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THE SOPHISTICATES: CONFLICTED REPRESENTATION AND THE LEHMAN BANKRUPTCY

Milan Markovic*

INTRODUCTION

One of the early lessons of the recent financial crisis is the degree to which conflicts of interest pervade the financial system. Employees of the U.S. Department of the Treasury (Treasury), the Federal Reserve Bank of the United States (Federal Reserve), and other government agencies were tasked with monitoring financial institutions that formerly employed them,¹ investment banks stood to profit if certain financial products they marketed were to fail,² and purportedly neutral ratings agencies overestimated the soundness of mortgage-backed securities so as to avoid losing business.³

This Article contends that attorney conflicts of interest also played an underappreciated role in the financial crisis. The well-known New York law firm of Sullivan & Cromwell LLP (Sullivan) represented, *inter alia*, Bear, Stearns & Co.

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¹ See, e.g., Julie Creswell & Ben White, *The Guys from 'Government Sachs,'* N.Y. TIMES, Oct. 19, 2008, at BU 1, available at http://www.nytimes.com/2008/10/19/business/19gold.html?pagewanted=all&_r=0; Stephen Foley, *How Goldman Sachs Took Over the World*, INDEPENDENT (July 22, 2008), <http://www.independent.co.uk/news/business/analysis-and-features/how-goldman-sachs-took-over-the-world-873869.html>.

² Goldman Sachs recently reached a settlement with the Securities and Exchange Commission for \$550 million in connection with allegations that it sold a subprime mortgage investment that was designed to fail. Zachary A. Goldfarb, *Goldman Sachs to Pay Record Settlement in Fraud Suit, Change Business Practices*, WASH. POST (July 16, 2010), <http://www.washingtonpost.com/wp-dyn/content/article/2010/07/15/AR2010071505111.html>. J.P. Morgan Chase settled a similar case for \$153.6 million. Marcy Gordon, *J.P. Morgan to Settle Fraud Case*, BOS. GLOBE (June 22, 2011), http://www.boston.com/business/articles/2011/06/22/jpmorgan_to_settle_fraud_case/.

³ See John C. Coffee Jr., *What Went Wrong? A Tragedy in Three Acts*, 6 U. ST. THOMAS L.J. 403, 409–11 (2009); see also Claire A. Hill, *Why Did Ratings Agencies Do Such a Bad Job Rating Subprime Securities?*, 71 U. PITT. L. REV. 585, 586 (2010) (suggesting conflicts of interest were partly responsible for poor performance of credit agencies but also that agencies genuinely believed mortgage-backed securities were safe investments).

(Bear), Lehman Brothers (Lehman), American Insurance Group (AIG), Goldman Sachs & Co. (Goldman), and Barclays PLC (Barclays) in the aftermath of the real estate market's crash.⁴ This Article uses Sullivan's representation of Lehman as a case study to demonstrate that conflicts of interest can prevent an attorney or law firm from acting in a client's best interests even if the representation is in accordance with the Model Rules of Professional Conduct (Model Rules) and the client is a sophisticated corporation like Lehman.

Scholars have largely assumed that only unsophisticated clients can be harmed by an attorney's conflicts of interest.⁵ This notion is also reflected in the Model Rules, which explain, "Experienced user[s] of legal services" can provide "general and open-ended" consent to attorney conflicts.⁶ This Article contends that all clients, regardless of their level of sophistication, may have difficulty assessing the significance of an attorney's conflicts. Under the Model Rules, an attorney can generally continue with a conflicted representation if the client consents to the

⁴ Jessica Centers, "Who Did You Rep During the Financial Crisis, Daddy?," N.Y. SUPER LAW. (Sept. 2009), <http://www.superlawyers.com/new-york-metro/article/Who-Did-You-Rep-During-the-Global-Financial-Meltdown-Daddy/ce95d239-a51e-42c3-9d74-a0d35291ed77.html>; Ben Hallman, *No Precedent*, AM. LAW., Apr. 2009, at 76, 76–78; see also ANDREW ROSS SORKIN, TOO BIG TO FAIL 379 (discussing lawyers at Sullivan switching from representing Lehman to representing Barclays).

⁵ See, e.g., Kevin McMunigal, *Rethinking Attorney Conflict of Interest Doctrine*, 5 GEO. J. L. ETHICS, 823, 873 (1992) ("Another interesting and important question unanswered by current doctrine is whether the same boundary for nonconsentable conflicts should be set for all clients. One could argue, for example, for more relaxed or even no limits on the range of choice regarding risk preference for clients who have considerable ability to assess and monitor risk."); Fred C. Zacharias, *Effects of Reputation on the Legal Profession*, 65 WASH. & LEE L. REV. 173, 200–01 (2008) [hereinafter Zacharias, *Effects of Reputation*] (suggesting that lawyers for sophisticated clients will adhere to conflict of interest rules for reputational reasons). This issue has also been recently debated in the *Yale Law Journal Online*. See James W. Jones & Anthony E. Davis, *In Defense of a Reasoned Dialogue About Law Firms and Their Sophisticated Clients*, 121 YALE L.J. ONLINE 589, 589–92 (2012), <http://yalelawjournal.org/images/pdfs/1064.pdf> (suggesting, on behalf of the general counsel of thirty-three prominent law firms, that sophisticated clients and their lawyers should be able to decide how conflict of interest rules should apply in their relationships). But see Lawrence Fox, *The Gang of Thirty-Three: Taking the Wrecking Ball to Client Loyalty*, 121 YALE L.J. ONLINE 567, 571–73 (2012), <http://yalelawjournal.org/images/pdfs/1063.pdf> (arguing proposed modifications to conflict of interest rules by thirty-three of the nation's largest law firms would undermine lawyers' loyalty to their clients).

⁶ See MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. 22 (2009); see also N.Y. RULES OF PROF'L CONDUCT R. 1.7 cmt. 22 (2011) ("[G]eneral and open-ended waivers by experienced users of legal services may be effective."). Although the comment to MODEL RULES OF PROF'L CONDUCT R. 1.7 does not define the term "experienced users of legal services," the key elements seem to be whether the client has experience in similar representations and is informed of the risks involved when, for example, being represented by independent counsel to determine whether to waive the conflict of interest. See MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. 22.

conflicted representation and the attorney reasonably believes he can provide “competent and diligent representation.”⁷ Instead, attorneys should be required to consider whether conflicts of interest may interfere with their ability to act in the best interests of their clients and achieve their clients’ objectives.⁸

Sullivan undoubtedly endeavored to represent Lehman to the best of its ability, and the purpose of this Article is not to determine whether Sullivan violated professional standards with regard to attorney conflicts of interest. Indeed, this Article assumes that, consistent with the Model Rules, Sullivan disclosed its conflicts of interest and Lehman gave “informed consent” for the representation to proceed.⁹ It is, of course, impossible to know all of the particulars of Sullivan’s representation of Lehman,¹⁰ but this Article nevertheless suggests that, based on information that has been made publicly available, there is strong reason to believe that Sullivan’s preexisting relationships with other clients, as well as Sullivan’s interest in preserving its reputation with the Federal Reserve and the Treasury, undermined the representation that it could provide to Lehman.

Part I of this Article briefly sets out the events immediately leading to the Lehman bankruptcy and Sullivan’s role in representing Lehman. Part II draws on existing scholarship to analyze the effectiveness of Model Rule 1.7 (Rule 1.7), the chief provision concerning attorneys’ concurrent conflicts of interest. Part III, which comprises the majority of the Article, identifies three conflicts of interest that may have interfered with Sullivan’s representation of Lehman. Although Sullivan could, consistent with the Model Rules, represent Lehman and some of its competitors concurrently, Sullivan’s relationship with Lehman’s competitors, as well as potential Lehman acquirers, appeared to compromise its representation of Lehman.

Sullivan failed to share certain information with Lehman out of a perceived sense of loyalty to another client, Merrill. Sullivan also did not fully carry out its due diligence into firm client Barclays that seemed intent on acquiring Lehman. Sullivan ultimately switched sides after the Lehman bankruptcy and represented Barclays in its acquisition of Lehman’s North American investment banking and

⁷ MODEL RULES OF PROF’L CONDUCT R. 1.7(b)(1).

⁸ For previous scholarship in this area pre-dating the current version of the Model Rules, see Peter R. Jarvis & Bradley F. Tellam, *When Waiver Should Not Be Good Enough: An Analysis of Current Client Conflicts Law*, 33 WILLAMETTE L. REV. 145, 155–56 (1997) (criticizing Model Rule 1.7); Fred C. Zacharias, *Waiving Conflicts of Interest*, 108 YALE L.J. 407, 423 (1998) [hereinafter Zacharias, *Waiving Conflicts*].

⁹ See MODEL RULES OF PROF’L CONDUCT R. 1.7(b)(4).

¹⁰ For example, large law firms such as Sullivan often employ in-house ethics counsel, and the ethics counsel may have concluded that the representation of Lehman was appropriate, notwithstanding the conflicts of interests identified in this Article. For a discussion of the growing importance of ethics counsel in large law firms, see generally Elizabeth Chambliss & David B. Wilkins, *The Emerging Role of Ethics Advisors, General Counsel, and Other Compliance Specialists in Large Law Firms*, 44 ARIZ. L. REV. 559 (2002).

broker-dealer business.¹¹ Finally, Sullivan may not have considered whether its personal interest in preserving its strong relationships with the Treasury and the Federal Reserve prevented it from aggressively advocating for Lehman.

Part IV attempts to explain why Sullivan's representation of Lehman is illustrative of a larger problem concerning attorney conflicts of interest rules, instead of being an isolated instance where a particular client may have been better served by another law firm. Part IV suggests that there can be negative aspects to representation from well-known and well-connected attorneys. Lastly, Part V proposes specific modifications to Rule 1.7. The Rule should be changed such that attorneys are required to (1) consider whether their conflicts of interest will frustrate their ability to meet their clients' objectives, and (2) regularly consult with their clients as to the effect their conflicts of interest are having on the representation, even if the relevant conflicts were disclosed and consented to at the beginning of the representation.

Lehman may well have filed for bankruptcy even if it had not received conflicted representation. Nevertheless, Lehman's experience underscores that conflict of interest rules do not fully protect even the most sophisticated of clients and should serve as a cautionary tale for both attorneys and their clients.

I. BACKGROUND TO SULLIVAN'S REPRESENTATION OF LEHMAN

On January 29, 2008, Lehman "reported record revenues of nearly \$60 billion and record earnings in excess of \$4 billion for its fiscal year ending November 30, 2007."¹² Less than eight months later, on September 12, 2008, Lehman's stock had declined 95% from its January value.¹³ On September 15, 2008, Lehman filed for the largest bankruptcy in U.S. history.¹⁴

The impact of Lehman's bankruptcy cannot be overstated. As a former vice-chairman of the Federal Reserve has explained, "[o]n the day Lehman [Brothers] went into Chapter 11, everything just fell apart."¹⁵ "The Dow Jones index plunged 504 points" on September 15, 2008.¹⁶ In the weeks that followed, investors began "a run on the \$3.6 trillion money market industry, which provides short-term loans" to businesses.¹⁷ As the credit markets dried up, many large corporations

¹¹ See Matt Byrne, *The Main Man: Focus on Rodgin Cohen*, LAWYER (Sept. 29, 2008), <http://www.thelawyer.com/the-main-man-focus-on-rodgin-cohen/134940.article/>; Centers, *supra* note 4.

¹² 1 Report of Anton R. Valukas, Examiner at 2, *In re Lehman Bros. Holdings Inc.*, 445 B.R. 143 (Bankr. S.D.N.Y. 2011) (No. 08-13555), available at <http://lehmanreport.jenner.com/> [hereinafter Examiner's Report].

¹³ *Id.*

¹⁴ *Id.*

¹⁵ SORKIN, *supra* note 4, at 535 (quoting Alan Binder).

¹⁶ See Examiner's Report, *supra* note 12, at 13.

¹⁷ Bob Ivry et al., *Missing Lehman Lesson of Shakeout Means Too Big Banks May Fail*, BLOOMBERG (Sept. 7, 2009, 19:01 EDT), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aX8D5utKFuGA>.

such as Goodyear Tire & Rubber Co. lacked sufficient funds to pay basic expenses.¹⁸ Morgan Stanley and Goldman Sachs appeared as though they would follow Lehman into bankruptcy.¹⁹ On October 3, 2008, Congress passed the controversial \$700 billion Troubled Asset Relief Program (TARP)²⁰ to prevent a total collapse of the economy.²¹

The causes of the Lehman bankruptcy have been explored at length.²² What is relatively clear is that regardless of whether a Lehman bankruptcy was inevitable, Lehman was widely considered to be the weakest of the remaining investment banks after Bear nearly collapsed in March 2008.²³ According to former Treasury Secretary Henry Paulson, Jr. (Secretary Paulson), Lehman “had the same profile of sky-high leverage and inadequate liquidity, combined with heavy exposure to real estate and mortgages that had helped bring down Bear Stearns.”²⁴

In its efforts to survive after the near collapse of Bear, Lehman retained Sullivan and its then-chairman H. Rodgin Cohen (Cohen).²⁵ Sullivan is one of the most successful law firms in the United States with a network of twelve offices and nearly eight hundred attorneys.²⁶ Cohen has personally been involved in many of the most high-profile banking transactions of the last three decades.²⁷ In 1984, for example, Cohen helped formulate a \$4.5 billion government rescue for Continental Illinois National Bank and Trust,²⁸ the original “too big to fail” bank.²⁹ Cohen is also very well respected by government regulators³⁰ and had represented Bear and the directors of Fannie Mae as they faced their own crises earlier in 2008.³¹ The

¹⁸ *Id.*

¹⁹ See SORKIN, *supra* note 4, at 417–18.

²⁰ Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat 3765 (codified as amended in scattered sections of 12 & 26 U.S.C.).

²¹ See Examiner’s Report, *supra* note 12, at 14.

²² See *id.*; William Poole, *Causes and Consequences of the Financial Crisis of 2007–2009*, 33 HARV. J.L. & PUB. POL’Y 421, 424–26 (2010).

²³ See Examiner’s Report, *supra* note 12, at 4–5.

²⁴ HENRY PAULSON, JR., ON THE BRINK 123 (2010).

²⁵ See SORKIN, *supra* note 4, at 193.

²⁶ See *About S&C*, SULLIVAN & CROMWELL LLP, <http://www.sullcrom.com/about/overview/> (last visited July 10, 2012). An unauthorized biography of Sullivan’s history was published in 1988. See NANCY LISAGOR & FRANK LIPSUS, *A LAW UNTO ITSELF: THE UNTOLD STORY OF THE LAW FIRM SULLIVAN & CROMWELL* (1988).

²⁷ See *H. Rodgin Cohen*, SULLIVAN & CROMWELL LLP, <http://www.sullcrom.com/lawyers/HRodgin-Cohen/> (last visited July 12, 2012).

²⁸ SORKIN, *supra* note 4, at 193.

²⁹ *Id.* (quoting Rep. Stewart McKinney) (internal quotation marks omitted).

³⁰ See *id.* (“[Timothy] Geithner often relied on [Cohen] to understand the Federal Reserve’s own powers.”); see also Hallman, *supra* note 4, at 76 (“More than any other lawyer, in a year when relationships with government authorities were invaluable, he knew which officials to call at the U.S. Department of the Treasury, at the Federal Reserve, [and] at the Securities and Exchange Commission.”).

³¹ See PAULSON, *supra* note 24, at 9 (noting representation of Fannie Mae’s board of directors); *id.* at 93 (noting Cohen’s representation of Bear Stearns); see also Centers,

New York Times has described Mr. Cohen as the “trauma surgeon of Wall Street” and “the Dean of Wall Street lawyers.”³²

One of Cohen’s proposals to Lehman management after the near collapse of Bear was for the investment bank to turn itself into a bank holding company, which would give the Federal Reserve the jurisdiction to regulate it and would also have allowed Lehman to access the Federal Reserve’s discount lending window that had traditionally been available only to deposit banks.³³ This was ultimately the strategy pursued by Goldman Sachs and Morgan Stanley when they too encountered liquidity difficulties after the Lehman bankruptcy.³⁴ The Federal Reserve, however, was concerned at the time that such an act would only cause investors to lose more confidence in Lehman³⁵ and insisted that Lehman’s chief strategy should be to find a strategic partner or buyer.³⁶

Lehman, with the assistance of Sullivan, contacted many potential investors and acquirers before its bankruptcy. According to the Lehman Bankruptcy Examiner’s Report, Lehman had discussions with Warren Buffet in late March 2008³⁷ and more cursory discussions with Buffet in the days prior to Lehman’s bankruptcy filing.³⁸ Lehman also engaged in serious negotiations with South Korea’s state-run bank KDB from June 2008 to early August 2008,³⁹ before negotiations broke down over KDB’s concerns regarding Lehman commercial real estate assets.⁴⁰ Lehman also discussed a purchase with Metlife in July and August of 2008⁴¹ and with the Investment Corporation of Dubai (ICD) in late August and early September of the same year.⁴²

supra note 4 (noting that Cohen represented Fannie Mae before the Federal Government and had represented Bear Stearns in its sale to JP Morgan Chase).

³² Alan Feuer, *Trauma Surgeon of Wall Street*, N.Y. TIMES, Nov. 13, 2009, at MB1 (New York ed.), available at http://www.nytimes.com/2009/11/15/nyregion/15cohen.html?_r=1&pagewanted=all.

³³ SORKIN, *supra* note 4, at 193.

³⁴ *See id.* at 483.

³⁵ *See id.* at 192.

³⁶ Examiner’s Report, *supra* note 12, at 662–63; PAULSON, *supra* note 24, at 173 (noting that the government had been pushing Lehman to find a buyer since the failure of Bear Stearns).

³⁷ Examiner’s Report, *supra* note 12, at 664–68. It does not appear that Buffett ever seriously considered investing in Lehman. *See id.* at 667.

³⁸ *See id.* at 667–68.

³⁹ *Id.* at 668–87.

⁴⁰ *Id.* at 676–77. The parties also could not reach an agreement on price and KDB was concerned with whether it could obtain approval of a substantial investment in Lehman from Korean regulators. *Id.* at 679–80.

⁴¹ Examiner’s Report, *supra* note 12, at 687–91. Metlife ultimately declined to invest in Lehman because of concerns regarding Lehman’s residential mortgage assets and because it did not believe it could complete its due diligence in the timeframe contemplated by Lehman. *Id.* at 689–90.

⁴² *Id.* at 691–94. ICD appeared to lose interest in Lehman after Lehman’s stock dropped by nearly 50% on September 9, 2008. *Id.* at 693.

Beginning in mid-July 2008, most of Lehman's efforts went toward a possible merger with Bank of America,⁴³ while Barclays emerged as the only remaining potential acquirer in the days preceding Lehman's bankruptcy filing.⁴⁴

Lehman was nearly able to complete a sale to Barclays that would have averted a bankruptcy. The proposed transaction would have allowed Barclays to purchase all of Lehman's businesses for \$3 billion.⁴⁵ Barclays would have also agreed to guarantee Lehman's debt as part of the transaction.⁴⁶ The Federal Reserve had managed to convince Lehman's competitors to facilitate the transaction by funding a spin-off of Lehman that would have contained only the company's toxic commercial real estate assets.⁴⁷ The proposed acquisition ultimately failed, however, when the British regulators were either unable or unwilling to approve the transaction.⁴⁸ According to Secretary Paulson, the British authorities had misgivings about the financial condition of Lehman and did not want to "import our cancer."⁴⁹ Moreover, although any purchase of Lehman would have required shareholder approval, Barclays never sought a waiver of shareholder approval requirements from the British Financial Services Agency so that the transaction could be completed.⁵⁰ At the urging of the U.S. government, and with no remaining options, Lehman filed for bankruptcy on September 15, 2008.⁵¹

While Sullivan represented Lehman in 2008 as it sought to find a buyer, Lehman's competitors such as Goldman and Merrill—the latter of which was also negotiating a sale to Bank of America⁵²—were also Sullivan clients. Barclays, the bank that nearly acquired Lehman before its bankruptcy, was another Sullivan

⁴³ *Id.* at 694–703. Bank of America ceased negotiating with Lehman in order to pursue a purchase of Merrill Lynch. *Id.* at 700–01. By September 13, 2008, the CEO of Bank of America would not even accept Lehman CEO Richard Fuld's phone calls. *Id.* at 701.

⁴⁴ *Id.* at 703–10.

⁴⁵ *Id.* at 706.

⁴⁶ *Id.* at 707.

⁴⁷ See PAULSON, *supra* note 24, at 206; SORKIN, *supra* note 4, at 340–42.

⁴⁸ See PAULSON, *supra* note 24, at 207–13. Lawyers for Barclays, as well as Lehman's CEO, thought that the two companies reached a deal that would have prevented a bankruptcy. See Examiner's Report, *supra* note 12, at 707–08; PAULSON, *supra* note 24, at 206 (describing optimism that a deal had been reached for Barclays to acquire Lehman).

⁴⁹ SORKIN, *supra* note 4, at 348; see also PAULSON, *supra* note 24, at 210 (recounting Chancellor of Exchequer Alistair Darling's statement: "[W]e were asking the British to take on too big a risk, and he was not willing to have us unload our problem on the British taxpayer.").

⁵⁰ Examiner's Report, *supra* note 12, at 709.

⁵¹ SORKIN, *supra* note 4, at 366–68. The Lehman board of directors authorized the filing even though Lehman's bankruptcy attorneys questioned the basis on which the federal government could order a corporation to file for bankruptcy. See *id.* at 358; see also PAULSON, *supra* note 24, at 220 (acknowledging that "it was unusual and awkward for a regulator to push a private sector firm to declare bankruptcy").

⁵² See, e.g., SORKIN, *supra* note 4, at 327–28; PAULSON, *supra* note 24, at 211–12.

client.⁵³ Sullivan did not represent any of these entities in connection with Lehman before the bankruptcy,⁵⁴ but as this Article will show, these representations nevertheless appeared to affect Sullivan's representation of Lehman, as did Sullivan's close relationships with Secretary Paulson and other government regulators. To fully analyze these potential conflicts of interest and why they are not adequately addressed by the Model Rules, it is first necessary to analyze how the Model Rules purport to protect clients from their attorneys' concurrent conflicts of interest.

II. CONCURRENT CONFLICTS OF INTEREST UNDER THE MODEL RULES

A. Rule 1.7 and Its Rationale

Under the Model Rules, which have been adopted by forty-nine states,⁵⁵ a lawyer is generally permitted to represent a client as long as the lawyer has no concurrent conflict of interest.⁵⁶ A concurrent conflict of interest exists under Rule 1.7 if either the representation of one client "will be directly adverse to another client" or "there is a significant risk that the representation of one [client] . . . will be materially limited by the lawyer's responsibilities to another client, a former client, or a third person or by a personal interest of the lawyer."⁵⁷ As the comment to Rule 1.7 makes clear, "the mere possibility of subsequent harm" will not establish a concurrent conflict of interest.⁵⁸ Rather, conflict of interest rules are designed to ensure the lawyer is loyal to the client and can exercise independent

⁵³ For example, Sullivan represented Barclays with respect to its failed acquisition of Dutch bank ABN Amro. Lindsay Fortado, *Sullivan & Cromwell Regains Top Spot in Merger Advice (Update4)*, BLOOMBERG (July 3, 2007 16:56 EDT), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aRRtGG9XzNWw/>.

⁵⁴ As set out in Part III.B, Sullivan did represent Barclays in its efforts to purchase Lehman after bankruptcy. Byrne, *supra* note 11; Centers, *supra* note 4; text accompanying note 177.

⁵⁵ See *Model Rules of Professional Conduct*, ABA, http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct.html (last visited Sept. 13, 2012). The Model Rules have also been adopted by the District of Columbia and the Virgin Islands. *Alphabetical List of States Adopting Model Rules*, ABA, http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/alpha_list_state_adopting_model_rules.html (last visited Sept. 17, 2012).

⁵⁶ See MODEL RULES OF PROF'L CONDUCT R. 1.7(a) (2009).

⁵⁷ *Id.* Some states have slightly modified Model Rule 1.7. For example, under New York's professional conduct rules, a concurrent conflict of interest exists if a "reasonable lawyer would conclude that either: (1) the representation will involve the lawyer in representing differing interests; or (2) there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests." N.Y. RULES OF PROF'L CONDUCT R. 1.7(a) (2011).

⁵⁸ MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. 8.

judgment.⁵⁹ When one lawyer in a firm has a conflict of interest in representing a client, the conflict is generally imputed to the entire firm.⁶⁰

The Model Rules do not specify when a representation is “directly adverse” to another client. Rather, the comment to Rule 1.7 offers illustrative examples such as when a lawyer acts as an advocate in one matter against a person who the lawyer represents in an unrelated matter.⁶¹ The comment also suggests that directly adverse conflicts can arise not only in litigation, but also in transactional matters.⁶² An example of such a conflict of interest is when a lawyer is asked to represent the seller of a business in negotiations with a buyer that the lawyer represents in another unrelated transaction.⁶³

To determine whether the attorney’s representation of the client may be “materially limited” by another representation or the attorney’s own interests, the comment to Rule 1.7 states that the attorney should consider “the likelihood that a difference in interests will eventuate” and whether the conflict will “materially interfere with the lawyer’s independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client.”⁶⁴

If a lawyer determines that a concurrent conflict of interest exists, the lawyer can only represent the client (or continue to represent the client) if the following four conditions are met under Rule 1.7(b):

- (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
- (2) the representation is not prohibited by law;

⁵⁹ See *id.* R. 1.7 cmt. 1.

⁶⁰ See *id.* R. 1.10(a). The main exception is if the conflict of interest is based on a personal interest of a lawyer. But even a conflict of interest based on an attorney’s personal interest can be imputed to a firm if the personal interest of the lawyer presents “a significant risk of materially limiting the representation of the client by the remaining lawyers in the firm.” See *id.* R. 1.10 cmt. 3. The wisdom of the imputation rule is beyond the scope of this Article, but for a persuasive early critique, see Charles W. Wolfram, *Ethics 2000 and Conflicts of Interest: The More Things Change....*, 70 TENN. L. REV. 27, 57–59 (2003). Professor Wolfram criticizes the imputation rule for not adequately considering the increased movement of lawyers between firms and failing to explicitly allow firms to screen lawyers from working on matters in which they have a conflict of interest. See *id.* at 59; see also Ronald Rotunda, *Resolving Conflicts by Hiring “Conflicts Counsel”*, 62 HASTINGS L.J. 677, 680 (2011) (suggesting that the imputation rule will often “disqualify a law firm even when there is no legitimate client expectation of loyalty and confidentiality”).

⁶¹ MODEL RULES OF PROF’L CONDUCT R. 1.7 cmt. 6.

⁶² *Id.* R. 1.7 cmt. 7.

⁶³ *Id.*

⁶⁴ *Id.* R. 1.7 cmt. 8.

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.⁶⁵

The comment to Rule 1.7 states that the purpose of requirements (b)(1)–(3) is to ensure “the interests of the clients will be adequately protected if the clients are permitted to give their informed consent to representation burdened by a conflict of interest.”⁶⁶ Informed consent presumes that the client has consented to the conflict only after the lawyer has explained “the relevant circumstances and . . . the material and reasonably foreseeable ways that the conflict could have adverse effects on the interests of that client.”⁶⁷

Permitting clients to accept conflicted representation arguably safeguards client autonomy.⁶⁸ At the same time, clients cannot consent to all conflicts of interest under Rule 1.7. A lawyer cannot, for example, bring a claim on behalf of one client against another client that the lawyer represents in the same proceeding even if both clients consent⁶⁹ because there is “institutional interest in vigorous development of each client’s position when the clients are aligned directly against each other.”⁷⁰

In addition, Rule 1.7(b)(1) requires that lawyers reasonably believe they can provide competent and diligent representation in spite of a conflict of interest.⁷¹ The central question attorneys must consider is whether their performance would be “objectively inadequate”⁷² on account of their conflict of interest, and therefore whether they should not proceed with the representation regardless of the client’s

⁶⁵ *Id.* R. 1.7(b).

⁶⁶ *Id.* R. 1.7 cmt. 15.

⁶⁷ *Id.* R. 1.7 cmt. 18. The former version of Rule 1.7 did not require that the client provide informed consent to the conflict of interest or that the consent be confirmed in writing. See ABA, REPORT ON THE MODEL RULES OF PROFESSIONAL CONDUCT: REPORTER’S EXPLANATION R. 1.7 (2000), available at http://www.americanbar.org/content/dam/aba/migrated/cpr/e2k/10_85rem.authcheckdam.pdf.

⁶⁸ See Zacharias, *Waiving Conflicts*, *supra* note 8, at 412; see also RESTATEMENT (THIRD) OF LAW GOVERNING LAWYERS § 122 cmt. g(iv) (2000) (“Concern for client autonomy generally warrants respecting a client’s informed consent.”). As Professor Zacharias suggests, it can be reasonable for clients to choose lawyers with conflicts of interests in many circumstances. For example, if cost is an issue, even two potential antagonists might be willing to accept common counsel. See Zacharias, *Waiving Conflicts*, *supra* note 8, at 414–15. The conflicted lawyer may also be the most qualified, or the client may simply be most comfortable with that lawyer. *Id.* at 415. Lastly, in smaller towns, there may be a dearth of lawyers such that a client would have no practical choice but to accept a lawyer with a conflict of interest. *Id.* at 416.

⁶⁹ See MODEL RULES OF PROF’L CONDUCT R. 1.7(b)(3).

⁷⁰ *Id.* R. 1.7 cmt. 17.

⁷¹ *Id.* R. 1.7(b)(1).

⁷² See Zacharias, *Waiving Conflicts*, *supra* note 8, at 413.

willingness to consent to the conflicted representation.⁷³ In this manner, Rule 1.7 attempts to respect client autonomy while still protecting clients from truly ill-advised representations.

B. Doubts Concerning Rule 1.7's Efficacy

One striking aspect of Rule 1.7 is the degree to which much of the evaluation of an attorney's conflict of interest does not involve the client. For example, although attorneys are required to have procedures in place to help identify potential conflicts of interest,⁷⁴ once the conflict is identified, the attorney alone determines whether a representation is "directly adverse" with another representation or may be "materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer."⁷⁵

If the lawyer determines that he does in fact have a concurrent conflict of interest that must be disclosed to the client, the lawyer is not required to consider whether the conflict may interfere with the lawyer's ability to satisfy the client's expectations of the representation. Rather, Rule 1.7(b)(1) states that the attorney may carry out the representation as long as he "reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client."⁷⁶ Although a client may expect far more than "competent and diligent representation" from an attorney, the Rule only seeks to assure that clients obtain this minimal level of representation.⁷⁷

Prior to 2002, for a conflict of interest to be consentable under the Model Rules, an attorney was required to determine that the concurrent conflict of interest would not "adversely affect the representation" pursuant to Rule 1.7(b)(1).⁷⁸ The change in Rule 1.7(b)(1) was motivated by attorneys' professed confusion regarding the circumstances under which client consent to a conflict of interest could be sought.⁷⁹ By replacing the requirement that an attorney consider whether a conflict is likely to "adversely affect the representation" with a reference to the lawyer's duty to provide "competent and diligent representation," the drafters believed that they were articulating a "relatively clear standard" as to when a client could consent to a conflict.⁸⁰

Regardless of whether the change of rule provides a clearer standard, Rule 1.7(b)(1) is largely redundant in its present form because the Model Rules already

⁷³ See McMunigal, *supra* note 5, at 861 ("Perhaps the central question for a risk approach to conflict of interest is defining which risks are acceptable and which are unacceptable.").

⁷⁴ MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. 3.

⁷⁵ *Id.* R. 1.7(b).

⁷⁶ *Id.* R. 1.7(b)(1).

⁷⁷ *Id.*

⁷⁸ See ABA, *supra* note 67.

⁷⁹ *Id.*

⁸⁰ *Id.*

require attorneys to provide competent and diligent representation.⁸¹ Furthermore, there is the possibility that the rule may encourage lawyers to believe that the majority of conflicts of interest are consentable by allowing them to overlook their conflicts' effects on their clients. As has been widely chronicled, lawyers generally have high opinions of their own abilities,⁸² and few lawyers are likely to believe that they cannot provide competent and diligent representation because of a conflict of interest, even if there is a possibility that the client would be better served by another attorney or firm. As Professor Zacharias has noted, "In all but the most egregious conflict situations, lawyers can convince themselves that they can represent multiple clients competently, on the theory that they are able to manage psychological pressures through the exercise of professional detachment."⁸³

Empirical research also provides some support for the proposition that lawyers view most conflicts of interest as consentable and that clients can therefore waive them. In Professor Gross's survey concerning conflicts of interest sent to attorneys who graduated from the Southern Illinois University School of Law, 68% of the responding attorneys claimed to inform their clients that conflicts were nonwaivable less than 10% of the time, and another 15% stated that they informed their clients that the conflicts were nonwaivable only 25% of the time.⁸⁴ Although these results should be considered with caution given that they only reflect the responses of 157 lawyers from one particular jurisdiction,⁸⁵ The study does tend to confirm that lawyers will usually believe that they can provide competent and diligent representation notwithstanding a conflict of interest, and few lawyers will apparently decline or terminate a representation solely because they have a conflict of interest.⁸⁶

Of course, for a lawyer to represent a client in spite of a concurrent conflict of interest, the attorney must disclose the conflict and the client must give "informed consent" to the conflicted representation pursuant to Rule 1.7(b)(4). Presumably, if

⁸¹ See MODEL RULES OF PROF'L CONDUCT R. 1.1; *id.* R. 1.3.

⁸² See, e.g., Donald C. Langevoort, *The Epistemology of Corporate-Securities Lawyering: Beliefs, Biases, and Organizational Behavior*, 63 BROOK. L. REV. 629, 650 (1997) ("Probably far more lawyers pride themselves on independence and good judgment than consistently exhibit it."); Fred C. Zacharias, *Steroids and Legal Ethics Codes: Are Lawyers Rational Actors?*, 85 NOTRE DAME L. REV. 671, 701 (2010) [hereinafter Zacharias, *Steroids and Legal Ethics*].

⁸³ Zacharias, *Steroids and Legal Ethics*, *supra* note 82, at 701.

⁸⁴ See Leonard E. Gross, *Are Differences Among the Attorney Conflict of Interest Rules Consistent with Principles of Behavioral Economics?*, 19 GEO. J. LEGAL ETHICS 111, 149 (2006).

⁸⁵ See *id.* at 127–28. Additionally, the study does not differentiate between the situation where an attorney concludes that he cannot provide "competent and diligent representation" under MODEL RULES OF PROF'L CONDUCT R. 1.7(b)(1) from the situation where the representation is expressly prohibited by MODEL RULES OF PROF'L CONDUCT R. 1.7(b)(3). See Gross, *supra* note 84, at 127 n.78.

⁸⁶ Gross, *supra* note 84, at 149; see also Zacharias, *Waiving Conflicts*, *supra* note 8, at 422 (suggesting attorneys have an incentive to obtain misguided conflict waivers).

a client seeks more than just the minimum level of “competent and diligent representation”⁸⁷ and is concerned with whether the attorney can meet his or her expectations of the representation, the client could choose to retain other counsel.

In practice, however, clients’ ability to protect themselves may be limited because attorneys are likely to understate the seriousness of conflicts of interests out of economic self-interest.⁸⁸ Equally important, clients may be unable to meaningfully assess the impact of the conflict of interest before the representation has started and will be hesitant to second-guess their original choice of counsel.⁸⁹ Clients may also overestimate their attorneys’ ability to compensate for their conflicts of interest.⁹⁰ Most clients appear to be willing to waive their attorneys’ conflicts of interest whatever the precise reason. Under Professor Gross’s survey, 63% of attorneys reported that their clients waived the conflict of interest virtually all the time, with an additional 19% reporting that clients waived conflicts 90% of the time.⁹¹

It is somewhat puzzling that so many clients are willing to accept conflicted representation because, in disclosing conflicts of interest to their clients, attorneys are in effect conceding that the conflict will “materially limit” their representation pursuant to Rule 1.7(a)(2). One plausible explanation for this behavior may be that clients are willing to waive an attorney’s conflict of interest and accept conflicted representation because they calculate that conflicted representation from a particular attorney is preferable to being represented by other counsel. But even if most clients waive conflicts of interest on this basis, social psychology research suggests that attorneys’ act of disclosing their conflicts of interest—as they are required to do by Rule 1.7(b)(4)—may have the unfortunate effect of amplifying the conflicts’ adverse effect on the representation.⁹² As Professor Eldred has noted, there are a variety of explanations for this phenomenon:

In some situations, advisors may “compensate” unconsciously for the effects of disclosure “by further skewing their advice” to a client. Similarly, once bias is disclosed, the decision-maker might unconsciously feel that the advisor has been ethical and thus is deserving

⁸⁷ MODEL RULES OF PROF’L CONDUCT R. 1.7(b)(1).

⁸⁸ See Zacharias, *Waiving Conflicts*, *supra* note 8, at 422; see also Gross, *supra* note 84, at 119 (“[L]awyers will be . . . likely to understate their own conflicts of interest when doing so will produce . . . tangible gain for them.”).

⁸⁹ See Gross, *supra* note 84, at 123–24; see also Zacharias, *Waiving Conflicts*, *supra* note 8, at 423 (“[T]he self-interested lawyer who views the conflicts provisions as a roadblock to be circumvented often can obtain misguided waivers. . . . By the time the case reaches court, the lawyer will have prepared her client and convinced him that she is essential to his cause.”).

⁹⁰ See Cassandra Burke Robertson, *Judgment, Identity, and Independence*, 42 CONN. L. REV. 1, 40 (2009).

⁹¹ Gross, *supra* note 84, at 149.

⁹² See Tigran W. Eldred, *The Psychology of Conflicts of Interest in Criminal Cases*, 58 U. KAN. L. REV. 43, 79 (2009).

of more, rather than less, trust. Finally, disclosure may result in what has been called “moral licensing,” which makes the advisor believe that, because the risks have been disclosed, there is less reason to “toe the ethical line and look out for the interests of those receiving their advice.”⁹³

To truly mitigate the effects of conflicts of interest, recent research suggests that advisors must fear sanction for failing to act in the interests of their clients.⁹⁴ However, disciplinary authorities rarely sanction attorneys for misconduct that does not involve the mishandling of client funds.⁹⁵ Consequently, from the perspective of the attorney, once a client’s consent to a conflict of interest is obtained, there is little risk in proceeding with a conflicted representation.

The next section discusses three specific conflicts of interest that impacted the representation that Sullivan provided to Lehman. It also seeks to answer why a highly sophisticated client like Lehman could not ensure that its attorneys’ conflicts would not interfere with the representation that it received.

III. CONFLICTS OF INTEREST IN SULLIVAN’S REPRESENTATION OF LEHMAN

Three conflicts of interest compromised the representation that Sullivan could provide to Lehman. First, Sullivan had duties not only to Lehman but also to Merrill, which, like Lehman, was seeking to sell itself to Bank of America. Second, Sullivan had a conflict of interest because it was seeking to sell Lehman to another firm client, Barclays, and in fact, transitioned from representing Lehman to representing Barclays after Lehman filed for bankruptcy—an experience that one Sullivan attorney likened to going “from shirts to skins.”⁹⁶ Lastly, Sullivan’s reputational interests—and those of Cohen in particular—may have precluded the firm from taking a more aggressive stance with the Federal Reserve and the Treasury on Lehman’s behalf. This section contrasts Sullivan’s representation in this regard to that offered by Lehman’s bankruptcy counsel, Weil, Gotshal, & Manges, LLP.

As noted in the introduction of this Article, the purpose of examining Sullivan’s representation of Lehman is not to determine whether Sullivan violated the Model Rules or the New York Lawyer’s Code of Professional Responsibility (NY Lawyer’s Code) that was in effect in New York when Sullivan represented

⁹³ *Id.* (citations omitted).

⁹⁴ See Bryan K. Church & Xi (Jason) Kuang, *Conflicts of Interest, Disclosure, and (Costly) Sanctions: Experimental Evidence*, 38 J. LEGAL STUD. 505, 526–27 (2009).

⁹⁵ Fred C. Zacharias, *The Future Structure and Regulation of Law Practice: Confronting Lies, Fictions, and False Paradigms in Legal Ethics Regulation*, 44 ARIZ. L. REV. 829, 861–62 (2002).

⁹⁶ SORKIN, *supra* note 4, at 379.

Lehman.⁹⁷ As a sophisticated law firm, Sullivan probably had Lehman consent to any conflicts that the firm was aware of with respect to other clients and had Lehman waive future conflicts as well.⁹⁸ Moreover, while Sullivan's ability to always act in Lehman's interests may have been limited by the firm's conflicts of interest, there is no reason to believe that Sullivan did not, on the whole, represent Lehman competently and diligently in 2008. For these reasons, Sullivan likely satisfied Rule 1.7, as well as the applicable provisions of the New York Lawyer's Code.⁹⁹

Nevertheless, although Sullivan may not have violated any disciplinary rules in representing Lehman, Sullivan's relationships with Merrill, Barclays, and banking regulators gave rise to concurrent conflicts of interest that made it more difficult for Sullivan to represent Lehman and made a Lehman bankruptcy a more realistic option for the company.

A. Perceived Duties to Merrill

While representing Lehman, Sullivan also represented Goldman, Merrill, and other investment banks that were Lehman's competitors.¹⁰⁰ Under the Model Rules,

⁹⁷ The New York Lawyer's Code of Professional Responsibility has been replaced by the New York Rules of Professional Conduct as of April 1, 2009. See N.Y. RULES OF PROF'L CONDUCT (2011).

⁹⁸ See Michael J. DiLernia, *Advance Waivers of Conflicts of Interest in Large Law Firm Practice*, 22 GEO. J. LEGAL ETHICS 97, 97 (2009) ("Advance waivers of conflicts of interest have become an essential business and ethics practice for large law firms in the United States."). Scholarly opinion, however, remains divided. Compare Lawrence J. Fox, *All's OK Between Consenting Adults: Enlightened Rule on Privacy, Obscene Rule on Ethics*, 29 HOFSTRA L. REV. 701, 715–17 (2001) (criticizing such waivers), with Jonathan J. Lerner, *Honoring Choice by Consenting Adults: Prospective Client Waivers as a Mature Solution to Ethical Gamesmanship—A Response to Mr. Fox*, 29 HOFSTRA L. REV. 971, 972–73 (2001) (defending prospective waivers, particularly for sophisticated clients); see also Richard W. Painter, *Advance Waiver of Conflicts*, 13 GEO. J. LEGAL ETHICS 289, 312 (2000) (suggesting prospective waivers should generally be enforced if they are unambiguous and the client was represented by counsel in signing the waiver, but that any ambiguity should be construed against the attorney seeking the waiver).

⁹⁹ Conflicts of interest under the New York Lawyer's Code of Professional Responsibility are regulated by Canon 5. Canon 5 expressly provides that an attorney may carry out a representation of clients with differing interests if both clients consent, unless "a disinterested lawyer would conclude that any of the affected clients should not agree to the representation under the circumstances." N.Y. LAWYER'S CODE OF PROF'L RESPONSIBILITY EC 5-16 (2007). Given that "there are many instances in which a lawyer may properly serve multiple clients having potentially differing interests in matters not involving litigation," *id.* at EC 5-15, Sullivan could have reasonably concluded that it could proceed with the representation of Lehman assuming that it obtained the requisite consents.

¹⁰⁰ The relationship between Sullivan and Goldman has long been particularly close. See John Carney, *Goldman Sachs' Special Relationship with Sullivan & Cromwell Is Alive and Well*, BUS. INSIDER (Jan. 25, 2010 9:13 AM), <http://www.businessinsider.com/goldman-sachs-special-relationship-with-sullivan-and-cromwell-is-alive-and-well-2010-1/>.

these representations would not give rise to a concurrent conflict of interest because “simultaneous representation in unrelated matters of clients whose interests are only economically adverse . . . does not ordinarily constitute a conflict of interest.”¹⁰¹ Since Sullivan did not appear to represent Goldman, Merrill, or any other investment bank against Lehman during the financial crisis, Sullivan’s decision to represent Lehman would not have created a concurrent conflict of interest under the Model Rules.

Furthermore, Sullivan, like most large, modern law firms, probably had Lehman waive any conflicts that could arise with respect to Goldman, Merrill, and other clients.¹⁰² The waiver would have likely taken the following form:

Our firm has in the past and will continue to represent clients listed on the attached Exhibit A (each an “Exhibit A Client”) in matters not substantially related to this engagement. Accordingly, each Client agrees to waive any objection, based upon this engagement, to any current or future representation by the firm of any of the Exhibit A Clients, its respective parent, subsidiaries and affiliates in any matter not substantially related to this representation. Of course, we will not accept any representation that is adverse to you in this matter.¹⁰³

It is also possible that the waiver extended to all Sullivan clients and not merely a subset thereof.¹⁰⁴

Under the Model Rules, lawyers may obtain such open-ended waivers of conflicts of interest when a client is an “experienced user of the legal services involved,” like Lehman, and as long as the conflict is otherwise consentable.¹⁰⁵ The comment also suggests that these waivers are most effective when the client is “independently represented by other counsel in giving consent,”¹⁰⁶ as Lehman would have been through its in-house counsel. The rationale for treating sophisticated and unsophisticated clients differently in terms of waiving conflicts of interest is that the former are presumed to better understand attorney conflicts of

Sullivan represented Merrill Lynch in the \$16 billion sale of Merrill Lynch’s asset-management business to BlackRock. See Jon Parker, *Skadden and Sullivan Bag \$16Bn BlackRock Roles*, *LAWYER* (Feb. 20, 2006), [http://www.thelawyer.com/skadden-and-sullivan-bag-\\$16bn-blackrock-roles/118881.article/](http://www.thelawyer.com/skadden-and-sullivan-bag-$16bn-blackrock-roles/118881.article/). Cohen himself may not have represented Lehman and any of its competitors concurrently, but any representation of other investment banks by Sullivan would have been imputed to Cohen pursuant to MODEL RULES OF PROF’L CONDUCT R. 1.10(a).

¹⁰¹ MODEL RULES OF PROF’L CONDUCT R. 1.7 cmt. 6.

¹⁰² DiLernia, *supra* note 98, at 97.

¹⁰³ *Id.* at 100 (citing *Gen. Cigar Holdings, Inc. v. Altadis*, 144 F. Supp. 2d 1334, 1336 (S.D. Fla. 2001)).

¹⁰⁴ See *id.* at 99 (comparing general waivers with regard to clients as opposed to specific waivers with regard to clients).

¹⁰⁵ MODEL RULES OF PROF’L CONDUCT R. 1.7 cmt. 22.

¹⁰⁶ *Id.*

interest and are less vulnerable to lawyer overreaching.¹⁰⁷ The permissibility of having experienced users of legal services provide general, advance consent to attorney conflicts of interest has been affirmed by opinions of the American Bar Association, the District of Columbia Bar Association, and the New York City Bar Association.¹⁰⁸

Although the concurrent representation of Lehman and its competitors in unrelated matters was in accordance with the Model Rules, Sullivan's representation became more problematic as Lehman's situation worsened. As Cohen was seeking to complete the sale of Lehman to Bank of America in the week prior to Lehman's bankruptcy, Gregory Fleming, Merrill Lynch's president and chief operating officer,¹⁰⁹ contacted Cohen to determine how negotiations were proceeding between Bank of America and Lehman.¹¹⁰ Sullivan had recently advised Merrill in the sale of its asset management business to BlackRock.¹¹¹ Cohen quickly determined that Merrill was, like Lehman, seeking to be acquired by Bank of America and refused to answer any of Fleming's questions.¹¹² Fleming then confided: "We've got to do a deal. The numbers are looking too risky. If Lehman goes, we'll be next."¹¹³

This was potentially crucial information because Lehman had been under the apparent misimpression that it alone was negotiating with Bank of America.¹¹⁴ Nevertheless, Cohen did not share the information with Lehman until days later.¹¹⁵ Indeed, Cohen *never* shared the substance of his conversation with Fleming with Lehman and informed Lehman that its prospective sale to Bank of America was in jeopardy only after Timothy Geithner (Geithner), the then-President of the New York Federal Reserve, revealed to Cohen that Bank of America was likely to acquire Merrill instead.¹¹⁶

If Merrill had not been Sullivan's client, it is possible that Fleming may have never confided in Cohen in the first place. Moreover, Lehman may have been unlikely to merge with Bank of America even if Cohen had disclosed what he learned from Fleming. In Secretary Paulson's view, Bank of America had never

¹⁰⁷ See Wolfram, *supra* note 60, at 44. *But see* Fox, *supra* note 5, at 574–76 (criticizing the “myth” of the sophisticated client).

¹⁰⁸ See ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 05-436 (2005); Ass'n of the Bar of the City of New York Comm. on Prof'l & Judicial Ethics, Formal Op. 2006-1 (2006); D.C. Bar Legal Ethics Comm., Op. 309 (2001).

¹⁰⁹ SORKIN, *supra* note 4, at 276.

¹¹⁰ *Id.* at 253.

¹¹¹ Parker, *supra* note 100.

¹¹² SORKIN, *supra* note 4, at 277.

¹¹³ *Id.*

¹¹⁴ See PAULSON, *supra* note 24, at 190; *see also* SORKIN, *supra* note 4, at 276 (describing Fuld's view that a merger was imminent).

¹¹⁵ See SORKIN, *supra* note 4, at 276, 329.

¹¹⁶ *See id.* at 329.

truly been interested in purchasing Lehman,¹¹⁷ and former Lehman executives suspect that Lehman may have been a “bargaining chip” to use against Merrill.¹¹⁸

Nevertheless, it would have unquestionably been in the best interests of Lehman for Cohen to share the substance of the Fleming conversation with Lehman. For example, if Lehman had known that Bank of America and Merrill were negotiating, Lehman could have lowered its demands of Bank of America. It could have also chosen to divert more of its energies to other potential acquirers. None of these actions would have necessarily allowed Lehman to avoid bankruptcy, but Cohen could not recommend either of these options without effectively revealing what he had learned from Fleming.¹¹⁹ Since Cohen possessed material information that he felt he could not disclose out of concern for another client, Sullivan had a conflict of interest that materially limited the representation of Lehman.¹²⁰ Lehman did eventually learn of the negotiations,¹²¹ but part of the materiality calculus is whether it would have been valuable to the client to possess the information earlier,¹²² as it would have been here.

To be sure, clients do not have any legitimate expectation that their lawyers will use confidential information obtained from other clients for their benefit.¹²³ But the information provided to Cohen was not protected by attorney confidentiality. A lawyer is prohibited only from revealing “information relating to representation of the client,”¹²⁴ and the information provided by Fleming was unrelated to any representation of Merrill. Indeed, Fleming did not contact Cohen in reference to any matter Sullivan may have been handling for Merrill, but because he knew that Cohen was representing Lehman and hoped to obtain

¹¹⁷ See PAULSON, *supra* note 24, at 195 (“[I]t was increasingly obvious that [Bank of America CEO Ken Lewis] didn’t really want to buy Lehman.”).

¹¹⁸ Examiner’s Report, *supra* note 12, at 701.

¹¹⁹ MODEL RULES OF PROF’L CONDUCT R. 1.7 cmt. 8 (2009); *see also* S.C. Bar Ethics Advisory Comm., Advisory Op. 91-33, 1991 WL 787761, at *1 (1991) (holding where an attorney has information that should be disclosed to one client but disclosing the information would be injurious to another client’s case, the attorney has a nonconsentable conflict of interest).

¹²⁰ See Ass’n of the Bar of the City of New York Comm. on Prof’l & Judicial Ethics, Formal Op. 2005-02, 2005 WL 682188, at *6; Los Angeles Cnty. Bar Ass’n Prof’l Responsibility & Ethics Comm., Ethics Op. No. 463, at 8 (1990).

¹²¹ See SORKIN, *supra* note 4, at 329.

¹²² See Ass’n of the Bar of the City of New York Comm. on Prof’l & Judicial Ethics, Formal Op. 2005-02, 2005 WL 682188, at *6.

¹²³ *Id.* at *2.

¹²⁴ MODEL RULES OF PROF’L CONDUCT R. 1.6(a); *see also id.* R. 1.8 cmt. 5 (“Use of information relating to the representation to the disadvantage of the client violates the lawyer’s duty of loyalty.” (emphasis added)); Ass’n of the Bar of the City of New York Comm. on Prof’l & Judicial Ethics, Formal Op. 2005-02, 2005 WL 682188, at *3 (holding attorneys are generally only required to refrain from sharing confidences and secrets obtained from a client).

information concerning the negotiations from someone he considered a close friend.¹²⁵

This is not to minimize the dilemma that Cohen faced. If he had revealed what he learned from Fleming, this could potentially hurt Sullivan's relationship with Merrill,¹²⁶ and there was no guarantee that Lehman would be able to complete a transaction with Bank of America.¹²⁷ Moreover, although Fleming appeared to not be approaching Cohen in his capacity as Merrill's lawyer, the Model Rules are sufficiently ambiguous such that the decision to preserve the confidence of Fleming may have seemed like an ethical course of action,¹²⁸ even though the decision was clearly contrary to Lehman's interests. Lastly, assuming that Lehman waived Sullivan's client conflicts at the start of the representation, Cohen may have assumed that Lehman knowingly assumed the risk that the firm would not share all relevant information that it possessed through its relationships with other clients.¹²⁹

Of course, to continue with the representation of Lehman, Sullivan would have had to reasonably believe that it could provide "competent and diligent representation" in spite of its decision to not disclose that Merrill and Bank of America were in negotiations.¹³⁰ Although it would have certainly been beneficial for Lehman to know that its deal with Bank of America was in jeopardy, neither Rule 1.1 (competence) nor Rule 1.3 (diligence) specifically requires attorneys to share all material information in their possession with the client, let alone

¹²⁵ See SORKIN, *supra* note 4, at 277.

¹²⁶ Aside from any perceived duties owed to Merrill Lynch, Cohen may have felt that he should preserve the confidence of Fleming as a friend. This would also constitute a cognizable concurrent conflict of interest under the Model Rules if Cohen felt that the representation of Lehman would be materially limited by his responsibilities to his friend. See MODEL RULES OF PROF'L CONDUCT R. 1.7(b)(1); see also S.C. Bar Ethics Advisory Comm., Advisory Op. 07-03, 2007 WL 7264729, at *1 (noting a conflict of interest exists when a lawyer has a personal relationship with an individual such that there is a risk that the lawyer's professional judgment and loyalty to a client could be compromised by the personal relationship, and the lawyer may impart confidences to the individual).

¹²⁷ For this reason, it was arguably in Cohen's self-interest to prioritize his relationship with Merrill over that of Lehman given that the former was more likely to survive the financial crisis.

¹²⁸ Attorney-client confidentiality is a foundational principle of the American legal profession. See MODEL RULES OF PROF'L CONDUCT R. 1.6 cmt. 2 (noting confidentiality rules contribute to the "trust that is the hallmark of the client-lawyer relationship" and help ensure that "the law is upheld"). Ethics opinions suggest that the obligation should be construed broadly. See, e.g., N.J. Advisory Comm. on Prof'l Ethics, Ethics Op. 695, 2004 WL 833032, at *1 (2004); Pa. Bar Ass'n Comm. on Legal Ethics & Prof'l Responsibility, Informal Op. 2000-05, 2000 WL 1616078, at *1 (2000). Moreover, notwithstanding Cohen's duties to Lehman, as a client of Sullivan, Merrill was also owed a duty of loyalty, and as such, Cohen was required to refrain from "disadvantageous use of client information." See MODEL RULES OF PROF'L CONDUCT R. 1.8 cmt. 5.

¹²⁹ See Eldred, *supra* note 92, at 79 (describing the phenomenon of "moral licensing").

¹³⁰ MODEL RULES OF PROF'L CONDUCT R. 1.7(b)(1).

information obtained from other clients.¹³¹ Sullivan could have revealed this information, and it would have been in the best interests of Lehman for it to do so. But Rule 1.7 does not explicitly require attorneys to decline or terminate a representation once a conflict of interest prevents them from acting in the client's best interest.¹³²

It is not unexpected that a law firm—even one as well-known as Sullivan—would choose to continue to represent a client notwithstanding a potentially serious conflict of interest. As Professor Gross's study suggests, few attorneys seem to conclude that they cannot provide "competent and diligent representation"¹³³ solely because of a conflict of interest.¹³⁴ The fact that Lehman probably waived any future conflicts with respect to Sullivan clients also made it less likely that Sullivan would look out for the interests of Lehman at the expense of these other clients.¹³⁵ Of course, it may have been perfectly logical for Lehman to waive any conflicts that Sullivan might have had in virtue of representing Lehman's competitors. Lehman could not have anticipated at the outset of the representation that the economy would degenerate to the point that both it and Merrill would need to merge with Bank of America to avoid bankruptcy.¹³⁶ Even towards the end of the representation, as the field of potential purchasers shrank, Lehman would not have

¹³¹ There is some authority to suggest that MODEL RULES OF PROF'L CONDUCT R. 1.3 and 1.4 require the disclosure of material information where it is crucial to a client's case. *See* Pa. Bar Ass'n Legal Ethics & Prof'l Responsibility Comm., Informal Op. 95-48, 1995 WL 935660, at *1 (1995) (holding an attorney in a domestic relations matter arguably violates PA. RULES OF PROF'L CONDUCT R. 1.4 (1987) if he does not reveal to his client that her husband also sought to be retained by the attorney); S.C. Bar Ethics Advisory Comm., Ethics Advisory Op. 07-03, 2007 WL 7264729, at *1 (2007) (holding an attorney would violate his duty of diligence if he does not disclose in a divorce case the identity of his client's husband's lover that he learned through another representation); *see also* *Spector v. Mermelstein*, 361 F. Supp. 30, 39-40 (S.D.N.Y. 1972) (holding an attorney breaches his fiduciary duty to a client where he "negligently or willfully withholds from his client information material to the client's decision to pursue a given course of action"). Although Sullivan's failure to disclose that Merrill and Bank of America were negotiating may have materially limited its representation, it is unclear whether the information was of such importance that the failure to disclose it was sanctionable or a breach of fiduciary duty. This is particularly so because Lehman was negotiating with other buyers besides Bank of America and, in any event, soon learned of Bank of America's interest in Merrill. *See* SORKIN, *supra* note 4, at 329.

¹³² One could argue that such a duty follows from the lawyer's duty to provide diligent representation pursuant to MODEL RULES OF PROF'L CONDUCT R. 1.3. However, while this Rule requires an attorney to act with "commitment and dedication to the interests of the client," it also stresses that a "lawyer is not bound . . . to press for every advantage that might be realized for a client." *Id.* R. 1.3 cmt. 1.

¹³³ *Id.* R. 1.7(b)(1).

¹³⁴ *See* discussion *supra* Part II.B.

¹³⁵ *See* Eldred, *supra* note 92, at 79 (noting counterproductive effects of disclosing conflicts of interest).

¹³⁶ Merrill believed until the week leading up to the Lehman bankruptcy that it could survive by selling a small stake in the firm. *See* SORKIN, *supra* note 4, at 309.

expected that a Merrill director would provide information to Cohen that was highly relevant to Lehman's negotiations with Bank of America.

Nevertheless, as explored in the next section, even when a sophisticated client like Lehman is fully aware that its interests might be opposed to those of another current client of its law firm, the client may be unable to ensure that the representation it receives is not compromised.

B. The Barclays Blind Spot

Of all of Lehman's potential acquirers, Barclays appeared to be the most interested in purchasing Lehman.¹³⁷ Barclays was also a Sullivan client. In the summer of 2007, Sullivan had represented Barclays in its attempted acquisition of the Dutch bank ABN Amro.¹³⁸ Cohen himself worked on several matters for Barclays in the United States, including its first U.S. public offering.¹³⁹ This section explores whether Sullivan's relationship with Barclays prevented it from fully defending Lehman's interests in its negotiations with Barclays.

The Model Rules do not forbid a lawyer from representing a client in selling a business to another client. A concurrent conflict of interest would exist in such a situation under Rule 1.7(a)(1) because the interests of the seller are "directly adverse" to those of the buyer,¹⁴⁰ but the comment to the Rule states that a lawyer can nevertheless undertake such a representation with the informed consent of each client.¹⁴¹

Pursuant to Rule 1.7(b)(1), the lawyer or firm would also have to reasonably believe "that it could provide competent and diligent representation to each affected client." Although few ethics opinions have addressed the issue, the prevailing view is that transactional matters are generally less likely to impact an attorney's ability to provide "competent and diligent" representation than litigation conflicts.¹⁴² Consequently, there are many situations where a lawyer, with disclosure and consent, may represent one client in a transaction with another client.¹⁴³ One possible exception is where a lawyer or firm endeavors to represent two clients with differing interests in the same transaction, although such a

¹³⁷ See *id.* at 258 (noting Barclay's had been monitoring Lehman for months as part of a planned expansion into the United States).

¹³⁸ Fortado, *supra* note 53.

¹³⁹ See *H. Rodgin Cohen*, SULLIVAN & CROMWELL LLP, <http://www.sullcrom.com/lawyers/HRodgin-Cohen/> (last visited July 12, 2012).

¹⁴⁰ See MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. 6 (2009).

¹⁴¹ See *id.* R. 1.7 cmt. 7.

¹⁴² See N.Y.C. Ass'n Bar Comm. Prof'l Judicial Ethics, Formal Op. 2006-1, 2006 WL 1662501, at *6; N.Y.C. Ass'n Bar Comm. Prof'l Judicial Ethics, Formal Op. 2001-2, 2001 WL 1870202, at *3 (2001); see also N.Y. LAWYER'S CODE OF PROF'L RESPONSIBILITY EC 5-15 (2007) ("[T]here are many instances in which a lawyer may properly serve multiple clients having potentially differing interests in matters not involving litigation.").

¹⁴³ Ass'n of the Bar of the City of New York Comm. on Prof'l & Judicial Ethics, Formal Op. 2001-2, 2001 WL 1870202, at *3.

representation is not explicitly prohibited by Rule 1.7(b).¹⁴⁴ As Sullivan did not appear to be representing Barclays with respect to Lehman, the concurrent representation of Barclays and Lehman would have been permitted under the Model Rules if both clients gave informed consent.¹⁴⁵

There has been little analysis as to why litigation conflicts should be viewed differently than transactional conflicts. One explanation may be that in transactional matters, parties' interests are usually "overlapping in the sense that both share the goal of consummating the transaction."¹⁴⁶ It is certainly the case, however, that parties in litigation may share the ultimate goal of settling a matter, just as the parties seeking to complete a transaction may be interested in doing so only on terms that are very disadvantageous to the other side. Moreover, as Professor Freedman has observed, transactional work will always have adversarial aspects because "[t]he advice given to a client and acted upon today may strengthen or weaken the client's position in negotiations or litigation next year."¹⁴⁷

Even assuming transactional conflicts are less problematic than litigation conflicts, Barclays' proposed acquisition of Lehman was hardly a typical transaction. Barclays had only officially approached Lehman in the week prior to its bankruptcy.¹⁴⁸ Barclays' board of directors authorized the beginning of due diligence on September 12, 2008,¹⁴⁹ and the first meeting between Barclays' CEO, Robert Diamond, and Lehman CEO, Richard Fuld, occurred later that same day.¹⁵⁰ At the meeting, Diamond apparently informed Fuld that "this is a horrible situation for you, because we're only going to be interested if the price is quite distressed."¹⁵¹

Moreover, hanging over the negotiations was the reality that if negotiations failed, Barclays would have the option of purchasing Lehman's prime assets in bankruptcy. Before Lehman even made the decision to file for bankruptcy, it had engaged in discussions with Barclays concerning a potential acquisition of the

¹⁴⁴ *Id.*; see Ohio Bd. Comm'rs Grievances & Discipline, Advisory Op. 2009-3, 2009 WL 1764109, at *7 (2009) ("[A] lawyer may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic, regardless of their consent." (quoting OHIO RULES OF PROF'L CONDUCT R. 1.7 cmt. 38 (2007))); see also Pa. Bar Ass'n Legal Ethics & Prof'l Responsibility Comm., Informal Op. 90-80, 1990 WL 709625, at *1 (1990) (holding once the relationship between lender and borrower represented in the same transaction becomes adversarial, the attorney should withdraw).

¹⁴⁵ As noted in Part III.A, *supra*, the informed consent to Sullivan's client conflicts may have been provided via a prospective waiver.

¹⁴⁶ Ass'n of the Bar of the City of New York Comm. on Prof'l & Judicial Ethics, Formal Op. 2001-2, 2001 WL 1870202, at *3.

¹⁴⁷ Monroe H. Freedman, *Professionalism in the American Adversary System*, 41 EMORY L.J. 467, 469-70 (1992).

¹⁴⁸ See Examiner's Report, *supra* note 12, at 703-06.

¹⁴⁹ *Id.* at 704-05.

¹⁵⁰ *Id.* at 705.

¹⁵¹ See SORKIN, *supra* note 4, at 288.

lucrative Lehman broker-dealer unit in bankruptcy.¹⁵² Three days after negotiations ended and Lehman entered bankruptcy, Barclays purchased Lehman's broker-dealer unit and the North American investment banking operations for \$1.75 billion.¹⁵³

Sullivan may not have appreciated that Lehman and Barclays had potentially divergent interests in the negotiations. While Lehman unquestionably wished to sell, Barclays' primary motivation may have been to ensure that it could purchase Lehman's most valuable assets at a "fire-sale price" after a Lehman bankruptcy was assured.¹⁵⁴

There is some evidence to suggest that Sullivan failed to fully protect Lehman by not investigating whether Barclays may have overestimated its capability to acquire Lehman.¹⁵⁵ The British Financial Services Authority (FSA) had informed Barclays that any acquisition of Lehman would require a shareholder vote—a vote that could have taken up to two months to complete—and Barclays did not share this information with either Lehman or U.S. regulators.¹⁵⁶ Indeed, Lehman's negotiators were under the mistaken impression that regulatory approval was not an issue.¹⁵⁷ To actually conclude any purchase, Barclays would have had to either convince British regulators to waive the shareholder voting requirements or find a partner to guarantee Lehman's trades until it could obtain shareholder approval to proceed with the purchase.¹⁵⁸ Barclays never formally submitted paperwork for the FSA to review the transaction and did not follow up with a potential partner who expressed interest in backstopping Lehman's operations until the transaction could close.¹⁵⁹

Sullivan is obviously not responsible for the fact that Barclays was not as forthcoming as it could have been with information concerning FSA approval. It is nevertheless surprising that in a transaction of this size and significance that Lehman's lawyers did not insist on documentation to substantiate Barclays'

¹⁵² See *id.* at 363–64.

¹⁵³ See Ben White & Eric Dash, *Barclays Reaches \$1.75 Billion Deal for a Lehman Unit*, N.Y. TIMES, Sept. 17, 2008, at C1, available at <http://www.nytimes.com/2008/09/18/business/worldbusiness/18barclays.html>.

¹⁵⁴ *Id.*; see SORKIN, *supra* note 4, at 364, 378.

¹⁵⁵ A less charitable view would be that Barclays deliberately misrepresented its ability to purchase Lehman to ensure that Lehman would not find another acquirer. See SORKIN, *supra* note 4, at 378 (noting views that Barclays' interest may have been a "charade"). In this regard, it is significant that Barclays had not been known for closing large transactions or moving on an expedited basis, and before even speaking to Lehman, its CEO Robert Diamond pressed the Federal Reserve to ensure that Barclays would be the exclusive bidder for Lehman. See PAULSON, *supra* note 24, at 180, 184.

¹⁵⁶ See SORKIN, *supra* note 4, at 324; see also PAULSON, *supra* note 24, at 207 (noting Barclays first informed the Federal Reserve of the FSA requirements on September 14, 2008).

¹⁵⁷ Examiner's Report, *supra* note 12, at 707.

¹⁵⁸ See SORKIN, *supra* note 4, at 324.

¹⁵⁹ See Examiner's Report, *supra* note 12, at 708–09. The potential partner was Warren Buffet. *Id.* at 708.

position that British regulators would permit Barclays to acquire Lehman. Lehman and Sullivan were shocked to learn on September 14, 2008, that the FSA would not approve the acquisition.¹⁶⁰

Although there may have been insufficient time for Sullivan to obtain all of the documentation that would generally accompany a transaction of such size, Sullivan certainly could have had U.S. regulators contact the FSA to ensure that Barclays had the authority to proceed. Sullivan lawyers could have also contacted the FSA directly. Cohen was a personal friend of Callum McCarthy, the FSA's chairman.¹⁶¹ Cohen did eventually contact McCarthy, but only after the Federal Reserve informed him that the FSA would not approve Barclays' acquisition of Lehman.¹⁶² By then it was too late to resuscitate the deal or find another potential acquirer.¹⁶³

Of course, lawyers should not be ethically obligated to use all of their personal connections in the service of their clients.¹⁶⁴ Moreover, as noted, Cohen and other Sullivan attorneys were operating under massive time pressures, so it is understandable that there would be some oversights in terms of due diligence. But it is fair to ask whether different attorneys may have at least considered the possibility that Barclays was overestimating its interest and capacity to acquire Lehman to better position itself to acquire the most lucrative assets of the company in bankruptcy. Sullivan, conversely, seemed to take for granted that Barclays was serious in its intention to save Lehman and that its assurances concerning regulatory approval were believable.¹⁶⁵

The notion that even talented attorneys like Cohen can have blind spots when it comes to their clients is not novel. Professor Langevoort has suggested that lawyers practice defensive avoidance to ignore red flags concerning possible client misconduct.¹⁶⁶ In transactional work, defensive avoidance is an adaptive trait so that lawyers can commit to their clients' positions and serve as effective negotiators.¹⁶⁷ If this view is correct, then it is highly dubious that lawyers can simply drop their commitments to a client and adopt a more skeptical view of the client and the client's intentions simply because a lawyer is now negotiating against the client.¹⁶⁸ Rather, once a lawyer voluntarily commits to a client, "there is

¹⁶⁰ See SORKIN, *supra* note 4, at 349–50; PAULSON, *supra* note 24, at 212–14.

¹⁶¹ See SORKIN, *supra* note 4, at 350. Cohen had been Barclays' lawyer in the 1990s when McCarthy had been a Barclays banker. *Id.*

¹⁶² *Id.*

¹⁶³ See *id.*

¹⁶⁴ A complicating factor is that Lehman may have chosen to be represented by Sullivan because of the firm's political connections and those of Cohen in particular.

¹⁶⁵ See SORKIN, *supra* note 4, at 349 (noting Cohen was "incredulous" that the British regulators would not approve the sale of Lehman to Barclays).

¹⁶⁶ See Donald C. Langevoort, *Where Were the Lawyers?*, 46 VAND. L. REV. 77, 103–04 (1993).

¹⁶⁷ *Id.* at 104.

¹⁶⁸ This point is illustrated in the criminal law context by *Mickens v. Taylor*, 535 U.S. 162 (2002), as recounted by Professor Eldred. Mickens, a death row inmate who was

a strong subconscious need to maintain consistency in the face of subsequent events, to justify the commitment to themselves and others.”¹⁶⁹ This may especially be the case if the lawyer, as with Cohen and Sullivan vis-à-vis Barclays, has represented the client for a significant period of time.¹⁷⁰

Another likely contributing factor was that Sullivan had just represented Barclays in its failed acquisition of ABN Amro.¹⁷¹ Barclays had been bitterly disappointed by the failure of that deal.¹⁷² Lawyers commonly internalize their clients’ goals,¹⁷³ and Sullivan likely assumed that Barclays was still very serious about expanding its operations.¹⁷⁴ Time pressures would have amplified Sullivan’s blind spot concerning Barclays’ possible ulterior motives.¹⁷⁵

Lawyers—particularly highly accomplished lawyers—may believe that they can neatly cabin the representation of one client from the representation of another such that they will not be affected by their clients’ divergent interests.¹⁷⁶ The Model Rules encourage this belief by allowing attorneys to undertake a representation even if they recognize that they have a concurrent conflict of interest caused by their duties to another client as long as the criteria of Rule 1.7(b) are satisfied. An attorney’s commitment to a client, however, will not necessarily disappear because the lawyer is now negotiating against that client—particularly where a lawyer has had a longstanding and continuing relationship with the client. Sullivan likely would have been far less sanguine of Barclays’ ability to acquire Lehman if it had no previous relationship with Barclays.

convicted of murder and forced sodomy, claimed that he received ineffective assistance of counsel because his attorney had not disclosed that he previously represented Mickens’s victim. Eldred, *supra* note 92, at 44. Mickens alleged that because of his previous representation, the attorney had failed to investigate whether the victim had been a male prostitute and may have consented to sexual relations. *Id.* Although clearly troubled by the attorney’s lack of disclosure of the conflict, the Supreme Court rejected the ineffective assistance of counsel claim because the Court accepted the attorney’s testimony that his work was not hampered by this loyalty to the victim. *Id.* at 45–46.

¹⁶⁹ Langevoort, *supra* note 82, at 642.

¹⁷⁰ See Langevoort, *supra* note 166, at 103 (“[O]nce commitment has occurred, and especially if it is publicly expressed and repeated, what might be an obvious red flag . . . may not appear [as] such . . .”).

¹⁷¹ See SORKIN, *supra* note 4, at 261.

¹⁷² See *id.*

¹⁷³ Professor Kim has recently written on this issue. See generally Sung Hui Kim, *Naked Self-Interest? Why the Legal Profession Resists Gatekeeping*, 63 FLA. L. REV. 129, 148–49 (2011) (suggesting lawyers internalize their clients’ goals because they act as their clients’ “voice-box”). Professor Kim also relies on sociological data to suggest that lawyers even internalize the antiregulatory biases of their clients. See *id.* at 150–52.

¹⁷⁴ See SORKIN, *supra* note 4, at 271.

¹⁷⁵ See Mark A. Sargent, *Lawyers in the Perfect Storm*, 43 WASHBURN L.J. 1, 36 (2003).

¹⁷⁶ See Eldred, *supra* note 92, at 66 (stating people have a “self as moral” bias, which makes people believe they are “more objective than their average peer”).

The degree to which Sullivan perceived the interests of Barclays and Lehman as intertwined is further illustrated by Sullivan's actions immediately after Lehman filed for bankruptcy. Sullivan ceased to represent Lehman and began to represent Barclays in its efforts to acquire Lehman's North American investment banking and brokerage business.¹⁷⁷ As noted above, one Sullivan lawyer described this experience of transitioning from the representation of Lehman to the representation of Barclays as "switching from shirts to skins."¹⁷⁸ But according to Cohen, Lehman management had consented to Sullivan representing Barclays, and "[t]hey were pleased because they knew we could help expedite the deal and it was very important to get that deal done."¹⁷⁹

Under the Model Rules, an attorney is permitted to represent a client against a former client, even if the lawyer performed work for the former client in the same matter, provided that the former client provides informed consent.¹⁸⁰ Consequently, assuming such consent was obtained—and Cohen has stated that it was—it was not necessarily improper for Sullivan to represent Barclays against Lehman after having previously represented Lehman against Barclays.¹⁸¹ In Sullivan's view, the representation likely served the best interests of both clients because they both stood to benefit if Barclays were to acquire some of Lehman's businesses and keep them operating.¹⁸²

The problem with this view is that Lehman (and its creditors) may have fared better if its attorneys viewed the interests of Lehman and Barclays as conflicting. As noted, Barclays may have had incentives to overestimate its ability to acquire Lehman prior to the bankruptcy so as to better position itself to acquire Lehman's most valuable assets in the bankruptcy proceeding, and Barclays did ultimately acquire Lehman's lucrative North American investment banking and brokerage business as part of the proceeding.¹⁸³ Lehman's creditors were so outraged by the low price that Barclays paid¹⁸⁴ that they, along with the trustee for the Lehman estate, sought to reverse the sale, alleging that Barclays obtained a substantial windfall by buying Lehman assets at a deep discount from their fair value.¹⁸⁵

¹⁷⁷ See Byrne, *supra* note 11; Centers, *supra* note 4.

¹⁷⁸ SORKIN, *supra* note 4, at 379.

¹⁷⁹ Centers, *supra* note 4.

¹⁸⁰ MODEL RULES OF PROF'L CONDUCT R. 1.9(a) (2009).

¹⁸¹ One issue that Sullivan may not have considered is whether it obtained informed consent from the correct individuals. There is case law that suggests that Sullivan should have sought the consent of the bankruptcy trustee to proceed with the representation and not Lehman management. See *In re Allboro Waterproofing Corp.*, 224 B.R. 286, 292–93 (Bankr. E.D.N.Y. 1998) (holding only the trustee of a bankrupt corporation can give consent to attorney to represent divergent interests in same matter); *In re Jaegar*, 213 B.R. 578, 591 (Bankr. C.D. Cal. 1997) ("The duty of loyalty that an attorney owes to a former client in substantially related matters extends to the chapter 7 trustee of a corporation.").

¹⁸² Byrne, *supra* note 11.

¹⁸³ See SORKIN, *supra* note 4, at 455.

¹⁸⁴ See White & Dash, *supra* note 153 (noting Lehman sold at a "fire-sale price").

¹⁸⁵ See *In re Lehman Bros. Holdings Inc.*, 445 B.R. 143, 152 (Bankr. S.D.N.Y. 2011).

Although the bankruptcy court refused to reverse the sale, it acknowledged that the sale to Barclays was “hastily-arranged,” and it agreed with the creditors and the Lehman trustee that there had been serious lapses in disclosure.¹⁸⁶ The court also found that Barclays had been in a “uniquely advantageous position relative to any other institution that might be interested in competing for the Lehman franchise” because of its pre-petition negotiations with Lehman.¹⁸⁷ Nevertheless, the court ultimately concluded that the terms of the sale were fair when considered in the context of the unprecedented market turmoil caused by the Lehman bankruptcy.¹⁸⁸ The fact that Barclays’ attorneys had been Lehman’s attorneys was not discussed in the opinion.

Sullivan may have believed that its representation of Lehman would be unaffected by its close relationship with Barclays. The firm may have also believed that it acted in the best interests of Lehman by helping to conclude the sale of some of its businesses to Barclays after the bankruptcy.¹⁸⁹ Lehman and Barclays’ interests, however, were not aligned prior to bankruptcy, and if Lehman’s creditors and the bankruptcy trustee are to be believed, the law firm may have ultimately assisted Barclays in obtaining a windfall when it purchased Lehman’s North American brokerage and investment banking business. That transactional lawyers can often effectively represent one client against another client is reflected in ethics opinions,¹⁹⁰ but, as Sullivan’s representation of Lehman in negotiations with Barclays underscores, lawyers may not be able to easily set aside their commitments to one client in the service of another.

C. Reputation with Regulators

Thus far, this Article has considered whether Sullivan’s relationships with other clients may have impacted the representation that it was able to provide to Lehman. This section considers whether Sullivan’s interest in preserving its own reputation with government regulators gave rise to a conflict of interest that led it to represent Lehman with less zealousness than may have been necessary to avert a Lehman bankruptcy.

A concurrent conflict of interest exists under Model Rule 1.7(a)(2) if “there is a significant risk that the representation of one or more clients will be materially limited by . . . a personal interest of the lawyer.”¹⁹¹ The comment to the Rule does not define “personal interest” but suggests that attorneys may have a personal

¹⁸⁶ *See id.* at 205.

¹⁸⁷ *Id.* at 154.

¹⁸⁸ *Id.* at 154–55 (noting the transaction—if approved—would “save a multitude of financial sector jobs” in the volatile Wall Street job market).

¹⁸⁹ *See* Byrne, *supra* note 11.

¹⁹⁰ *See, e.g.,* Ass’n of the Bar of the City of New York Comm. on Prof’l & Judicial Ethics, Formal Op. 2006-1, 2006 WL 1662501, at *6 (2006); Ass’n of the Bar of the City of New York Comm. on Prof’l & Judicial Ethics, Formal Op. 2001-2, 2001 WL 1870202, at *3 (2001).

¹⁹¹ MODEL RULES OF PROF’L CONDUCT R. 1.7(a)(2) (2009).

interest that gives rise to a conflict of interest if they are seeking employment with their clients' adversary or with the law firm representing the adversary.¹⁹² A concurrent conflict of interest exists under these circumstances because there is a danger that the attorney's interest may have an adverse effect on the attorney's loyalty to the client.¹⁹³

Although Cohen was under consideration for the position of Deputy Secretary of the Treasury in 2009,¹⁹⁴ there is no evidence to suggest that he was seeking a government position during the time that he represented Lehman. Nevertheless, Sullivan as a firm arguably had a "personal interest" in maintaining its strong reputation with the Treasury and the Federal Reserve so that leading financial institutions would continue to seek the firm's services in working with these and other government agencies.¹⁹⁵ If Sullivan's interest in preserving its reputation "materially limited" the representation of Lehman, then the representation was conflicted pursuant to Rule 1.7(a)(2), and Sullivan should have sought the informed consent of Lehman to proceed with the representation.¹⁹⁶

To be sure, all attorneys have an interest in maintaining positive relationships with individuals and agencies with whom they interact on their clients' behalf. If attorneys engage in "Rambo-style" tactics¹⁹⁷ in the service of their clients, they will have difficulty working with the same individuals and entities in the future, regardless of whether the attorneys can expect to be sanctioned. For this reason, as Professor Zacharias has observed, even if ethics rules did not prohibit lawyers from lying in the course of representing their clients, most attorneys would shy

¹⁹² *Id.* R. 1.7 cmt. 10.

¹⁹³ *See id.*

¹⁹⁴ *See* Michael M. Phillips, *Cohen Drops Bid for Treasury*, WALL ST. J. (Mar. 12, 2009 5:54 PM), <http://online.wsj.com/article/SB123689377819011905.html>.

¹⁹⁵ *See* Jonathan R. Macey & Geoffrey P. Miller, *Reflections on Professional Responsibility in a Regulatory State*, 63 GEO. WASH. L. REV. 1105, 1106 (1995) (suggesting if a lawyer has substantial experience with a government agency, alienating the agency could result in loss in value of attorney's investment in his relationship with the agency); *see also* Philadelphia Bar Ass'n Prof'l Guidance Comm. Phila. Ethics Op. 88-11 (1988), *available at* <http://www.philadelphiabar.org/page/EthicsOpinion88-11?appNum=2> (suggesting attorney has concurrent conflict of interest where he received referrals from his client's adversary).

¹⁹⁶ *See* MODEL RULES OF PROF'L CONDUCT R. 1.7(a)(2); *id.* R. 1.7(b)(4).

¹⁹⁷ "Rambo litigation" is characterized by "deception, nastiness, intimidation and general lack of civility among lawyers." Gideon Kanner, *Welcome Home Rambo: High-Minded Ethics and Low-Down Tactics in the Courts*, 25 LOY. L.A. L. REV. 81, 81 (1991); *see also* Jean M. Cary, *Rambo Depositions: Controlling an Ethical Cancer in Civil Litigation*, 25 HOFSTRA L. REV. 561, 562 (1996) ("In law offices across the country, the John Rambos of the legal world are invading deposition rooms, yelling obscenities at opposing counsel, and attempting to mow down their 'enemies' with nasty verbal invectives. Unlike the silver screen stars, the John Rambos of the legal world are not heroes. Instead, they are ruining the practice of law for those engaged in the legitimate process of civil discovery.").

away from such behavior.¹⁹⁸ Attorneys who seek to preserve their good reputations among regulators and members of the legal profession will not, in the vast majority of cases, be materially limited in representing their clients and will not therefore have a conflict of interest under Rule 1.7(a)(2).¹⁹⁹ To the contrary, lawyers' willingness to temper their zeal may be crucial to the advancement of a client's matter.²⁰⁰

Nevertheless, it is certainly possible that an attorney's interest in preserving his reputation becomes so strong that he is unable to represent his client effectively. For example, Professor Freedman has in the past criticized the Securities Bar for failing to zealously represent clients to ingratiate itself with the Securities and Exchange Commission:

What has turned the Securities Bar from the attorneys' traditional role of champions of their clients into wholly owned subsidiaries [of] the enforcement conglomerate? . . . [I]ncentives [from the Commission] include rewards as well as punishments.

The rewards consist of favored treatment to some lawyers in their appearances before the Commission. . . . The punishments are directed toward intimidating attorneys into foregoing zealous advocacy on behalf of their clients.²⁰¹

More recently, Professors Macey and Miller have suggested that this phenomenon is not confined to discrete segments of the organized bar but potentially all lawyers who represent clients before government agencies. They write:

[T]he importance to clients of hiring lawyers with expertise and a proven track record in representing clients before particular regulatory agencies creates a situation in which lawyers representing clients before agencies easily are "captured" by the agencies before whom they practice. In particular, because private-sector lawyers are often "repeat players" in their actions before governmental regulators, they have strong incentives not to alienate the bureaucrats. . . . Repeat player representation by law firms can lead to less than zealous representation because lawyers balance the immediate interests of their clients against the long-term interests of their firms in maintaining a cordial relationship with a particular bureaucrat or bureaucracy.²⁰²

¹⁹⁸ Zacharias, *Effects of Reputation*, *supra* note 5, at 202.

¹⁹⁹ There appear to be no recorded cases of attorneys sanctioned for being concerned with their reputations at the expense of their clients' interests.

²⁰⁰ See Zacharias, *Effects of Reputation*, *supra* note 5, at 179.

²⁰¹ Monroe Freedman, *A Civil Libertarian Looks at Securities Regulation*, 35 OHIO ST. L.J. 280, 285 (1974) (citation omitted) (internal quotation marks omitted).

²⁰² Macey & Miller, *supra* note 195, at 1106.

That clients are entitled to zealous representation is a fundamental tenet of the American legal profession,²⁰³ although the degree to which attorneys should zealously advocate for their clients is obviously a subject of intense dispute among ethics scholars.²⁰⁴ But if Professors Macey and Miller are correct, attorneys and firms who are repeat players like Cohen and Sullivan may be unwilling to fully press their clients' interests because they cannot risk alienating government regulators.²⁰⁵

There is no doubt that Cohen had a particularly strong relationship with the Federal Reserve and other banking regulators at the time Sullivan represented Lehman. According to Sorkin, "Geithner often relied upon [Cohen] to understand the Federal Reserve's own powers."²⁰⁶ Such was Cohen's relationship with the Federal Reserve that after Bear's stock price dropped precipitously on March 12, 2008, due to concerns about its investments in mortgage-backed securities, Cohen, who had just begun representing Bear that day, was able to reach Geithner at 10:45 PM to urge the Federal Reserve to lend money directly to Bear.²⁰⁷

Cohen's level of access to Geithner and other government officials was probably one of the main reasons that Bear, Lehman, and so many other financial institutions sought Cohen's counsel during the financial crisis.²⁰⁸ But to maintain his and Sullivan's reputation with governmental regulators and to continue to enjoy preferential access to them, Cohen may have been disinclined to directly confront the Federal Reserve and the Treasury on Lehman's behalf, even as a Lehman bankruptcy became increasingly likely.

This was not a concern for Lehman's bankruptcy attorneys at Weil, Gotshal, & Manges, LLP (Weil).²⁰⁹ When Tom Baxter, the general counsel for the New

²⁰³ The words "zealous" and "zealously" appear eight times in the *Model Code of Professional Responsibility*. See, e.g., MODEL CODE OF PROF'L RESPONSIBILITY EC 7-1 (1980) ("The duty of a lawyer, both to his client and to the legal system, is to represent his client zealously within the bounds of the law."). The notion that lawyers should zealously advocate for their clients is also reflected in the Model Rules. See MODEL RULES OF PROF'L CONDUCT R. 1.3 cmt. 1 (2009) ("A lawyer must also act with commitment and dedication to the interests of the client and with zeal in advocacy upon the client's behalf.").

²⁰⁴ Compare Monroe H. Freedman, *In Praise of Overzealous Representation—Lying to Judges, Deceiving Third Parties, and Other Ethical Conduct*, 34 HOFSTRA L. REV. 771, 772 (2005) (arguing zealous representation of the client can even require the attorney to violate other disciplinary rules), with DAVID LUBAN, *LAWYERS AND JUSTICE* 58 (1988) (criticizing the "adversary system excuse" when it causes lawyers to violate the dictates of morality).

²⁰⁵ This may particularly be the case for lawyers like Cohen with highly specialized areas of practice. See Macey & Miller, *supra* note 195, at 1110.

²⁰⁶ SORKIN, *supra* note 4, at 193.

²⁰⁷ See Kate Kelly, *Fear, Rumors Touched Off Fatal Run on Bear Stearns*, WALL ST. J. (May 28, 2008), <http://online.wsj.com/article/SB121193290927324603.html>.

²⁰⁸ See *supra* note 30.

²⁰⁹ Weil is a New York-based international law firm with offices located in Beijing, London, and other cities. See *Offices*, WEIL, <http://www.weil.com/locations/> (last visited Aug. 5, 2012).

York Federal Reserve, informed Weil partner Harvey Miller that Lehman had to immediately file for bankruptcy, the two lawyers had the following exchange:

"Tom," Miller persisted, "This makes no sense. Yesterday, no one from the Fed was talking to us about bankruptcy and now we have to have a filing ready before midnight? And what is the magic of midnight? The only way we could ever file, and it won't be by midnight, is with a skinny Chapter 11 petition. What will that accomplish?"

"Well, we have our program," Baxter repeated.

Miller stood up, his six-foot-two frame looming over the other lawyers.

"What," he slowly bellowed, "is this *program*?"

Baxter just stared uneasily, offering no immediate answer.

"If Lehman goes into bankruptcy, totally unprepared, there's going to be Armageddon," Miller warned. "I've been a trustee of broker-dealers, little cases, and the effect of their bankruptcies on the market was significant. Here, you want to take one of the largest financial companies, one of the biggest insurers of commercial paper, and put it in bankruptcy in a situation where this has never happened before. What you're going to do is take liquidity out of the market. The markets are going to collapse." Miller waved his finger, and repeated, "This will be Armageddon."²¹⁰

Although Miller was unable to convince the government that Lehman should not file for bankruptcy, even after further heated exchanges,²¹¹ his protestations led the Federal Reserve to loan money to Lehman's broker-dealer business and to allow the unit to delay its bankruptcy filing.²¹² Miller's advocacy ensured that Lehman's broker-dealer business would continue to operate, which was vital to preserving the unit's value until a buyer could be found.²¹³ Despite the gravity of Lehman's situation and the fact that the government had already decided on a course of action, Miller pressed Lehman's case in an aggressive manner that could have alienated officials at the Federal Reserve and the Treasury. It is conceivable that a more deferential approach would have achieved the same result; however, as a bankruptcy attorney whose business was not dependent on a good relationship

²¹⁰ SORKIN, *supra* note 4, at 357–58.

²¹¹ See *id.* at 359 (noting Miller's mocking of the Federal Reserve's plan to mollify the market with press releases).

²¹² See *id.* at 11–17.

²¹³ See Press Release, Sec. Exch. Comm'n, Statement on Proposed Lehman Bros. Acquisition by Barclays (Sept. 17, 2008), available at <http://www.sec.gov/news/press/2008/2008-206.htm>.

with either the Treasury or the Federal Reserve, Miller was free to advocate for Lehman in whatever manner he thought could best achieve Lehman's objectives.

Conversely, Cohen's representation of banking clients depends in large part on strong relationships with the Treasury, Federal Reserve, and other government regulators. Cohen had to be mindful of these important and lucrative connections and would have been disinclined to directly confront banking regulators to protect these connections.

For example, Cohen believed that no deal could be completed for Lehman without government assistance²¹⁴—a view that was shared by Geithner²¹⁵ and many outside observers.²¹⁶ Bank of America and Barclays had also informed regulators that they would not purchase Lehman without financial assistance from the government.²¹⁷ However, there seemed to be no organized effort by Cohen and Sullivan to pressure the government to reverse its position on providing monetary assistance to Lehman in order to facilitate a sale.

According to Secretary Paulson, the Federal Reserve did not have the authority to inject capital into Lehman, and Lehman's assets were insufficient to support a loan large enough to avoid Lehman's collapse.²¹⁸ But many observers discount this explanation and believe that political considerations explain why Lehman was allowed to fail while other banks, including Sullivan client Bear,²¹⁹ were not.²²⁰ Secretary Paulson was determined to not be "Mr. Bailout"²²¹ after political figures and the public-at-large had sharply criticized the Treasury and the

²¹⁴ SORKIN, *supra* note 4, at 295.

²¹⁵ *Id.*

²¹⁶ See Matthew Goldstein, *Lehman Endgame Looks Ugly*, BUS. WEEK (Sept. 12, 2008), http://www.businessweek.com/investing/insights/blog/archives/2008/09/lehman_endgame_looks_ugly.html ("Without that kind of government-backed guarantee, it's by no means certain any bank will be willing to take on the risk of adding Lehman's questionable commercial real estate assets to its balance sheet."); see also *id.* ("There's very little chance anyone will do a deal for Lehman without the government stepping in.").

²¹⁷ See SORKIN, *supra* note 4, at 283 (noting Barclays was seeking government money to purchase Lehman); PAULSON, *supra* note 24, at 184–86 (noting Bank of America would not purchase Lehman without governmental or private help).

²¹⁸ See Examiner's Report, *supra* note 12, at 11–12.

²¹⁹ See, e.g., Byrne, *supra* note 11; Centers, *supra* note 4.

²²⁰ See, e.g., Michael Lewis & David Einhorn, Op-Ed., *The End of the Financial World As We Know It*, N.Y. TIMES, Jan. 4, 2009, at WK9 (New York ed.) available at <http://www.nytimes.com/2009/01/04/opinion/04lewiseinhorn.html?pagewanted=all/> (noting inconsistency in the government's strategy by providing a bailout for Bear while allowing Lehman to fail); SORKIN, *supra* note 4, at 536 (same); cf. PAULSON, *supra* note 24, at 225 (claiming that "I ought to have been more careful with my words" when mentioning moral hazard in the context of the Lehman bankruptcy).

²²¹ SORKIN, *supra* note 4, at 282.

Federal Reserve for extending a \$29 billion loan to Bear, backed by the company's questionable mortgage assets.²²²

The government may have been unwilling to fund a solution for Lehman no matter the actions of Lehman's attorneys. As Lehman's counsel, however, Sullivan was not required to go along with Secretary Paulson's determination that he not serve as "Mr. Bailout."²²³ Sullivan could have, for example, turned to Secretary Paulson's superiors to emphasize the dangers that a Lehman bankruptcy would bring. In this regard, it is noteworthy that George H. Walker IV—the former President's second cousin—was head of Lehman's investment management unit.²²⁴ At the urging of a subordinate and apparently without speaking to Sullivan, Mr. Walker sought to contact the White House after the Federal Reserve and the Treasury had decided that Lehman should file for bankruptcy.²²⁵ By this time, however, it was much too late to save the company.²²⁶

The decision to circumvent Secretary Paulson would not only have made strategic sense, but it also could have been justified given Secretary Paulson's own conflict of interest as the former CEO of Goldman, one of Lehman's primary competitors.²²⁷ Although Secretary Paulson surely did not wish to see Lehman fail, his employment at Goldman afforded him a dim view of Lehman. According to his account of the financial crisis:

I was frankly skeptical about [Lehman's] business mix and its ability to attract a buyer or strategic investor. . . . Founded in 1850, Lehman had a venerable name but a rocky recent history. Dissension had torn it apart before it was sold to American Express in 1984. A decade later, it was spun off in an initial public offering. Dick Fuld, as CEO, had done a remarkable job of rebuilding it. But in many ways, Lehman was really only a 14-year-old firm, with Dick as its founder. I liked Dick Fuld . . . but like many "founders," his ego was entwined with the firm's.²²⁸

²²² See PAULSON, *supra* note 24, at 117, 120 (acknowledging action to save Bear Stearns was "hugely controversial" and was "bad precedent"); see also SORKIN, *supra* note 4, at 282, 302 (noting backlash to the Bear bailout).

²²³ SORKIN, *supra* note 4, at 282.

²²⁴ *Id.* at 361.

²²⁵ See *id.* at 362. Another potentially useful contact was Jeb Bush, the former governor of Florida, who served as an advisor to Lehman's private equity business. See *id.* at 284.

²²⁶ See *id.* at 362.

²²⁷ Secretary Paulson has been sharply criticized for maintaining close ties with his former colleagues at Goldman at the expense of employees of other investment firms. See Gretchen Morgenson & Don Van Natta Jr., *Paulson's Calls to Goldman Tested Ethics*, N.Y. TIMES (Aug. 8, 2009), <http://www.nytimes.com/2009/08/09/business/09paulson.html?pagewanted=all/>.

²²⁸ PAULSON, *supra* note 24, at 123; see also Evan Thomas, *Paulson's Complaint*, NEWSWEEK (May 15, 2009, 8:00 PM), <http://www.newsweek.com/2009/05/15/paulson-s-complaint.html> ("The Lords of Goldman, who tend to come from Ivy League schools,

Because of his background at Goldman, Secretary Paulson may have also perceived Lehman as less integral to the economy than it actually was²²⁹ and may have been less willing than other members of the Bush administration to consider financing Lehman. Indeed, much of Secretary Paulson's attention—even as Lehman appeared to be headed for bankruptcy—was focused on finalizing a merger between Merrill and Bank of America.²³⁰ Nevertheless, Sullivan did not appear to question whether Lehman was well served by dealing directly with Secretary Paulson.

Even after British regulators signaled that they could not approve the Barclays' purchase of Lehman unless the U.S. government was willing to help limit Barclays' potential exposure,²³¹ there was no concerted effort on the part of Sullivan to secure government assistance for the transaction. When informed by Secretary Paulson that the FSA had refused to approve the sale of Lehman to Barclays, Cohen's reaction was to pressure the FSA to change its view, as opposed to exhorting Secretary Paulson to provide immediate monetary assistance so that the company would have additional time to either complete a deal with Barclays or to find another acquirer.²³²

It is possible that Sullivan exerted pressure on U.S. government officials in private and that its efforts in this regard have not been reported. Moreover, if Lehman were to somehow survive, the strategy of working with regulators could prove in the long-term interest of the company. But if Sullivan truly believed that a sale of Lehman could not be completed without government assistance,²³³ the strategy of working almost entirely on a private sector solution for Lehman—even as the deal with Barclays collapsed and bankruptcy was imminent—was highly suspect.

However, to press for financial assistance for Lehman would have posed a threat to Sullivan's relationships with the Treasury and the Federal Reserve. Regulators tend to value "lawyers . . . who take reasonable positions, screen their clients' desires, and incorporate the decision makers' needs."²³⁴ In particular, seeking to circumvent Secretary Paulson or make an issue of his conflict of interest

looked down on the hustlers at lower-ranked firms like Lehman, who came out of state schools and the trading pits.").

²²⁹ See Thomas, *supra* note 228.

²³⁰ See *id.*

²³¹ See SORKIN, *supra* note 4, at 348; see also *id.* at 345 (indicating the British government was seeking to have someone guarantee Lehman's trades until the transaction with Barclays could be completed); James Quinn, *Hank Paulson Blames FSA for Lehman Failure*, TELEGRAPH (Jan. 30, 2010, 10:11 PM), <http://www.telegraph.co.uk/finance/globalbusiness/7111156/Hank-Paulson-blames-FSA-for-Lehman-failure.html>.

²³² See SORKIN, *supra* note 4, at 349–50. Given that Sullivan's business is predominantly focused on the United States, Cohen may have felt more comfortable challenging British regulators than American ones.

²³³ See *id.* at 295.

²³⁴ See Zacharias, *Effects of Reputation*, *supra* note 5, at 191.

as the former CEO of Goldman would have almost certainly resulted in Sullivan losing the access that it previously enjoyed to Treasury and Federal Reserve officials. Having brokered the unpopular Bear bailout, Sullivan may have also been wary to demand that financial regulators now act to save Lehman.

To the extent that the decision to generally defer to government regulators was made in tandem with Lehman, Sullivan's interest in preserving its reputation among government regulators may not have had an adverse impact on the representation that Lehman received. Indeed, Sullivan could have reasonably advised, and Lehman may have believed, that the company's best chance of survival was to comply with all of the government's demands. Nevertheless, since it was in Sullivan's self-interest to protect its reputation with the Treasury and the Federal Reserve, it is fair to ask whether Sullivan could objectively assess what course of action would be best for Lehman. Sullivan's concern for the wishes of government regulators was so strong that when Secretary Paulson ordered Cohen to exclude Lehman CEO Richard Fuld from meetings at the Federal Reserve that would decide Lehman's future, Cohen did as he was told.²³⁵

The decision to work cooperatively with regulators may have been prudent when Sullivan's representation of Lehman began. But with the economy rapidly deteriorating and it becoming increasingly certain that Lehman would need a government bailout of some form to survive, Sullivan should have considered whether Lehman would have been better served by attorneys who could challenge recalcitrant regulators in the Treasury and the Federal Reserve to provide financial assistance to facilitate Lehman's sale. The Model Rules in their current form simply do not require that attorneys engage in this kind of critical self-analysis.

IV. LEHMAN AND LEGAL ETHICS

Thus far, this Article has sought to show that Sullivan's relationships with its other clients and its concern for its reputation among government regulators appears to have interfered with its representation of Lehman during the financial crisis. The fact that Lehman was a sophisticated client and may have consented to the conflicts of interest discussed in this Article in accordance with Rule 1.7 did not ensure that its interests would be protected.

A natural reaction to this Article's case study of the representation that Lehman received is to question whether it is truly worrisome that Lehman did not receive ideal representation. Lehman knowingly chose to be represented by a law firm that represents numerous banking clients, and it should have known that Sullivan would have duties and responsibilities to Merrill and other banks that could impact the representation that it received. Similarly, assuming Lehman knew that Barclays was a Sullivan client, it should have surmised that Sullivan would not be as rigorous in its due diligence as it would have been if it had no previous relationship with Barclays. Lastly, if Lehman wanted attorneys who would be

²³⁵ See SORKIN, *supra* note 4, at 306.

more aggressive and confrontational with regulators, it could have chosen to be represented by lawyers with reputations for these traits.

This Article's case study of Sullivan's representation of Lehman may simply suggest that clients should not necessarily turn to the most well-connected lawyers and law firms if they need to have their interests defended aggressively. Lehman should have considered whether Sullivan could be expected to do everything possible to avert a Lehman bankruptcy when the firm also had close relationships with other banks and had a strong interest in preserving its reputation with government regulators. Other firms may have had more flexibility to advance Lehman's interests because they had not been involved in negotiating the enormously unpopular rescue of Bear, for example.²³⁶

Lehman's experience should also cast some doubt, however, on the practice of allowing law firms to solicit prospective waivers of conflicts of interest. The Model Rules contemplate that "experienced users of legal services" can provide "general and open-ended consent" to future conflicts of interest,²³⁷ and large law firms like Sullivan view prospective waivers of client conflicts as "a routine large firm practice."²³⁸ Through these waivers, Lehman may have consented to Sullivan's client conflicts with respect to Merrill and Barclays. Consequently, Sullivan may not have disclosed that Merrill had contacted it to learn of the progress of negotiations between Lehman and Bank of America and would not have necessarily been required to do so under Rule 1.7. Similarly, while Lehman was undoubtedly aware that Barclays was a long-time Sullivan client, Sullivan would not have been required to inform Lehman of the extent of the relationship, even after Barclays emerged as Lehman's most likely acquirer.

Although some commentators, and law firms themselves, have defended the propriety of prospective waivers of conflict of interest for sophisticated clients,²³⁹ Professor Fox may well be correct when he suggests:

It does not matter how smart a client is, how experienced a client is, how sophisticated a client is, how many lawyers a client has representing him or her, for how many years he or she has hired lawyers, or how many lawyers he or she has hired . . . Clients do not know anything about this

²³⁶ This is not to say that Sullivan's competitors might not have had conflicts of their own, but Sullivan's representation appeared to have been particularly conflicted because it represented so many institutions during the financial crisis and because Mr. Cohen "has been a counsel to just about every major player on Wall Street." Jennifer Parker, *Third Top Treasury Pick Withdraws from Consideration*, ABC NEWS (March 12, 2009, 2:30 PM) <http://abcnews.go.com/blogs/politics/2009/03/another-top-tre/>. Indeed, Cohen allegedly withdrew from consideration for a position with the Treasury Department because of the extent of his relationships with the banks that he would have been regulating. *See id.*

²³⁷ MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. 22 (2009).

²³⁸ *See* DiLernia, *supra* note 98, at 98.

²³⁹ *See id.* at 126–27 (noting widespread acceptance of prospective waivers of conflicts of interest among large-firm lawyers); Lerner, *supra* note 98, at 971–73; Wolfram, *supra* note 60, at 44.

prospective waiver except that they are informed that they are not informed.²⁴⁰

Even if one believes that prospective waivers should be permitted in some circumstances—such as to permit lawyers from different offices of a firm to work on matters that are in conflict—there is a far greater risk that a lawyer's loyalty to one client will compromise his ability to represent the other client effectively when it is the same lawyer or group of lawyers working on both matters.²⁴¹

The rationale for treating sophisticated clients differently under Rule 1.7 is that sophisticated clients ostensibly do not need as much information as unsophisticated clients do because they can monitor and supervise their attorneys and dismiss them if they are not performing adequately because of conflicts of interest.²⁴² However, unless it is assumed that sophisticated clients generally micro-manage their attorneys, which would partly defeat the purpose of retaining sophisticated law firms such as Sullivan, they may be unable to ascertain their attorneys' precise conflicts of interest or monitor the conflicts' impact.²⁴³ Even if sophisticated clients like Lehman were to inform themselves of all of their attorneys' conflicts of interest, the clients may not be able to entirely "fend for themselves" because no client can fully anticipate what a representation will require, and a conflict of interest may not seem problematic until it is too late.²⁴⁴

The Model Rules disregard these realities by encouraging lawyers to think of conflicts of interest in static terms: they exist before the lawyer accepts the representation, arise after the representation has begun, or are entirely unforeseen, and the lawyer is asked to assess the conflict's significance and make the appropriate disclosures.²⁴⁵ But the significance of a conflict of interest can change over the course of a representation. Sullivan's relationships with Merrill and Barclays would have been of minimal relevance to Lehman when Sullivan began the representation, and Lehman would have viewed Sullivan's relationships with government regulators as an asset. These relationships became far more

²⁴⁰ Fox, *supra* note 98, at 716.

²⁴¹ This point seems to be conceded even by some defenders of prospective waivers. See Jones & Davis, *supra* note 5, at 594 ("[L]aw firms as institutions are capable of being 'loyal' to different clients through different lawyers and . . . sophisticated clients are capable of understanding that."); see also *id.* (suggesting current conflict rules may be effective for small firms but questioning their utility "in firms of hundreds of lawyers representing clients in dozens of offices in multiple countries of the world").

²⁴² See *id.* at 597; McMunigal, *supra* note 5, at 873.

²⁴³ See Fox, *supra* note 5, at 574 ("[W]hen . . . law firms talk about sophisticated clients they are talking about organizations, largely corporations, that are indeed often extremely sophisticated, though even more often hopelessly naive. . . . [Their sophistication] has little or nothing to do with our profession, our skill sets, [or] our rules of professional conduct.").

²⁴⁴ Macey & Miller, *supra* note 195, at 1111.

²⁴⁵ See MODEL RULES OF PROF'L CONDUCT R. 1.7 cmts. 3–5 (2009).

problematic for Lehman, however, as its list of potential acquirers grew shorter and the company's prospects for survival diminished.

Of course, no professional responsibility rule can fully insulate clients from attorney conflicts of interest. But Rule 1.7 may actually make it more likely that a client will receive conflicted representation. By establishing a step-by-step process for attorneys to follow to carry out a conflicted representation, Rule 1.7 encourages lawyers to think of conflicts of interest as obstacles to be circumvented.²⁴⁶ Lawyers can easily convince themselves that because they are following the Rule's minimal steps, they are acting ethically and a conflict of interest will not be problematic. The client's role is to consent to the conflict of interest that has been identified by the attorney, which, as noted in Part II.B of this Article, the client will usually provide. The lawyer will rarely receive pushback from the client even as the lawyer's performance suffers because Rule 1.7 simply does not contemplate an ongoing dialogue with the client concerning the conflict of interest and its impact on the representation.

Lastly, Sullivan's representation of Lehman illustrates that there can be a societal interest in the "vigorous development" of client positions outside of litigation,²⁴⁷ and, to the extent that a sophisticated client fails to fully safeguard its interests by closely monitoring its attorney's conflicts of interest, the consequences can extend to society as a whole. The consensus view is that allowing Lehman to enter into bankruptcy was "the mistake of a lifetime."²⁴⁸ Lehman may have been unable to avoid bankruptcy regardless, but it would have been better served if its attorneys' ability to act in its interest was not undermined by client conflicts and reputational interests.

The course of Sullivan's representation of Lehman during the financial crisis should engender increased skepticism as to the desirability of conflicted representation for even highly sophisticated clients. The next section draws on the lessons of Sullivan's representation of Lehman to suggest specific modifications to Rule 1.7.

V. PROPOSED MODIFICATIONS TO RULE 1.7

Rule 1.7 purports to protect clients from their attorneys' concurrent conflicts of interest by requiring attorneys to disclose their conflicts and for clients to provide informed consent to these conflicts. Assuming that clients are willing to consent to a particular conflict, lawyers still cannot carry out the representation

²⁴⁶ Professors Baron and Greenstein have persuasively argued that the structure of legal education encourages lawyers to think of ethical rules as "occasional potholes in the road—danger areas that the conscientious and attentive lawyer should either avoid altogether or navigate through carefully and safely." Jane B. Baron & Richard K. Greenstein, *Constructing the Field of Professional Responsibility*, 15 NOTRE DAME J.L. ETHICS & PUB. POL'Y 37, 48 (2001).

²⁴⁷ MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. 17.

²⁴⁸ See *The Price of Failure*, ECONOMIST, Oct. 4, 2008, at 82, available at <http://www.economist.com/node/12342689>.

unless they believe that they can provide “competent and diligent representation,”²⁴⁹ and the Model Rules entirely prohibit some representations.²⁵⁰

However, even if one assumes that lawyers honestly disclose their conflicts of interest—despite it being against their financial interest to do so—clients routinely waive them,²⁵¹ and the vast majority of lawyers will conclude that they can competently and diligently represent their clients notwithstanding conflicts of interest. Rule 1.7 does not mandate that attorneys consider whether their conflicts of interest will frustrate the objectives of the representation, and the Rule may, in fact, provide false assurance to lawyers that their conflicts of interest are not problematic as long as they have disclosed their conflicts and their clients have consented to them.

There are undoubtedly some conflicts of interest that are so minor in nature that they will not affect the representation that a client will receive. For example, if a client has a long-standing relationship with a large law firm, the client may want the firm to represent him, even if some of the firm’s lawyers represent the adversary in a small, unrelated matter. The firm may well be able to provide effective representation to both clients.²⁵² Many conflicts of interest, however, will be far more difficult to evaluate and could ultimately jeopardize the representation that attorneys are able to provide, even if their clients are prepared to consent to the conflicts.

Although sophisticated clients like Lehman can be expected to better assess their attorneys’ conflicts of interest, the widespread use of prospective waivers of conflicts of interest by large law firms means that many of these firms’ clients may be unaware of their attorneys’ specific conflicts; even if the clients make themselves aware of these conflicts, they may have difficulties gauging their full significance until it is too late. When Sullivan began representing Lehman, Lehman certainly would not have anticipated that it and Merrill would both be seeking to merge with Bank of America. Nor could Lehman have expected that

²⁴⁹ MODEL RULES OF PROF’L CONDUCT R. 1.7(b)(1).

²⁵⁰ See *id.* R. 1.7(b)(3).

²⁵¹ See *supra* Part II.B.

²⁵² For a trenchant criticism of the presumption that an attorney should not represent one client against another client when the two representations are unrelated, see Daniel J. Bussel, *No Conflict*, 25 GEO. J. LEGAL ETHICS 207 (2012). See also Jones & Davis, *supra* note 5, at 592–93 (noting that the practice in England and many other countries is to allow a lawyer to take a representation directly adverse to an existing client when the matters are unrelated). In the United States, Texas alone follows the English rule. See *id.* at 593. Although the merits of MODEL RULES OF PROF’L CONDUCT R. 1.7(a)(1) are beyond the scope of the Article, eliminating the Rule would not alleviate the attorney’s obligation to consider case-by-case whether his or her loyalty to a client is likely to “materially limit” his or her ability to represent an individual or entity against that client pursuant to MODEL RULES OF PROF’L CONDUCT R. 1.7(a)(2). In addition, if one assumes that most clients would seek to fire their lawyers if they litigate against them without consent, the only circumstance that a lawyer would willingly sue a current client is when the lawyer wishes to drop that client for a higher-paying one. See Fox, *supra* note 5, at 577.

Barclays would emerge as its only viable acquirer or that the government would prefer for Lehman to file for bankruptcy rather than provide monetary assistance to facilitate the investment bank's purchase.

Rule 1.7(b) should require attorneys to consider the extent to which their conflicts of interest will have a negative effect on their clients' objectives as opposed to attorneys' ability to provide "competent and diligent representation."²⁵³ In addition, the Rule should seek to ensure that clients receive sufficient information during the course of a representation to revoke their consent to their attorneys' conflicts of interest when these conflicts' circumstances change. In light of the foregoing, Rule 1.7 should be modified as follows:

Model Rule 1.7

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that ~~the lawyer will be able to provide competent and diligent representation to each affected client~~ **the conflict of interest will not frustrate the lawyer's ability to meet the client's objectives in the representation**²⁵⁴;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

Model Rule 1.7 Comment

[21] **The lawyer shall regularly consult with the client as to the conflict of interest's effect on the representation.** A client who has given consent to a conflict may revoke the consent and, like any other client, may terminate the lawyer's representation at any time. Whether revoking consent to the client's own representation precludes the lawyer from continuing to represent other clients depends on the circumstances, including the nature of the conflict, whether the client revoked consent because of a material change in circumstances, the reasonable expectations of the other client, and whether material detriment to the other clients or the lawyer would result.

Although it is impossible to know whether Sullivan and Lehman would have acted differently if Rule 1.7(b) as modified above had governed their relationship,

²⁵³ MODEL RULES OF PROF'L CONDUCT R. 1.7(b)(1).

²⁵⁴ See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 60 cmt. c(i) (2000) (defining what constitutes an "adverse effect" on a representation in the context of a lawyer's duty to preserve client confidences).

the modified Rule would have at least required Sullivan to consider whether its conflicts of interest would have a bearing on Lehman's efforts to avoid bankruptcy. For example, Cohen's refusal to disclose that Merrill was seeking to merge with Bank of America certainly jeopardized Lehman's ability to conclude a merger with Bank of America.²⁵⁵ Once confronted with this conflict, Sullivan should have considered withdrawing from the representation, even if Lehman had previously waived any Merrill-related conflicts.²⁵⁶ Similarly, once Sullivan determined that finding a merger partner for Lehman would not be possible without monetary assistance from banking regulators, and regulators were unwilling to provide such assistance, Sullivan should have been forced to consider whether it could risk its relationships with regulators in order to pursue much-needed financial backing for Lehman.

Equally important, the requirement that lawyers regularly consult with their clients as to a conflict of interest's effect on a representation allows the client to reassess conflicts with which it previously may have been unconcerned. When Sullivan's representation of Lehman began, for example, there were many potential Lehman acquirers.²⁵⁷ Assuming that Sullivan solicited and received a prospective waiver of its client conflicts from Lehman, Sullivan and Lehman would not have necessarily been required to reassess the Barclays conflict when Barclays emerged as one of the only interested merger partners.²⁵⁸ Modifying the rule to require regular consultation empowers clients to retract their consent to conflicts that they did not foresee or did not fully appreciate at the outset of the representation.²⁵⁹ Consequently, to the extent that Sullivan and Lehman did not discuss whether Sullivan's relationship with Barclays would affect its ability to negotiate effectively for Lehman, they would have been required to do so under the modified Rule 1.7.

CONCLUSION

This Article has suggested that attorney conflicts of interest can impact the representation that even sophisticated clients like Lehman receive. Although Sullivan undoubtedly attempted to represent Lehman to the best of its ability and may have not violated any disciplinary rules in representing Lehman, Sullivan's ability to act in the best interests of Lehman and achieve the bank's objectives was

²⁵⁵ See *supra* Part III.A.

²⁵⁶ See MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. 22 (noting a lawyer must withdraw if a conflict is nonconsentable).

²⁵⁷ See *supra* Part I.

²⁵⁸ This is because Lehman is a sophisticated client that would have been represented by in-house counsel in signing any prospective waiver. See D.C. Bar Legal Ethics Comm. Op. 309 (2001) ("An advance waiver given by a client having independent counsel (in-house or outside) available to review such actions presumptively is valid . . . even if general in character."); see *supra* Part III.A.

²⁵⁹ See D.C. Bar Legal Ethics Comm. Op. 309 (suggesting it is "prudent" for a lawyer to revisit a conflict when a conflict actually arises").

frustrated by its close relationships with Merrill and Barclays, as well as its desire to maintain its strong reputation among Treasury and Federal Reserve officials. The history of Sullivan's representation of Lehman during the financial crisis illustrates that technical compliance with conflict of interest rules does not ensure that a client's interests will be protected, regardless of the sophistication of the client and the lawyers providing the representation.

Rule 1.7 can be improved by requiring attorneys to regularly consult with their clients concerning the effect that their conflicts of interest are having on the representation. To the extent that a lawyer feels that a conflict of interest is compromising his ability to achieve the objectives of the representation, he should seek to withdraw, even if the lawyer reasonably believes that he can provide "competent and diligent representation."²⁶⁰ There is little value in allowing a lawyer to carry out a conflicted representation when the client either receives little information concerning the lawyer's conflict or when the lawyer's ability to satisfy the client's objectives in the representation is frustrated by the conflict.

Perhaps of even greater importance is that practicing attorneys take conflicts of interest seriously and do not merely view them as obstacles to be circumvented. There is a societal interest in clients receiving zealous representation even in nonlitigation settings. Some conflicts of interest will not encumber a representation, and the client's choice of counsel should be respected. In cases where a lawyer's loyalties are consciously or unconsciously divided, however, a conflict of interest is an affirmative reason that the attorney should decline or terminate the representation. Sullivan's loyalty to Merrill, its credulity of Barclays' motives, and its inability to aggressively challenge the Federal Reserve and the Treasury to fund a solution for Lehman interfered with the representation that Lehman was able to receive. In light of these conflicts, Lehman may have been better served if another firm represented it—a firm that was able to always act in Lehman's best interests.

That attorneys will often have conflicts of interest in representing clients may be a consequence of the increasing complexity of modern legal practice. This Article focused on Sullivan's representation of Lehman, but conflicted representation was a characteristic of much of the legal work carried out in connection with the financial crisis, including the controversial government rescue of American Insurance Group (AIG). As articulated in the Final Report of the Congressional Oversight Committee on the TARP:

The AIG rescue illustrated the tangled nature of relationships on Wall Street. People from the same small group of law firms, investment banks, and regulators appear in the AIG saga (and many other aspects of the financial crisis) in many roles, and sometimes representing different and conflicting interests. The lawyers who represented banks trying to put together a rescue package for AIG became the lawyers to [the Federal Reserve Bank of New York], shifting sides in a matter of minutes. . . . The need to address conflicts and the appearance of conflicts by

²⁶⁰ MODEL RULES OF PROF'L CONDUCT R. 1.7(b)(1).

government actors, counterparties, lawyers, and all other agents involved in this drama was wrongly treated largely as a detail that could be subjugated to the primary goal of keeping the financial system up and running.²⁶¹

Clients of all levels of sophistication deserve to be represented by attorneys who are entirely dedicated to protecting their clients' interests. Attorneys may fall short of providing this type of representation, but this should not be because the legal profession has become so certain of its ability to manage conflicts of interest that it overlooks their potentially pernicious effects.

²⁶¹ CONG. OVERSIGHT PANEL, FINAL REPORT OF THE CONGRESSIONAL OVERSIGHT PANEL 141–42 (2011), *available at* <http://cybercemetery.unt.edu/archive/cop/20110401232213/http://cop.senate.gov/documents/cop-031611-report.pdf>.

