that “About half the practice of a decent lawyer is telling his clients that they are damned fools and should stop.”

- increasingly, the best corporate counsel are those who have the capacity to say no and the credibility that they are listened to

### **C. The Folly of Accountabilism**

Accountability in inherently constrained and, unguarded, can easily become “accountabilism” – the practice of eating sacrificial victims in an attempt to ward off evil. It has evolved from a buzz word into the focus of voluminous legislation by the myth of precision – because it suggests that there is a right and wrong answer to every question, it flourishes where we think we can measure results exactly. It is also based on two faulty assumptions – (a) that systems go wrong because of individuals and (b) that the right set of controls will enable us to prevent individuals from creating disasters. The result often manifests itself in a set of related beliefs and practices:

- It looks at complex systems that have gone wrong for complex reasons and decides the problem can be solved at the next level of detail – sacrificing innovation and adaptability for more complication (e.g., 9/11).
- It assumes perfection – if anything goes wrong, it’s a sign that the system is broken.
- It is blind to human nature (e.g., it assumes that if we know we’re being watched, we won’t do wrong).
- It beaurocratizes and atomizes responsibility – while claiming to increase individual responsibility, it drives out human judgement.

### **D. Reputational Risk**

- Any serious reflection on ethics leads to the conclusion that there are very severe limits on what can be done to regulate ethical conduct (and that, like trying to measure or regulate trust, much of such regulation is counter-productive).
- The idea of responsibility is, itself, highly ambiguous (although it generally involves broad discretion in exercising powers with significant effects on the welfare of others).
- Such exercises of responsibility ordinarily permit effective challenge only to decisions that are irrational or that were impelled by conflicts of interest (e.g., the business judgement rule) – hence, conflict of interest aside, legal controls on the exercise of responsibility are largely illusory. That is a difficult conclusion to accept in the modern era in

which we have come to equate controls with formal procedures and legal liability but, I suspect, the conclusion is inevitable.

- Western society has wanted to “legalize” virtue and make decision-making by those in authority wholly transparent. If my analysis is even partly correct, this is a foolish aspiration – the burden of responsibility simply rests upon us. It follows that the exercise of responsibility is effectively governed primarily through the dynamic of reputation.

**E. Managerial Challenge**

- Law firms face the tension of competing managerial models – apprenticeship (on the ground) vs. corporate (firm wide).
- It is also increasingly challenging to preserve the “partnership ethic” – feeling emotionally bound by a common set of values, goals and training.
- Increasingly, this is a managerial (vs. partnership) challenge – leaders create standards for selecting and “socializing” lawyers (partners or associates).

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