WHEN LAW AND ECONOMICS MET PROFESSIONAL RESPONSIBILITY

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I. LAW AND ECONOMICS AS FRIEND

A. A Love Story for the '90s

Law and economics and professional responsibility have in some sense grown up together, though they have only recently seen fit to make each other's acquaintance. Although both fields have old antecedents, their modern versions have traveled parallel paths and sounded similar themes. In the early 1960s, Coase and Lucas v. Hamm startled the legal world by asserting that, under certain circumstances, legal rules do not matter: Coase by arguing that parties will bargain around them, and Lucas by holding that lawyers can competently ignore them. Interestingly, Coase and Lucas also support—and probably should be better understood as standing for—exactly the opposite point, that legal rules do in fact matter. Coase's concept of transaction costs spawned a whole new vocabulary for explaining and justifying legal rules, while Lucas's rejection of the privity rule and recognition that lawyers owed legal duties to nonclients generated new possibilities for regulating lawyers through legal rules. In response, the most creative subsequent efforts on both the academic and judicial sides pursued the latter paths. These efforts peaked in the 1970s with the publication of Posner's Economic Analysis of Law, which offered the bold theory that economic analysis could explain all of law (or, at least the common law—well, most of it), and the National Student Marketing decision, which offered the bold proposition that the SEC could define the contours of proper lawyer behavior.

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1. R.H. Coase, The Problem of Social Cost, 3 J.L. & Econ. 1 (1960). A few years later, a similar theme of the irrelevancy of law was the central thesis of Stewart Macaulay, Non-Contractual Relations in Business: A Preliminary Study, 28 Am. Soc. Rev. 55 (1963), which although not written from an economic perspective, has since been endorsed as an important law and economics work. See Readings in the Economics of Contract Law 1 (V. Goldberg ed., 1989) (reprinting an excerpt from the Macaulay article and noting that the paper "has had a considerable influence on economic scholarship").
2. 364 P.2d 685, 689-91 (Cal. 1961) (in bank) (holding that a lawyer did not commit legal malpractice by drafting a will in such a way that a trust established under the will was invalid under the rule against perpetuities because a lawyer of "ordinary skill and capacity" would not have expected the rule to apply).
3. Coase has always insisted that this was his main point. See R.H. Coase, The Firm, the Market, and the Law 28 (1988) ("Economic policy involves a choice among alternative social institutions, and these are created by the law or are dependent on it.").
through its interpretation of the securities acts (though the court was too timid to act on this proposition and the bar strongly resisted it). But Posner's book scarcely made mention of the regulation of lawyers and National Student Marketing paid little attention to the economic effects of its decision.

Not until the 1980s did law and economics develop an interest in professional responsibility. In part, this attraction resulted from the need for law and economics to find (increasingly scarce) virgin fields to conquer. Less cynically, it resulted from the development of agency theory and its application to business organization and corporate law. It seemed natural to extend these ideas to the organization of rapidly growing law partnerships as well as to "entrepreneurial" lawyering in class actions and derivative suits. On the legal profession side, the adoption of the Model Rules of Professional Conduct in 1983 solidified the trend toward making ethical rules more regulatory and coercive rather than hortatory and aspirational. Further, the increased competition and accompanying laments about law as a business rather than a profession made economic explanations seem more relevant. Still, law and economics largely stayed away from the "core" legal rules governing lawyers. In fact, the focus was not on legal rules at all, but on private contracting mechanisms for reducing agency costs.

That focus has changed somewhat in the last decade, as law and economics scholars have started to turn their attention to the legal

regulation of the key areas in legal ethics: prohibited assistance, confidentiality, and conflicts of interest. Their conclusions have ranged from general support of the rules governing lawyers to outright hostility. The goal of this paper is to take stock of the relationship as it now stands and—in true '90s fashion—to offer some therapeutic counseling that may help strengthen the relationship in the future. I have three main observations. First, agency problems take multiple forms. Second, solutions to these problems may be tradeoffs or complements; finding complementary solutions is the key to minimizing agency costs. Third, the legal rules governing lawyers matter a great deal in today's environment. Paying more attention to these traits should bond law and economics with professional responsibility for some time to come.

B. Self-Interest: The Tie that Binds

If we are to discuss the relationship between law and economics and professional responsibility, then the obvious place to start is self-interest, because, at first blush, the two fields take diametrically opposed positions on the topic. For law and economics, the assumption of self-interested behavior is the engine that drives much of the analysis. In fact, the recognition of nonobvious self-interested responses to legal or economic constraints is one of the key forms of "insight" that law and economics provides (the other insight involves making analogies by recognizing the economic similarity between seemingly different subjects). On the other hand, for professional responsibility, the working assumption has often been that ethics or professionalism requires lawyers to resist self-interest, and the relevant question has been thought to be simply what the nature of this resistance—that is, the content of ethical behavior—should be.

On closer inspection, however, neither field is as wedded to these basic assumptions as it purports to be. Economists have sometimes been surprisingly slow to recognize the possibility of self-interested behavior. For example, Coase has always complained that economists have resisted his insight that private parties may be able to overcome

13. The extent of these insights is a matter of debate. Some have said of law and economics, as of other intellectual innovations: "What's new isn't true, what's true isn't new." See generally Michael Scriven, Reasoning 117 (1976) ("The crucial problem in the search for truth in this world is to combine novelty with accuracy. . . . The problem is to find a statement which is both true and informative, that is, not already known to be true.").

14. Even law and economics scholars sometimes accept this assumption about lawyers. See Ronald J. Gilson, The Devolution of the Legal Profession: A Demand Side Perspective, 49 Md. L. Rev. 869, 886-89 (1990) (arguing that lawyers are less likely than their clients to act in a self-interested way because a legal career attracts people who are predisposed to professional values rather than profit, and because law schools teach students that they have an obligation to pursue the public good, even at their own expense).
externality problems by bargaining around legal rules, while lawyers have more readily embraced this concept. One reason for this disparity is that transactional lawyers immediately recognized that the kind of contracting around legal rules that Coase envisioned was exactly what they did for a living, whereas economists tended to take the more naive view that people generally follow legal rules rather than manipulate them. But even Coase did not take the self-interest assumption as far as he could have. As many have pointed out, Coase took a very optimistic view of bargaining behavior. In fact, Oliver Williamson extended Coase’s transaction cost analysis by playing out the implications of assuming that economic actors engage not merely in self-interested behavior, but in “opportunistic” behavior. This is not to suggest that failing to carry the self-interest assumption to its extremes is necessarily a fault of economists; to the contrary, recognizing the limits of self-interest often makes economic analysis more realistic and persuasive.

On the professional responsibility side, self-interested behavior has always been an important part of the picture. First, the existence of ethics rules and other law governing lawyers (as well as all law) presupposes the possibility of self-interested behavior. After all, legal rules are largely the fossilized remains of prior misconduct. Even if most lawyers act ethically most of the time, the assumed few “bad apples” (or, in economic terms, “marginal lawyers”) are often moti-

15. See Coase, supra note 3, at 20-29 (criticizing economists for assuming too quickly that government action is necessary to address externality problems and failing to recognize the incentives for private parties to develop their own solutions).

16. What made Coase’s analysis surprising to lawyers was the subject matter to which he applied it—nuisance law.

17. See Robert Cooter, The Cost of Coase, 11 J. Legal Stud. 1, 15-20 (1982). Coase remains optimistic about the possibility of cooperation. See Coase, supra note 3, at 161-62 (noting that “there is good reason to suppose that the proportion of cases in which no agreement is reached will be small,” in part because “[t]hose who find it impossible to conclude agreements will find that they neither buy nor sell and consequently will usually have no income,” and “[t]raits which lead to such an outcome have little survival value, and we may assume (certainly I do) that normally human beings do not possess them . . . .”).


20. Cf. Grant Gilmore, The Ages of American Law 111 (1977) (“In Heaven there will be no law, and the lion will lie down with the lamb . . . . In Hell there will be nothing but law, and due process will be meticulously observed.”).
vated by self-interest, especially when the wrongs they commit are for financial gain. And to the extent that professional responsibility serves a regulatory function, it has always been interested in how the self-interested lawyer acts. We do not deem criminal law or contract law uninteresting simply because most people are law-abiding or honor their contracts.21

Second, self-interested behavior may be consistent (or at least not inconsistent) with ethical behavior. The more this is true, the less important the question of "ethical" behavior, defined in contrast to self-interested behavior, becomes. Take, for example, the following ethical "rule": "A lawyer's representation of a client . . . does not constitute an endorsement of the client's political, economic, social or moral views or activities."22 This rule seems to assume that lawyers are not self-interested because self-interested lawyers would generally prefer more business to less (assuming that controversial clients have the ability to pay).23 At least to an economist, it seems odd that an ethical rule would be necessary to encourage lawyers to act in their self-interest.24 Thus, even if the goal of professional responsibility is aspira-

21. The point is somewhat less true for contract law, the academic study of which has a strand dating back at least to Macaulay, supra note 1, and continuing today with the "norms" literature that finds the content of legal rules less important than other forces. It is this "school" to which Gilmore referred, at least in part, in the title of his famous book, and whose penchant for "descriptive" analysis he summarily dismissed as itself "uninteresting." See Grant Gilmore, The Death of Contract 3 (1974).

22. Model Rules of Professional Conduct Rule 1.2(b) (1995). As stated, Model Rules of Professional Conduct Rule 1.2(b) is not really a "rule" at all, but merely a declaration. It could be understood to mean that a lawyer may represent clients with whose views he disagrees; however, unlike other ethics rules formulated as "may" rules—such as Model Rules of Professional Conduct Rules 1.2(c), 1.5(c), 1.6(b), 1.13(c), and 1.16(b)—it is hard to imagine an alternative universe in which the lawyer would be prohibited from representing such clients. Alternatively, the rule could be interpreted to mean that a lawyer should represent clients holding unpopular views or pursuing unpopular causes. This is the reading suggested by the comment. See id. Rule 1.2(d) cmt. [3]. Such a reading would make the rule an aspirational one similar to Model Rules of Professional Conduct Rule 6.1 (pro bono service).

23. One could argue that it might be in a lawyer's self-interest to turn down a controversial client because the representation would upset other clients and potential clients, causing the lawyer to lose business. That argument assumes that clients are not self-interested, that is, they choose lawyers based on whom the lawyers represent rather than the quality of the lawyer's work. Moreover, the argument ignores the possibility that some clients might find it admirable that a lawyer would represent unpopular people because, for example, it demonstrates the lawyer's independence. Even if some lawyers would lose business by representing an unpopular client, it is possible that, consistent with Model Rules of Professional Conduct Rule 1.5(a)(2), a lawyer could charge a premium for representing an unpopular client if such representation were likely to hurt his business. But if the market for lawyers were competitive, it would be unlikely that it would be necessary for unpopular clients to pay such a premium, because they would probably be able to find a lawyer to represent them at market rates.

24. Model Rules of Professional Conduct Rule 1.2(b) might be understood as a kind of anti-boycott rule in that the fear is not that individual lawyers would reject unpopular clients, but that the bar as a group would do so. Such an act might present
tional, it is useful to identify those situations in which self-interest and ethics are most likely to pull in opposite directions and, where the pull of self-interest is strongest, to know when ethical behavior is likely to be most crucial and most difficult.

Third, lawyer self-interest is not the only type of self-interest relevant for professional responsibility. Clients also may or may not be self-interested and their self-interest may or may not take an extreme form. For example, Justice Holmes’s “bad man” theory of law has sometimes been thought applicable to lawyering. If the implication of the theory is that the lawyer should (must? may? does?) view the client as a “bad man,” that is, as a self-interested person, then the question is, how bad and under what circumstances? The lawyer may presume that the more “bad” the client, the less the lawyer can lawfully do on his behalf. On the other hand, in some situations, the “bad man” may more likely be the lawyer than the client.

In addition, people with whom clients deal (including other lawyers and government actors) may or may not act in a self-interested way toward those clients. Certainly one of the lawyer’s primary—and perhaps most satisfying—roles in both transactional and litigation work is to protect one’s client against the (perhaps imagined) self-interested behavior of others. In economic terms, lawyers often advise their clients that they must protect themselves against a “prisoner’s dilemma” in which altruistic behavior by the client could lead to disastrous results if the other side behaves in a self-interested way. But what exactly is a lawyer professionally obligated or permitted to presume about the self-interestedness of others? Again, the answers are highly relevant to the nature and extent of ethical conflicts.

See FTC v. Superior Court Trial Lawyers Ass’n, 493 U.S. 411, 430-36 (1990) (holding a boycott by court-appointed lawyers for higher wages illegal per se).


27. One could argue, for example, that self-interested clients should be presumed in large commercial litigation, where the mere fact that the parties have failed to resolve their differences through private negotiation might be thought to say something about the parties’ tendencies toward self-interested behavior. Similarly, one could argue that self-interested clients should be presumed in the criminal defense context where the stakes for the client are particularly high.


29. See generally Charles J. Goetz, Law and Economics 8-17 (1984) (discussing the “prisoner’s dilemma”); see also id. at 32-34 (describing a business school course on negotiations in which one of the main lessons is for students to understand that “they may be lied to”).

30. With respect to what lawyers and others may presume about opposing counsel, see, for example, SEC v. National Student Mktg. Corp., 457 F. Supp. 682, 712-13 (D.D.C. 1978) (holding a lawyer for one party in merger who trusted the other party’s lawyer’s assurances concerning a “comfort letter” had aided and abetted his client in violating federal securities laws by allowing the merger to proceed even though the
The point is that self-interested behavior or its absence should not casually be assumed, but should be justified. Economic analysis, of course, offers a justification, although somewhat circular perhaps because it is itself based on an assumption of self-interested behavior. We should expect to see more self-interested behavior (and less ethical behavior) as the cost of engaging in self-interested behavior decreases or the benefit from such behavior increases. Economic theory can thus help identify the conditions, behavioral patterns, and structures that increase the incentives and opportunities for self-interested behavior.

There are good reasons to think that there has been an increase in self-interested behavior by lawyers, clients, and those with whom clients interact. The key fact is that there has been an increase in competition in the market for legal services, as well as in the markets in which many lawyers' clients operate. The law governing lawyers and clients has also undergone significant change. As a result, this may be a propitious period to study the implications of self-interested behavior for rules governing lawyers.

II. Taking Agency Costs Seriously

The economic theory of agency costs has been expounded and applied extensively in the context of lawyering. My goal in this part is to summarize and critique this model from within the economic framework. The three main critiques of the model are that it: (1) ignores the importance of multiple agency problems; (2) pays insufficient attention to the extent to which proposed solutions to agency problems complement or conflict with each other; and (3) underemphasizes the importance of legal rules given its assumptions.

A. All in the Family of Agency Problems

By now, the basic agency theory is well-known. In all principal-agent relationships, there is a divergence of interests because of the separation of ownership (in the principal) and control (in the agent) of productive assets. Because the agent does not reap the full reward from his efforts on the principal’s behalf, and because the agent knows more than the principal about what the agent is doing (what economists refer to as “asymmetric information”), the agent has the incentive and opportunity to act—whether alone or in concert with others—in numerous ways that harm the principal’s interests. The

comfort letter raised questions about the propriety of the deal), and Greysas, Inc. v. Proud, 826 F.2d 1560, 1562 (7th Cir. 1987) (suggesting that concealing a family tie to one’s lawyer might support a charge of fraud by an opposing party who had relied on the lawyer’s professional opinion on the loan in dispute).

31. Gilson, supra note 14, at 899-903 (attributing decrease in “professionalism” to increased monitoring of lawyers by corporate clients using in-house counsel, which in turn resulted from higher legal fees stemming from increased corporate litigation).
principal must therefore find ways to control these agency costs. The primary means of control are monitoring, which involves frequent checking up on the agent, and bonding, which involves less frequent checking but large penalties for discovered misbehavior. The many variations on these control mechanisms are usually differentiated by whether the parties themselves, private “third” parties, or government actors are doing the checking and/or the penalizing.

Law and economics scholars have used agency theory to analyze the client-lawyer relationship. Examples of lawyer conduct that have been traced to agency cost problems include misusing client confidential information for the lawyer’s personal gain, favoring one client’s interests over another’s, and increasing or skewing the demand for legal services in ways that benefit the lawyer but not the client. Some scholars have argued that not only do lawyers face the same agency cost temptations that all other agents do, but that these cost temptations are even greater for lawyers. The reasons they have suggested for this phenomenon are that lawyers’ specialized expertise makes their recommendations about what legal services the client needs and how well those services are provided particularly difficult to monitor and evaluate, even after the legal services have been rendered, and that the misuse of information is harder for clients to police than the misuse of physical assets entrusted to an agent’s care. In my view, these assessments do not quite get it right, because lawyers are no different from other professionals in their possession of specialized knowledge that is hard to monitor and evaluate. I do agree, however, that lawyers are different from these other professionals in a crucial respect that increases the agency cost temptations for them. Lawyers, because of their knowledge of the legal system,
have unique opportunities to do harm to their clients through manipulating the licensed violence of that system.\textsuperscript{39} That is not to say that lawyers necessarily can do more harm than others, but rather that the nature of the harm is unique and relevant for addressing the agency cost problems that lawyers face.

Lawyers' unique ability to do harm is more often recognized in conjunction with a second type of agency cost problem: lawyers colluding with their clients against others. Interestingly, this problem is not typically recognized as an agency problem in the law and economics literature,\textsuperscript{40} perhaps because the economic theory of agency does not focus on it.\textsuperscript{41} This omission is odd because in agency law the problem of principals and agents acting in concert to harm others is widely recognized as an "agency problem"; in fact, if collusion is understood broadly, then this problem arguably includes vicarious liability and contractual authority, the subjects at the very heart of agency law. The problem also plays a prominent role in the law governing lawyers, but is often understood in a limited way, referring to aiding and abetting client wrongdoing\textsuperscript{42} or to merely assisting clients to engage in lawful, though socially undesirable, conduct. This limited understanding of the problem of lawyer-client harm to others—what economists refer to as the "gatekeeping" problem\textsuperscript{43}—may also help explain why the problem is not typically viewed as one of "agency costs."

Suppose, however, we consider the legal rules that prohibit lawyer wrongdoing in the assistance of a client's goals, not simply lawyer assistance in the client's wrongdoing.\textsuperscript{44} For example, lawyers may not "knowingly . . . make a false statement of material fact or law to a

\textsuperscript{39.} The classic statement of the legal system as one of licensed violence is made in Robert M. Cover, \textit{Violence and the Word}, 95 Yale L.J. 1601 (1986).

\textsuperscript{40.} See, e.g., Ribstein, supra note 34 (manuscript at 3 n.2, on file with author) (distinguishing "agency cost reduction" from "lawyers' ability to harm society on behalf of their clients").

\textsuperscript{41.} The reason that the economic theory does not focus on these problems is that its main focus is agency problems within corporations, where the idea of management colluding with the abstract principal, the corporation, may be less obvious. In any case, economists are beginning to address these problems. See Jean Tirole, \textit{Hierarchies and Bureaucracies: On the Role of Collusion in Organizations}, 2 J. L. Econ. & Org. 181 (1986).

\textsuperscript{42.} See Model Rules of Professional Conduct Rules 1.2(d), 3.4(a)-(b) (1995).


\textsuperscript{44.} See Model Rules of Professional Conduct Rules 3.1-3.5, 4.1-4.4.
third person." What is the economic justification for this prohibition? It seems obvious that if there were no such prohibition, then clients would be able to use lawyers to evade the rule that they may not knowingly make a false statement of material fact to others, a legal rule that is socially justified, due among other things to the fact that without it people would make wasteful investments in fraudulent activity. The prohibition on client fraud would be rendered completely ineffective, and worse, costs would be even higher than if client fraud were simply permitted. This is because clients would be hiring lawyers to do their lying for them, as well as to protect them against the lies of other lawyers. Similar reasoning explains the prohibitions on lawyers’ obstructing access to evidence, falsifying evidence, and bribing a judge or juror or witness, all of which are variations on the general rule of agency law that a principal can not use an agent to do things that the principal could not lawfully do on his own.

What do these rules have to do with agency costs and collusion? Just as lawyers may act in a self-interested way to use their informational advantage to evade their responsibilities to their clients, they may also act in a self-interested way to use this advantage to help their clients evade their responsibilities toward others. The assumptions of self-interested behavior by the agent, along with the difficulty of monitoring this behavior are the same in both cases, at least at this level of generality; thus, the label “agency costs” comfortably fits both situations. Moreover, when two people combine to pursue an illegitimate act that would be more costly for one to do alone, it is a form of collusion. On this view, lawyer wrongdoing to assist a client and a lawyer assisting a client’s wrongdoing are variations on the same theme. The difficulties in both situations arise from the fact that lawyers are occasionally legitimately permitted—even privileged—to “collude” with their clients to hurt third parties. But these difficulties present questions of enforcement and categorization that arise in other areas of law. For example, the law does not generally view com-

45. Id. Rule 4.1(a). The rule applies generally to agents. See Restatement (Second) of Agency § 348 (1958).
47. See Model Rules of Professional Conduct Rule 3.4(b).
48. See id. Rules 3.5(a), 3.4(b).
49. See Restatement (Second) of Agency § 217(b)(ii). The ethics rules themselves contain such a rule with respect to lawyers acting as principals. See Model Rules of Professional Conduct Rule 8.4(a).
50. Another way to see the connection between the lawyer’s obligation to his client and the lawyer’s obligations to third parties is to view the third parties’ interests as essentially the client’s ex ante interests when behind a Rawlsian veil of ignorance. See Gilson, supra note 14, at 875-76; see also John Rawls, Political Liberalism 305 (1996) (describing the “veil of ignorance”). This nifty rhetorical move transforms all lawyer-client collusion problems into traditional agency problems with an idealized “Rawlsian” client (though if one were to actually try to explain this notion to a real client rather than an academic, the Golden Rule would serve just fine).
petition as a tort because, like legal advice, we generally believe that competition promotes social welfare despite the fact that it hurts some people. But we distinguish "competition on the merits" from blowing up a competitor's plant, and joint ventures from price fixing agreements.51

Aside from the problems of lawyers acting against their clients' interests and lawyers colluding with their clients against the interests of third parties, there is a third type of "agency problem" that plays a lesser role in professional responsibility and agency law generally, but deserves a brief mention—if only because it is so often ignored. This problem is the collusion of clients and third parties against the lawyer. Although the lawyer generally enjoys an informational advantage over clients and third parties, the lawyer may, in certain circumstances, find himself at a contractual disadvantage. The client and third party (and usually the third party's lawyer), after having received the benefit of the (client's) lawyer's advice, may try to cut the (client's) lawyer out of the deal. Two seemingly unrelated ethics rules address this problem, at least indirectly.52 The first is the so-called "no contact" rule.53 Although this rule is ostensibly directed at protecting a client from being taken advantage of by another client's lawyer, it also protects the absent lawyer from being cut out without his knowledge.54 The other relevant rule is the prohibition of restrictions on the lawyer's right to practice as part of a settlement.55

51. Cf. Robert D. Cooter & Daniel L. Rubinfeld, Economic Analysis of Legal Disputes and Their Resolution, 27 J. Econ. Literature 1067, 1083-84 (1989) (defining nuisance litigation action as one that both sides recognize as having no merit and the expected damage reward is zero).

52. For a discussion of a similar agency problem in the settlement of a class action suit conditioned on a waiver of statutorily authorized attorney fees for the class lawyers, see Evans v. Jeff D., 475 U.S. 717, 742-43 (1986) (holding that a district court had the discretion to approve such a settlement).

53. See Model Rules of Professional Conduct Rule 4.2 ("In representing a client, a lawyer shall not communicate about the subject of the representation with a party the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized by law to do so.").

54. Of course, lawyers who contact the client of another lawyer for the purpose of undermining that client's relationship with his lawyer also run the risk of committing the tort of intentional interference with contractual relations, or aiding and abetting their own clients' commission of the tort. See generally Phoebe Carter, Annotation, Liability in Tort for Interference with Attorney-Client Relationship, 90 A.L.R.4th 621 (1991) (discussing third party liability for tortious interference with attorney-client relationships). But this tort may be difficult to prove. Thus, like the ethics rules on conflicts of interest, Model Rules of Professional Conduct Rule 4.2 may serve a prophylactic purpose consistent with the tort law goals.

55. See Model Rules of Professional Conduct Rule 5.6(b) (stating that a lawyer shall not participate in offering or making "an agreement in which a restriction on the lawyer's right to practice is part of the settlement of a controversy between private parties").
ported purpose of this heavily criticized rule is to make legal services available to more people. But another possible purpose for the rule is to prevent the client and the third party from opportunistically taking advantage of the lawyer by depriving the lawyer of one of the ordinary benefits of representation—future business—at a time when the lawyer might be in a vulnerable bargaining position.

We have not yet exhausted the potential agency problems that exist in legal representation. Agency problems may be compounded by the fact that clients, their lawyers, and third parties may all have agency problems within themselves. The paradigmatic example of agency costs within the client is, of course, the corporate client, which faces agency costs from not only the managers, whose self-interest gave rise to agency theory in the first place, but also from in-house counsel. The problem, however, is broader than that; it includes problems such as: clients who are agents themselves, as with fiduciaries; clients who are represented by agents, as in class actions or unions; or clients who have contractual relationships with insurance companies under which the insurance company provides the lawyer. The paradigmatic agency problem “within the lawyer” is the law firm in which the lawyer practices. Lawyers are agents of their firms as well as of their clients, and difficulty of monitoring poses problems in the lawyer-firm relationship similar to those in the lawyer-client relationship. But again, the problem is broader, for it includes inter-lawyer relationships as well as intra-lawyer (that is, intra-firm) relationships.

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56. See, e.g., Stephen Gillers, A Rule Without a Reason: Let the Market, Not the Bar, Regulate Settlements that Restrict Practice, A.B.A. J., Oct. 1993, at 118, 118 (criticizing Model Rule of Professional Conduct Rule 5.6(b)).

57. This rationale, which the rule shares with its neighbor rule prohibiting restrictive covenants, Model Rules of Professional Conduct Rule 5.6(a), explains the otherwise bizarre placement of Model Rules of Professional Conduct Rule 5.6(b) in a group of rules dealing with “Law Firms and Associations.”

58. Model Rules of Professional Conduct Rule 5.6(b) thus operates as a limitation on the general requirement in Rule 1.2(a) that a lawyer “shall abide by a client’s decision whether to accept an offer of settlement of a matter.”

59. See generally Model Rules of Professional Conduct Rule 1.13 (discussing the lawyer-client relationship when the client is an organization).

60. For an optimistic view of in-house counsel, see Gilson, supra note 14, at 913-15 (suggesting that in-house counsel might serve as the new gatekeepers). For a more pessimistic view, see Langevoort & Rasmussen, supra note 34, at 402 (arguing that in-house lawyers may act in self-interested ways to maximize the volume of their work and size of their staffs).


63. For an argument that these agency problems support imposing discipline on law firms rather than on only individual lawyers, see Ted Schneyer, Professional Discipline for Law Firms?, 77 Cornell L. Rev. 1 (1991).

64. Ethics rules dealing with intra-lawyer agency problems are numerous. See, e.g., Model Rules of Professional Conduct Rule 1.6 cmt. [8] (discussing lawyer disclosure
These multiple agency problems are mainstays of professional responsibility. If law and economics is to seriously engage professional responsibility, then its practitioners must recognize that they are buying into not simply one relationship, but a whole family. This fact has important practical consequences for economic analysis. First, multiple agency problems complicate matters tremendously. Instead of just a concern with lawyers' acting against their clients' interests, lawyers acting with clients against the interests of third parties, and clients acting with third parties against lawyers, each of these possible agency problems can exist in one of the subsidiary relationships. For example, lawyers may collude with another corporate agent against the corporate client's interest,\(^6\)\(^5\)\(^6\)\(^5\)\(^6\)\(^5\) or become victimized by a corporate client colluding with its agents against the lawyer.\(^6\)\(^7\) Similarly, a lawyer may collude with aligned lawyers against a client,\(^6\)\(^8\) collude with the client against these aligned lawyers,\(^6\)\(^9\) or become victimized by the client colluding with the aligned lawyers.\(^7\)\(^0\) Second, the interaction among these agency problems may be complex; in particular, attempts to mitigate one agency problem may simultaneously exacerbate an-

\(^{65}\) See, e.g., In re American Continental Corp./Lincoln Sav. and Loan Sec. Litig., 794 F. Supp. 1424, 1453 (D. Ariz. 1992) (holding that "where a law firm believes the management of a corporate client is committing serious regulatory violations, the firm has an obligation to actively discuss the violative conduct, urge cessation of the activity, and withdraw from representation where the firm's legal services may contribute to the continuation of such conduct").

\(^{66}\) This concern is the justification for the so-called "Miranda warning" contained in Model Rules of Professional Conduct Rule 1.13(d).

\(^{67}\) See, e.g., Balla v. Gambro, Inc., 584 N.E.2d 104 (Ill. 1991) (rejecting a claim of retaliatory discharge by in-house counsel).

\(^{68}\) For example, one of the justifications for Model Rules of Professional Conduct Rule 1.5(e)'s restriction on fee splitting is that fee splitting arrangements could lead to collusion between the referring lawyer and an inferior referee who could not get business on his own and bribes the referring lawyer to send business his way. See Gilson, supra note 14, at 896.

\(^{69}\) See, e.g., Meehan v. Shaughnessy, 535 N.E.2d by 1255 (Mass. 1989) (noting that lawyers breached fiduciary duties to their partners by soliciting clients before leaving to start their own firm).

\(^{70}\) See, e.g., In re Himmel, 533 N.E.2d 790 (Ill. 1988) (suspending a lawyer for one year for failing to report the ethical violation of his client's former lawyer, partially on the ground that the successor lawyer drafted a settlement agreement under which the successor lawyer and the client were to receive money in return for the client's promising not to prosecute or seek discipline against his former lawyer).
other. Economic analysis can play a useful role in helping to develop
a sense of judgment about which problems are most significant in any
given situation.

B. Solutions to Agency Problems: Complements of the Firm

There is no perfect solution to the agency problems described
above. All solutions are costly and none completely eliminates all
agency problems. The approach of law and economics is to try to
identify those solutions that yield the greatest reduction in agency
problems at the lowest cost.\textsuperscript{71} One way to do this is to compare the
effects various solutions might be expected to have on the agency
problems discussed above. In doing so, it is useful to distinguish be-
tween solutions that create tradeoffs among agency problems and sol-
lutions that act as complements by mitigating more than one problem
simultaneously.

The notion of tradeoffs is ubiquitous in economic analysis. In a
world of scarce resources, having more of some resources usually en-
tails having less of others. On the other hand, in law generally and in
professional responsibility specifically, some theorists prefer to think
in absolute rather than relative terms, especially where they believe
"rights" or "principles" are at stake. Law, like life, is more flexible
and less internally consistent than these theorists would prefer. "Bal-
ancing" and "reasonableness" are found everywhere. Thus, law and
economics has enjoyed great success in "explaining" law by articulat-
ing the tradeoffs that exist in different areas, lying in wait to ensnare
those who dare attempt to impose a foolish consistency.

In professional responsibility, the most commonly discussed tension
is that between the duty the lawyer owes to the client and the duty the
lawyer owes to others. Using the economics of agency discussed
above, we can recast this tension as a tradeoff between solutions to
the lawyer-client agency problem and the lawyer-client collusion prob-
lem. Consider the bonding solution to the lawyer-client agency prob-
lem, in which some of the lawyer's assets are put at risk of forfeiture in
the event that the lawyer acts against the client's interests. The more
successful the bonding, and thus the lower the risk of the lawyer-client
agency problem arising, the greater the risk that the lawyer-client col-
lusion problem will occur. As a result, the law governing lawyers has
always included not only bonding rules, but antibonding rules, better
known as rules attempting to promote the lawyer's "independence"
from the client.\textsuperscript{72} Independence helps solve the lawyer-client collu-

\textsuperscript{71} See Macey & Miller, supra note 33, at 970.
\textsuperscript{72} See Model Rules of Professional Conduct Rule 1.2(b) (1995) (allowing inde-
pendence from client's views or activities); id. Rule 1.5(d) (prohibiting contingent fees
in criminal or domestic relations cases); id. Rule 1.8(e) (prohibiting a lawyer from
providing financial assistance in litigation); id. Rule 1.8(j) (prohibiting a lawyer from
acquiring a proprietary interest in the cause of action or subject matter of litigation);
sion problem, but at the expense of exacerbating the lawyer-client agency problem. In general, there is no unique solution to this tradeoff; rather, in evaluating rules one must examine the particular context to see whether it is more important to guard against the lawyer-client agency problem or the lawyer-client collusion problem.

When law and economics met professional responsibility, however, it purported to find a way out of the tradeoff. The trick was to find an institution that simultaneously reduced the risk of the lawyer-client agency problem and the risk of the lawyer-client collusion problem; that is, the solution to one problem must complement rather than exacerbate the solution to the other. The institution economists have identified is the large law firm.\(^7\) The theory is that the law firm protects clients against the lawyer-client agency problem by posting a bond in the form of its reputation for client service and then monitoring the conduct of its member lawyers to prevent forfeiture of the reputational bond. At the same time, the firm protects third parties from lawyer-client collusion by developing client-specific human capital, which makes it costly for the client to switch firms. This lock-in effect gives the law firm sufficient bargaining power to thwart any attempt by the client to wrongfully impose costs on third parties. In the language of antitrust, the legal services offered by law firms present a tying arrangement: if clients want the benefits of monitoring against lawyer-client agency problems, they must accept the tied product of anti-collusion measures.\(^7\)

Though the possibility of a complementary solution, such as the law firm, is quite tempting, it is important to understand the conditions necessary for such a solution to work. If too many celestial bodies must align, then the Age of Aquarius may never arrive, or may be too fleeting to achieve the prophesied results.\(^7\) As a preliminary matter, it is important to note that the law firm solution is procedural rather than substantive; it represents a choice about which institution should resolve the tradeoff rather than identifying how the tradeoff should be resolved. And although the firm solution is common in economics, in the sense that single ownership “eliminates” the problem of conflict-

\(^7\) See Ribstein, supra note 34 (manuscript at 14-23, on file with author).


\(^7\) See Aquarius, on Hair: Original Soundtrack Recording (RCA Records 1979).
ing resource uses by internalizing the problem within the firm, in this context the law firm is not playing that role. Thus, the law firm solution depends crucially on how much we really believe the firm can successfully navigate the lawyer-client agency problem and the lawyer-client collusion problem simultaneously. Let us consider the two problems in turn.

The key to the firm as a solution to the lawyer-client agency problem is the effectiveness of the reputational bond. There is no doubt that reputation matters to some degree. Business clients, like most customers, rely on brand name as a proxy for quality that is difficult to assess directly. But there are limits to reputation. For example, for reputational bonding to work, lawyer-client agency problems must be accurately identified and widely publicized, and the reputational bond of potential future business must be large enough that the harm to the law firm's reputational asset from misconduct is commensurate with the social harm the misconduct causes. One would expect, however, that the same information asymmetry that created the lawyer-client agency problems in the first place also makes reputation difficult for clients or the public to assess. Moreover, law firms may be particularly adept at manipulating evidence of agency problems so as to often be able to evade or minimize reputational penalties. As for the information law firms cannot control, it may misrepresent or exaggerate agency problems. In the jargon of law and economics, there will be overinclusion and underinclusion problems in the "enforcement" of the reputational bond.

There are several ways to improve the effectiveness of the reputational bond provided by law firms. One way is to increase the size of the bond by increasing the size of the firm. To the extent that large size puts the firm more at risk, the firm may face something akin to a


77. As Oliver Williamson explains:
    Reputation effects will deter defection from the letter and the spirit of an agreement in the degree to which (1) defections can be made public knowledge, (2) the consequences of defection can be fully ascertained . . . , and (3) parties who experience or observe defection penalize the offender and/or his successors in "full measure."

Williamson, supra note 18, at 395-96; see also id. at 406-07 (listing other reasons why reputational bonding might not be effective); Gillian K. Hadfield, Problematic Relations: Franchising and the Law of Incomplete Contracts, 42 Stan. L. Rev. 927, 978 n.232 (1990) (discussing limits of reputational effects in franchising).

78. According to Professor Ribstein, "Specific misconduct will diminish the value of the lawyer's reputation in an amount that varies according to the public's perception of the seriousness of the conduct." Ribstein, supra note 34 (manuscript at 15, on file with author) (emphasis added). The question is how accurate the public's perception is.

79. See Langevoort & Rasmussen, supra note 34, at 410.

80. See Ribstein, supra note 34 (manuscript at 17-19, on file with author).
private punitive damage regime. But law firm size does not guarantee a larger or more effective reputational bond; in fact, size may cut in the opposite direction. Size increases the cost of monitoring—that is, agency problems—within the firm. Relatedly, size makes it difficult for a firm to establish and maintain an ethical “culture” of informal norms rather than formal monitoring and regulation. Size also may make it easier for the firm to explain away misconduct as an aberration and blame it on individual wrongdoers rather than the firm itself, thus reducing the reputational penalty the firm suffers. On the other hand, if large size is effective at increasing the reputational bond, then the bond may create overdeterrence and client opportunism problems well-recognized in punitive damage regimes.

A second way to improve the effectiveness of reputational bonding is to supplement it with additional monitoring to improve the accuracy of the reputational information. That is precisely what many clients have done through the use of in-house counsel. But while in-house counsel may improve client monitoring, it is not clear whether in-house counsel from different companies coordinate their knowledge to the extent necessary to significantly improve the effectiveness of reputational bonding. Moreover, the ability of in-house counsel to monitor outside lawyers is itself limited by the competence and experience of in-house counsel as well as their own self-interest.

Even if the reputational bonding mechanism successfully minimizes lawyer-client agency problems, there nevertheless remains the question of whether the firm simultaneously minimizes lawyer-client collusion problems. A key to the firm’s success in this arena is bargaining power, which results from the specific knowledge the firm develops about a client’s needs and the firm’s quality. But, as Professor Gilson has argued, once clients become concerned enough about lawyer-client agency problems to increase their monitoring of law firms, the law firm loses the bargaining advantage necessary to resist lawyer-client

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81. Professor Ribstein’s contrary view, that size conquers all, reminds me of Boxer, the horse, whose response to every problem was “I will work harder.” But that response, although often admirable, is not always best, as Boxer discovers too late to avoid his demise. See George Orwell, Animal Farm (1945).

82. Professor Ribstein disagrees. He argues: “But to the extent that a firm’s reputational bond is an increasing function of size, large size may make economic sense even if it increases shirking and monitoring costs.” Ribstein, supra note 34 (manuscript at 20, on file with author) (emphasis added). Although it is certainly possible that increasing size could reduce agency costs more than it increases them (and likely true when comparing small firms as a group with large firms as a group), it seems highly unlikely that this relationship invariably holds true.

83. The idea that organizations with large reputational capital may be better able to weather misconduct is captured by the phrase “living off one’s reputation.”

84. Professor Williamson cites the Japanese car supplier associations and labor unions as two economic institutions that serve to improve the accuracy of reputational information. See Williamson, supra note 18, at 121 & n.11 (discussing supplier associations); id. at 261 (discussing unions).

85. See Langevoort & Rasmussen, supra note 34, at 401-02.
collusion. Even if bargaining power exists, however, it may not be sufficient to ensure that lawyer-client collusion does not occur. In the first place, the law firm might use the lock-in effect to harm the client rather than to prevent the client from wrongfully harming others. On the other hand, if the law firm decides that the benefit from pleasing the client exceeds the costs it will suffer by colluding with the client against third parties, then the law firm will not be able to resist lawyer-client collusion. Indeed, the very reputational bond that enables the law firm to combat lawyer-client agency problems could be strengthened by a firm’s willingness to collude against third parties. This tendency would be exacerbated by agency problems within the client which, interestingly, could result in the complementary solution completely flipping, so that the law firm would wind up engaging or acquiescing in conduct that hurts both the client and third parties simultaneously.

My point is not to disparage law firms or the possibility of complementary solutions, but to suggest that more may be involved in developing such solutions than law and economics scholars have thus far recognized. We now have the makings of a theme. Law and economics has much to offer professional responsibility, from playing out the implications of self-interest to identifying agency problems to recognizing tradeoffs and the potential for complementary solutions. But law and economics also has much to learn, both about when to press the analysis farther than it has done and when to pull back. Relationships are complicated things.

C. Beyond the Shadow of the Rules

Law and economics must pay more attention to the role that legal rules governing lawyers can play in developing solutions to agency problems. In the discussion above, I have provided some examples of how ethics rules and other law governing lawyers attempt to ad-

86. See Gilson, supra note 14, at 899-903.
87. See Williamson, supra note 18, at 138 (noting that although “reputation effects can deter managers from behaving irresponsibly,” they are imperfect because “[s]ome managers may shrug them off if the immediate gains are large enough and if they cannot be required to disgorge their ill-gotten gains”).
88. Professor Gilson is quite pessimistic on whether law firms can recapture the gatekeeper role he postulates they might have played, although he tentatively suggests that in-house counsel might be able to provide the complementary solution. See Gilson, supra note 14, at 913-15. As he recognizes, however, there are “very real barriers” to in-house counsel successfully serving as gatekeepers. Id. at 915. For example, in-house counsel are far more strongly bonded to their clients and, perhaps more importantly, to the agents of those clients, than most law firms are, making their ability to resist lawyer-client collusion difficult.
89. My focus here is on the choice between legal and nonlegal solutions to agency problems, not on the choice among legal institutions for regulating lawyers. On that question, see David B. Wilkins, Who Should Regulate Lawyers?, 105 Harv. L. Rev. 799 (1992).
dress various agency problems, either directly (through prohibition or punishment of conduct resulting from agency problems) or indirectly (through prohibition of activities that facilitate agency problems). In this section, I suggest two related ways in which legal rules can serve as complementary solutions to agency problems.

First, ethics rules and the law governing lawyers can play the same role as the one discussed in the prior section of this Article relating to law firms. The reason is that the rules define the qualifications for membership in the profession and the scope of acceptable conduct within the profession; in turn, the profession acts, in some sense, as a mega-firm. Thus, there are rules designed to protect against both lawyer-client agency problems and lawyer-client collusion problems. More important, however, is that the rules are tied together through regulatory bundling. Thus, clients are legally protected from lawyer-client agency problems, but in return, they must submit to regulation of lawyer-client collusion problems. The market power of the legal profession as a whole allows this tying—or regulatory bundling—to occur because clients will have a difficult time finding a substitute for legal services. This account provides a parallel to Professor Gilson’s explanation for the decline in “professionalism”: as clients find more ways to substitute away from legal services, it becomes more difficult for regulatory bundling to work.

In some sense, this notion is not new at all. Professional responsibility has long recognized the quid pro quo of a limited monopoly for the legal profession in return for an undertaking of various social obligations. What is new in this account is the recognition that there is an inextricable link between the rules intended to solve very different problems, along with a clearer understanding of how that link works. To ignore this link is to miss an important aspect of the regulatory structure of the legal profession.

A second role for legal rules is to complement or facilitate nonlegal solutions to agency problems. Law and economics scholars, in their zest to find private solutions to agency problems, sometimes overlook this role for legal rules, and even find the legal regime hostile to these solutions. For example, legal regulation may enhance reputational effects by publicizing misconduct and providing more accurate information about it than would otherwise exist. In addition to reputational bonding, economists sometimes suggest certification as another pri-

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90. The profession and the firm do not exhaust all the possible options. There are numerous subgroups within the profession that serve similar functions, such as the American Bar Association, the Association of Trial Lawyers Assurance, the American College of Trial Lawyers, and the American Law Institute. These organizations all provide a type of professional bonding. In addition, as I have recently written, legal malpractice insurers such as the Attorneys’ Liability Assurance Society, through their loss prevention programs, also play a similar role. See George M. Cohen, Legal Malpractice Insurance and Loss Prevention: A Comparative Analysis of Economic Institutions, 4 Conn. Ins. L.J. 305 (1997).
vate mechanism for overcoming the lawyer-client collusion problem. Legal rules facilitate lawyer certification of client positions in both litigation\textsuperscript{91} and transaction\textsuperscript{92} settings. Further, the growth of malpractice liability has given rise to increase loss prevention activity by malpractice insurers.\textsuperscript{93}

We have thus come full circle from where we began. Legal rules matter. They are the protector of last resort against the excessive pursuit of self-interest. They tie solutions directed at various agency problems together in ways that may reduce tradeoffs. And they are often complementary to nonlegal solutions. Taking agency problems seriously means taking the law governing lawyers seriously.

III. SOME RULES OF ENGAGEMENT

Thus far, I have tried to trace and develop the relationship between law and economics and professional responsibility. In this part, I briefly play out some of the themes in a few specific areas that have received recent attention from law and economics scholars.

A. Confidentiality, Legal Advice, and Prohibited Assistance

The duty of confidentiality, along with the related attorney-client privilege and work product doctrine, has received a surprisingly cold reception from law and economics scholars.\textsuperscript{94} I say surprising because the classic rationale for these doctrines—that they are necessary to encourage clients to seek out legal advice so that they will comply with the law—has a definitive law and economics flavor to it. Law and economics often focuses on how legal rules affect incentives ex ante rather than how parties behave ex post. Yet Professor Fischel has recently argued that the confidentiality doctrines should be abolished because they benefit lawyers while harming clients and society as a whole.\textsuperscript{95} Although Fischel argues that the legal profession has

\begin{itemize}
\item \textsuperscript{91} See Fed. R. Civ. P. 11.
\item \textsuperscript{92} See Model Rules of Professional Conduct Rule 2.3 (1995) (permitting attorneys to conduct evaluations at the client's direction but for the primary benefit of third parties).
\item \textsuperscript{93} See Cohen, supra note 90.
\item \textsuperscript{95} Fischel states: "Confidentiality rules . . . benefit lawyers but are of dubious value to clients and society as a whole. Absent some more compelling justification for
conned us into accepting these perverse rules, it may be he who has been unwittingly seduced by the bar’s “P.R.”

In the first place, confidentiality rules are an essential part of agency relationships (and agency law) generally because in the absence of such rules, the informational advantage the agent has would enable the agent to use information about the principal to the principal’s disadvantage. Applied to the lawyer-client context, the fundamental purpose of confidentiality rules is to help minimize lawyer-client agency costs. Although this point is obvious, it is surprising how often it is neglected in professional responsibility discussions of the duty of confidentiality. Instead, these discussions often focus only on client incentives, rather than lawyer incentives, and they seem to view lawyers as neutral, altruistic, or victims of client manipulation.

This focus on client incentives partly results from the tendency to lump the duty of confidentiality with the attorney-client privilege, which does seem to be more directed to client incentives. But even the attorney-client privilege implicates lawyer-client agency problems. Absent the privilege, lawyers’ informational advantage over their clients would be magnified: lawyers would be in a much better position than their clients to assess and control the increased legal risks to clients associated with the possibility of lawyer testimony. Although clients would be more reluctant to hire lawyers in the first place, for those who did, this informational asymmetry would give self-interested lawyers a greater ability and incentive to manipulate the creation and presentation of evidence to promote their own interests at the expense of their clients' interests. Thus, the loyal lawyer as-

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96. See Restatement (Second) of Agency § 395 (1958). In agency law, the duty of confidentiality is considered part of the duty of loyalty agents owe to principals. In professional responsibility, the duty of confidentiality is often distinguished from the duty of loyalty.

97. The ethics rules, for example, take this approach to justifying the general duty of confidentiality stated in Model Rules of Professional Conduct Rule 1.6. See Model Rules of Professional Conduct Rule 1.6 cmt. [2]-[4]; id. pmbl. [7]; id. Scope [20]. The lawyer-client agency problem aspect of confidentiality is relegated to the conflict of interest rules, see id. Rules 1.8(b), 1.9(c), in contrast to the agency law rule, Restatement (Second) of Agency § 395, which lumps the use and disclosure of confidential information together.

98. See Allen et al., supra note 94, at 362-74 (stating that the attorney-client privilege encourages clients to present to lawyers negative information that may nevertheless not be legally detrimental to clients).

99. Recall the discussion above about what makes lawyers unique agents. In the agency cost theory, the attorney-client privilege is another example of a rule in part designed to protect clients from the unique harm lawyers can do to them. See supra Part II.

100. Fischel suggests that lawyers would respond to the absence of the attorney-client privilege by investigating less, reducing the number of lawyers working on a case, and avoiding written memoranda and interview notes, all of which would reduce the value of legal services to clients and so the demand for those services. Fischel,
sumed in most discussions of the attorney-client privilege may be in part a result of the privilege, which helps bond lawyer interest to client interest.

Lawyers may have an interest in characterizing the confidentiality problem as one of client incentives for seeking legal advice rather than lawyer incentives for disloyalty, but law and economics is supposed to be sensitive to self-interested behavior that other approaches overlook. The duty of confidentiality is about lawyer self-interest; in fact, the duty of confidentiality presupposes lawyer self-interest. Fischel not only ignores this rationale for the duty of confidentiality, but he also turns it on its head by arguing that lawyer self-interest has perpetuated and expanded the rule.

Fischel makes the same move when he discusses the self-defense exception to the ethics rule on confidentiality. He joins others who have criticized this exception as reflecting rather than responding to lawyer self-interest. But the self-defense exception fits within agency theory. Absent the self-defense exception, self-interested lawyers would be more reluctant to represent clients who, as Fischel recognizes, might attempt to use an absolute confidentiality obligation to unfairly hold up the lawyer's fees or otherwise blackmail the lawyer. This same rationale might also justify the application of the self-defense exception to suits brought by third parties against lawyers, which Fischel finds unjustifiable. In fact, in one sense, the rationale for third-party suits is stronger. One way a lawyer could respond

\[ \text{supra note 37, at 7. Although these responses are plausible, my point is that lawyers' responses would not be limited to those that arguably favor clients' interests. Lawyers might, for example, investigate more, put more lawyers on a case, or write more memoranda if those actions would protect them more from the greater number of third-party suits to which they would now be exposed, or if those actions would enable them to extract greater fees. True, these responses would decrease the demand for lawyers even more. But, if the elimination of the attorney-client privilege itself eliminated clients whose demand for legal services was relatively elastic, the remaining clients would have a more inelastic demand that might be ripe for lawyer exploitation, or avoidance of client exploitation.} \]

\[ \text{101. This omission is quite remarkable given that Professor Fischel is one of the preeminent exponents of agency cost theory as applied to corporate law. See Easterbrook & Fischel, supra note 9, at 14-15 (noting the use of "agency costs" throughout their book).} \]

\[ \text{102. Model Rules of Professional Conduct Rule 1.6(b)(2).} \]

\[ \text{103. One interesting question raised by the self-interest rationale for the self-defense exception is whether it makes self-interested behavior by lawyers a self-fulfilling prophecy. The exception applies only to lawyers who are threatened with certain kinds of harm, largely economic. But lawyers whose morals are compromised by client behavior are not provided a disclosure option by the ethics rules, though the rules do allow counseling, see id. Rule 2.1, and withdrawal, see id. Rule 1.16(b)(3), while making vague references to other possibilities. See id. pmbl. [6]; id. Scope [14]. To the extent that these approaches are weaker than the explicit disclosure option, the profession may discourage altruistic people, relative to self-interested people, from becoming lawyers. That does not necessarily mean a morality self-defense rule would be a good thing. Such a defense might be too hard to enforce and too vulnerable to self-serving justifications by lawyers.} \]
to the absence of a self-defense exception would be to exercise more caution in choosing clients. That strategy, however, would not help lawyers avoid third-party suits. Another argument Fischel makes in criticizing the self-defense exception is that lawyers could use it to blackmail the client, that is, to "threaten to reveal the information if a client refuses to pay a disputed bill or threatens to expose malpractice." Although that is possible, under the current legal regime (in contrast to Fischel’s "no duty of confidentiality" regime) it is unethical, not to mention possibly illegal or tortious. The risk to the lawyer is asymmetric with the risk to the client for blackmailing the lawyer in a world with confidentiality rules but no self-defense exception, because in that world the lawyer would be handcuffed from proving the blackmail, whereas the client in the existing regime is able to report or sue the lawyer.

The best criticism of the self-defense exception, which Professor Fischel suggests, is that it is hypocritical because lawyers are more interested in protecting themselves from client abuse than in protecting third parties from client abuse. That brings us to the lawyer-client collusion problem, which, of course, is the biggest problem with confidentiality rules generally. The agency theory discussed above suggests that the duty of confidentiality should not be interpreted so as to facilitate lawyer-client collusion; thus, the duty cannot be absolute. Moreover, lawyer self-interest means that the absence of lawyer-client collusion cannot merely be assumed, but must be actively secured. Yet traditional discussions of lawyer confidentiality often simply assume that lawyers will (altruistically) counsel their clients not to engage in wrongful behavior and that the "ethical moment" occurs when the client says no. In fact, the problem arises when the lawyer sees signals of client misconduct and chooses to ignore those signals rather than act on them. That is the beginning of complicity.

104. Fischel, supra note 37, at 11.
105. The exception in Model Rules of Professional Conduct Rule 1.6(b)(2) is limited to information the lawyer “reasonably believes necessary” to reveal. Moreover, the threat itself would be prohibited by Rule 1.8(b) because it is not permitted by Rule 1.6.
106. See, e.g., Model Rules of Professional Conduct Rule 1.6 cmt. [1], [3] (“One of the lawyer’s functions is to advise clients so that they avoid any violation of the law in the proper exercise of their rights. . . . Based upon experience, lawyers know that almost all clients follow the advice given, and the law is upheld.”). The problem is that confidentiality rules themselves do not provide an incentive for lawyers to give such advice. Other ethics rules recognize that the lawyer in fact might not want to give advice that the client does not want to hear and so require such advice to be given. See id. Rules 1.2(e), 1.2 cmt. [6], 2.1, 2.1 cmt. [5]. Again, however, it is interesting that the agency problems with confidentiality are not discussed or referred to in the confidentiality rule and the accompanying comments.
107. See, e.g., United States v. Benjamin, 328 F.2d 854, 862 (2d Cir. 1964) (holding that a lawyer can be held to have committed criminal fraud if he “deliberately closed his eyes to facts he had a duty to see . . . or recklessly stated as facts things of which he was ignorant” (citations omitted)).
It is also consistent with the self-interest story. The very lawyer self-interest that makes the protection of confidentiality necessary also makes the abuse of confidentiality possible. Confidentiality rules hinder lawyers' ability to use clients' information against them. But by enabling lawyers to get more information about clients, the confidentiality rules give lawyers a leg up on future business. Future business depends on how successful the client is, which, in turn, depends on how many risks the client is willing to take. If clients bear the downside legal risks while lawyers do not, then the lawyers have an incentive to advise or permit clients to take "aggressive" legal positions, which at some point may spill over into criminal or fraudulent acts. If the risky action succeeds, then the lawyer is rewarded; if it fails, then the lawyer does not expect to suffer.108

The law of lawyering, as discussed above, recognizes the lawyer-client collusion problem by limiting the confidentiality rules. Lawyer liability to third parties, such as aiding and abetting liability or negligent misrepresentation, is one way of bonding lawyers to their advice (or lack thereof). The crime-fraud exceptions to the attorney-client privilege and the work product doctrine make legal sanctions against client wrongdoing more effective, and so deter lawyers from engaging in the collusive strategy. How effective these limitations are and how far they should extend are matters of great debate, though it is apparent from the legal wreckage that makes up professional responsibility cases that lawyers too often underestimate the import of these limitations. For my purposes, however, three observations will suffice.

First, the confidentiality rules and the limits to those rules represent a good example of the regulatory bundling discussed above. Although clients benefit from confidentiality rules, and the attorney-client privilege and work product doctrine give lawyers market advantages over other groups, these benefits come at a price, namely, the limitations designed to thwart lawyer-client collusion.109 You have to take the

108. Langevoort and Rasmussen worry that transactional lawyers too often overstate legal risks to get more fees. See Langevoort & Rasmussen, supra note 34, at 377. To the extent that future business is more important than current fees, they may have it exactly backward, depending on how strongly the rules against lawyer-client collusion are enforced. Transactional lawyers' bias is more likely to be in favor of legal advice that permits client activity. If that activity turns out to be legally problematic, lawyers typically argue either that the client was unfairly singled out (in the underenforcement world) or that the client's activity was socially desirable and the law should not be interpreted rigidly to prohibit it (in the overenforcement world). Lawyers have more incentive to overstate legal risks in one-shot transactions, such as real estate closings, wills, divorces, and other consumer transactions.

109. Confidentiality rules also may encourage private complementary solutions. In particular, confidentiality rules may encourage greater investigation because clients have less reason to fear that lawyers will use information they discover to their clients' disadvantage. But investigation is a classic tying arrangement: at the time the investigation is conducted, the lawyer does not know whether the information found will be good or bad. Critics of confidentiality rules seem to assume that it is easy for lawyers to suppress bad information, but at least in civil litigation, this is not so given liberal
bad with the good. For this to work, however, the “good” has to be
good enough for clients and lawyers to buy into the system. Thus, the
criticism that confidentiality rules benefit lawyers is insufficient.

Second, the limits to confidentiality that try to combat lawyer-client
collusion are sensitive to economic considerations of when such collu-
sion is likely to occur. For example, many of the recent developments
of the law governing lawyers that limits confidentiality have occurred
in the context of client insolvency, most notably the savings and loan
crisis. Although these developments are often criticized as simply
searching for deep pocket defendants, there is an economic explana-
tion. Just as the law of vicarious liability deters principals from reduc-
ing their liability bills by hiring insolvent agents, so, too, does the law
of lawyering deter lawyers from leeching onto potentially insolvent
clients who may be underdeterred by legal sanctions, which ineffi-
ciently inflicts costs on third parties. Moreover, the insolvency con-
text is more conducive to the complex client problem of managing
agents acting against the entity’s best interests.

Third, though Fischel recognizes the lawyer-client collusion prob-
lem associated with confidentiality rules, he falls into the trap of
thinking that the rules do not matter. He makes no reference in his
article to the crime-fraud exception110 or the law governing lawyer lia-
bility to third parties or even clients.' Rather, he focuses on the self-
interested behavior of the bar in attempting to resist liability for law-
yers through confidentiality rules.112 This story is surely an important
one, and the criticism of the bar is well-taken, but as an argument
against the existing legal regime, it is grossly incomplete.

discovery rules. In transactional work, negative information limits the actions lawyers
may take on behalf of clients. In both cases, ex ante investigation facilitates ex post
policing.

110. See, e.g., Fischel, supra note 37, at 8 (discussing the use of the attorney-client
privilege and the work product doctrine to shield negative results from product tests
without mentioning the crime-fraud exception); id. at 9 (noting that confidentiality
rules “create powerful obstacles to the discovery of attorney participation in an un-
lawful scheme” without citing to the crime-fraud exception or lawyer liability); id. at
30 (noting that “legal advice can itself decrease the probability that the proposed
conduct will be sanctionable by providing clients with advice on how to minimize the
probability of detection” without noting limits on such advice).

111. Fischel refers to the “noisy withdrawal” comment in Model Rules of Profes-
sional Conduct Rule 1.6 and criticizes it as enabling lawyers to “protect themselves”
from liability without making any “provision . . . for the return of fees.” Id. at 15.
Although this may indeed be the bar’s intent behind Rule 1.6, the ethics rules do not
provide immunity from liability.

112. See id. at 12-15. Interestingly, one of the three cases Fischel cites is Barker v.
Henderson, Franklin, Starnes & Holt, 797 F.2d 490 (7th Cir. 1986), in which Judge
Easterbrook declined to impose liability against lawyers under the securities laws be-
cause the ethics rules did not impose a duty to disclose. Again it is ironic that Judge
Easterbrook, Professor Fischel’s co-author and fellow exponent of agency theory, ig-
nores the agency problems created by so strongly deferring to the bar’s vision.

113. The story is well-told, and the criticism effectively made by Susan Koniak. See
Koniak, supra note 6.
B. Conflicts of Interest

Conflicts of interest rules provide a useful comparison to confidentiality rules, both in the treatment they receive from professional responsibility and from law and economics. First, unlike professional responsibility's justification for confidentiality, which seems almost to assume lawyer altruism, the justifications for conflicts rules seem to assume extreme lawyer self-interest. The ethics rules and the law of disqualification do not simply create a duty not to act for an adverse party without the client's consent, which is the agency law rule, but instead forbid representation entirely, which in law and economics jargon is known as a property rule. In addition, the rules governing vicarious disqualification, that is, extending the conflict beyond the lawyer to the firm, also establish strict presumptions which assume that lawyers will find it difficult to resist economic temptation. Moreover, unlike confidentiality rules, conflicts rules have largely received a supportive reception from law and economics scholars, who have justified the harshness of these rules as necessary to combat the agency problems discussed here.

Even in the conflict of interest context, however, law and economics scholars sometimes downplay agency problems. Although generally supportive of the existing conflicts regime, Macey and Miller argue for two reforms. First, lawyers should be allowed to pay clients for the right to engage in conflicting representations. Second, client consent to conflicts should always be allowed to cure the conflict. With respect to lawyer payment to clients, Macey and Miller apparently have in mind situations in which the conflict is likely to impose significant costs on the client to be paid; if the costs to the client are trivial, the client might very well consent without explicit payment. But the situations in which bargaining might make sense are also the situations in which the agency problems are likely to be the greatest. Lawyers have an informational advantage in knowing both how much one client is going to be hurt by divulging information and how much the other is going to be helped. Why the client would be willing to trust the lawyer's assessment of these values is not clear.

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114. See Restatement (Second) of Agency §§ 389, 391 (1958).
115. See Macey & Miller, supra note 33, at 979-93.
116. See Epstein, supra note 33, at 582 (noting difficulty in proving breach of confidentiality); Macey & Miller, supra note 33, at 968-70 (arguing that simply punishing disclosure as opposed to prohibiting representation is not sufficient to address problems of reduced vigor in representation and enforcement). But see Ribstein, supra note 34 (manuscript at 23-48, on file with author) (arguing that current conflicts rules can increase agency costs).
117. See Macey & Miller, supra note 33, at 1003.
118. See id. at 1004.
119. The role the lawyer plays is important. Generally, lawyers are not hired to market their clients' information. See Epstein, supra note 33, at 583 ("The strong separation of legal functions from investment functions is thus understood as part of the..."
national asymmetry helps explain why the waiver rules do not automatically credit client consent. In some sense, the rules—by restricting waiver—are trying to ensure meaningful or fully informed consent.

Law and economics scholars have also paid insufficient attention to the way the conflict of interest rules and the law of disqualification serve as effective bonding devices. Consider the rules concerning joint representation in a transactional setting. If the relationship between the parties comes unglued, then the lawyer is thereafter generally prohibited from representing either in the same transaction. This rule bonds the lawyer to his judgment regarding the potential for conflict. The lawyer pays a large penalty if conflict in fact occurs. This gives the lawyer an incentive to evaluate carefully ex ante the potential for conflict in joint representation and to avoid biasing this judgment by factoring in the possibility of future work arising out of the subsequent turmoil. A similar justification applies to the general rule that in a successive representation a lawyer may not attack his prior work. Allowing lawyers to do so would weaken the lawyer's bond to his prior work and provide too great an incentive for the lawyer to intentionally or accidentally leave loopholes to preserve the possibility of future work.

Conclusion: Courtship or Frigate

One of the themes of the movie from which I took the title of this essay explores is whether true friendship between men and women is possible, or whether sex always gets in the way. The same may be asked of law and economics and professional responsibility. The natural inclination of those inclined toward the philosophical side of legal ethics might be to disparage the encroachment of law and economics on the field and fear that its blind devotion to self-interested behavior threatens to swallow up whatever remains of professionalism. I have taken a different view here. I have argued that self-interested behavior is an inevitable, though not all-consuming, part of professional responsibility, that agency theory—when understood—can richly illuminate many features of professional responsibility, that law and economics can make an import contribution towards our developing complementary solutions to agency problems, and that legal rules do matter. If scholars keep these features in mind, then this may indeed be the beginning of a beautiful friendship.

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120. See Model Rules of Professional Conduct Rule 2.2(c) (1995).
121. When Harry Met Sally (Castle Rock Entertainment 1989).