Where were the lawyers when Lehman crashed?

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In the autopsy on the financial crisis, corporate lawyers have managed to avoid forensic scrutiny. We often hear the cry "where were the auditors", but it is rarer to hear the same question asked of lawyers. This question needs to be asked separately in relation to different legal functions. We need to think about the role of in-house counsel. Where were they when, according to Lord Turner, Barclays was "gaming" the regulator; what was their role in the Standard Chartered wire stripping debacle; what of their role in the hacking saga? We also need to ask these questions about corporate law firms and the services they provided to financial institutions.

Lawyers have a venerable tradition of putting clients first. They also have strong economic incentives to strain every sinew for the benefit of their corporate clients. But does this straining ever result in irresponsible or even anti-social behaviour? If it does, is the lawyer's obligation to act in the interests of their clients so sacred as to justify such behaviour? We think such questions are both underexplored and not adequately addressed by lawyers' codes of practice or their regulators.

In a recent article* we address these questions through the lens of Lehman Brothers now infamous Repo 105 transactions which involved an elite UK corporate law firm, Linklaters. According to Lehman's US Bankruptcy Examiner, an overindebted Lehman engaged in "balance sheet manipulation" to create the appearance that it was reducing its debt. It did so by using repos, which provide bank to bank financing. The "manipulation" involved Lehman entering into these repos just before it prepared its financial statements, reporting these transactions as sales of assets rather than, as is typical, secured loans, and then unwinding the transactions as soon as it had reported. In this way they created the appearance of reduced leverage ratios. At one quarter end approximately $50bn debt was taken off balance sheet.

Linklaters role in these transactions was to provide a legal opinion stating that in English law repos amounted to a true sale and repurchase. When first revealed, Linklaters was subject to some knee-jerk criticism. Yet, as a vehicle for criticising lawyers the case is not clear cut. Linklaters' opinion was wholly accurate. Asked are repos to be treated as true sales under English law, they correctly said they were. So if they acted competently what is the problem?

The problem is this. First, in the view the Bankruptcy Examiner there is a strong case that this "balance sheet manipulation" was unlawful and acted as a platform for other alleged securities law violations by Lehman and its management. Secondly, Lehman could not have entered into the Repo 105s for this accounting purpose without a legal opinion saying they were true sales. Without it the "balance sheet manipulation" and the alleged securities law violations would not have taken place. The question this raises is whether corporate lawyers in such instances should bear any responsibility when their competently provided services facilitate wrongdoing by the client. Or do lawyers only have an ethical responsibility to pursue their client's interests provided they themselves do not break the law?

There is a public interest in ensuring that lawyers do not use their skills and experience to facilitate probable wrongdoing or undermine the effective application of laws and regulation. In our article we argue that a lawyer's duty to the public interest is not taken seriously enough. The requirement that the public interest trumps the client's interest is not understood in corporate practice. Ideas of zealous lawyering derived from criminal advocacy need restraining in the world of corporate and financial law. We argue that the regulation of the legal profession should require corporate lawyers not to act in ways that proactively facilitate client action were there is a substantial likelihood of wrongdoing. This is the case even whether such advice and assistance is wholly accurate. Current regulation of solicitors in this regard is inadequate. Professional rules have been formed with small scale lawyers and litigation in mind and without regard to transactional lawyering.

It may, of course, be difficult to apply such consequential responsibility to the complexities of corporate and financial lawyering, but we do not think those difficulties should be overstated. We only have a limited public record in the Repo 105 case and so cannot judge whether Linklaters' behaviour was appropriate or not. But from what we do know we can explore what we should expect lawyers to do in such situations. In such contexts we can expect lawyers to pose demanding questions to the client and its auditor; to clarify the intended use of the opinion and to assess whether such use would be lawful. If such clarification is not forthcoming the opinion should not be given. And the opinion should not be given if it is reasonably foreseeable that its use is likely to lead to unlawful acts.

Ultimately the purpose of our exploration is not to wag our finger at Linklaters but to ask whether current professional regulation ensures that lawyers do not ignore the public interest in the name of serving their client. In our view, it does not.

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