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Enron and the New Disinterestedness - The Foxes are Guarding the Henhouse

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ENRON AND THE NEW DISINTERESTEDNESS—THE FOXES ARE GUARDING THE HENHOUSE*

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After years of effort fighting the (mostly mean-spirited) proposed amendments to the Bankruptcy Code,[1] we[2] lost. Most of the amendments are simply awful, and many of the most awful ones demonstrate unchecked greed.[3] As outraged as I am about the consumer bankruptcy amendments, one of the amendments affecting business bankruptcies troubles me as well. This amendment relaxes the definition of "disinterested" under section 101(14)—which is a necessary precursor to approving appointment as a professional under section 327—by taking away the absolute prohibition of the employment of certain investment bankers.[4] In so doing,

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† Dean and Professor of Law, University of Houston Law Center. The views expressed in this essay are mine alone and not those of the University of Houston or its faculty or administration. As always, I owe so much to Jeff Van Niel and Morris Rapoport, not just for their editing (which is always good), but also for their moral support. I am also grateful to Professor Spencer Simons and reference librarians Adrienne Cobb and Peter Egler; Professor Ray Warner, and the editorial board of the American Bankruptcy Institute Law Review.

[1] 11 U.S.C. §§ 101–1330 (2000) (the "Bankruptcy Code").

[2] I joined a group of over sixty academics who protested the proposed amendments for years; unfortunately, our protests went unheeded.

[3] *See* Peter C. Alexander, *"Herstory" Repeats: The Bankruptcy Code Harms Women and Children*, 13 AM. BANKR. INST. L. REV. 571 (2005) (examining adverse effect of amendments on low-income families); Jean Braucher, Rash *and Ride-Through Redux: The Terms for Holding on to Cars, Homes and Other Collateral under the 2005 Act*, 13 AM. BANKR. INST. L. REV. 457, 458–59 (2005) (noting credit industry supported amendments pushing more potential chapter 7 debtors into chapter 13, but new chapter 13 will make it harder for debtors to retain collateral); *see also* Courtney Mabeus, *Big Donors Go for Broke with Bankruptcy Bill* (Mar. 4, 2005), http://www.bankruptcyfinder.com/ article%20folder/bigdonors2005.html (discussing motives of proponents of new bankruptcy legislation).

[4] Section 101(14) *used* to read as follows:

> (14) "disinterested person" means person that—
> (A) is not a creditor, an equity security holder, or an insider;
> *(B) is not and was not an investment banker for any outstanding security of the debtor;*
> *(C) has not been, within three years before the date of the filing of the petition, an investment banker for a security of the debtor, or an attorney for such an investment banker in connection with the offer, sale, or issuance of a security of the debtor;*
> (D) is not and was not, within two years before the date of the filing of the petition, a director, officer, or employee of the debtor or of an investment banker specified in subparagraph (B) or (C) of this paragraph; and
> *(E) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor or an investment banker specified in subparagraph (B) or (C) of this paragraph,* or for any other reason . . . .

Congress argued that it was merely trying to give investment bankers the same break as other professionals seeking approval of employment.[5] By eliminating the absolute prohibitions against employing investment bankers who are or were "investment banker[s] for any outstanding security of the debtor" or who were "within three years before the date of the filing of the petition, . . . investment banker[s] for a security of the debtor," Congress "leveled the playing field"[6] for investment bankers. After all, the proponents of the amendment argued, lawyers and accountants who are or were representing the debtor before bankruptcy can get a case-by-case review of whether they are "disinterested" within the meaning of section 101(14). Why shouldn't investment bankers get the same case-by-case review?

Actually, there are three good reasons why Congress should have left section 101(14) alone, and this essay will discuss all three: the lack of a prophylactic code of ethics covering investment bankers; the fact that there is no pressing rationale for loosening the restrictions on investment bankers who previously represented the debtor; and the fact that our fleeting memory of history means that we are doomed to repeat the hard-earned lesson that true conflicts of interest always matter.

I. FOX IN THE HENHOUSE I: NO CODE OF ETHICS FOR INVESTMENT BANKERS

Lawyers, at least, are bound to avoid conflicts of interest not just under the conflict of interest provisions of the Bankruptcy Code, but also under the ethics codes of the states in which they are licensed to practice law.[7] Therefore, there is an extra check on lawyers who worked for the debtor pre-petition. There is no equivalent check on investment bankers.

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11 U.S.C. § 101(14) (2000) (Emphasis added).

[5] I like the way that Representative Spencer Bachus of Alabama explained the proposed change to the definition of disinterestedness. *See* 150 CONG. REC. H129, 151 (daily ed. Jan. 28, 2004) (statement of Rep. Bachus):

> Section 414 of the present legislation, I think, is a large snake. It is the proverbial fox in the henhouse. And what section 414 does is it eliminates the disinterested rule. That rule has existed in bankruptcy law for 66 years. Under current law, a person that advises the trustee must be "disinterested" in order to avoid conflicts of interest. Section 414 eliminates that exclusion. Consequently, section 414 would allow the same entities that may be engaged in negligence or even fraud prior to bankruptcy to advise the trustee during the bankruptcy process.

Id.; *see also* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 414, 119 Stat. 23, 107 (2005) (to be codified at 11 U.S.C. § 101(14)).

[6] 151 CONG. REC. S2297, 2334 (daily ed. Mar. 9, 2005) (statement of Sen. Grassley).

[7] *See* 2 COLLIER ON BANKRUPTCY ¶ 101.14, at 101–64 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2005) ("Courts will review not only whether attorneys meet the standards of disinterestedness under the Bankruptcy Code, but also whether they have complied with the ethical codes applicable to them.").

Under Model Rule 1.7, used either in whole or in a slightly modified version in most states

> (a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
> (1) the representation of one client will be directly adverse to another client; or
> (2) there is a significant risk that the representation of one or more clients 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.
> (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;
> (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.[8]

Add to the lawyer's conflicts restrictions under his or her state's ethics rules the restrictions of section 327(a) of the Bankruptcy Code:

> (a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, *that do not hold or represent an interest adverse to the estate, and that are disinterested persons,* to represent or assist the trustee in carrying out the trustee's duties under this title.[9]

Section 327(a) has two parts: the professional person seeking approval for employment must "not hold or represent an interest adverse to the estate" and must be "disinterested."[10] "Disinterested," under section 101(14), used to include

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[8] MODEL RULES OF PROF'L CONDUCT R. 1.7 (2003).
[9] 11 U.S.C. § 327 (2000) (emphasis added).
[10] *Id.* This embedded redundancy in the requirements for estate professionals has proven confusing to many courts. In *In re Marvel Entertainment Group, Inc.*, 140 F.3d 463, (3d Cir. 1998), the Third Circuit

> [a] person that—
> (A) is not a creditor, an equity security holder, or an insider;
> (B) is not and was not an investment banker for any outstanding security of the debtor;
> (C) has not been, within three years before the date of the filing of the petition, an investment banker for a security of the debtor, or an attorney for such an investment banker in connection with the offer, sale, or issuance of a security of the debtor;[11]
> (D) is not and was not, within two years before the date of the filing of the petition, a director, officer, or employee of the debtor or of an investment banker specified in subparagraph (B) or (C) of this paragraph; and
> (E) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor or an investment banker specified in subparagraph (B) or (C) of this paragraph, or for any other reason . . . .[12]

Now, take a look at section 101(14), as amended:

> (14) The term "disinterested person" means a person that—
> (A) is not a creditor, an equity security holder, or an insider;
> (B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and

clarified its own standards for appointment of a professional person under section 327 of the Bankruptcy Code:

> We previously interpreted the standards applicable to employment of trustee's counsel under §§ 327(a) and 101(14)(E) in *BH & P*, 949 F.2d 1300. Insofar as both parties have somewhat misread *BH & P*, and urge upon us such conflicting interpretations of it, we have studied our previous decision in great detail and today expressly reiterate its holding: (1) Section 327(a), as well as § 327(c), imposes a *per se* disqualification as trustee's counsel of any attorney who has an actual conflict of interest; (2) the district court may within its discretion— pursuant to § 327(a) and consistent with § 327(c)—disqualify an attorney who has a potential conflict of interest and (3) the district court may not disqualify an attorney on the appearance of conflict alone.

Id. at 476; *see also* 3 COLLIER ON BANKRUPTCY ¶ 327.04[2][a][i], at 327–33 (Alan N. Resnick & Henry Sommer eds., 15th ed. rev. 2005) (describing split of courts regarding how strictly to apply disinterestedness test of section 101(14)) ("The majority of courts demand *per se* application of the statute . . . . But some courts have held that judges have latitude to depart from *per se* application of the statute and make case-by-case decisions looking to the totality of the circumstances") (footnotes omitted).

[11] Note that, under this part of the definition, at least one category of attorney also is barred absolutely from representing the DIP.

[12] 11 U.S.C. § 101(14) (2000).

> (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason . . . .[13]

According to Senator Chuck Grassley of Iowa,

> [U]nder current law, investment banks are not allowed to compete on the same playing field as other professionals. Right now, investment banks are precluded per se, in many circumstances, from representing a debtor in a business bankruptcy if the investment bank acted as the investment banker for the company before it filed for court protection.
>
> I think this is a draconian rule. The bill would give the bankruptcy judge the ability to determine whether an investment banker is disinterested, just as the judge determines whether other professionals are disinterested. The provision in the bill, it seems to me, is not only fair, but it will also safeguard the proceedings from any conflict of interest. Do we trust our Federal judges, or don't we, to make this determination?[14] After all, the environment for this is in the judiciary—before judges. We happen to trust them for all other professionals involved in the bankruptcy proceedings, whether there is any conflict of interest for anyone involved. So then the question becomes, why should it be different for investment banks?[15]

Fifth Circuit Judge Edith Jones—herself a proponent of most of the proposed amendments (including means-testing)—was among those who answered Senator Grassley's question:

> The National Bankruptcy Review Commission was asked to recommend a modification of the disinterestedness standard in order to accommodate, as I recall, the geographic growth and increasing sophistication of professional firms of all kinds involved in chapter 11 bankruptcy practice. Despite fervent lobbying by

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[13] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 414, 119 Stat. 23, 107 (to be codified at 11 U.S.C. § 101(14)).

[14] As an aside, I guess we trust our federal judges more here than we do in terms of "substantial abuse" under section 707(b). Isn't that why Congress decided to establish the means test—because it didn't trust judges to throw out abusive chapter 7 filings? *See* Marianne B. Culhane & Michaela M. White, *Catching Can-Pay Debtors: Is the Means Test the Only Way?*, 13 AM. BANKR. INST. L. REV. 665, 669 (2005) (citing legislative history as indicating Congress was dissatisfied with inconsistency under former section 707(b)).

[15] 151 CONG. REC. S2297, 2334 (daily ed. Mar. 9, 2005) (statement of Sen. Grassley).

> prominent bankruptcy professionals and scholars, the Commission resisted making such a recommendation. We voted (by a lopsided majority, I believe) to retain the standard as it has existed since the 1930's.
>
> The Commission report cites two reasons for retaining a strict prophylactic standard for all bankruptcy professionals. These are worth brief restatement. First, such a standard can alone protect integrity in the bankruptcy process. If professionals who have previously been associated with the debtor continue to work for the debtor during a bankruptcy case, they will often be subject to conflicting loyalties that undermine their foremost fiduciary duty to the creditors. Strict disinterestedness, required by current law, eliminates such conflicts or potential conflicts.
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> Second, enforcing a strict standard of disinterestedness is necessary to maintain public confidence in the integrity of the bankruptcy system. A bankruptcy case should not be subject to the criticism that professional fees are generated to no purpose or for a bad purpose such as delay. The courts' efforts to ensure that fees remain reasonable are enhanced when, because of the complete disinterestedness of participating professionals, no hidden motives may be imputed to the actors in the case.
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> One need not focus solely on today's high-profile bankruptcy cases to realize that the challenge of maintaining disinterested professional services has permeated modern corporate reorganization law . . . . Given the ongoing nature of the problem, I do not see how any professional group can advocate, consistent with the public interest, eliminating the statutory requirement of disinterestedness. Moreover, as it appears likely that many future complex bankruptcy cases will arise in which the role of investment bankers will have to be explored, it seems particularly unwise to grant that group—alone among bankruptcy professionals—a status insulated from the strict disinterestedness requirement.[16]

In an unusual turn of events, Judge Jones found herself on the same side of the issue as Professor Elizabeth Warren (and me). Professor Warren, former SEC Chair Arthur Levitt, and I, all separately, also opposed the proposed section 101(14).[17] To

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[16] 150 CONG. REC. H129, 151 (daily ed. Jan. 28, 2004) (statement of Rep. Bachus) (quoting letter from Judge Edith H. Jones of United States Court of Appeals, 5th Circuit). By changing the strict disinterestedness standard for investment bankers, Congress added an extra layer of expense (case-by-case analysis) for investment bankers—the one group that truly doesn't have to be carried over from pre-petition work to post-petition work.

[17] *See* 151 CONG. REC. S2405, 2425–26 (daily ed. Mar. 10, 2005) (statement of Sen. Sarbanes):

us, the idea that investment bankers needed special, case-by-case consideration to help the debtor in possession ("DIP") identify circumstances under which the pre-petition investment bankers needed to continue to work for the DIP post-petition was ludicrous.

Senator Patrick Leahy of Vermont tried to soften the blow of the proposed amendment by re-establishing a per se ban on investment bankers who had worked for the debtor during the five years prior to the bankruptcy.[18] His proposal failed.[19]

The best way to think about the theory underlying lawyers' conflict of interest rules is to think of it in two parts. The rules prohibit conflicts of interest in order to

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> Elizabeth Warren says:
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> "There is reason why the professionals who have worked for a business that collapses into bankruptcy are not permitted to stay on. The company must go back after bankruptcy and reexamine its old transactions . . . ."
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> Obviously, having the same professionals review their own work is not likely to yield the most searching inquiry.
>
> Arthur Levitt, former Chairman of the SEC, said:
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> "I haven't read a single argument made by the investment banks that would persuade me that the prohibition should be changed. What we are talking about is a significant potential conflict of interest, and I think it is outrageous that investment banks would even try to go down this road."
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> This prohibition has existed in law ever since 1938, which has been reaffirmed by the Bankruptcy Study Commission, by all the experts in the field, those who have no vested interest in the outcome, who come objective, people who are in favor of modifying the bankruptcy law, people not in favor of it, but they all come together and agree on this issue.
>
> Professor Warren said:
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> "It is not a provision to ensure investor confidence, or to enhance protection for employees, pensioners, or creditors of failing companies. This is a provision to enrich an already wealthy interest group, nothing more."
>
> It needs to be understood that an investment bank that advised on the creation of a company's capital structure before a bankrupt filing may itself be exposed to potential liability. If it is brought in to work out the deal that permits the company to emerge from bankruptcy, you are opening the door that they may be tempted to prefer the creditors who have a potential claim against the investment bank. Don't open this stable door.

Id. (quoting Elizabeth Warren & Arthur Levitt); *see also* 151 CONG. REC. S2297, 2331 (daily ed. March 9, 2005) (statement of Sen. Sarbanes):

> Dean Rapoport of the University of Houston Law Center pointed out that the current disinterestedness standard saves the bankruptcy court from having to make time-consuming, factual findings regarding the disinterestedness of those categories which by their very nature are rife with conflicts of interest. Removing investment bankers from the exclusion list will increase the time, cost and attorney fees for every bankruptcy case without increasing the benefits to the estate as a whole.

Id.

[18] *See, e.g., id.* (statement of Sen. Sarbanes) (commending Senator Leahy's proposed five-year rule and joining with Senator Leahy and Senator John Warner of Virginia in proposing five-year rule).

[19] *See* 151 CONG. REC. S2405, 2426 (daily ed. Mar. 10, 2005) (Rollcall Vote No. 39) (rejecting Senator Patrick Leahy's proposed amendment (S. Amend. 83) to Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 by vote of 55 nays to 44 yeas).

avoid two serious risks: the abuse of client confidences[20] and the need to give short shrift to the representation of one client because of competing needs (*e.g.*, the representation of another client or the lawyer's own interests).[21] Apparently, investment bankers—who have no mechanism of self-governance and no rules helping them sort through conflicts of interest—can help debtors spiral into bankruptcy and then, with equal equanimity, help them re-emerge from it.

II. FOX IN THE HENHOUSE II: INVESTMENT BANKERS DON'T NEED TO KNOW THE DIP'S FORMER BUSINESS

Lawyers (the most typical professionals seeking approval under section 327) may have a reason to know the past business of the debtor in possession, especially if the business is complicated. I've previously suggested that lawyers' conflicts of interest in bankruptcy should be treated differently from the way that conflicts are treated outside bankruptcy, in part because of the advantage of understanding certain information about the players in a chapter 11 case.[22]

Under prior section 101(14), the disinterestedness test at least acknowledged that lawyers were different from investment bankers. Knowledge of the DIP's prior business decisions might matter for lawyers and, to a lesser degree, for accountants. It matters less for investment bankers.

Lawyers could do very good pre-petition work for a client and, nonetheless, the client would still have to file for bankruptcy. Chances are decent that the DIP won't

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[20] *See, e.g.*, GEOFFREY C. HAZARD, JR., ETHICS IN THE PRACTICE OF LAW 76–78, 81 (1978) (discussing underpinnings of attorney conflict of interest); GEOFFREY C. HAZARD, JR. & W. WILLIAM HODES, THE LAW OF LAWYERING § 10.2, at 10-8, § 10.5, at 10-12 (3d ed. Supp. 2004) (acknowledging various improprieties involved in modern conflicts of interest); WILLIAM H. FORTUNE, RICHARD H. UNDERWOOD & EDWARD J. IMWINKELRIED, MODERN LITIGATION AND RESPONSIBILITY HANDBOOK: THE LIMITS OF ZEALOUS ADVOCACY § 3.3, at 95 (2d ed. 2000) (footnote omitted) ("Two basic principles underlie the rules prohibiting lawyer conflicts of interest: The lawyer must represent the client with undivided or "undiluted" loyalty and must protect the client from disclosure or adverse use of the client's confidential information. ") *Id.*

[21] *See* MODEL RULES OF PROF'L CONDUCT R. 1.3 (2003) ("A lawyer shall act with reasonable diligence and promptness in representing a client."). Under the newer Model Rules of Professional Conduct, Rule 1.3 does not mention zealousness in the text but does in its Comment. *See id.* cmt. 1 (mentioning "zeal" when referring to how attorneys should represent clients); GEOFFREY C. HAZARD, JR. & W. WILLIAM HODES, THE LAW OF LAWYERING § 6.2, at 6-5 (3d ed. Supp. 2003) ("Comment [1] refers to 'zeal' as the lawyer's appropriate mode in litigation, and uses 'commitment and dedication' to describe lawyer's stance in other settings."). Then the Rules bound zealousness by pointing out the limitation of representation being "within the bounds of the law" (using phrase "within the bounds of the law" from Canon 7's text to confine term "zealousness"). *Id.*

[22] *See generally* Nancy B. Rapoport, *Turning and Turning in the Widening Gyre: The Problem of Potential Conflicts of Interest in Bankruptcy*, 26 CONN. L. REV. 913 (1994) (establishing first theory of DTACs: dormant, temporary, actual conflicts); *see also* Nancy B. Rapoport, *The Intractable Problem of Bankruptcy Ethics: Square Peg, Round Hole*, 30 HOFSTRA L. REV. 977 (2002) (exploring DTAC concept for conflicts of interest in bankruptcy field); Nancy B. Rapoport, *Our House, Our Rules: The Need for a Uniform Code of Bankruptcy Ethics*, 6 AM. BANKR. INST. L. REV. 45 (1998) (advocating that bankruptcy lawyers should abide separate ethics code).

have to review the lawyers' pre-petition work with a fine-toothed comb. But when investment bankers participate in deals that go south, leading to a client's bankruptcy, the chances are very good that the DIP will have to review those deals to see if the estate has a claim against the investment bankers. The costs of doing a case-by-case analysis on disinterestedness thus make sense for lawyers but not for investment bankers.

Moreover, the universe of sophisticated chapter 11 lawyers is finite[23] in a way that the universe of investment bankers isn't—there are always more investment bankers willing to do deals, and those deals for a DIP may be very different in kind from the deals done for the debtor pre-petition. In any event, the case-by-case, nuanced approach to determine if a lawyer has a conflict of interest makes sense, even if the analysis that a court must do to appoint a lawyer under section 327(a) is more intensive.[24] A bright-line rule for investment bankers is much more efficient. Without a countervailing reason to preserve the pre-petition knowledge of an investment banker, why add that case-by-case, nuanced expense to the cost of running a chapter 11 case?

III. FOX IN THE HENHOUSE III: THOSE WHO FORGET HISTORY ARE DOOMED TO REPEAT IT

We've been through the hubbub of revising disinterestedness standards before.[25] Every time we discuss proposed revisions, we have a ritual of reciting the history of

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[23] It's fair to say that, in a real sense, the "bankruptcy ring" that William O. Douglas was trying to break up has regrouped. *See* William O. Douglas & Adelaide Rosalia Hasse, *Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees: Pursuant to Section 211 of the Securities Exchange Act of 1934*, U.S. G.P.O. (1937–1940); *see also* Todd J. Zywicki, *Mend It, Don't End It: The Case for Retaining the Disinterestedness Requirement for Debtor in Possession's Professionals*, 18 MISS. C. L. REV. 291, 302 (1998) (acknowledging existence of Justice Douglas's term "bankruptcy ring"). Another, more optimistic, way to think of the group of truly national bankruptcy lawyers, though, is that they have invested more time and garnered more experience than their colleagues. That time and experience is worth something to DIPs that have a chance of reorganizing.

[24] My thanks to Professor Spencer Simons for the following observation:

> One argument, that investment bankers for the company's securities have an inherent conflict, in wanting to minimize damage to those to whom they offered the securities, in order to avoid lawsuits or future customers, has been made by others. *See* http://www.tewlaw.com/ CM/NewsAndEvents/NewsAndEvents242.asp.
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> More generally, investment bankers' conflicts are potentially very subtle. Their main asset is a web of contacts and information, and the marketing implications of almost any relationship are so extensive as to be almost untraceable.

Comment from Spencer Simon to author, regarding previous draft of essay, previously on file with author.

[25] For a superb history of disinterestedness, *see* Gerald K. Smith, *Standards for the Employment of Professionals in Bankruptcy Cases: A Response to Professor Zywicki's "Case for Retaining the Disinterestedness Requirement for Debtor in Possession's Professionals,"* 18 MISS. C. L. REV. 327, 338–48 (1998) (discussing historic progression of disinterestedness theory).

disinterestedness,[26] and we discuss the abuses under the Bankruptcy Act. All cultures have rituals and symbols, and the culture of bankruptcy academics and practitioners is no exception. We revisit the reasons for maintaining disinterestedness for trustees and their professionals, and we parse the issue of whether the DIP's professionals also need to be disinterested.[27] But, usually, we recognize the difference between what lawyers can do for bankruptcy estates and what investment bankers can do. Congress, however, didn't recognize that difference, and its failure to do so has hurt bankruptcy law, both in reality and in terms of the law's symbolism.

Remember the scramble to pass Sarbanes-Oxley[28] after the Enron-WorldCom-Adelphia-Global Crossings-etc. corporate scandals? Those in Congress who had cozied up to the power-players like Enron were all too happy to pass legislation to "fix" the financial problems that had long lain beneath the surface of overblown financial statements.[29] Although some of the hearings were useful to reveal some systemic problems,[30] and although others were truly priceless,[31] most of the

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[26] For just a small sampling of this ritual, take a look at the symposium edition of 18 MISS. C. L. REV. (1998). *See* Gerald K. Smith, *Standards for the Employment of Professionals in Bankruptcy Cases: A Response to Professor Zywicki's "Case for Retaining the Disinterested Requirement for Debtor in Possession's Professionals,"* 18 MISS. C. L. REV. 327 (1998) (proposing alternative standards for professionals employed by debtors); Charles W. Wolfram, *The Boiling Pot of Lawyer Conflicts in Bankruptcy*, 18 MISS. C. L. REV. 383 (1998) (scrutinizing Congressional inaction regarding bankruptcy law and omission of bankruptcy in Restatement of Law Governing Lawyers); Todd J. Zywicki, *Mend It, Don't End It: The Case for Retaining the Disinterestedness Requirement for Debtor in Possession's Professionals*, 18 MISS. C. L. REV. 291 (1998) (arguing for preservation of disinterestedness standard); Todd J. Zywicki, *Of Bubbling Pots and Bankruptcy Ethics: A Comment on Wolfram and Smith*, 18 MISS. C. L. REV. 399 (1998) (asserting reasons why disinterestedness standard should not be changed); *see also* John D. Ayer et al.., *Ethics: Is Disinterestedness Still a Viable Concept? A Discussion*, 5 AM. BANKR. INST. L. REV. 201 (1997) (discussing history of disinterested standard and whether it should be removed).

[27] *See supra* note 26.

[28] David Ivanovich, *Accord Settles Business Fraud Bill; No Hurdles Seen to Enactment*, HOUSTON CHRONICLE, July 25, 2002, at A1 (describing Congressional debate over Sarbanes-Oxley Act).

[29] *See* Arthur Levitt, Chairman, Sec. and Exch. Comm'n, The "Numbers Game", Remarks at the NYU Center for Law and Business (Sept. 28, 1998), http://www.sec.gov/news/speech/speecharchive/1998/spch220.txt.:

> [Earnings management] has evolved over the years into what can best be characterized as a game among market participants. A game that, if not addressed soon, will have adverse consequences for America's financial reporting system. A game that runs counter to the very principles behind our market's strength and success.
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> ....
>
> As a result, I fear that we are witnessing erosion in the quality of earnings, and therefore, the quality of financial reporting. Managing may be giving way to manipulation; Integrity may be losing out to illusion.

Id.

[30] *See, e.g.*, ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS 145 (Nancy B. Rapoport & Bala G. Dharan eds., Foundation Press 2004) [hereinafter ENRON]; Bala G. Dharan, *Enron's Accounting Issues:*

hearings were stage-dressing. Sarbanes-Oxley tightened up the penalties for financial malfeasance[32] and increased the costs for public companies to do business. As a symbolic gesture, Sarbanes-Oxley was a good idea: it got the public's attention and likely forced trustees to understand their obligations to shareholders. As wholly new law, though, it was probably unnecessary.

Symbolism is important, however, and the public's push for Congress to do something—anything—was a direct result of the financial distress that the corporate cheaters unleashed on our economy. A scant three years after Sarbanes-Oxley was enacted, there have been calls for its revision.[33] Have corporate executives weeded out all of the bad apples? Have financial disclosures become easier for the general public to understand? No. The calls for revision and relaxation of the Sarbanes-Oxley requirements are a result of the increased costs now borne by public

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What Can We Do to Prevent Future Enrons, *in* ENRON, at 114; *Accounting Reform and Investor Protection: Hearings Before the Sen. Comm. on Banking, Hous. and Urban Affairs*, 107th Cong. 582 (2003) (prepared statement of John C. Coffee Jr., Professor, Columbia Law School) (investigating how Congress should legislate regarding auditing and securities standards).

[31] Remember when Senator Barbara Boxer asked Jeff Skilling what sort of business degree he had and at which university he had received his degree? *See The Collapse of the Enron Corporation: Hearing Before the S. Comm. on Commerce, Sci. and Transp.*, 107th Cong. (forthcoming):

> BOXER: I want to tell you, if you look at Ms. Watkins' testimony, she says it in a sentence, "My understanding as an accountant," she says, "is that a company could never use its own stock to generate a gain or avoid a loss on its income statement." Is that true? Were you aware of that?
> SKILLING: Um.
> BOXER: Were you aware of that?
> SKILLING: I'm not an accountant.
> BOXER: I didn't ask you that. Is her statement true?
> SKILLING: I think I'd have to be an accountant to know if it's true. I don't—
> BOXER: Wait a minute. You have to be an accountant to know that a company could never use its own stock to generate a gain or avoid a loss in an income statement. What was your education, Mr. Skilling? I know I read that it was pretty good. What—
> SKILLING: I have a master's in business administration.
> BOXER: A master's in business administration. And yet you didn't know this simple fact. Is that correct? You're saying you were ignorant of the fact that Ms. Watkins has told us—it's not complicated. Those of us up here understand it very clearly.
> SKILLING: Okay. Well, just a second, Senator . . .
> BOXER: The company can never use its own stock to generate a gain or avoid a loss. And you're saying—getting your master's—and where did you go to school?
> SKILLING: Harvard Business School.
> BOXER: Okay. In Harvard Business School, you did not know this. Is that correct?

Id. (providing verbatim transcript of testimony of Jeffrey Skilling).

[32] *See, e.g.*, Geraldine Szott Moohr, *An Enron Lesson: The Modest Role of Criminal Law in Preventing Corporate Crime*, *in* ENRON, *supra* note 30, at 431.

[33] *See, e.g.*, Tosha Hoffman, *Section 404 of the Sarbanes-Oxley Act: Where the Knee Jerk Bruises Shareholders and Lifts the External Auditor*, 43 BRANDEIS L.J. 239, 240 (2004) (recommending the repeal of section 404); Note, *The Case for Federal Threats in Corporate Governance*, 118 HARV. L.REV. 2726, 2747 (2005) (advocating repeal of Sarbanes-Oxley Act in response to shift in Delaware jurisprudence); 151 CONG. REC. S3717, E657 (daily ed. Apr. 15, 2005) (statement of Hon. Ron Paul) (introducing Due Process and Economic Competitiveness Restoration Act to repeal Section 404 of the Sarbanes-Oxley Act).

companies, which now have to pay for more lawyers and more accountants in order to comply with Sarbanes-Oxley. Due to those increased costs, public companies are having trouble making the same kind of (ostensibly real) profits that they were able to make before Sarbanes-Oxley went into effect.

It's clear that the increased costs of Sarbanes-Oxley aren't going to deter the determined corporate cheat. It is also clear that the increased costs of Sarbanes-Oxley harm those companies not inclined toward fraud. Symbolism, though, is part of what brought Enron down—the symbols of greed permitted to run amok everywhere, from Enron's parking garage filled with Porsches to the transcripts of Enron's energy traders gloating over the money they were making in round-trip trading.[34] I believe that some of the rampant misconduct at Enron was due to the example set by many of those at the top, who looked away at the sight of public temper-tantrums and who knew that many of the biggest deals were fraudulent.[35]

Symbolism is important in bankruptcy law, too—even in chapter 11. That's why there are new rules making certain types of retention bonuses (also known as key employee retention plans, or KERPs) into potential fraudulent conveyances.[36] When I compare the very real—and very depressing—changes that consumer debtors faced on October 17, 2005,[37] to the obvious victory that investment bankers won in the changes to section 101(14), I see a DIP-henhouse, with no asset-hens, just banker-foxes—and each fox is licking its chops.

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[34] *See, e.g.*, Jessica Doyle, *Enron Traders Manipulated Markets*, WASHINGTON POST, Jun. 3, 2004, http://www.washingtonpost.com/wp-srv/mmedia/business/060304-1s.htm (audio transcripts of traders' telephone conversations with each other).

[35] *See* Nancy B. Rapoport, *Enron, Titanic, and The Perfect Storm*, *in* ENRON, *supra* note 30, at 927.

[36] *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No., 109-8, § 1402(2), 119 Stat. 23, 214–15 (2005) (to be codified at 11 U.S.C. § 548(a)(1)).

[37] October 17, 2005 is the effective date for most of the changes made by the 2005 amendments.