

Brooklyn Journal of Corporate, Financial & Commercial Law

Volume 1

Issue 1

SYMPOSIUM:

New Models for Securities Law Enforcement:
Outsourcing, Compelled Cooperation, and
Gatekeepers

Article 6

2006

Differentiating Gatekeepers

Arthur B. Laby

Follow this and additional works at: <https://brooklynworks.brooklaw.edu/bjcfcl>

Recommended Citation

Arthur B. Laby, *Differentiating Gatekeepers*, 1 Brook. J. Corp. Fin. & Com. L. (2006).

Available at: <https://brooklynworks.brooklaw.edu/bjcfcl/vol1/iss1/6>

This Article is brought to you for free and open access by the Law Journals at BrooklynWorks. It has been accepted for inclusion in Brooklyn Journal of Corporate, Financial & Commercial Law by an authorized editor of BrooklynWorks.

DIFFERENTIATING GATEKEEPERS

Arthur B. Laby*

INTRODUCTION

Collective blame for recent business failures has fallen on gatekeepers. The conventional view is that auditors, lawyers, underwriters, analysts, and others have shirked their responsibilities and permitted illegal conduct. If we clarify and enhance the responsibilities of gatekeepers, some say, we will avoid such debacles in the future.¹ This claim traditionally depended on a rational actor model under which a gatekeeper would prevent misconduct by a primary violator because the gatekeeper's expected liability or reputational harm from failing to prevent misconduct exceeded the benefits gained in fees.² Because investors understand a gatekeeper would not act irrationally, his statements are to be believed.³ While this model has merits, it fails to distinguish among gatekeepers, who are likely to respond differently to incentives. It also fails to appreciate differences in the

* Associate Professor, Rutgers University School of Law–Camden. I gratefully acknowledge comments and suggestions from Sharon Byrd, James Fanto, Jay Feinman, Jill Fisch, Edward Janger, Sung Hui Kim, Richard Lai, Dennis Patterson, George Siedel, Allan Stein, and participants at the Brooklyn Law School Symposium on New Models for Securities Law Enforcement: Outsourcing, Compelled Cooperation and Gatekeepers. Special thanks to Roberta Karmel and Edward Janger for organizing the Symposium. Sue Carpenter, Michelle Ferrigno, and Michael Suleta provided valuable research assistance.

1. See, e.g., Assaf Hamdani, *Gatekeeper Liability*, 77 S. CAL. L. REV. 53, 55 (2003) (noting consensus that insufficient deterrence is to blame for corporate scandals); Hillary A. Sale, *Gatekeepers, Disclosure, and Issuer Choice*, 81 WASH. U. L.Q. 403, 407 (2003) (stating that gatekeepers did not do their jobs in companies such as Enron). Compare John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 345–63 (2004) (proposing modified form of strict liability for auditors and proposing gatekeeper responsibilities on attorneys), with Frank Partnoy, *Strict Liability for Gatekeepers: A Reply to Professor Coffee*, 84 B.U. L. REV. 365, 368–74 (2004) (proposing modified strict liability limited by contract).

2. See Lawrence A. Cunningham, *The Appeal and Limits of Internal Controls to Fight Fraud, Terrorism, Other Ills*, 29 J. CORP. L. 267, 317 (2004) (stating that Sarbanes-Oxley accepts a deterrence model that “hypothesizes that target decision-making is conducted by comparing the cost of compliance with the product of enforcement threats and penalty levels”); Jill E. Fisch & Carolina M. Gentile, *The Qualified Legal Compliance Committee: Using the Attorney Conduct Rules to Restructure the Board of Directors*, 53 DUKE L.J. 517, 524 (2003) (“[T]he reforms of Sarbanes-Oxley are principally directed toward improving the incentives and responsibilities of gate-keepers—especially accountants.”); Sean Griffith, *Afterword and Comment: Towards an Ethical Duty to Market Investors*, 35 CONN. L. REV. 1223, 1224 (2003) (stating that investors can take comfort in gatekeepers’ opinions because firms risk both legal liability and discredit to reputation if false); Reinier Kraakman, *Third Party Liability*, in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 583, 585–86 (Peter Newman ed., 1998) (stating that accountants, underwriters, and lawyers often prevent misconduct, regardless of its returns).

3. See John C. Coffee, Jr., *Can Lawyers Wear Blinders? Gatekeepers and Third Party Opinions*, 84 TEX. L. REV. 59, 60 (2005).

character of a gatekeeper's relationship with a primary violator and to consider whether such differences bear upon gatekeeper behavior.⁴

This paper examines gatekeepers by focusing not on their similarities, but on their differences. All gatekeepers are not alike. They vary widely in the functions they serve, skills necessary for the job, relationships with their principals, and duties they owe. There are differences in their approaches as well. Accounting determinations, for example, are often formalistic and unambiguous, while legal advice is said to be more nuanced, requiring an attorney to explore a range of options with a client, who evaluates the lawyer's advice and then makes up her own mind.⁵ The securities analyst, unlike the accountant or lawyer, makes predictions, which are frequently wrong.⁶ Distinguishing among the character of gatekeepers' evaluations is helpful, but it masks deeper differences in the structure of gatekeepers' relationships with their clients.

This article focuses on one difference in particular that bears closely on whether the gatekeeper can be effective: whether, as a normative matter, the gatekeeper is meant to be independent of the client, acting as a neutral umpire,⁷ or whether the gatekeeper is meant to be dependent on the client, charged with promoting the client's ends in a fiduciary or similar capacity. The label *dependent* is used because certain gatekeepers depend on the client to determine the nature, purpose, and scope of their agency.

Distinguishing between independent and dependent gatekeepers, however, is only a starting point. One also must ask why gatekeepers have not been more robust monitors. At least part of the answer is that the conventional view of the gatekeeper's role is inadequate, focusing on the actions of a single individual, rather than the dynamics of the group. Similarly, until recently Congress, regulators, and courts have relied largely on a command and control philosophy of governance, rather than addressing biases that can cause one small misstep but lead incrementally to large scale disasters. Thus, rather than looking at the gatekeeper problem from the perspective of a rational actor, this paper explores it from a behavioral viewpoint.

4. Kraakman, *supra* note 2, at 586 (discussing accountants, underwriters, and lawyers); Coffee, *supra* note 1, at 309 (discussing auditors, rating agencies, analysts, investment bankers, and attorneys).

5. See Steven L. Schwarcz, *Financial Information Failure: Redrawing the Boundary Between Lawyer and Accountant Responsibility* 13–16 (Duke Law Sch., Working Paper No. 28, 2005); Coffee, *supra* note 1, at 353 (describing the auditor's world as "relatively precise and rule bound"). Much of accounting is of course nuanced as well. Accounting literature, for example, requires the auditor to conclude that the financial statements, apart from technical reporting rules, "fairly present" an issuer's financial position and operations. See, e.g., *United States v. Simon*, 425 F.2d 796, 805–06 (2d Cir. 1969).

6. Coffee, *supra* note 1, at 353 ("[T]he securities analyst is essentially a prognosticator whose predictions about the future are frequently wrong.").

7. See John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293, 1300 (2003).

Advances in behavioral and social psychology demonstrate that individual behavior is strongly influenced by others.⁸ Commenters in this area have begun to pay attention to the institutional and interpersonal context in which gatekeepers formulate judgments about whether the conduct of others is appropriate.⁹ Joining this chorus, this article maintains that dependent gatekeepers, far more than independent ones, perform their responsibilities under the yoke of unconscious bias that affects the rigor they bring to the gatekeeping task and the accuracy of their judgments. Thus, the thesis advanced is that independent agents are better gatekeepers than dependent ones.

Drawing on this literature, however, does not suggest that people who make poor decisions or fail to guard against wrongdoing are not responsible. It is easier, however, to investigate harm after it occurs and assign blame than to conduct a searching inquiry into one's underlying decision process with the aim of improving it.¹⁰ Furthermore, this paper does not attempt to provide a complete behavioral explanation of gatekeeper conduct, but rather raises, for future consideration, whether insights from behavioral psychology can be married with the understanding of the structure of gatekeeper relationships.

Part I of the paper distinguishes independent from dependent gatekeepers and discusses critical features that differentiate them. Gatekeepers are categorized as independent or dependent based on which features should predominate, recognizing that this split is not clear-cut and some gatekeepers, such as underwriters, share characteristics of both. Part II draws on research in the fields of behavioral and social psychology to demonstrate that fiduciaries such as lawyers and other advisors are less prone to the gatekeeping task than their independent counterparts. Part III

8. See generally S.T. Fiske, *Theories of Social Psychology*, in 21 INTERNATIONAL ENCYCLOPEDIA OF THE SOCIAL & BEHAVIORAL SCIENCES 14413 (Neil J. Smelser & Paul B. Baltes eds., 2001) (recording prominent theories in social psychology).

9. See, e.g., 11th Annual Business Law Forum, Behavioral Analysis of Corporate Law: Instruction or Distraction?, 10 LEWIS & CLARK L. REV. 1 (2006); Symposium, *Corporate Misbehaviors By Elite Decision-Makers: Perspectives from Law and Social Psychology*, 70 BROOK. L. REV. 1165 (2005); Sung Hui Kim, *The Banality of Fraud: Resituating the Inside Counsel as Gatekeeper*, 74 FORDHAM L. REV. 983, 1026–34 (2005) (applying self-serving bias and motivated reasoning to inside counsel role); Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233, 1251 (2002); Robert A. Prentice, *The Case of the Irrational Auditor: A Behavioral Insight into Securities Fraud Litigation*, 95 NW. U. L. REV. 133 (2000); Donald C. Langevoort, *Where Were the Lawyers? A Behavioral Inquiry Into Lawyers' Responsibility for Clients' Fraud*, 46 VAND. L. REV. 75, 117 (1993); James D. Cox & Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, 48 LAW & CONTEMP. PROBS. 83 (1985); see also Revision of the Commission's Auditor Independence Requirements, Securities Act Release No. 7919, 65 Fed. Reg. 76,008, 76,016 (Dec. 5, 2000) ("Two academics presented research tending to show that subtle but powerful psychological factors skew the perceptions and judgments of persons—including auditors—who have a stake in the outcome of those judgments.").

10. See ELLIOT ARONSON, *THE SOCIAL ANIMAL* 19 (8th ed. 1999).

extends the argument by examining indeterminacy in corporate and securities law, which further complicates the gatekeeping role because it gives wide latitude to gatekeepers to claim that their principal's conduct is appropriate. This "complex nature" of the law provides a "fertile breeding ground for the kind of motivated and self-serving interpretations that rationalize unethical actions."¹¹ Part III then addresses how these observations help explain recent reforms and discusses several additional potential reforms.

Understanding recent reforms and suggesting new ones is important and timely. Efforts are underway to scale back recent changes in the law,¹² and the direction of future reforms is uncertain.¹³ Indeed, many commentators have addressed whether recent changes, including Sarbanes-Oxley, are worthwhile or have unintended costs exceeding their benefits.¹⁴ Over the past several years, gatekeepers have received careful consideration as corporate monitors and will likely continue to draw attention.

I. INDEPENDENT AND DEPENDENT GATEKEEPERS

A. DEFINING GATEKEEPER

Descriptions of gatekeepers typically focus on their ex ante role. One common definition of gatekeeper is a reputational intermediary who provides verification or certification services to investors.¹⁵ Another is one

11. Kim, *supra* note 9, at 1030–31.

12. Floyd Norris, *Trusting Bosses Not to Cheat*, N.Y. TIMES, June 23, 2006, at C1; Randall Smith, Aaron Lucchetti & Susanne Craig, *Wall Street Pushes for Fewer Market Masters—As Stocks Revive, Scandals Fade, A Behind-the-Scenes meeting Signals Effort to Reduce Policing*, WALL ST. J., June 29, 2006, at C1; Jason McLure, *Statistics Show Drop in U.S. Prosecution of Corporate Fraud*, N.Y. L.J., July 18, 2006, at 1 (attributing decline to, among other things, shift in priorities to terrorism prosecutions).

13. See *Hedge Funds and Independent Analysts: How Independent are Their Relationships?: Hearing Before the S. Comm. on the Judiciary*, 109th Cong. (2006) (statement of Hon. Richard Blumenthal, Att'y Gen. of Conn.) (urging Congress to expand aspects of Sarbanes-Oxley); *id.* (statement of Marc E. Kasowitz, Senior Partner, Kasowitz, Benson, Torres & Friedman LLP, Alliance for Investment Transparency) ("[Congress] should consider whether further steps are necessary" to address hedge funds colluding with analysts.); *id.* (statement of Dr. Howard M. Schilit, Founder and Non-Executive Chair, Center for Financial Research and Analysis) (recommending PCAOB-type body to regulate analysts).

14. See, e.g., Robert B. Ahdieh, *From "Federalization" to "Mixed Governance" in Corporate Law: A Defense of Sarbanes-Oxley*, 53 BUFF. L. REV. 721, 745 (2005); Jayne W. Barnard, *Historical Quirks, Political Opportunism, and the Anti-Loan Provision of the Sarbanes-Oxley Act*, 31 OHIO N.U. L. REV. 325, 344 (2005); Bernard S. Carrey, *Enron—Where Were the Lawyers?*, 27 VT. L. REV. 871, 875 (2003); John C. Coffee, Jr., *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 CORNELL L. REV. 269, 280 (2004); Roger C. Cramton, George M. Cohen & Susan P. Koniak, *Legal and Ethical Duties of Lawyers After Sarbanes-Oxley*, 49 VILL. L. REV. 725, 727 (2004); Mae Kuykendall & Elliot A. Spoon, *Introduction to Michigan State University College of Law Sarbanes-Oxley Symposium: Enforcement, Enforcement, Enforcement . . .*, 2004 MICH. ST. L. REV. 271, 277 (2004); Bernd Schunemann, *The Sarbanes-Oxley Act of 2002: A German Perspective*, 8 BUFF. CRIM. L. REV. 35 (2004).

15. Coffee, *supra* note 1, at 309.

who is “positioned at a critical point in the flow of events” where approval is needed before a transaction can close.¹⁶ Gatekeepers, however, also engage in ex post monitoring designed to uncover misconduct after it occurs, initiate an investigation, and report the misconduct or take enforcement measures.¹⁷ Also, many gatekeepers perform an advisory role with respect to structural or regulatory issues regarding a transaction without necessarily providing verification, certification, or approval. Such advisors are gatekeepers too because we expect them to advise a client to avoid illegal conduct. Taking these considerations into account, gatekeeper is defined in this paper as a person or firm that provides verification or certification services or that engages in monitoring activities to cabin illegal or inappropriate conduct in the capital markets.

B. DIFFERENTIATING *INDEPENDENT* FROM *DEPENDENT* GATEKEEPERS

The emphasis on gatekeepers in the financial markets is not new. The early securities laws recognized the difference between independent and dependent gatekeepers in the context of directors.¹⁸ The Securities Act of 1933 placed responsibilities on gatekeepers such as auditors, underwriters, and company directors, and the legislative history to the Securities Act highlighted their role.¹⁹ In the 1970s, Securities and Exchange Commission actions against gatekeepers such as lawyers and accountants were based on the so-called access or passkey theory of liability, under which access to the securities markets was controlled by certain professionals like lawyers and accountants.²⁰ Today such actions often fall under the rubric of “aiding and abetting” or “secondary liability,” and the SEC has broad authority to impose sanctions against those who aid and abet violations of law.²¹ This

16. GEOFFREY C. HAZARD JR. & ANGELO DONDI, *LEGAL ETHICS: A COMPARATIVE STUDY* 201 (2004).

17. Kraakman, *supra* note 2, at 585. While not initiating wrongdoing, a gatekeeper may deter it or shift its costs away from investors. *See id.* at 583–84.

18. In the Investment Company Act of 1940, Congress placed responsibility on fund directors but, in doing so, it required that at least forty percent of a fund’s directors be independent of the advisory firm that typically establishes the funds it manages. 15 U.S.C. § 80a-10(a) (2000) (prohibiting more than 60 percent of a fund’s directors from being interested persons of the fund). The statute refers to directors who are not “interested persons,” as opposed to “independent” directors. *Id.* Congress entrusted to the independent directors the principal responsibility for protecting the fund’s shareholders. *Burks v. Lasker*, 441 U.S. 471, 485 (1979).

19. James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 35 (1959); *see also* H.R. REP. NO. 85 (1933).

20. *See* ROBERTA S. KARMEL, *REGULATION BY PROSECUTION* 174 (1982).

21. 3B HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, *SECURITIES & FEDERAL CORPORATE LAW* § 14:31 (2d ed. 2006). In *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), the U.S. Supreme Court ruled that a private plaintiff may not maintain an aiding and abetting action under section 10(b) of the Securities Exchange Act of 1934. As part of the Private Securities Litigation Reform Act, Congress amended the Exchange Act to allow the

section distinguishes independent from dependent gatekeepers by examining the roles of four types of gatekeepers: auditors, analysts, lawyers, and underwriters.

1. Independent Gatekeepers

Gatekeepers are retained as agents to perform a task or a series of tasks for a principal. In the course of doing so, they receive information, as the access theory suggests, that puts them in a unique position to evaluate whether the principal has violated, or is about to violate, the law. But the tasks they perform and the relationships with their principals vary. Some gatekeepers are supposed to be independent of their clients in order to critically evaluate a set of facts and render an unbiased opinion for an unknown audience. The normative qualities of independent gatekeepers are illustrated through a closer look at auditors and analysts.

a. Auditors

The auditor of a public company should be the archetypal independent gatekeeper. Federal law requires that financial information filed by public companies be audited by an independent public accountant.²² In the world of auditing, independence has a special meaning beyond exercising independent judgment required of most professionals. Independence calls for independence of the *audit client*. The Supreme Court contrasted the roles of the auditor and the lawyer with respect to independence. In deciding whether the work-product privilege applies to auditors, the Court explained:

The *Hickman* work-product doctrine was founded upon the private attorney's role as the client's confidential advisor and advocate, a loyal representative whose duty it is to present the client's case in the most favorable possible light. An independent certified public accountant performs a different role. By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client.²³

An auditor cannot be the client's advocate. The Court in the *Arthur Young* case concluded by saying that the "'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust."²⁴ Indeed, the

SEC to bring an action against a person who knowingly aids or abets a primary violation. 15 U.S.C. § 78t(e) (Supp. II 2002). The provision does not address actions by private plaintiffs.

22. Securities Act, Schedule A, Items 25 and 26, 15 U.S.C. §§ 77aa(25) and (26) (2000) and Securities Exchange Act § 17(e), 15 U.S.C.A. § 78q(e) (West 2006) require financial statements to be audited by independent public or certified accountants.

23. United States v. Arthur Young & Co., 465 U.S. 805, 817 (1984).

24. *Id.* at 818.

courts have stated that accountants have disclosure obligations because of their “special relationship of trust vis-à-vis the public” and their duty to “safeguard the public interest.”²⁵ An accountant who knows of, or recklessly disregards, fraud can be liable for aiding and abetting it.²⁶

The law discourages auditors and clients from developing long-term relationships. An auditor’s long-term relationship with a client can jeopardize independence, something accounting literature refers to as a *trust threat*.²⁷ Under SEC rules required by Sarbanes-Oxley, audit partners must “rotate off” an audit engagement after no more than seven years—presumably to cut short the relationship between auditor and client before it can blossom into a trust relationship that can impair independence.²⁸

The contrast between auditors and lawyers also is seen by comparing rules of imputation used by accounting firms, as opposed to law firms.²⁹ Unlike accounting firms, law firms have strict imputation rules that arise as a result of the lawyer’s duty of loyalty.³⁰ If one lawyer in a firm has a conflict of interest with respect to a client, the conflict is imputed to the firm.³¹ With hundreds of clients and lawyers switching firms often, conflicts easily arise.³² Large law firms manage conflicts on a daily basis by imposing procedures to ensure that information gained by an attorney regarding one client does not fall into hands of another attorney at the firm,

25. Rudolph v. Arthur Andersen Co., 800 F.2d 1040, 1044 (11th Cir. 1986).

26. *In re Am. Cont’l Corp./Lincoln Sav. & Loan Sec. Litig.*, 794 F. Supp. 1424, 1442–43 (D. Ariz. 1992).

27. AICPA Practice Alert 99-1, *Guidance for Independence Discussions with Audit Committees*, May 1999 (Updated through November 1, 2000), available at <http://www.aicpa.org/pubs/cpaltr/may99/supp/public.htm>.

28. Strengthening the Commission’s Requirements Regarding Auditor Independence, Securities Act Release No. 8183, 68 Fed. Reg. 6006, 6038 (Feb. 5, 2003) (“Under the new rules, no ‘audit partner’ will serve on an audit engagement team for more than seven consecutive years, and the ‘lead’ and ‘concurring’ partners will be prohibited from serving for more than five consecutive years.”). Hillary Sale and Jonathan Macey have expressed skepticism that rotation can eliminate client capture. See Jonathan Macey & Hillary A. Sale, *Observations on the Role of Commodification, Independence, and Governance in the Accounting Industry*, 48 VILL. L. REV. 1167, 1185–86 (2003).

29. See Draft Letter from Richard I. Miller, General Counsel and Secretary, AICPA, Potential Impact of ABA Commission on Multidisciplinary Practice Proposal on Professional Service Firms: Comparison of ABA and AICPA Rules of Conduct (August 24, 1999) (on file with the author) (comparing ABA and AICPA rules regarding imputation, conflicts of interest, and confidentiality).

30. MODEL R. OF PROF’L CONDUCT R. 1.10 (2003) (“While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules [related to conflicts of interest].”).

31. *Id.* R.1.10, 1.7(a) (imputing knowledge of one lawyer to every lawyer in the firm).

32. In one recent case, Gibson, Dunn & Crutcher was disqualified from representing a limited partnership in a dispute with a private equity fund because a Gibson, Dunn lawyer, while working at another firm, had represented the private equity fund. The court noted the “especially heavy” burden to show the conflict should not be imputed. *Casita, LP v. Maplewood Equity Partners (Offshore) Ltd.*, No. 603525/2005, 2006 WL 399796 (N.Y. Sup. Ct. Feb. 22, 2006).

who might be under a duty to use the information for the benefit of another client.

Accounting firms are not so constrained. A conflict by one member of an accounting firm will only preclude the firm from accepting an engagement if the conflict could be viewed as impairing another member's objectivity.³³ Similarly, AICPA rules impose duties of confidentiality, but they do not impute the knowledge of one member of the firm to everybody else.³⁴ Accounting firms routinely audit the books of competitors or companies that have business relationships with one another.³⁵

b. Securities Analysts

A second example of an independent gatekeeper is the securities analyst. An analyst is supposed to research a company to judge its value as an investment.³⁶ The analyst's role should be to review corporate information and present an unvarnished view of the company to investors or potential investors. The analyst's role should not be to advocate on behalf of the company, but rather, like the auditor, to objectively analyze the facts. Conflicts of interest must be disclosed.³⁷ The Supreme Court noted that the analyst's role in many cases is to expose negative facts the company may wish to withhold.³⁸ Like with auditors, long-term relationships between analysts and issuers are discouraged. Evidence indicates that the longer an analyst follows a company, for example, the more likely he is to evaluate the company positively.³⁹ Longevity leads to error.

The view of the analyst as independent is under attack.⁴⁰ Over the past several years, the principal criticism waged against analysts is that they have slowly lost their independence and become adjuncts of the investment banking departments of the firms that employ them.⁴¹ These criticisms are valid and reinforce the view that the norm for the analyst is independence.

33. AICPA CODE OF PROF'L CONDUCT ET § 102, interpretation 102-2 (1995) (Conflicts of Interest).

34. *Id.* § 301.01.

35. HAZARD & DONDI, *supra* note 16, at 193.

36. *See, e.g.*, Jill E. Fisch & Hillary A. Sale, *The Securities Analyst as Agent: Rethinking the Regulation of Analysts*, 88 IOWA L. REV. 1035, 1040 (2003).

37. The Securities Act requires that a research firm paid by a company for issuing research reports about that company must disclose the nature and amount of the compensation received. Securities Act § 17(b), 15 U.S.C. § 77q(b) (Supp. II 2002).

38. *Dirks v. SEC*, 463 U.S. 646, 658 n.18 (1983) (noting role analysts play in "revealing information that corporations may have reason to withhold from the public").

39. Paul M. Healy & Krishna G. Palepu, *How the Quest for Efficiency Corroded the Market*, HARV. BUS. REV. 76, 80 (July 2003).

40. *See, e.g.*, Fisch & Sale, *supra* note 36, at 1043 ("[T]he traditional hands-off approach to analyst regulation, which was premised on the theory that analysts functioned as independent gatekeepers, is no longer appropriate.").

41. Joe Nocera, *The Anguish of Being an Analyst*, N.Y. TIMES, Mar. 4, 2006, at C1 ("[A]nalytsts were routinely selling investors down the river by promoting stocks purely to land banking business from companies.").

If independence were not expected, analysts would not be denounced for losing their objectivity.

2. Dependent Gatekeepers

While some gatekeepers like auditors and analysts are supposed to be independent of their principal, others are not. Dependent gatekeepers provide advice and recommendations to assist a client in meeting its goals. They often act in a fiduciary capacity, owing both a duty of loyalty and a duty of care to the client. As a fiduciary, these agents must act for the client's benefit, furthering its ends.⁴² Courts maintain that the essence of the fiduciary duty is to act with "utmost good faith for the benefit" of the principal⁴³ and "single-mindedly pursue the interests of those to whom a duty of loyalty is owed."⁴⁴ Regardless of the context, fiduciary cases are replete with language about how the fiduciary must act to further the objectives of the principal.⁴⁵

A fiduciary relationship is characterized by values such as longevity and mutual trust, and fiduciary cases refer to a close bond that exists between the fiduciary and the principal.⁴⁶ Those same bonds, however, are anathema to relationships held by independent gatekeepers, such as auditors and analysts. And an auditor is not considered a fiduciary to the client when performing the audit function.⁴⁷

The differences in the type of relationships independent and dependent gatekeepers have with their clients are striking. The characteristics of

42. See RESTATEMENT (SECOND) OF TRUSTS § 2 cmt. b (1959) (noting that person in a fiduciary relationship has a duty to act for the benefit of another as to matters within the scope of the relationship).

43. *Barbara A. v. John G.*, 145 Cal. App. 3d 369, 372 (1983).

44. *Birnbaum v. Birnbaum*, 73 N.Y.2d 461 (1989).

45. The "first duty" of a trustee is to act wholly for the benefit of the trust. *Willers v. Wettstad*, 510 N.W.2d 676, 680 (S.D. 1994). A company director must act in the "best interest" of the corporation. *Lien v. Lien*, 674 N.W.2d 816, 824 (S.D. 2004). A partner must pursue the interests of his other partners. *Ashley MRI Mgt. Corp. v. Perkes*, No. 1915/05, 2006 WL 27685, at ***5 (N.Y. Sup. Ct. Jan. 3, 2006). A company officer violates the fiduciary duty to her employer if she fails to act solely for its benefit during the course of her employment. *NTSI Corp. v. Nelson*, No. 54229-0-I, 2006 WL 119119, at *6 (Wash. Ct. App. Jan. 17, 2006).

46. *Martinelli v. Bridgeport Roman Catholic Diocesan Corp.*, 196 F.3d 409, 430 (2d Cir. 1999) (stating that "close relationship with the Diocese" gave rise to fiduciary duty); *Clark v. Bowler*, 623 A.2d 27, 29–30 (R.I. 1993) (stating that close loving relationship gave rise to fiduciary duties); *Broomfield v. Kosow*, 212 N.E.2d 556, 561 (Mass. 1965) (finding fiduciary relationship where "close business relationship and business friendship" existed between two men); *Strode v. Spoden*, 284 S.W.2d 663, 665 (Ky. Ct. App. 1955) (stating that family ties contributed to fiduciary relationship).

47. See, e.g., *VTech Holdings, Ltd. v. PricewaterhouseCoopers, LLP*, 348 F. Supp. 2d 255, 268 (S.D.N.Y. 2004) ("In New York, the accountant-client relationship does not generally give rise to a fiduciary relationship absent special circumstances . . ."). An accountant, however, can become a fiduciary by establishing a relationship of trust and confidence, and by providing advice to a client. *Burdett v. Miller*, 957 F.2d 1375, 1381–82 (7th Cir. 1992).

dependent gatekeepers are illuminated by examining more closely the role of attorneys and underwriters.

a. Attorneys

A prime example of a dependent gatekeeper is the lawyer. Lawyers have a special place in the adversary system, which recognizes that conflict is inevitable and cannot always be resolved through consensus.⁴⁸ In the adversary system, lawyers are not meant to be impartial. An attorney is required to “advance the client’s lawful objectives and interests.”⁴⁹ Every lawyer knows about the duty of zealous advocacy.⁵⁰ As Geoffrey Hazard has written, “A lawyer’s service consists of guiding affairs for the client’s private and often selfish purposes, with an eye to legal requirements that have been designed for the very purpose of limiting or regulating selfish purposes.”⁵¹

The relationship between client and lawyer is akin to an “informal partnership.”⁵² They work together toward a common goal, although the client, not the lawyer, ultimately calls the shots.⁵³ This is particularly true of in-house lawyers because of their long-term role as employees or subordinates of the client.⁵⁴ In describing the lawyer’s role, it is useful to contrast it with the role of the judge. The traditional figure of justice—blindfolded—represents the court or the judge, not the lawyer.⁵⁵ The lawyer, particularly in litigation, seeks to achieve success for his or her client to the disadvantage of the opposing client; the judge interposes herself between the two positions, seeking justice.⁵⁶ The judge’s ethical norm is impartiality; the lawyer’s is loyalty.⁵⁷

48. Martin H. Redish, *The Adversary System, Democratic Theory, and the Constitutional Role of Self-Interest: The Tobacco Wars, 1953–1971*, 51 DEPAUL L. REV. 359, 367 (2001) (explaining that democratic adversary theory recognizes individuals are all worthy of dignity and respect, interests differ, conflict is inevitable, and deliberation will not always yield consensus); see also HAZARD & DONDI, *supra* note 16, at 9.

49. *People v. Reiner*, No. B150375, 2004 WL 1171507, at *11 n.2 (Cal. Ct. App. May 26, 2004).

50. MODEL R. OF PROF’L CONDUCT R. 1.3 cmt. 1 (2003) (“[A] lawyer must . . . act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client’s behalf.”).

51. HAZARD & DONDI, *supra* note 16, at 172.

52. *Id.* at 213.

53. MODEL R. OF PROF’L CONDUCT R. 1.2(a) (2003) (“[A] lawyer shall abide by a client’s decisions concerning the objectives of representation and . . . shall consult with the client as to the means by which they are to be pursued.”).

54. See Kim, *supra* note 9, at 1004.

55. *Stone v. Williams*, 891 F.2d 401, 405 (2d Cir. 1989) (“The figure representing justice is blindfolded so that the scales are held even, but justice is not blind to reality. Plaintiff therefore should have her day in court and an opportunity to have a jury determine the merits of her claim.”).

56. HAZARD & DONDI, *supra* note 16, at 64.

57. *Id.* at 80.

Notwithstanding the role of zealous advocate, the attorney's duty of loyalty is not unlimited. Courts and commentators have recognized the tension between the lawyer's fidelity to his client on the one hand, and his role as gatekeeper on the other—and lawyers are at the center of the corporate governance debate.⁵⁸ ABA rules provide that a lawyer cannot “counsel a client to engage, or assist a client, in conduct the lawyer knows is criminal or fraudulent.”⁵⁹ ABA rules permit an attorney to withdraw from representation where the client “insists upon taking action that the lawyer considers repugnant.”⁶⁰ Recent changes to the ABA Model Rules, which expand the circumstances when a lawyer may breach client confidentiality, illustrate the complexity of the lawyer's role.⁶¹ Certain states, such as New Jersey, go farther than the Model Rules and require lawyers to disclose information to prevent a client “from committing a criminal, illegal or fraudulent act that the lawyer reasonably believes is likely to result in death or substantial bodily harm or substantial injury to the financial interest or property of another.”⁶²

Studies suggest that attorneys do not take this language completely seriously. Particularly with regard to financial injury, only a small

58. Jill E. Fisch & Kenneth M. Rosen, *Is There a Role for Lawyers in Preventing Future Enrons?*, 48 VILL. L. REV. 1097, 1100 (2003); see HAZARD & DONDI, *supra* note 16, at 65 (noting that attacks have been mounting against lawyers over the past several years); Dan Ackman, *Enron: Now the Recriminations*, FORBES, Nov. 30, 2001, available at www.forbes.com/2001/11/30/1130_topnews.html; see also *Lincoln Sav. & Loan Ass'n v. Wall*, 743 F. Supp. 901, 920 (D.D.C. 1990) (asking why lawyers did not speak up or disassociate themselves from illegal transactions); Transcript of Stephen M. Cutler, Director, Division of Enforcement, U.S. SEC, Remarks Before the 2004 Investment Company Institute Securities Law Developments Conference (Dec. 6, 2004), available at <http://sec.gov/news/speech/spch120604smc.htm>; David J. Beck, *The Legal Profession at the Crossroads: Who Will Write the Future Rules Governing the Conduct of Lawyers Representing Public Corporations?*, 34 ST. MARY'S L.J. 873, 874 (2003); Jenny B. Davis, *The Enron Factor: Experts Say the Energy Giant's Collapse Could Trigger Changes in the Law That Make it Easier to Snare Professionals*, 88 A.B.A. J. 40, 44–45 (April 2002); Symposium Panel, *The Evolving Legal and Ethical Role of the Corporate Attorney After the Sarbanes-Oxley Act of 2002: Panel Three: Ethical Dilemmas Associated with the Corporate Attorney's New Role*, 52 AM. U. L. REV. 655, 661 (2003).

59. MODEL R. OF PROF'L CONDUCT R. 1.2(d) (2003).

60. *Id.* R. 1.16(b)(4).

61. Before 2003, the Model Rules provided that client information could not be revealed, without the client's consent, unless necessary “to prevent imminent death or substantial bodily harm” or “to establish a claim or defense on behalf of the lawyer” MODEL RULES OF PROF'L CONDUCT R. 1.6 (1983) (amended 2003). In 2003, the ABA amended its rules in accordance with changes recommended by the Ethics 2000 Commission. Revised Rule 1.6 differs from the old rule in two ways. A lawyer now can reveal confidential information if necessary “to prevent reasonably certain death or substantial bodily harm” or “to prevent, mitigate or rectify substantial injury to the financial interests . . . of another.” *Id.* R. 1.6(b)(1) (2003). After some debate, the ABA determined that the rule would be permissive; disclosure is not required. See Lawrence A. Hamermesh, *The ABA Task Force on Corporate Responsibility and the 2003 Changes to the Model Rules of Professional Conduct*, 17 GEO. J. LEGAL ETHICS 35, 38–39 (2003).

62. N.J. RULES OF PROF'L CONDUCT R. 1.6(b)(1) (2006).

percentage of lawyers make the required disclosure.⁶³ This is not surprising as the overall role of the lawyer is to promote the aims and objectives of his client. The unwillingness to make such disclosures is consistent with the insights from behavioral psychology, explored below. As one writer noted, “In the law, bias is a professional obligation.”⁶⁴ While lawyers are occasionally found liable for wrongdoing, the facts of those cases are generally egregious.⁶⁵

While this paper places lawyers in the dependent gatekeeper class, occasionally one hears that lawyers must be independent. What does independence mean in this context? Geoffrey Hazard has distilled a lawyer’s independence to four principles: independence from the state, independence from improper relationships (including other clients and colleagues), independence from personal views regarding politics or morality, and independence from the *client*.⁶⁶ This last principle warrants a closer look because if lawyers are supposed to be independent of their clients, then they would fall into the category of other independent gatekeepers, like auditors.

A lawyer’s independence from the client, however, is different from the auditor’s or analyst’s independence. Hazard explains that a lawyer’s independence from the client means forbearing from assisting a client in violating the law or from rendering advice that encourages a violation.⁶⁷ Such conduct ultimately would harm the client and be tantamount to a violation of the duty of loyalty. Independence in this special sense, therefore, is better described as a *corollary* of the duty of loyalty, not opposed to it.⁶⁸ A lawyer also is said to be morally independent from his client in the sense that while the lawyer acts on behalf of the client, the actions and responsibilities of the two are distinct.⁶⁹ Moral independence in that regard does not detract from the thesis of this paper; it supports it because it demonstrates that lawyers, as zealous advocates, make arguments that they may feel uncomfortable making on their own behalf.

The lawyer’s role as gatekeeper is clearest when giving legal opinions; it is there one should look to determine whether a lawyer is independent of his client. A legal opinion is an informed judgment, usually reduced to

63. Leslie C. Levin, *Testing the Radical Experiment: A Study of Lawyer Response to Clients Who Intend to Harm Others*, 47 RUTGERS L. REV. 81, 129–30 (1994).

64. PAUL G. HASKELL, WHY LAWYERS BEHAVE AS THEY DO 55 (1998).

65. See, e.g., *In re Am. Cont’l Corp./Lincoln Sav. & Loan Sec. Litig.*, 794 F. Supp. 1424, 1450–52 (D. Ariz. 1992) (explaining that Jones Day provided opinion letter despite evidence it knew Lincoln backdated files, destroyed documents, and violated regulations).

66. HAZARD & DONDI, *supra* note 16, at 147.

67. *Id.* at 159.

68. *Id.* at 116 (“A corollary of the principle of independence is the virtue of loyalty to client.”).

69. Richard W. Painter, *The Moral Interdependence of Corporate Lawyers and Their Clients*, 67 S. CAL. L. REV. 507, 508–09 (1994).

writing, on discrete legal issues.⁷⁰ An opinion generally provides the recipient with the lawyer's judgment on how a particular court would resolve a discrete issue.⁷¹ Lawyers provide opinions to clients and non-clients on a number of matters that allow a transaction to go forward.⁷² In giving an opinion, the lawyer does not function as a conventional advocate. Rather, the goal of the opinion giver should be to fairly and accurately provide a legal conclusion based on the relevant facts.⁷³ When a lawyer gives an opinion and he knows or has reason to know that a third person is likely to rely on it, the lawyer owes the third person a duty of reasonable care.⁷⁴

The lawyer's responsibility to a third person when preparing an opinion is in tension with his responsibility to his client.⁷⁵ The lawyer as opinion-giver is not completely objective for several reasons. First, a lawyer rendering an opinion often serves a dual role as opinion-giver and engineer of the transaction about which he is opining.⁷⁶ In that sense, the lawyer is passing on his own work, which, as discussed, is prohibited for the independent auditor.⁷⁷ Second, opinions typically are negotiated documents whose terms are agreed in advance of the consummation of a transaction.⁷⁸

70. See Special Committee on Legal Opinions in Commercial Transactions et al., *Legal Opinions to Third Parties: An Easier Path*, 34 BUS. LAW. 1891, 1896 (1979).

71. *Third-Party "Closing" Opinions: A Report of the TriBar Opinion Committee*, 53 BUS. LAW. 591, 595-96 (1998).

72. In public offerings, an underwriting agreement often will require outside counsel to give a negative assurance that nothing has come to counsel's attention to lead them to believe that the registration statement or the prospectus is materially misleading. CHARLES J. JOHNSON, JR. & JOSEPH MCLAUGHLIN, *CORPORATE FINANCE AND THE SECURITIES LAWS* 102 (3d ed. 2004). SEC Regulation S-K requires an "opinion of counsel as to the legality of the securities being registered." See Item 601(b)(5) to Regulation S-K, 17 C.F.R. § 229.601 (2006). In the case of private transactions, lawyers for broker-dealers often provide an opinion setting forth certain risk factors and the process the broker used to review the issuer's offering memorandum, which the broker-dealer then uses in its sales efforts. JEANNE M. CAMPANELLI & BRADLEY J. GANS, *SECURITIES OFFERINGS; THE MECHANICS OF 144A/REGULATION S UNDERWRITINGS, WHAT ISSUERS' & UNDERWRITERS' COUNSEL NEED TO KNOW NOW* (2001) (explaining that opinion recites investigatory process of issuer and offering memo that counsel undertook and gives negative assurance that following investigation nothing changed).

73. See Steven L. Schwarcz, *The Limits of Lawyering: Legal Opinions in Structured Finance*, 84 TEX. L. REV. 1, 13 n.63 (2005).

74. See JAY M. FEINMAN, *PROFESSIONAL LIABILITY TO THIRD PARTIES* 99 (2000).

75. See *id.* at 100.

76. Griffith, *supra* note 2, at 1225 ("[L]awyers not only pass judgment, as gatekeepers, on the validity of transactions, they also exercise a significant degree of authorship over those transactions."); see also RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 152 cmt. c (Tentative Draft No. 8, 1997) (stating that in opinion-giving role, lawyer must provide a "fair and objective opinion").

77. Qualifications of accountants, 17 CFR § 210.2-01(b) (2006) (Preliminary Note) ("[T]he Commission looks in the first instance to whether a relationship or the provision of a service . . . places the accountant in the position of auditing his or her own work."); see also Griffith, *supra* note 2, at 1225 ("The conflict between lawyer-as-gatekeeper and lawyer-as-transaction engineer thus parallels the conflict between accountant-as-auditor and accountant-as-consultant.").

78. See JOHNSON & MCLAUGHLIN, *supra* note 72, at 103.

Third, unlike an audit, a legal opinion is considered one aspect of counseling a client who has requested that the lawyer provide the opinion to a third party.⁷⁹ As Steven Schwarcz notes, lawyers should have the right to issue opinions to facilitate lawful transactions. They should not be expected to assess the overall legality of the transaction.⁸⁰ Finally, an opinion does not give rise to a lawyer-client relationship with the third-party recipient.⁸¹ Even those who advocate a more robust gatekeeping role for lawyers rendering legal opinions concede that opinion givers are not independent in the same sense as auditors.⁸²

b. Securities Underwriters

An investment bank acting as an underwriter in a public securities offering plays an important gatekeeping role but, as we shall see, the underwriter is a dependent gatekeeper in many respects. This may be surprising because the underwriter is said to play a special role as the only participant who, as to matters not certified by the auditor, has the background and knowledge to conduct a sufficient investigation to protect the investor.⁸³ Section 11 of the Securities Act names the underwriter, unlike the lawyer, as a potential defendant in a private lawsuit if a registration statement is misleading.⁸⁴ Section 11 also provides a due diligence defense to the underwriter, who must undertake a “reasonable investigation” to assure itself that statements made in the registration statement are true.⁸⁵ The underwriter must perform this responsibility on its own. It cannot rely on information provided by the issuer.⁸⁶ “Tacit reliance on management assertions is unacceptable; the underwriters must play devil’s advocate.”⁸⁷ Thus, there is a sense in which the underwriters are acting independently of the issuer to perform the due diligence required by the Securities Act. The role of the underwriter, however, is more complex.

Notwithstanding the emphasis on due diligence, the underwriter is not meant to be wholly independent of the issuer in the same way the auditor is independent. The issuer engages the underwriter to promote the distribution

79. *Third-Party “Closing” Opinions*, *supra* note 71, at 596.

80. *See* Schwarcz, *supra* note 73, at 33 (analyzing lawyers’ duties in rendering opinions in structured finance transactions).

81. *Third-Party “Closing” Opinions*, *supra* note 71, at 596.

82. *See* Coffee, *supra* note 3, at 59 (“[T]he attorney’s role in this special context of third-party opinions is fundamentally that of a gatekeeper—a role that is midway between that of the attorney as advocate and that of the auditor.”).

83. *In re WorldCom, Inc. Sec. Litig.*, 346 F. Supp. 2d 628, 675 (S.D.N.Y. 2004) (quoting *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 581 (E.D.N.Y. 1971)).

84. Securities Act § 11, 15 U.S.C. § 77k(a)(5) (2000).

85. *Id.* § 77k(b)(3).

86. *See* *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643, 696–97 (S.D.N.Y. 1968).

87. *WorldCom*, 346 F. Supp. 2d at 675 (quoting *Feit*, 332 F. Supp. at 582).

of its securities.⁸⁸ In that regard, the underwriter's role, as an adviser to the issuer, usually predates the offering itself. In many cases, the managing underwriter provides advice on a number of issues pertinent to the offering, such as the type and amount of securities sold, the timing of the offer, and steps the issuer can take to make itself more attractive.⁸⁹ As a result of advice given, some courts have begun to recognize a fiduciary relationship between an underwriter and an issuer.⁹⁰

In addition, an underwriter often has a direct or indirect financial interest in an offering. Some underwriters invest directly in their clients,⁹¹ which is prohibited for independent accountants.⁹² Also, many underwritings are performed on a so-called best efforts basis where the underwriter will not receive a fee unless some or all of the securities are sold.⁹³ In a recent Second Circuit case, the court summarized the underwriter's incentives as follows:

Underwriters have strong incentives to manipulate the IPO [initial public offering] process to facilitate the complete distribution and sale of an issue. Underwriting is a business; competitive forces dictate that underwriters associated with successful IPOs will attract future issuers. Moreover, because underwriters assume a large measure of risk in the event an IPO fails, they have a direct interest in the IPO's success.⁹⁴

Moreover, underwriters perform multiple services for their clients. Performance of such services, notwithstanding the due diligence respons-

88. Even where the issuer does not engage an underwriter, but one simply acts for the benefit of an issuer in furtherance of a distribution, that person is considered an underwriter. In the case of *SEC v. Chinese Consolidated Benevolent Association*, an association, which helped the Chinese government during a bond offering in soliciting and receiving funds from Chinese communities in the United States, was considered an underwriter although it had no contractual relationship with the issuer. *SEC v. Chinese Consol. Benevolent Ass'n*, 120 F.2d 738, 740 (2d Cir. 1941). Similarly, promoters, officers, and control persons who promote an offering are generally considered underwriters as well. JAMES D. COX, ROBERT W. HILLMAN & DONALD C. LANGEVOORT, *SECURITIES REGULATION: CASES AND MATERIALS* 351–52 (5th ed. 2006).

89. See COX, HILLMAN & LANGEVOORT, *supra* note 88, at 120–21.

90. The New York Court of Appeals held that while the underwriting agreement for an IPO did not itself create a fiduciary duty, the advisory relationship between the underwriter and the issuer was marked by trust and confidence and gave rise to a fiduciary relationship. *EBC I, Inc. v. Goldman, Sachs & Co.*, 832 N.E.2d 26, 31–33 (N.Y. 2005) (“eToys hired Goldman Sachs to give it advice for the benefit of the company, and Goldman Sachs thereby had a fiduciary obligation to disclose any conflict of interest concerning the pricing of the IPO.”); see also *Breakaway Solutions, Inc. v. Morgan Stanley & Co. Inc.*, No. Civ. A. 19522, 2004 WL 1949300, at *13 (Del. Ch., Aug. 27, 2004) (holding that issuer sufficiently alleged fiduciary relationship with its description of relationship with defendant underwriters).

91. Royce de Barondes, *NASD Regulation of IPO Conflicts of Interest—Does Gatekeeping Work?*, 79 TUL. L. REV. 859, 862 (2005) (“[Investment banks] may, and occasionally do, have financial interests in an issuer or a securities offering in addition to receipt of underwriting fees.”).

92. 17 C.F.R. § 210.2-01(c)(1)(i)(A) (2006) (stating that an accounting firm is not independent if firm or immediate family member has “any direct investment in an audit client”).

93. See COX, HILLMAN & LANGEVOORT, *supra* note 88, at 121–22.

94. *Billings v. Credit Suisse First Boston Ltd.*, 426 F.3d 130, 139 (2d Cir. 2005).

bility under section 11, distinguishes underwriters from auditors and makes them dependent in a way that auditors now cannot be. Unlike auditors, which are restricted in the performance of non-audit services, underwriters continue to have an interest in cultivating the client relationship to obtain additional consulting and other work.⁹⁵ The very provision of advice can turn a non-fiduciary relationship into a fiduciary one by dint of reliance by the principal on the skills and expertise of the agent and the trust and confidence reposed in him.⁹⁶

Application of National Association of Securities Dealers (NASD) rules demonstrates an underwriter is a *dependent* gatekeeper. NASD rules require its members, in some cases, to hire an independent agent (known as a qualified independent underwriter) to conduct due diligence on a registration statement and provide an independent pricing opinion.⁹⁷ If a conventional underwriter were independent, the NASD rules would be superfluous.⁹⁸

This Part demonstrates that all gatekeepers are not alike. Some, like auditors, are meant to be independent of their clients. Others, like attorneys, are dependent on the goals and objectives of their clients and often serve in a fiduciary capacity. Part II explores aspects of social and behavioral psychology with a view to determining whether these differences bear on how gatekeepers are likely to behave. Drawing on these insights, Part III discusses how dependent gatekeepers, charged with furthering the interests of their clients, are less likely to be effective gatekeepers than independent ones, and what we should do about it.

II. GATEKEEPER MOTIVATION AND BIAS

Intuition tells us that a dependent gatekeeper will be ineffective. The dependent gatekeeper faces a dilemma. He can act as a weak monitor, enhancing his potential liability, but preserving his client relationship and positioning himself for future business. Alternatively, he can act as a robust

95. See COX, HILLMAN & LANGEVOORT, *supra* note 88, at 125.

96. See *Burdett v. Miller*, 957 F.2d 1375, 1381–82 (7th Cir. 1992).

97. See NASD RULES OF THE ASSOCIATION R. 2710, *Corporate Financing Rule—Underwriting Terms and Agreements* (2006); NASD RULES OF THE ASSOCIATION R. 2720, *Distribution of Securities of Members & Affiliates—Conflicts of Interest* (2006); see also 24 WILLIAM M. PRIFTI, *SECURITIES PUB. & PRIV. OFFERINGS* § 5:25 (June 2006); 1 HAROLD S. BLOOMENTHAL, *SECURITIES LAW HANDBOOK* § 19:22 (2006).

98. See Notice of Filing of Proposed Rule Change Relating to the Corporate Financing Rule and Shelf Offerings of Securities, 69 Fed. Reg. 70,731, 70,735 (proposed Feb. 4, 2004) (setting forth rules governing an underwriter participating in distribution of securities of issuer with which it has conflict of interest); see also *Amendments to the Corporate Financing Rule*, NASD NOTICE TO MEMBERS 04-13, Feb. 2004, at 114, available at http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_003258.pdf (noting that NASD member firms have expanded services provided to corporate financing clients including “venture capital investment, financial consulting, commercial lending, hedging risk through derivative transactions, and investment banking”).

monitor, shielding himself from potential liability, but possibly damaging his client relationship and acting inconsistently with his fiduciary duty.⁹⁹

Liability for breach of fiduciary duty could be overcome by fiat. Congress or regulators could draft laws or rules to trump state common law and limit liability for certain violations of the duty of loyalty. The same result might be achieved through contract, although such terms could be difficult to negotiate and enforce. The SEC's attorney conduct rules, which require lawyers to report violations of law "up the ladder" in the business organization, was a partial measure in this regard. In adopting the rules, the SEC reaffirmed that they "shall prevail over any conflicting or inconsistent laws of a state or other United States jurisdiction in which an attorney is admitted or practices."¹⁰⁰ While the rules are controversial, the ABA recognized that federal law may provide a basis for the pre-emption of attorney-client confidentiality.¹⁰¹

Even if such protections are available, open-ended responsibilities placed on fiduciaries to act as gatekeepers are unlikely to be effective. One reason for this, Part I demonstrates, is that a dependent gatekeeper should be committed to furthering the goals of his principal. This part explores a related reason, namely whether a gatekeeper's decision making process in determining whether to act in a way that could harm his principal is constrained by unconscious bias. This Part begins with a short discussion of how conventional analysis has failed and why incorporating lessons from behavioral and social psychology is essential.

A. FAILURES OF CONVENTIONAL ANALYSIS

The primary failure of the traditional analysis of gatekeeper liability is that it did not sufficiently consider the dynamics of the group. People are motivated to act in the way they do out of biases deeper than an urge to maximize their wealth, reputation, or another measure of well-being. They are concerned about many other factors, such as how they are perceived by peers, and they make decisions in many cases based on what will be acceptable to the group. Moreover, most people stick to their decision, even if the

99. Acting as a robust gatekeeper may be inconsistent with the duty of care, by failing to further the principal's objectives, and inconsistent with the duty of loyalty, by acting against the principal's interests. Griffith, *supra* note 2, at 1234 n.43 (stating that vague duties "to 'the public' threaten to increase the agency costs of the legal representation as lawyers may seek to pursue their own ideological goals in favor of client interests").

100. Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 8185, Exchange Act Release No. 47,276, Investment Company Act Release No. 25,919, 68 Fed. Reg. 6296, 6296 n.7 (Feb. 6, 2003); Letter from Giovanni P. Prezioso, General Counsel, SEC, to J. Richard Manning, President, and David W. Savage, President-Elect, Washington State Bar Association (July 23, 2003), available at <http://www.sec.gov/news/speech/spch072303gpp.htm>.

101. See Letter from Alfred P. Carlton, Jr., President, American Bar Assoc. to Jonathan G. Katz, Sec'y, SEC (December 18, 2002), available at <http://www.sec.gov/rules/proposed/s74502/apcarlton1.htm>.

decision turns out to be wrong-headed, long after they figure that out. These group dynamics, however, are only now getting significant attention in the literature regarding gatekeeper reform.¹⁰²

Focus on the individual, as opposed to the group, pervades our system of justice. Our system determines the guilt of an individual actor.¹⁰³ This is consistent with the emphasis in corporate law on discrete rational individuals acting to maximize their own wealth.¹⁰⁴ Ignoring group dynamics, however, is inconsistent with the way individuals operate in a business environment. This observation is not new. Law and economics scholars, often criticized by proponents of social psychology, recognized long ago that the nature of the corporation could be best understood by placing the individual into the group and recognizing the role of the individual within it.¹⁰⁵ Ignoring group dynamics leads one back to a rational actor model of individualized action and stresses a “bad apples” approach to understanding corporate wrongdoing.¹⁰⁶ It deemphasizes the influence one person or group of persons has on another, such as the interaction of a board of directors or the relationship between and among gatekeepers and their principals. This de-emphasis elides the complicated causes of misbehavior and may prevent meaningful reform.

Second, analysts of gatekeeper liability have ignored certain root causes of corruption. Corruption can begin with certain small steps that “have their origins in actions that are not themselves corrupt.”¹⁰⁷ Small or insignificant actions can spread within an organization with each subsequent actor rationalizing that his or her conduct is not much different from conduct that preceded it. If this is correct, wrongdoing cannot be alleviated in large organizations by screening out individuals deemed corrupt.¹⁰⁸ The problems are deeper because many or most people are susceptible to the kinds of actions they ultimately might brand as wrong. And even if one is not susceptible to committing an action that could be considered corrupt in hindsight, conventional analysis has not accounted for how loyalty in an organization can cause some persons to fail to question others.

A related, frequently ignored concern is the haste with which individual decisions in large organizations are often made. This phenomenon is masked by the time it takes for tangible results to be achieved, such as the

102. See *supra* note 9 and accompanying text.

103. See James A. Fanto, *Perspectives From Law and Social Psychology*, 70 BROOK. L. REV. 1165, 1166 (2005).

104. See Daniel J.H. Greenwood, *Discussing Corporate Misbehavior: The Conflicting Norms of Market, Agency, Profit and Loyalty*, 70 BROOK. L. REV. 1213, 1216 (2005).

105. See FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 8 (1991).

106. John M. Darley, *The Cognitive and Social Psychology of Contagious Organizational Corruption*, 70 BROOK. L. REV. 1177, 1178 (2005).

107. *Id.* at 1180.

108. *Id.* at 1183.

introduction of a new product or service. But hundreds or thousands of smaller decisions are made within an organization for the tangible result to be achieved, often with little or no reflection. John Darley has explained that improper decisions “may be overridden by the more deliberate thinking of the reasoning system, but only if something triggers that system into action.”¹⁰⁹

Third, in addressing gatekeepers’ behavior, ideas of agency cost theory and the nexus-of-contracts approach are overemphasized. This approach focuses on purported contractual relationships, such as the relationship between an individual director and the corporation. It recognizes that a director’s interests may diverge from the shareholders’ and it considers ways shareholders can ensure that a director’s interests are aligned with shareholders’ interests. Under this view, a manager or director’s fiduciary duty is nothing more than a safeguard to ensure he makes the right decisions on behalf of investors, as the residual claimants of the firm.¹¹⁰ The individualism characteristic of the contractualist view, however, is inconsistent with board experience and fails as an explanatory theory of the recent business failures.¹¹¹

Finally, conventional analysis remains largely wedded to a “command and control” (as opposed to a self-regulatory) model of corporate governance. Where a command and control model relies on external sanctions and rewards, a self-regulatory model relies on shaping employees’ internal motivations.¹¹² Behavioral and social psychologists have shown that people

109. *Id.*

110. Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 403 (1983).

111. See Rakesh Khurana & Katharina Pick, *The Social Nature of Boards*, 70 BROOK. L. REV. 1259, 1262–64 (2005).

112. Tom R. Tyler, *Promoting Employee Policy Adherence and Rule Following in Work Settings: The Value of Self-Regulatory Approaches*, 70 BROOK. L. REV. 1287, 1293–98 (2005).

are not profit maximizers.¹¹³ As a result, external sanctions and rewards often are not effective strategies for influencing behavior.¹¹⁴

B. SOCIAL PSYCHOLOGY

Lessons from the fields of social and behavioral psychology address many of these shortcomings. Social psychology bridges the fields of psychology, which emphasizes the mental processes and behavior of the individual, and sociology, which emphasizes social structure, social institutions and processes, and human interaction. In general terms, social psychology addresses the influences people have on the beliefs and behavior of others.¹¹⁵ Much of the work in this area focuses on an individual's behavior in a social environment and motivations that affect the individual's decision making.¹¹⁶ It is a broad field with, by one count, some 600 theories to explain human behavior.¹¹⁷

The research suggests that unconscious bias can affect gatekeeper decisions. Social psychology teaches that goals and motives influence reasoning—the way people process information—and the judgments they make.¹¹⁸ Motives affect reasoning by inducing people to rely on a biased set of cognitive processes that reflect the goals we seek to achieve. Cognitive processes that can become corrupted include the way one accesses information and the way one constructs and evaluates beliefs.¹¹⁹

113. *Id.* at 1297–98 (citing Marius Aalders & Ton Wilthagen, *Moving Beyond Command and Control: Reflexivity in the Regulation of Occupational Safety and Health and the Environment*, 19 L. & POL'Y 415, 415–43 (1997)); Neil Gunningham & Joseph Rees, *Industry Self-Regulation: An Institutional Perspective*, 19 L. & POL'Y 363, 363 (1997); Andrew A. King & Michael Lenox, *Industry Self-Regulation Without Sanctions*, 43 ACAD. MGMT. J. 698, 698–716 (2000); Clifford Rechtschaffen, *Deterrence vs. Cooperation and the Evolving Theory of Environmental Enforcement*, 71 S. CAL. L. REV. 1181, 1181–1272 (1998); Darren Sinclair, *Self-Regulation Versus Command and Control? Beyond False Dichotomies*, 19 L. & POL'Y 529, 529–59 (1997); see also Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211, 218 (1995) (“[C]ognitive psychology has established that real people use certain decisionmaking rules (heuristics) that yield systematic errors, and that other aspects of actors’ cognitive capabilities are also systematically defective.”); Jon D. Hanson & Douglas A. Kysar, *Taking Behaviorism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. REV. 630, 672 (1999) (“[H]uman individuals display a startling ineptitude for comprehending causality and probability.”); Cass R. Sunstein, *Behavioral Analysis of Law*, 64 U. CHI. L. REV. 1175, 1191–95 (1997) (explaining that people do not make decisions based on rational choice).

114. *Id.* at 1295–96.

115. ARONSON, *supra* note 10, at 6.

116. E.F. Borgatta, *Social Psychology*, in 4 THE CORSINI ENCYCLOPEDIA OF PSYCHOLOGY & BEHAVIORAL SCIENCE 1572 (3d ed. 2001); Michael A. Hogg, *Social Identity and Misuse of Power: The Dark Side of Leadership*, 70 BROOK. L. REV. 1239, 1240 (2005) (“Most social-psychological theories subscribe to an interactionist metatheory.”).

117. See Fiske, *supra* note 8, at 14,420.

118. A motive in this context is any wish, preference, or desire concerning the outcome of a reasoning task.

119. Ziva Kunda, *The Case for Motivated Reasoning*, 108 PSYCH. BULL. 480, 480 (1990).

Gatekeeper decisions also can be biased because of a related reliance on heuristics, which are shortcuts or rules of thumb we use all the time to aid decision making. Most work in the area of heuristics and biases concerns facts. Heuristics, however, also are used in moral and legal decision making.¹²⁰ By utilizing heuristics, one can avoid the hard cognitive work of receiving, understanding, and interpreting complex information and analyzing the costs and benefits of alternative courses of action.¹²¹ Heuristics work well most of the time, but not always.¹²² They fail us when a generalization that results from a heuristic is taken out of context and used as a universal principle where it no longer applies.¹²³

C. REDUCING DISSONANCE

Psychologists explain that goals and motives influence reasoning because people seek to maintain consonance between relevant cognitions. The lack of consonance, or dissonance, produces pressure to avoid situations and information that increase the dissonance. One type of dissonance is post-decisional dissonance, which arises where a person must choose between two alternatives with positive and negative features.¹²⁴ Most people typically choose the alternative that will result in less, not more, dissonance after the decision is made. In making such decisions, research demonstrates that reasoning can be driven by accuracy goals on the one hand or directional goals on the other. When one has accuracy in mind, the motive is to arrive at an *accurate* conclusion. When one has a directed goal in mind, the motive is to arrive at a *particular* conclusion. Accuracy goals yield better reasoning; directional goals yield strategies intended to reach the conclusion desired.¹²⁵

The distinction between accuracy goals and directional goals goes to the core of the difference between independent and dependent gatekeepers

120. Cass R. Sunstein, *Moral Heuristics and Moral Framing*, 88 MINN. L. REV. 1556, 1560 (2004).

121. Jennifer S. Lerner & Philip E. Tetlock, *Accounting for the Effects of Accountability*, 125 PSYCH. BULL. 255, 256 (1999); see also Philip E. Tetlock, Linda Skitka & Richard Boettger, *Social and Cognitive Strategies for Coping With Accountability: Conformity, Complexity, and Bolstering*, 57 J. PERSONALITY & PSYCHOL. 632, 633 (1989).

122. The pioneers in this area of research were Daniel Kahneman and Amos Tversky. They explained that people rely on a small number of heuristic principles, which reduce the difficult task of assessing probabilities and predicting values to simple judgments. See Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124 (1974); Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, in JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 3 (Daniel Kahneman et al. eds., 1982); see also Tetlock, Skitka, & Boettger, *supra* note 121, at 633 (describing people as “cognitive misers”).

123. Sunstein, *supra* note 120, at 1558.

124. LEON FESTINGER, A THEORY OF COGNITIVE DISSONANCE 3–5 (Stanford University Press 1962) (1957); see also J.B. Campbell, *Cognitive Dissonance*, in 1 THE CORNELL ENCYCLOPEDIA OF PSYCHOLOGY & BEHAVIORAL SCIENCE 312–13 (3d ed. 2001).

125. Kunda, *supra* note 119, at 481.

discussed in Part I. Independent gatekeepers should be concerned with accuracy. They owe duties of objectivity and accuracy to the public. They should not be motivated by the clients' goals and ends in the same way that dependent gatekeepers are. Dependent gatekeepers, by contrast, are interested in reaching a particular result. A dependent gatekeeper, as discussed in Part I, must act for the client's benefit, furthering its ends and presenting the client in "the most favorable possible light."¹²⁶

D. MOTIVATIONAL GOALS

This section discusses mechanisms that result in thought processes to reduce dissonance that are closely related to accuracy versus directional goals that arise in the context of group dynamics. The focus is on two mechanisms—accountability and commitment—that are likely to bear on gatekeepers' decisions, and that likely bear differently on dependent and independent gatekeepers as well as related heuristics that may lead to bias.

1. Accountability

a. The Perils of Accountability in Decision Making

Generally, accountability refers to an expectation to justify one's beliefs, feelings, or actions to others.¹²⁷ Accountability enhances accuracy because people who are held accountable will avoid making arbitrary or incorrect decisions. Politicians, teachers, supervisors, and colleagues are often called upon to be more accountable. Failure to provide sufficient justification for a decision can result in negative consequences. Providing compelling justifications results in positive ones.¹²⁸

But researchers have uncovered a negative side to accountability as well. Accountability in some cases can negatively affect the formation of attitudes and the accuracy of judgments.¹²⁹ One way to understand accountability is that it acts as a constraint on everything we do.¹³⁰ Constraint caused by accountability can lead people to censure particular views and to short-circuit their decision process, omitting important considerations.¹³¹ We short-change accuracy goals for the sake of directional goals. Students, for example, are asked to complete evaluations of faculty anonymously to ensure that the students will *not* be held accountable. Imagine how

126. *United States v. Arthur Young & Co.*, 465 U.S. 805, 817 (1984).

127. See Karen Siegel-Jacobs & J. Frank Yates, *Effects of Procedural and Outcome Authority on Judgment Quality*, 65 *ORG. BEHAV. & HUM. DECISION PROCESSES* 1, 1 n.1 (1996); see Kim, *supra* note 9, at 1010–11 (discussing accountability in gatekeeper context).

128. See Lerner & Tetlock, *supra* note 121, at 255 (reviewing literature).

129. *Id.* at 270 (summarizing 20 years of research and concluding that accountability is complex phenomenon that interacts with decision-makers and environment and produces "an array of effects—only some of which are beneficial").

130. See Tetlock, Skitka, & Boettger, *supra* note 121, at 632.

131. See *id.*

inaccurate evaluations would be if we told students they must affix their signature and justify their beliefs to the faculty they are evaluating.

This example suggests that the effect of accountability on accuracy differs depending on whether the views of the audience to whom one is accountable are known or unknown to the decision maker. In the example, the views of the audience (the faculty) are known to the decision maker (the student) because the student would be justifying her evaluation to the same faculty she is rating. People generally are motivated to seek approval from their audience and are biased in favor of conclusions that conform to the audience's views. When the views of the audience are known to the decision maker before she forms an opinion, she will redirect her opinion to conform to them. Directional goals take over. People adopt positions that are likely to be pleasing to those to whom they are accountable.

When the audience's views are unknown, conformity is not possible and accuracy goals predominate. In that case, people are more likely to consider multiple objectives and engage in a more thoughtful, deliberate, self-critical analysis.¹³² As Jennifer Lerner and Philip Tetlock explain, "When participants expect to justify their judgments [to an unknown audience], they want to avoid appearing foolish in front of the audience. They prepare themselves by engaging in an effortful and self-critical search for reasons to justify their actions."¹³³ Thus, in our example, accountability could promote accuracy if we held students accountable to an independent board whose views about the faculty were unknown.

Closely related to the motivation to conform one's views to those of a known audience is what psychologists call the *acceptability heuristic*. Adopting the position of one's audience circumvents hard cognitive work. Studies demonstrate that when participants were unaware of the audience's views, they engaged in more complex information processing.¹³⁴ When one expects to discuss one's views with an audience whose views are known, one will shift attitudes toward those of the audience, even if the results are inefficient.¹³⁵ People do this in several ways. One possibility is to rely on

132. See Lerner & Tetlock, *supra* note 121, at 257; see also Tetlock, Skitka, & Boettger, *supra* note 121, at 633 (explaining that when people do not know audience's views and are unconstrained by commitment, people engage in preemptive self-criticism, processing information from self-critical perspective and anticipating objections of critics); see also *id.* at 638 (stating that when audience views are unknown, decision makers think about issues "in more integratively complex and evaluatively inconsistent ways").

133. See Lerner & Tetlock, *supra* note 121, at 263.

134. Serena Chen, David Shechter & Shelly Chaiken, *Getting at the Truth or Getting Along: Accuracy—Versus Impression—Motivated Heuristic and Systematic Processing*, 71 J. OF PERS. & SOCIAL PSYCH. 262, 263 n.3 (1996).

135. See Lerner & Tetlock, *supra* note 121, at 256. In one study, persons making financial aid determinations, who had to justify their decisions to recipients, allocated funds inefficiently. They provided some money to all recipients, with the result that many had insufficient funds to cover costs. Those who were not accountable to recipients, provided enough money to some recipients to meet their needs rather than trying to please all. *Id.* In another study, subjects who knew the

irrelevant information in making a decision. In one study, when asked to predict grade point averages of a student audience, participants who were accountable short-circuited their reasoning and relied on irrelevant information, such as the number of plants a student keeps, as opposed to the number of hours the student studied.¹³⁶ This allowed the participants to pursue their directional goals—predicting high GPAs—at accuracy’s expense.

b. Accountability and Gatekeeper Bias

How do accountability and audience views bear on decisions made by independent and dependent gatekeepers? Independent gatekeepers should be accountable to an audience whose views are unknown. The audience for independent gatekeepers, such as auditors and analysts, is a diverse public with heterogeneous views. Financial statements, for example, are necessary not only for management to get a complete snapshot of the company’s affairs, but also for use by creditors, suppliers, analysts, employees, competitors, and, perhaps most importantly, public investors. While some of these may wish to see a clean opinion from an auditor or a “buy” recommendation from an analyst, others may want the opposite. Empirical studies of auditors confirm that when audience views were known, auditors were animated by directional goals and conformed their conclusions to them. When the views were unknown, auditors were accuracy-oriented and engaged in a more deliberative process.¹³⁷

While an auditor may be retained by the issuer, it must conduct itself independently of the issuer. As Robert Haft has explained, “[T]here is a greater tendency for courts to decide that a duty to disclose material facts to nonclient investors exists for accountants than for attorneys”¹³⁸ Similarly, analysts should be independent of the companies they research and should present the company to the public in an objective fashion. These gatekeepers cannot know the views of their audience as the audience comprises public investors.

Dependent gatekeepers, by contrast, are accountable to an audience whose views are known, the clients who hired them. The lawyer’s primary audience is his client; the same is true for an underwriter. As discussed in Part I, dependent gatekeepers advocate on their clients’ behalf and, in some cases, owe them fiduciary duties. The dependent gatekeeper is charged with furthering the client’s goals, which the gatekeeper appreciates and understands because the purpose of his engagement is to promote those

views of their audience “expressed more liberal views to the liberal audience and more conservative views to the conservative audience.” Tetlock, Skitka, & Boettger, *supra* note 121, at 638.

136. See Lerner & Tetlock, *supra* note 121, at 265.

137. See *id.* at 257.

138. ROBERT J. HAFT, LIABILITY OF ATTORNEYS AND ACCOUNTANTS FOR SECURITIES TRANSACTIONS § 6.01 (1995).

goals. Sung Hui Kim refers to lawyers' "ethical ecology," explaining that "alignment pressure can distort the lawyer's judgments."¹³⁹

Underwriters, while subject to section 11 liability, assume substantial risk if an offering fails. Thus, while the underwriter's dependence may not be as clear as the lawyer's, the underwriter faces alignment pressure just like the lawyer. By contrast, lawyers are exempt from section 11 liability—Congress simply did not include them in the list of potential defendants. Moreover, lawyers generally are accountable to their clients, not third parties, for their legal opinions.¹⁴⁰ As one court stated, "[T]he law, as a general rule, only rarely allows third parties to maintain a cause of action against lawyers for the insufficiency of their legal opinions."¹⁴¹ The comment to the relevant section in the Restatement of the Law Governing Lawyers explains, "Making lawyers liable to nonclients, moreover, could tend to discourage lawyers from vigorous representation. Hence, a duty of care to nonclients arises only in . . . limited circumstances."¹⁴² Thus, in the case of dependent gatekeepers, the views of the audience are known and the gatekeeper has a strong desire to maintain views consistent with them.

2. Commitment

a. Commitment and Bias

Once people commit to a course of action, they tend to escalate their enthusiasm. Even after it becomes clear that the disadvantages of pursuing a course of action outweigh the advantages, people refuse to let go. "Groups may stick to a consensus view, even in the face of changing information, because consensus assures them their assessment or decision is correct."¹⁴³ Social psychology teaches that when an individual is a group member, committed to the purposes and tasks of the group, the task of the individual is to first become a "prototypical member of that group, and then help the group as best she can in reaching its goals."¹⁴⁴ Moreover, after committing to a decision, if called upon to justify the choice, people are highly

139. Kim, *supra* note 9, at 1008.

140. *In re Enron Corp. Sec., Deriv. & ERISA Litig.*, 235 F. Supp. 2d 549, 601 (S.D. Tex. 2002) (citing *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1124 (5th Cir. 1988)). Lawyers can be liable to third parties if an opinion was prepared for a third party's use or the lawyer knew or should have known a particular person would rely on it. *Id.* According to the Restatement, a lawyer owes a duty of care to third parties to the extent the lawyer or client "invites the nonclient to rely" on the opinion or other services, "the nonclient so relies[.]" and the nonclient is not "too remote from the lawyer to be entitled to protection." RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51(2)(a), (g) (2000). See generally FEINMAN, *supra* note 74, at 99 (stating that lawyer owes third party duty of reasonable care); see also Jay M. Feinman, *Attorney Liability to Nonclients*, 31 TORT TRIAL & INS. L.J. 735, 756–60 (1996).

141. *Abell*, 858 F.2d at 1124.

142. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51 cmt. b (2000).

143. Khurana & Pick, *supra* note 111, at 1277.

144. Darley, *supra* note 106, at 1191.

motivated to avoid self-criticism and justify their original decision. Studies show that subjects concern themselves with thinking up as many reasons they can for why they were right and their critics wrong.¹⁴⁵ Psychologists refer to this as *retrospective rationality*¹⁴⁶ or *defensive bolstering*.¹⁴⁷

The presence of commitment marks an important distinction between independent and dependent gatekeepers and between accuracy versus directional goals. Commitment to the interests of the principal is the cornerstone of the fiduciary relationship which, as discussed, describes the link between dependent gatekeepers and their principals. Dependent gatekeepers, as fiduciaries, owe a duty of loyalty to their clients to act on their behalf. They are directed to advance the client's lawful interests and must single-mindedly pursue those interests. The traditional model of lawyering often is referred to as the *total commitment* model.¹⁴⁸

To see how commitment might take hold, consider the role of gatekeepers in a securities offering. The process begins with the issuer who will look to an investment bank as a lead underwriter. The lead underwriter will investigate the issuer and decide whether to underwrite its securities. After the issuer and underwriter sign a letter of intent, the underwriter's experts and its lawyers labor, along with the issuer and its attorneys, to understand the company from several perspectives and assess its future prospects. The effort is a joint commitment by the issuer, the underwriter, and their respective lawyers.¹⁴⁹ They have a joint stake in seeing the project through; they share the same directional goal. This group dynamic is important to understanding gatekeeper behavior.¹⁵⁰ The role of the auditor, however, is more circumscribed. The auditor, after undertaking its own investigation, issues a certificate under its name as to the accuracy and completeness of the financial statements—the goal is accuracy.¹⁵¹

Commitment once established can affect decision making in several ways. Continuing with the example of an offering, it is likely that the decision to participate entails some dissonance because not all aspects of an engagement are likely to be positive and most transactions entail some risk.

145. Tetlock, Skitka & Boettger, *supra* note 121, at 638.

146. *Id.* at 633.

147. See Lerner & Tetlock, *supra* note 121, at 257.

148. See Marie A. Failing, *Face-ing the Other: An Ethics of Encounter and Solidarity in Legal Services Practice*, 67 FORDHAM L. REV. 2071, 2103 (1999); see also Roger C. Cramton, *Professionalism, Legal Services, and Lawyer Competency*, in AMERICAN BAR ASSOCIATION, JUSTICE FOR A GENERATION 144, 149 (1985); Roger C. Cramton, *Furthering Justice by Improving the Adversary System and Making Lawyers More Accountable*, 70 FORDHAM L. REV. 1599, 1602 (2002); Charles P. Curtis, *The Ethics of Advocacy*, 4 STAN. L. REV. 3, 18 (1951) (referring to the "entire devotion" principle).

149. For a review of the offering process still relevant today, see *United States v. Morgan*, 118 F. Supp. 621 (S.D.N.Y. 1953); see also HAROLD S. BLOOMENTHAL & SAM WOLFF, GOING PUBLIC AND THE PUBLIC CORPORATION § 2:3 (West 2004).

150. See Fanto, *supra* note 103, at 1169.

151. See Haft, *supra* note 138.

After making decisions, one way people reduce dissonance is to reassure themselves they made the right choice by focusing on information that will lead them to that conclusion.¹⁵² Once a dependent gatekeeper has agreed to an engagement, he has committed himself to the client's ends and is more likely to focus on positive aspects of the choice and downplay negative ones.¹⁵³

This commitment has important consequences. After executing an underwriting agreement, which generally occurs immediately before the offering closes, an underwriter must continually assess whether the prospectus should be updated or revised so as to not be materially misleading. But since directional goals predominate over accuracy goals, an underwriter committed to the transaction has an incentive to filter information to avoid amending the registration statement with negative information, which would impede selling efforts.¹⁵⁴ This was the context of the famous case of *SEC v. Manor Nursing Centers, Inc.*¹⁵⁵ The court held that the appellants, including the underwriters, were under a duty to amend the prospectus to reflect developments that occur after the SEC declares the registration statement effective, and the failure to do so was a violation not only of the registration provisions, but also the anti-fraud provisions.¹⁵⁶

b. Commitment to Outcome Versus Process

Recent research bridging accountability and commitment reinforces the negative relationship between commitment and accuracy. This line of research distinguishes *outcome* accountability from *process* accountability. Outcome accountability is accountability for the outcome of a decision; it is goal directed. Process accountability is accountability for the quality of the process used to arrive at a decision.¹⁵⁷ Outcome accountability increases commitment to previous decisions about what the outcome should be and leads to defensive bolstering. Outcome-accountable subjects in decision making displayed what is known as more scatter (the presence of irrelevant judgments) than subjects who had to account for procedures, or subjects who were not accountable at all.¹⁵⁸

152. ARONSON, *supra* note 10, at 194.

153. *Id.*

154. John J. Jenkins, *Recirculation of the Preliminary Prospectus: Statutory Basis and Analytical Techniques for Resolving Recirculation Issues*, 55 BUS. LAW. 135 (1999); *see also* COX, HILLMAN & LANGEVOORT, *supra* note 88, at 211.

155. *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082 (2d Cir. 1972).

156. *Id.* at 1100 (holding that by failing to amend, prospectus was no longer Securities Act section 10(a) prospectus and therefore appellants violated Securities Act section 5(b)(2)); *see also* Gray v. First Winthrop Corp., 82 F.3d 877, 886 (9th Cir. 1996). The SEC more recently has addressed a similar problem in new Rule 159 under the Securities Act. *See* Joseph McLaughlin, *Securities Offerings, Late-Breaking Information and the SEC's Rule 159*, 38 SEC. REG. & LAW REP. 1077 (2006).

157. Siegel-Jacobs & Yates, *supra* note 127, at 2.

158. *Id.* at 14.

Process accountability by contrast leads to a better decision making process, such as more consideration of alternatives and less self-justification.¹⁵⁹ If justification focuses on the process used to make judgments, then accountability can be helpful. Outcome accountability, however, had no beneficial effects whatsoever, and in fact was harmful compared to no accountability.¹⁶⁰ The distinction between outcome and process accountability mirrors the distinction between directional goals and accuracy goals.

The distinction between outcome and process accountability explains the rules in place with respect to gatekeepers discussed below, and it demonstrates the difference between them. Independent gatekeepers are not held accountable for outcomes in the same way dependent gatekeepers are. Special protections exist for independent gatekeepers—particularly auditors—when the client disagrees with the outcome. It is difficult for a public company to terminate an auditor when the client disagrees with the outcome. Terminating an auditor is a public event and must be reported on an SEC form designed to disclose certain material events at the time they occur.¹⁶¹ No such protections exist for lawyers.

The dependent gatekeeper's commitment to outcome is closely related to a heuristic called *anchoring and adjustment*. Anchoring and adjustment describes the phenomenon that, in making decisions, we begin with a starting point and adjust our estimates upward or downward insufficiently relative to where we started. Insufficient adjustments result in bias. If a sale item costs \$1 and the sign says "limit 10 per customer," you are more likely to leave with seven or eight, although you need only one.¹⁶² Similarly, when executives forecast a project's completion, they adjust the estimates based on new information, but they prepared the original estimates making their case for success, which skews subsequent forecasts toward optimism.¹⁶³

Dependent gatekeepers are likely to be more prone to bias through anchoring and adjustment than independent gatekeepers. Think again about

159. Lerner & Tetlock, *supra* note 121, at 258.

160. Siegel-Jacobs & Yates, *supra* note 127, at 9; *see also* TOM R. TYLER & STEPHEN L. BLADER, COOPERATION IN GROUPS: PROCEDURAL JUSTICE, SOCIAL IDENTITY, AND BEHAVIORAL ENGAGEMENT 77–89 (2000); Tyler, *supra* note 112, at 1309.

161. Instructions to Form 8-K clarify that "[t]he resignation or dismissal of an independent accountant, or its refusal to stand for reappointment, is a reportable event separate from the engagement of a new independent accountant." SARBANES-OXLEY SEC RULES & REGULATIONS § 490-13, Item 4.01, Instruction (2002).

162. Brian Wansink, Robert J. Kent, & Stephen J. Hoch, *An Anchoring and Adjustment Model of Purchase Quantity Decisions*, 35 J. MARKETING RES. 71, 79 (1998) ("A consistent finding in these studies is that consumers purchase more units when they see high anchors in POP [point of purchase] promotions.").

163. Dan Lovallo and Daniel Kahneman, *Delusions of Success: How Optimism Undermines Executives' Decision*, HARV. BUS. REV. 56, 60 (2003) ("Because the initial plan . . . [is] designed to make the case for the project—it will skew the subsequent analysis toward overoptimism. This phenomenon is the result of anchoring, one of the strongest and most prevalent of cognitive biases.").

the offering example. The issuer and its lawyers are the ones who generally draft the initial version of a registration statement.¹⁶⁴ In doing so, they are preparing a document they hope will result in a successful distribution. With the assistance of the underwriters, they come up with an initial draft that will then be adjusted based on comments from third parties and the SEC staff. It is the initial draft of the registration statement, however, that serves as the anchor, and any amendments must be justified as departures from the original.

Accountants performing an annual audit or analysts researching a public company do not have the same anchors to contend with. They are not wedded to the issuer's numbers. Under Auditing Standard No. 2, auditors must obtain independent evidence, employ professional skepticism, and use the work of others only in limited circumstances.¹⁶⁵ The same is true for analysts. As opposed to using financial data provided by an issuer as an anchor, an analyst may choose instead to use industry averages against which to measure an issuer's performance. In that regard, an underwriter may seek out analysts' views, in the context of an offering, to learn of the strengths and weaknesses of the competition.¹⁶⁶

Given that dependent gatekeepers are accountable to their principals and committed to furthering their ends, careful consideration should be paid to how directional goals and bias may affect their decisions. One cannot ignore the powerful draw that motivations have on judgment and the unconscious bias that can result. Moreover, everyday heuristics like acceptability and anchoring can bias judgments as well. If gatekeepers' decisions about whether to stop a transaction from going forward or report wrongdoing to a third person were clear-cut, one would have little cause for concern. Such decisions, however, are highly indeterminate. Part III addresses the indeterminate nature of such decisions and, drawing on Parts I and II, what to do about them.

164. See, e.g., BLOOMENTHAL & WOLFF, *supra* note 149, § 2:3 at 2-16; JOHNSON & MCLAUGHLIN, *supra* note 72, at 141; see also *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643, 689 (S.D.N.Y. 1968) (noting that issuer's outside counsel took initial responsibility for preparing registration statement).

165. See *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*, PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD, AUDITING STANDARD NO. 2 ¶¶ 104-12, available at www.pcaobus.org/Rules/Rules_of_the_Board/Auditing_Standard_2.pdf; see HAROLD S. BLOOMENTHAL, *SARBANES-OXLEY ACT IN PERSPECTIVE* § 6.26 (2005).

166. JOHNSON & MCLAUGHLIN, *supra* note 72, at 343; John L. Orcutt, *Investor Skepticism v. Investor Confidence: Why the New Research Analyst Reforms Will Harm Investors*, 81 DENV. U. L. REV. 1, 49 (2003) (“[A]nalytists gather information (both publicly available and not publicly available) about the company, its industry, and its competitors. . .”).

III. REFORMING GATEKEEPER BIAS

The observations in Parts I and II advance the understanding of gatekeeper behavior. This Part considers recent and potential reforms. The discussion so far suggests two possible paths for reform. One path is to discount the work of dependent gatekeepers. To the extent they are charged with promoting their clients' ends, as discussed in Part I, they are prone to directional goals as opposed to accuracy goals, as discussed in Part II, and destined to fail. This appears to be the path suggested by some commenters, who discuss shrinking the scope of underwriter liability.¹⁶⁷ Another path is to expand the scope of liability of dependent gatekeepers precisely because of the biases discussed.

The observations in Parts I and II regarding the differences among gatekeepers and the tendency to self-justify are magnified because of indeterminacy in the law. One result of indeterminacy is that when one wants to reach a particular result, one often can reach it, and then defend the result as reasonable. This is not true to the same degree for independent gatekeepers. While auditors face some ambiguity in the course of an audit, as a general matter, auditors use relatively objective rules that contain few principles and standards leaving wide latitude for interpretation. If managers sought to improperly influence financial statements, Generally Accepted Accounting Principles (GAAP) inhibit such conduct even if the auditors were willing to oblige.¹⁶⁸ This Part, therefore, begins with a discussion of the indeterminacy inherent in the corporate and securities area.

A. INDETERMINACY IN CORPORATE AND SECURITIES LAW

Securities and corporate law is inherently ambiguous for a number of reasons. First, notwithstanding many technical provisions, the responsibilities of issuers and market professionals often turn on state common law fiduciary duties—a notoriously ambiguous area of the law.¹⁶⁹ This is particularly true for the duty of care, which is an open-ended requirement to exercise the care and skill of an ordinary prudent person.¹⁷⁰ Courts, particularly in the corporate law area, recognize that the duty to pay attention to corporate matters is inherently ambiguous. In *Barnes v.*

167. See, e.g., John C. Coffee, Jr., *Brave New World? The Impact(s) of the Internet on Modern Securities Regulation*, 52 *BUS. LAW.* 1195, 1211 (1997); Donald C. Langevoort, *Deconstructing Section 11: Public Offering Liability in a Continuous Disclosure Environment*, 63 *LAW & CONTEMP. PROB.* 45, 67 (2000).

168. See COX, HILLMAN & LANGEVOORT, *supra* note 88, at 547 (explaining that managers' temptation to distort financial statements is checked by outside auditor).

169. Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 *COLUM. L. REV.* 1908, 1909 (1998) (stating that fiduciary duties provide only rough guidelines governing managers' behavior and rely instead on ad hoc judicial decisions); see also Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Control*, 86 *CORNELL L. REV.* 1205, 1214, 1237–41 (2001).

170. See, e.g., RESTATEMENT (SECOND) OF TRUSTS § 174 (1959).

Andrews, Judge Learned Hand remarked, “The measure of a director’s duties in this regard is uncertain; the courts contenting themselves with vague declarations, such as that a director must give reasonable attention to the corporate business.”¹⁷¹ The latitude inherent in the duty of care is embodied in the business judgment rule, which provides that, in the absence of fraud or bad faith, courts will not second guess directors’ decisions if they turn out badly.¹⁷²

1. Standard of Care

The ambiguity of the duty of care renders the gatekeeper’s responsibilities highly indeterminate. Under the Securities Act of 1933, the underwriter (and others) can defend against a claim of liability if it conducted a “reasonable investigation” into the facts disclosed in the registration statement.¹⁷³ There is little or no guidance, however, on what a reasonable investigation entails and few litigated cases have been decided on this point. The leading case, *Escott v. BarChris Construction Company*, is nearly 40 years old and, in that case, the court stated, “There is no direct authority on this question, no judicial decision defining the degree of diligence which underwriters must exercise to establish their defense under Section 11.”¹⁷⁴ The court could not arrive at a rule: “It is impossible to lay down a rigid rule suitable for every case defining the extent to which such verification must go. It is a question of degree, a matter of judgment in each case.”¹⁷⁵ More recent cases addressing whether due diligence should be decided by a judge or jury make the same point.¹⁷⁶ In the end, the standard required for due diligence under the Securities Act is the vague duty of care. This standard is now codified in section 11(c) of the Act, which reads, “In determining . . . what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.”¹⁷⁷

2. Materiality Requirement

A second reason the law is hard to pin down is that at the heart of every disclosure requirement, and every claim of fraud under the securities laws, is a materiality requirement. The materiality standard turns on the following:

171. *Barnes v. Andrews*, 298 F. 614, 615 (S.D.N.Y. 1924).

172. See DENNIS J. BLOCK, NANCY E. BARTON & STEPHEN A. RADIN, *THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS* (5th ed. 1998).

173. Securities Act § 11, 15 U.S.C. § 77k (2000).

174. See *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643, 696 (S.D.N.Y. 1968).

175. *Id.* at 697.

176. *In re Software Toolwoks, Inc. Sec. Litig.*, 789 F. Supp. 1489, 1496 (N.D. Cal. 1992) (“[W]ith a question like due diligence, the inquiry does not lend itself to any objective standards.”).

177. 15 U.S.C. § 77k(c).

[Whether] there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the “total mix” of information made available.¹⁷⁸

The standard is ambiguous. It depends on what a reasonable investor would decide, which is often dependent on how a particular judge or regulator views the facts.¹⁷⁹ Attempts to quantify materiality or provide a bright-line rule have been rejected.¹⁸⁰ The Supreme Court in *Basic Inc. v. Levinson* rejected a bright-line rule to determine when merger negotiations would be considered material stating that “ease of application alone is not an excuse for ignoring the purposes of the Securities Acts and Congress’ policy decisions. Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive.”¹⁸¹

3. Form of Rules

In addition to these substantive points, corporate and securities law is indeterminate because of the form of the rules themselves. First, securities regulation is often promulgated through standards as opposed to bright-line rules. The conventional distinction between rules and standards is that rules are clear cut and set forth the law *ex ante* whereas standards provide only general principles that judges can apply to a particular set of facts. Rules constrain judicial discretion more than standards.¹⁸² Yet standards are common in the securities area. A frequent criticism of the SEC is that it has always resisted bright-line rules to preserve flexibility in enforcement cases.¹⁸³ The SEC in many cases refuses to adopt bright-line rules and instead provides factors that apply flexibly depending on the facts. In the due diligence context, for example, the Commission sought to provide guidance in Securities Act Rule 176. In doing so, however, the Commission only set out factors to be considered in a determination of whether due diligence was met.¹⁸⁴ The rule is inconclusive, and the Commission

178. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

179. Yvonne Ching Ling Lee, *The Elusive Concept of “Materiality” Under U.S. Federal Securities Laws*, 40 WILLAMETTE L. REV. 661, 664 (2004).

180. SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150, 45,151 (Aug. 19, 1999) (to be codified at 17 C.F.R. pt. 211) (rejecting rule that five percent is appropriate cut off for materiality); see also KARMEL, *supra* note 20, at 236–38 (noting historical forces that have caused SEC to abandon quantitative materiality in favor of qualitative).

181. *Basic, Inc. v. Levinson*, 485 U.S. 224, 236 (1988).

182. Kamar, *supra* note 169, at 1914.

183. See KARMEL, *supra* note 20, at 97 (“[T]he Commission has always resisted requests for guidelines, expressing the need for flexibility and the belief that guidelines are a roadmap for fraud.”).

184. 17 C.F.R. §230.176 (2006).

explicitly left the ultimate conclusion regarding the satisfaction of due diligence to the courts.¹⁸⁵

A second reason why the form of rules in the securities area leads to ambiguity is that litigation is rare. In many cases, rules are pronounced through settled enforcement cases, as opposed to through litigated cases or administrative rulemaking. The vast majority of SEC actions and many state law corporate cases, particularly in Delaware, are settled. A legal rule announced through a settlement necessarily lacks the level of specificity that would attend a decision after a litigated case on the merits with a fully developed record.¹⁸⁶ Moreover, when cases do not settle, many are decided at a preliminary stage in the proceedings where, again, the record is not fully developed. Such opinions are likely to be more indeterminate than cases decided at a later stage in the proceedings when the record is complete.¹⁸⁷ Finally, a settlement sidesteps the need for the government to articulate the legal theory on which the action is based and leaves potential questions about its precedential effects.¹⁸⁸

Indeterminacy has important implications for gatekeepers. Consider two examples of the kinds of decisions gatekeepers must make. First, under new SEC rules governing attorney conduct, the duty to report “up-the-ladder” is triggered when the attorney “become[s] aware of evidence of a material violation” by the issuer, and material violation is defined as “a material breach of fiduciary duty.”¹⁸⁹ The attorney, therefore, must interpret what constitutes “evidence,” what constitutes a “violation” and whether the violation is “material.” Since the definition of violation includes breach of fiduciary duty, the attorney is left to determine when a fiduciary breach has occurred.¹⁹⁰ Second, in the context of public offerings, the underwriter must determine whether the registration statement “contained an untrue statement

185. Circumstances Affecting the Determination of What Constitutes Reasonable Investigation and Reasonable Grounds for Belief Under Section 11 of the Securities Act, Securities Act Release No. 6335, 1981 WL 31062, at *13 (Aug. 6, 1981) (“The Commission also believes that only a court can make the determination of whether a defendant’s conduct was reasonable under the circumstances of a particular offering.”).

186. See KARMEL, *supra* note 20, at 220 (“There are fewer clear wins or losses. More cases are disposed of and less money is spent in the disposition, but the law becomes cheapened in the process.”).

187. For a discussion, see Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1082–84 (2000); KARMEL, *supra* note 20, at 220 (“[T]he adversary system, for all its faults, is a preferred way to ascertain facts and develop the law.”).

188. Cf. KARMEL, *supra* note 20, at 166.

189. Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 8185, Exchange Act Release No. 47,276, Investment Company Act Release No. 25,919, 68 Fed. Reg. 6296, 6296 n.7 (Feb. 6, 2003).

190. See Kim, *supra* note 9, at 1049 (noting that the standard the SEC adopted for “an attorney’s reporting obligation” is “difficult to understand, interpret and apply”). For a general discussion of ambiguity in legal analysis, see HAZARD & DONDI, *supra* note 16, at 159–60, 164, 230–31.

of material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading.”¹⁹¹ The underwriter therefore, must determine when a fact is “untrue,” whether it was “material,” or whether an omitted fact was “required” or necessary to make other statements “not misleading.” In these cases, the gatekeeper consciously or unconsciously may arrive at a conclusion acceptable to the client because of ambiguity in the law.

Finally, it is important to distinguish the *ex ante* from the *ex post* perspectives when assessing gatekeepers’ conduct. One could always argue that, from an *ex post* perspective, gatekeepers’ actions or inactions were not appropriate because they assisted the client with an improper end. From an *ex ante* perspective, a dependent gatekeeper has other values to consider. One such value is client autonomy. The legal system accommodates individual autonomy by giving significant latitude for individual decision making above a floor of clear illegality.¹⁹² Dependent gatekeepers have multiple considerations in deciding whether to “report up” in the organization or force an issuer to make certain disclosures. As mentioned, federal securities laws do not require disclosure of *all* material information; disclosure is only required if an omission renders something that was said misleading. If the attorney discovers something wrong, it must not necessarily be disclosed.¹⁹³ It is precisely in the vagary of trying to determine whether the omission is necessary to render other information not misleading that the gatekeeper’s biases are likely to take hold.

B. GATEKEEPER REFORM

1. Focus of Recent Reforms

The Sarbanes-Oxley reforms and their aftermath have accounted for some of the lessons from behavioral and social psychology. Discussions on the Senate floor suggest that the Sarbanes-Oxley Congress sought to go beyond an approach of punishing individual wrongdoers. Senator Sarbanes stated:

The bad apples ought to be punished. There is no question about it. They ought to be punished severely. But it is very clear, as this issue has unfolded, that we need to make structural changes. We need to change the system so that the so-called gatekeepers are doing the job they are supposed to be doing. That has not been happening. That is why we need to remove these conflicts of interest on the part of auditors who are also consultants for the same company, collecting huge fees. And they are supposed to come in as outside auditors and be very tough on

191. Securities Act § 11, 15 U.S.C. § 77k(a) (2000).

192. Stephen L. Pepper, *The Lawyer’s Amoral Ethical Role: A Defense, a Problem, and Some Possibilities*, 1986 AM. B. FOUND. RES. J. 613, 617 (1986).

193. Langevoort, *supra* note 9, at 79 n.14.

the company, which at the same time is giving them large fees for consultancy We have to put in place a framework, a system which tightens up and begins to screen out these things.¹⁹⁴

The new framework departs from the “command and control” model mentioned above. While one cannot force a change in attitudes, Congress and regulators attempted to make compliance a priority. Much of the emphasis in reform over the past five years has been enhancing policies and procedures to ensure compliance and getting information into the hands of the persons making decisions. The 2004 changes to the Federal Sentencing Guidelines set forth what organizations must do to have an effective compliance and ethics program. The changes respond to requirements in the Sarbanes-Oxley Act, which directed the Sentencing Commission to review and amend its guidelines to ensure they are sufficient to deter and punish criminal misconduct.¹⁹⁵ Under the revised guidelines, company directors must be knowledgeable about the ethics program, and they must receive reports “on the effectiveness of the compliance and ethics program.”¹⁹⁶ Similarly, according to the SEC, “Companies also must have internal communications and other procedures to ensure that important information flows to the appropriate collection and disclosure points on a timely basis.”¹⁹⁷

In the area of mutual funds and investment advisers, the SEC now requires codes of ethics¹⁹⁸ and compliance programs, including the appointment of a chief compliance officer.¹⁹⁹ In adopting these rules, the SEC observed that compliance failures have occurred when service providers to a mutual fund deny information to the board or provide incomplete information because complete disclosure would harm the service providers’ own interests. Under the rules, the chief compliance officer is “responsible for keeping the board apprised of significant compliance events at the fund or its service providers and for advising the board of needed changes in the fund’s compliance program.”²⁰⁰ The SEC’s lawyer rules, also mandated by Sarbanes-Oxley, were intended to enhance the likelihood that companies will act at an early stage to remedy violations internally. “By mandating up-the-ladder reporting of violations, the rule helps to ensure that evidence of material violations will be addressed and

194. 148 CONG. REC. S6526 (daily ed. July 10, 2000) (statement of Sen. Sarbanes).

195. Sarbanes-Oxley Act of 2002 § 805(a)(2)(5) (2002).

196. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b)(2)(C) (2005).

197. Certification of Disclosure in Companies’ Quarterly and Annual Reports, Exchange Act Release No. 46079, 67 Fed. Reg. 41,877, 41,878 (June 20, 2002).

198. Investment Adviser Codes of Ethics, Investment Advisers Act Release No. 2209, 69 Fed. Reg. 4040, 4040 (Jan. 27, 2004) (expressing concern that the fiduciary obligations are lost on growing number of advisers in SEC’s enforcement calendar).

199. 17 C.F.R. § 270.38a-1 (2006).

200. Compliance Programs of Investment Companies and Investment Advisers, Investment Advisers Act Release No. 2204, 68 Fed. Reg. 74,714, 74,722 (Dec. 24, 2003).

remedied within the corporation, rather than misdirected or ‘swept under the rug.’²⁰¹ The emphasis is less on sanctioning individualized improper conduct after it occurs and more on promoting structural changes to strengthen a culture of compliance and address problems at an earlier stage.

2. Independent Gatekeepers

a. Auditors

Congress and federal regulators recognized that, in the case of auditors, the ties that bound auditors to their clients had to be severed. As Part II discussed, accountability to the client, whose views are known to the auditor, can result in an auditor redirecting his opinions to conform to the client’s views. People adopt positions that are likely to please others. By performing a significant volume of non-audit services for the audit client, the auditor had an overwhelming desire to please the client in the course of the audit itself and continue to generate non-audit business.

The SEC recognized this conflict in its own administrative rules adopted before Sarbanes-Oxley and sought to insulate the auditor from improper influence. The SEC prohibited auditors from providing certain non-audit services, such as consulting services, to audit clients because the large fees generated by such services could jeopardize the auditor’s independence.²⁰² The Commission stated that its rules were “designed to ensure that auditors are qualified and independent of their audit clients both in fact and in appearance.”²⁰³ “If investors do not believe that an auditor is independent of a company, they will derive little confidence from the auditor’s opinion and will be far less likely to invest in that public company’s securities.”²⁰⁴ The auditor, as an independent gatekeeper, must

201. Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 8185, Exchange Act Release No. 47,276, Investment Company Act Release No. 25,919, 68 Fed. Reg. 6296, 6296 n.7 (Feb. 6, 2003).

202. See Revision of the Commission’s Auditor Independence Requirements, Securities Act Release No. 7919, 65 Fed. Reg. 76,008, 76,022 (Dec. 5, 2000) (“[I]n recent years there has been a dramatic growth in the number of non-audit services provided to audit clients and the magnitude of fees paid for non-audit services.”); see also James D. Cox, *Reforming the Culture of Financial Reporting: The PCAOB and the Metrics of Accounting Measurements*, 81 WASH. U. L.Q. 301 (2003) (noting reasons accounting firms emphasized growth in non-audit services revenue).

203. Preliminary Note, Qualifications of accountants, 17 C.F.R. § 210.2-01 (2006). The rules attempted to ameliorate bias that some argued could never be eliminated completely. Max Bazerman, for example, argued against the possibility of auditor independence because of self-serving bias. He argued that calls for independence were naïve because auditor misrepresentations occur not because of any willingness to mislead, but rather because of unconscious and unintentional bias in decision making. When auditors are called on to make independent judgments, they will act in a way that is commensurate with self interest. Max H. Bazerman, Kimberly P. Morgan & George F. Loewenstein, *The Impossibility of Auditor Independence*, 38 SLOAN MGMT. REV. 89, 91 (1997).

204. Revision of the Commission’s Auditor Independence Requirements, 65 Fed. Reg. at 76,008.

resist an advocacy role, which characterizes dependent gatekeepers, like lawyers. In evaluating independence, SEC rules state, “The Commission looks in the first instance to whether a relationship . . . places the accountant in a position of being an advocate for the audit client.”²⁰⁵

Sarbanes-Oxley went further than the SEC’s own independence requirements and prohibited auditors from providing eight categories of non-audit services, such as bookkeeping, actuarial, investment, and legal services.²⁰⁶ Sarbanes-Oxley also included a provision placing responsibility on the audit committee, which must be composed solely of independent directors, to be “directly responsible” for the appointment, evaluation, compensation and replacement of the independent auditor for a listed company.²⁰⁷

Understanding the difference between independent and dependent gatekeepers illuminates the auditor’s role. The auditor serves to correct the biases of managers, who are themselves dependent gatekeepers. Managers are chosen by the board to further the ends of the corporation as a profitable enterprise to the benefit of the shareholders. Bias on the part of the managers is appropriate. Unchecked, however, such bias can lead to abuse. Thus, the bias of the dependent gatekeeper is held in check by the independent gatekeeper.

Since the audit firm is compensated by the client, some argue it will always defer to the client to ensure future business.²⁰⁸ While this may be true to some degree, the requirement to report the termination of the auditor on Form 8-K reduces this risk. Moreover, this risk was far worse before the SEC’s auditor independence rules were adopted. The termination of a consulting agreement, unlike the termination of the auditor relationship, is not disclosed on Form 8-K. As a result, an issuer could quietly threaten to terminate a consulting agreement as a club to pressure the auditor to provide a clean audit.²⁰⁹ If the auditor were not performing non-audit services for the company, there would be no club.²¹⁰ While the issuer could threaten to fire an auditor, that event is publicly disclosed and most companies resist making such a filing. The SEC’s auditor independence rules began to

205. Preliminary Note, Qualifications of accountants, 17 C.F.R. § 210.2-01.

206. 15 U.S.C. § 78j-1(g) (Supp. II 2002).

207. *Id.* § 78j-1. Under section 301 of the Sarbanes-Oxley Act, only independent directors may serve on an audit committee of a listed company. *Id.* § 78j-1(m)(3)(A).

208. See Revision of the Commission’s Auditor Independence Requirements, 65 Fed. Reg. at 76,015 n.79 (noting that commenters to SEC rule argued there has always been potential for conflict of interest, since auditor is paid by client).

209. See John C. Coffee, Jr., *Understanding Enron: “It’s About the Gatekeepers, Stupid,”* 57 BUS. LAW. 1403, 1411–12 (2002) (explaining that if auditor is consultant, issuer can threaten auditor in “low visibility” way).

210. Stephen J. Choi, *A Framework for the Regulation of Securities Market Intermediaries*, 1 BERKELEY BUS. L.J. 45, 63 (2004) (“Managers can thus punish auditors that fail to follow the managers’ wishes through a reduction in the non-audit related consulting services.”).

address this concern by limiting the non-audit services that an auditor could perform for its audit client.

One question in the wake of Sarbanes-Oxley is whether auditor independence requirements have gone too far or not far enough. Above I discussed the need, with respect to independent gatekeepers, to counter the bonding that often characterizes a fiduciary relationship. Characteristics like trust and longevity can threaten independence. The Public Company Accounting Oversight Board (“PCAOB”), using rulemaking authority in section 103 of Sarbanes-Oxley, has gone further than Congress or the SEC in some respects. Under new rules, for example, a public accounting firm is not independent if it gives tax services to certain persons, such as members of management who fill a financial reporting oversight role at an audit client. Performing such services can create the appearance of a “mutual interest between the auditor and those individuals” and impair independence.²¹¹

Should all non-audit services be banned? Sarbanes-Oxley now requires all non-audit services the auditor proposes to perform to be pre-approved by the issuer’s audit committee.²¹² With respect to certain tax services still permitted, the PCAOB has made the process more deliberate by requiring the auditor to play a role in seeking the audit committee’s pre-approval. The audit firm must describe to the audit committee, in writing, the nature of the services to be provided, discuss with the audit committee the effects on the auditor’s independence, and document the firm’s discussion.²¹³

Placing additional limits on non-audit services is consistent with addressing inappropriate bonding between issuers and auditors. Moreover, this specified deliberation is consistent with Darley’s discussion of addressing the small decisions that can grow into large scale corruption. By slowing the process and requiring the audit firm to describe, in writing, the services it seeks to perform and the effects on independence, it is unlikely that a series of quick decisions will be made by either the auditor or the issuer that will impair independence, at least with respect to tax services. Requiring the auditor to play a role in the issuer’s deliberation also is consistent with the overall program of enhancing policies and procedures that focus less on individualized wrongdoing and more on instituting compliance norms at both the audit firm and the issuer.

One could consider requiring this sort of deliberative process for all non-audit services. The suggestion was put forward by certain commenters on the PCAOB’s rule, but the PCAOB determined to gather experience

211. Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees, PCAOB Release No. 2005-014, at 34–35 (July 26, 2005), *available at* http://www.pcaobus.org/rules/docket_017/2005-07-26_release_2005-014.pdf.

212. *See* Sarbanes-Oxley Act § 202, codified in Exchange Act § 10A(h), 15 U.S.C. § 78j-1(h).

213. *See* Ethics and Independence Rules, *supra* note 211, at 40–41.

with respect to tax services first.²¹⁴ While gathering experience with respect to tax services is laudable, it may not be necessary if the PCAOB could obtain the information it needs from a separate request for comment. Indeed the tax services area is different from other areas of permissible non-audit services, so the PCAOB would likely have to publish a separate request for comment before applying the deliberation rule more broadly.²¹⁵ Since the deliberation rule does not seem unduly burdensome and would likely have positive effects, the PCAOB may wish to consider such a request for comment at this time.

b. Securities Analysts

Securities analysts are subjected to new rules passed not only by Congress and the SEC, but also by state prosecutors, the self-regulatory organizations, and others—all with an eye toward ensuring independence. The concern, like in the case of auditors, was that the analysts were tied too closely with the issuers they were supposed to be researching.

Congress sought to strengthen analyst objectivity in Sarbanes-Oxley. The law required new administrative rules restricting when the broker-dealer arm of an underwriter engaging in a public offering can publish research on the security offered, and it required analysts to disclose certain conflicts.²¹⁶ SEC rules now require analysts to include in a research report a certification stating that the opinions expressed in the report accurately reflect the analysts' personal views, and that their compensation was not related to their recommendations.²¹⁷ The touchstone for the SEC rule is independence. While the new rule applies to broker-dealer firms, the Commission has stated that the rule shall not apply to research performed by an affiliate of the broker-dealer with a "sufficient level of independence" from the firm. Those meeting this criteria should have "a sufficient level of independence so that pressures from the broker-dealer . . . should not compromise their research."²¹⁸

214. *See id.* at 42.

215. *See id.* (stating that the PCAOB would seek additional information before expanding the rule).

216. Sarbanes-Oxley Act § 501, adding Exchange Act § 15D, 15 U.S.C. § 78o-6(b) (Supp. II 2002).

217. If compensation is related to the recommendation, the certification must include the source, amount and purpose of the compensation, and a disclosure stating that the compensation may influence the recommendation in the report. Regulation Analyst Certification, 68 Fed. Reg. 9482 (Feb. 27, 2003).

218. *Id.* at 9484 (defining "covered person"). The technical provisions of the rule make it applicable to broker-dealers and to associated persons of broker-dealers, which include other firms controlling, controlled by, or under common control with the broker-dealer. The SEC made an exception, however, for associated persons that do not share officers or employees with the broker-dealer, and so long as the broker-dealer maintains and enforces policies and procedures to prevent the broker dealer from influencing the activities of the analysts and the content of the research. The Commission stated, "Where the broker-dealer has informational and structural

The securities analyst settlements entered into by ten large investment banking firms in 2003 contained regulatory requirements to help ensure “that research provided to investors is objective.”²¹⁹ Similarly, the New York Stock Exchange brought actions against analysts for failing to establish procedures adequate to maintain independence.²²⁰ The Self-Regulatory Organizations (SROs), namely the NYSE and NASD also have adopted rules barring investment banking departments from supervising analysts.²²¹ An analyst’s compensation may not be tied to investment banking transactions, and new rules impose a 40-day cooling off period after an initial public offering before an analyst whose firm managed the offering can issue a report on the security. To guard against analysts making an overwhelming number of buy recommendations compared to sell recommendations, analysts must now disclose the distribution of buy, sell, and hold recommendations.²²² The goal of these reforms has been to promote independence.²²³ In approving rules proposed by the SROs, the SEC made clear that the goal of independence has not been abandoned:

The Commission believes that the SRO proposals are designed to promote the objectivity and independence of research analysts by explicitly requiring that all research analyst written and oral communications with customers, as well as with internal firm personnel, must be fair, balanced and not misleading, considering the context of the communications. These requirements build on existing SRO standards for research analyst communications with the public and provide additional safeguards for research communications with personnel within the broker-dealer.²²⁴

These rules are designed to combat accountability to a known audience and enhance accuracy-based goals, discussed above. Certifying that an

separations from its associated person, the rule does not apply to that associated person.” *Id.* at 9486.

219. *Global Research Analyst Settlement: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 108th Cong. (May 7, 2003) (statement of SEC Chairman William H. Donaldson).

220. Merrill Lynch, Pierce, Fenner & Smith, Inc. Member Organization, New York Stock Exchange, Exchange Hearing Panel Decision 03-67, 2003 WL 21643131, at *17 (April 22, 2003); Citigroup Global Markets Inc. f/k/a Salomon Smith Barney Inc. Member Organization, New York Stock Exchange, Exchange Hearing Panel Decision 03-72, 2003 WL 21643136, at *30 (April 22, 2003).

221. See NASD RULES OF THE ASSOCIATION R. 2711 (2006); see also NYSE RULES, OPERATION OF MEMBER ORGANIZATIONS R. 351 (2006); see also NYSE RULES, COMMUNICATIONS WITH THE PUBLIC R. 472.

222. See generally COX, HILLMAN & LANGEVOORT, *supra* note 88, at 145.

223. Fisch & Sale, *supra* note 36, at 1038 (“The goal of these various measures was to implement a more thorough regulatory regime to alleviate the conflict of interest problems that have plagued analyst recommendations in recent years.”).

224. Order to Prohibit Participation by a Research Analyst in a Road Show Related to an Investment Banking Services Transaction and to Require Certain Communications About an Investment Banking Services Transaction to be Fair, Balanced and Not Misleading, Exchange Act Release No. 51593, 85 SEC Docket 739 (April 21, 2005).

analyst's opinion represents his personal views helps ensure the analyst is not accountable to a third party, such as the issuer he is researching or the investment banking arm of the firm that employs him, which, acting as securities underwriter or strategic advisor, has its own directional goals in mind.

Whether recent reforms have caused analysts to become independent once again is unknown. Evidence continues of retaliation and pressure on analysts from both company officials and institutional investors to avoid sell recommendations.²²⁵ Some have suggested that independent research departments will not survive because, without investment banking revenue, financial firms must pay securities analysts out of revenue obtained from trading commissions, which are not as lucrative as they once were.²²⁶

In the meantime, the SEC, NASD, or others, could consider educating the public on how to interpret research calls or other information from sell-side analysts, analysts who typically work for brokerage firms and generate research for the investing public. One should recognize that sell-side analysts have little incentive to issue a "sell" recommendation. Issuers generally do not like a "sell" recommendation because it might cause the stock to decline in value. Some evidence indicates that, in many cases, if enough analysts downgrade the stock, it can cost the CEO his or her job.²²⁷ Similarly, most investors do not like a "sell" recommendation because they are "long" in the stock. Investors who already own shares also may not like a sell recommendation for the deeper reason that it could call into question their previous decision to buy and, as discussed, once people commit to a decision, they usually do not change their minds—even in the face of evidence to the contrary.

The rule which now requires analysts to disclose the ratio of buy-to-sell recommendations is an important start toward educating the public on how to interpret analysts' recommendations, but additional education is needed. Sell-side analysts, for example, are generally not compensated based solely on investment performance. Buy-side firms rate, and presumably pay, sell-side analysts based on factors other than performance, including timeliness of information, responsiveness, innovation, and comprehensibility of

225. Gretchen Morgenson, *Downgrade a Stock, Then Duck And Cover*, N.Y. TIMES, March 12, 2006, at BU1; Nocera, *supra* note 41 ("[B]uy recommendations still vastly outnumber sells—and most analysts still spend far more time currying favor with companies than analyzing them.").

226. It also is possible that the recent failure of analysts to be independent can be traced to the elimination of fixed commissions in the 1970s. After commissions were deregulated, brokerage firms could not afford to pay analysts, and they went to work instead for investment banks and underwriters, who funded their research. Healy & Palepu, *supra* note 39, at 80 (explaining how research costs were covered through fixed commissions). Regardless of whether such research is economical, the norm of independence is not diminished.

227. Jason Leow, "Sell"=Fire: Analysts' Views Cloud CEOs' Jobs; Credit Suisse Looks at Case of Provocative Email, WALL ST. J., Aug. 5, 2006, at B3.

research reports.²²⁸ Additional education on some or all of these issues could be valuable to the public.

3. Dependent Gatekeepers and Lawyer Certifications

The problem of how to enhance the monitoring role of dependent gatekeepers is more intractable because of the reasons discussed in Parts I and II. Others have recognized that dependent gatekeepers play a role as advocate for a client, which is in tension with the role as gatekeeper.²²⁹ How does this tension arise? Because attorneys often are closely aligned with their clients in an “informal partnership” to accomplish their clients’ objectives, requiring attorneys to act as gatekeepers may place them in a situation where they are required to audit their own work.²³⁰ Similarly, once a client and an attorney have committed to a particular course of action, the attorney may be biased toward the client’s directional goals at the expense of accuracy and fail to put a halt to the course of action previously determined.

John Coffee has suggested that the SEC could adopt a rule requiring a securities lawyer to certify that he has reviewed the non-financial disclosure in publicly filed reports, and that the attorney believes the statements are true and he is not aware of any material omissions.²³¹ Such a certification, Coffee says, is consistent with certifications required of auditors, analysts, and senior officers, and it would simply fill a void for Exchange Act filings that is currently filled by standard negative assurance letters in the case of Securities Act filings.²³² Moreover, the certification, according to Coffee, ideally would include a statement that the attorney undertook reasonable inquiry, which would establish a due diligence obligation.²³³ While this proposal has merit, it is narrow in scope because it would be limited to the relatively small group of lawyers who are principally responsible for preparing a document or report filed with the SEC.

A more ambitious reform may be appropriate. Congress in the Sarbanes-Oxley Act was concerned about all “attorneys appearing and practicing before the Commission in any way in the representation of issuers.”²³⁴ This language includes a larger group of attorneys than those principally responsible for preparing a document filed with the SEC. In adopting rules under this provision, the SEC defined the scope of appearing and practicing before the Commission as: (i) transacting any business with

228. See Tom Johnson, *The 2005 All-America Research Team*, INSTITUTIONAL INV., Oct. 1, 2005, at 54, 81.

229. Coffee, *supra* note 1, at 353.

230. See *supra* Part I.B.2.b.

231. Coffee, *supra* note 1, at 355–56; Coffee, *Attorney as Gatekeeper*, *supra* note 7, at 1312–15.

232. Coffee, *supra* note 1, at 357.

233. *Id.* at 358.

234. Sarbanes-Oxley Act of 2002 § 307, 15 U.S.C. § 7245 (Supp. II 2002).

the SEC; (ii) representing an issuer in any SEC investigation, inquiry, or request; (iii) providing securities laws advice regarding any document the attorney knows will be filed with the SEC; or (iv) advising an issuer on whether information, under the securities laws, must be filed with the SEC.²³⁵ Thus, the scope of the attorney conduct rules is relatively broad.

One possible solution is to marry these two approaches and require an annual certification under section 307 of Sarbanes-Oxley. Under the SEC's rules, an attorney appearing and practicing before the SEC already is subject to a reporting requirement. Under the SEC's rule as adopted, an attorney who "becomes aware of evidence of a material violation by the issuer or by any officer, director, employee, or agent of the issuer . . . [must] report such evidence to the issuer's chief legal officer . . . or to both the issuer's chief legal officer and its chief executive officer . . . forthwith."²³⁶ Thus, lawyers already have a clear obligation to make a report if they become "aware" of certain evidence. One possibility, therefore, is to require an annual certification to the SEC or the bar that a lawyer, covered by this rule, is either not aware of such evidence or has made the required report.

This proposal should entail only modest tangible costs by attorneys (although it would likely result in emotional distress). Those appearing and practicing before the SEC already must make the determinations that would be required by a certification. Under current law, an attorney who is aware of evidence of a material violation must make a report of the evidence "forthwith."²³⁷ For those attorneys who spend no time considering whether a report is needed, the proposal would require some action on their part. The SEC or state bar associations would of course incur costs in processing the certifications, which would have to be received and tracked on a regular basis.

The proposal would have important salutary effects for at least four reasons. First, it would require securities lawyers, who are not yet aware of the requirements of section 307, to not only become aware, but to undertake the inquiry expected by the Act and the SEC's rules. Second, requiring a certification would require securities lawyers to reflect on their current matters, and state of awareness, and deliberate over whether they could make the required certification or whether a "reporting up" was called for. This could be the triggering mechanism to which Darley refers when he indicates that improper decisions can be overridden by deliberate thinking if something can trigger the deliberate thinking into action.²³⁸ Third, the proposal would counter the biases that arise from the perils of accountability, discussed above. To the extent that the attorney is required to make a truthful, objective filing to a regulator or state bar, the attorney will

235. 17 C.F.R. § 205.2(a) (2006).

236. *Id.* § 205.3(b)(1) (2006).

237. *Id.*

238. Darley, *supra* note 106, at 1183.

necessarily have accuracy and not directional goals in mind. Finally, requiring a certification would mean that an attorney, who violated the rule, would make a false filing, which is qualitatively different than failing to make any filing at all. I have discussed elsewhere the difference between a wrongful act on the one hand and a wrongful omission on the other, which some call “omission bias.”²³⁹ The prospect of making a false filing would likely have deterrent effects absent where the harm amounted to failing to make a filing.

This proposal also is consistent with the rationale for CEO and CFO certifications required by Sarbanes-Oxley. That rationale, drawn from the 1980 requirement for certain senior officers and a majority of the board to sign the annual report, is that people are more likely to pay attention to disclosures made in a report, and to participate more closely in the preparation of a report, if they have to sign them.²⁴⁰

CONCLUSION

Gatekeepers are not alike, and the distinction between independent and dependent gatekeepers is important to an understanding of gatekeeper behavior. Independent gatekeepers, like auditors and analysts, should critically evaluate a set of data and render an opinion for an unknown audience. Dependent gatekeepers, such as lawyers and underwriters, act on a client’s behalf providing advice and recommendations to a known audience—the client itself—in reaching its goals. Consequently, independent gatekeepers will be better monitors than dependent gatekeepers, and perform a more robust gatekeeper role. That conclusion is consistent with research in the area of social and behavioral psychology, which teaches that people’s behavior is influenced by others and that goals and motives can influence our thinking. Accountability to a known audience and commitment to a course of conduct can alter a rational evaluation of the facts. These phenomena appear more starkly in the case of dependent gatekeepers and are more likely to influence their behavior.

The differences between independent and dependent gatekeepers, and the lessons from social and behavioral psychology, help explain many of the recent reforms for gatekeepers, including auditors and analysts.

239. Arthur B. Laby, *Resolving Conflicts of Duty in Fiduciary Relationships*, 54 AM. U. L. REV. 75, 130–31 (2004) (discussing reasons the common law holds an actor more responsible for an act than a failure to act); see also Vincent Di Lorenzo, *Does the Law Encourage Unethical Conduct in the Securities Industry?*, 11 FORDHAM J. CORP. & FIN. L. 765, 789 (2006) (“Omission bias, sometimes referred to as regret theory, refers to the finding that individuals regret adverse consequences stemming from their actions more than adverse consequences stemming from their inaction.”); Kim, *supra* note 9, at 1033–34 (explaining that “omission bias” is relevant for securities lawyers who choose not to prevent misconduct and later shift blame to others as proximate cause of harm).

240. See Certification of Disclosure in Companies’ Quarterly and Annual Reports, Exchange Act Release No. 46079, 67 Fed. Reg. 41,877 (June 20, 2002).

Moreover, the same lessons can help with additional reforms in the case of dependent gatekeepers, such as lawyers. One tentative proposal that bears additional consideration is to require certifications to the SEC or state bar by securities lawyers stating positively that they are unaware of evidence that would necessitate a “reporting up” under the SEC’s lawyer rules. This affirmative obligation would combat the biases discussed in this paper and have other salutary effects.