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THE BANK AND CREDIT UNION DISASTERS IN LITHUANIA: WHERE WERE THE LAWYERS?

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ABSTRACT

Since Lithuania's independence in 1991, sixteen banks in the country have gone bankrupt. From 2011 to 2013 two banks—the fifth and sixth largest banks in the country—went bankrupt and three credit unions collapsed. One more credit union collapsed in 2014. One of the questions not yet posed in the context of this crisis of financial institutions in Lithuania is the question: "Where were the lawyers?" This article focuses on a comparative analysis of the regulation and practice of the legal profession in considering whether and how outside and inside bank and corporate lawyers can be effective gatekeepers, foreseeing, preventing, and mitigating such collapses. This comparative research concludes with propositions for changing legal profession regulations as well as lawyers' and corporate officers' education.

KEYWORDS

Corporate lawyers, bankruptcies of banks, legal ethics, legal education

INTRODUCTION

The recent financial crisis in Cyprus demonstrates that the bankruptcies of financial institutions can be detrimental to any country's financial system. Bank disasters and the collapse of other financial institutions are especially dangerous to the fragile financial systems of Eastern European countries which not so long ago emerged from the planned economy of the Soviet Union. Lithuania's independence was restored just over twenty years ago. During this period of independence Lithuania has seen sixteen banks go bankrupt—twelve of them in 1994-1995. However, in 2011-2013 two banks—the fifth and sixth largest banks in the country—suffered bankruptcy, and three credit unions collapsed. One more credit union collapsed in 2014. These debacles nearly brought the entire Lithuanian financial system to its knees.

One of the questions not yet posed in the context of this crisis of Lithuanian financial institutions is the question: "where were the lawyers?" From the global perspective, this question was asked in the aftermath of Enron[1], WorldCom, Tyco, the failure of Lehman Brothers, and the troubled subprime mortgage markets that had a cascade effect on the global financial system.[2] These collapses all have at least two features in common: risky behavior in financial markets, and allegations of accounting fraud. The stories of banks' demise in Lithuania include examples of deliberate wrongdoing; but these aspects will not be analyzed in this paper, because official investigations are not yet concluded. The purpose of this paper is to analyze the roots of the systematic problem that lawyers should serve as effective gatekeepers in such events. There is no doubt that some lawyers as well as accountants were close to the causes of those events. For victims of these the Lithuanian bank debacles it is difficult to understand why none of the professionals blew the whistle to stop the overreach that took place. So, what role, if any, did lawyers play in this crisis of financial institutions? The point here is not to prove that lawyers are pervasively immoral, but to explain what the challenges of being corporate lawyer are. These lawyers "have both economic incentives and cognitive biases that systematically incline them to at least shut their eyes to instances of

[1] "The fall of Enron, once the seventh largest corporation in America, is more than the story of individual misconduct, greed, and deceit. … With the collapse of the former energy giant, more than 4,000 employees lost their jobs; thousands of investors also lost their life savings, as '$70 billion in wealth vanished,' … after public exposure of the firm's alleged role in the creation and misleading public reports of Enron investment" (Deborah L. Rhode and Paul D. Paton, "Lawyers, Ethics, and Enron": 625-626; in: N. B. Rapoport and B. G. Dharan, eds., *Enron: Corporate Fiascos and Their Implications* (Foundation Press, 2004)).

[2] Stephen M. Bainbridge, "Corporate Lawyers as Gatekeepers," *Journal of Scholarly Perspectives* Vol. 8, No. 1 (2012): 6 // http://escholarship.org/uc/item/4tn3p38g.pdf.

client misconduct."[3] Coupled with regulatory failures of legal ethics, it is unrealistic to anticipate that lawyers will serve as effective gatekeepers.

It is also obvious that the banks' demise unfolded from issues of corporate misconduct, which involve failures not only on the part of lawyers, but of multiple regulatory institutions: "accountants, politicians, lawyers, government regulators, corporate officers, and financial advisors", which all needed to work together to devise solutions.[4] Also, it should be noted that in hindsight, "things always look clearer than they were at the time"[5].

This paper focuses on a comparative analysis of the regulations and practices of the legal profession in considering whether lawyers both inside and outside to banks and other corporations can be effective gatekeepers, foreseeing, preventing, and mitigating collapses, as in the aforementioned cases of financial institutions in Lithuania and Cyprus, Enron, LTCM, WorldCom, Lehman Brothers, etc. This article also examines "some lessons from psychology on ways to promote greater mindfulness in business settings"[6] and how the education of lawyers could be improved in order that lawyers would be better able to help their clients identify and prevent potentially harmful correlations. The article draws upon two theoretical paradigms and bodies of literature: 1) the regulation of the legal profession in the context of changing roles of inside and outside legal counsel in corporate settings; and 2) the pressures of the context of the corporate lawyer's role, including organizational culture, psychological biases, and lack of financial expertise. The article concludes with propositions for changing the regulation of both the inside and outside corporate legal profession, as well as for lawyers' and corporate officers' education.

1. THE BANK AND CREDIT UNION DISASTERS IN LITHUANIA: REASONS FOR THE LAWYERS' TORPIDITY

In fall of 2011 the bankruptcy of Snoras, the fifth largest bank in Lithuania, was announced. Barely a year later, in the spring of 2013, the collapse of the sixth largest bank in the country, Ūkio bankas, shattered the fragile financial system of Lithuania, again. From 2012 to 2014 the collapse of four credit unions contributed to customers' distrust in the Lithuanian financial system. These bankruptcies were not a consequence of the recent global financial crisis, but rather a part of the systematic problems mostly unfolding from issues of corporate misconduct. The

[3] *Ibid.*: 8.
[4] Deborah L. Rhode and Paul D. Paton, *supra* note 1: 656.
[5] Donald C. Langevoort, "Getting (Too) Comfortable: In-House Lawyers, Enterprise Risk, and the Financial Crisis," *Wisconsin Law Review* Vol. 2012, No. 2 (2012): 507.
[6] *Ibid.*: 499.

main shareholders and managing directors of Snoras bank, V. Antonovas and R. Baranauskas, are accused of financial fraud and asset embezzlement; they directed nearly half of a billion euros from Snoras accounts to their personal accounts in Switzerland. More than thirty large money transfer transactions were conducted from August of 2008 to June of 2011. Moreover, these so-called "owners" of the bank, using bank resources, allegedly purchased luxury items, like apartments and villas in Vilnius, Nice, Kiev, etc., and exclusive luxury cars, such as Ferraris and Porsches, and made personal use of them. Until the noisy collapse of this bank, no one from the larger institutional structures designated to supervise activity of financial institutions in Lithuania, including the Central Bank of Lithuania, FCIS (Financial Crime Investigation Service), Snoras auditing company Ernst and Young, and others, blew the whistle. It is obvious that these overarching acts of misconduct could not be accomplished without the participation of bank employees and professionals. In comparison with financial chicanery of Enron, which used much more sophisticated financial models to enter transactions considered too risky or controversial and avoid disclosure requirements, the aforementioned patterns of misconduct seem very primitive. But in both cases, despite the vast numbers involved in business and its administration and control professionals and experts, the result was the same: a collapse which saw thousands of employees lose their jobs, and thousands of investors lose their life savings as billions of euros in wealth evaporated.

The disastrous collapse of financial institutions in Lithuania highlights the structural features that permit potentially harmful correlations. Of course, analysis of the situation draws attention to many "longstanding problems, including inadequate disclosure obligations, conflicts of interest, offshore tax havens, and insider trading."[7] But the goal of this article is to scrutinize the lawyers' conduct, because too many members of the legal profession are part of the problem, rather than its solution.[8] In order to execute this analysis, the article analyzes the systematic issues underlying lawyers' perceptions of corporate clients, the ethical pressures for inside and outside corporate lawyers, the impact of psychological biases in organizational culture, and lawyers' lack of financial expertise.

1.1. WHO IS A CLIENT?

In terms of legal relations among corporation and lawyer, analysis sets the question of who is the client of the lawyer, because an individual lawyer in the organization usually works with managers of different levels within the client-

[7] Deborah L. Rhode and Paul D. Paton, *supra* note 1: 625.
[8] *Ibid*.

corporation who may have conflicts of interest with the interests of the corporation' as an entity. The usual mindset of a lawyer working for a corporate client is well defined by an explanation given by Enron lawyers, who have denied that their firm acted improperly. In their view, outside lawyers may assist in a transaction that is not illegal and that has been approved by company management.[9] Moreover, risky business behavior is not illegal per se, and legal counsels "may be aware of aggressive and risky conduct by management but is unaware of fraud or other illegality."[10] So, in many cases counsel may have grounds for suspicion, but no direct evidence of illegality. Thus, from the corporate client's perspective, the question is: what kind of ethics do corporate clients expect of their lawyers? Even if the management of corporations relies on legal advice and approval in structuring transactions, it is not easy for corporate legal counsel to withstand the pressures of corporate cultures that prize aggressive behavior and put a premium on risk.[11] Especially in emerging economies, it is very common for corporations to "want litigators who will press for every advantage and counselors who will exploit every regulatory loophole".[12] In such business settings it is also a common attitude of managers that, "when lawyers are involved in the business aspects of a deal, they usually yield confusion and wasted time, so "the best way to deal with lawyers is not to deal with them at all."[13] This means that in most cases the corporate client "sets the tone for the ethical behavior of its lawyer: the higher the ethical standard of the client, the better the chances that its lawyers behave ethically."[14] Furthermore, taking into consideration the conventional corporate law and lawyers' ethics rule that lawyers are "expected to maximize the interests and benefits of their corporate clients ..., regardless of potential adverse consequences to others,"[15] it becomes inevitable that "allegiance to management's short-term financial interests may compromise obligations to the broader public, as well as to the entity itself."[16] However, the entity, and not its managers, is the lawyer's client, and they owe duty not to the managers, but to the corporation as an entity. The position of the Supreme Court of Lithuania with regards to a limited liability company manager's obligations to the creditors when the company is in financial trouble confirms that the interests of creditors and other stakeholders of the company as an entity shall be balanced with the interests of shareholders. In the

[9] *Ibid*.: 635.
[10] Stephen M. Bainbridge, *supra* note 2: 12.
[11] Deborah L. Rhode and Paul D. Paton, *supra* note 1: : 634.
[12] Christopher J. Whelan and Neta Ziv, "Privatizing Professionalism: Client Control of Lawyers' Ethics," *Washington & Lee Legal Studies Paper* No. 2011-22 (December 8, 2011): 3 // http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1969869.
[13] Stephen M. Bainbridge, *supra* note 2: 8.
[14] Christopher J. Whelan and Neta Ziv, *supra* note 12: 9.
[15] *Ibid*.: 4.
[16] Deborah L. Rhode and Paul D. Paton, *supra* note 1: 642.

case UAB 'Panevėžio spaustuvė' v. RŠ, AB and AG, Civil Case No 3K-3-19/2012[17], the court held that in the normal financial state of the limited liability company, there are no legal relations between the director and creditors of the company. However, when the financial state of the company worsens, the fiduciary duty of the director to take into consideration the interests of the creditors emanates. In other words, the worse the financial state of the company, the more weight the interests of the creditors gain in decision-making by the company's executives. This means that, although a company may be an autonomous subject of law and its executives as well as shareholders may act in the name of the company, they do not assume personal liability for their decisions. The balance of interests that must be taken into account in the decision-making procedure changes when the company is in financial trouble. In such cases the significance of taking into consideration creditors' and other stakeholders' interests entails the fiduciary duty of company executives to carefully weight their decisions. Otherwise their decisions could be held as fraudulent with regards to creditors and subsequently the shield of the company's limited liability may be lifted and the company's executives and shareholders could be held personally liable for the company's obligations.

In terms of the lawyers' obligations to the company as an entity, the result of an unduly circumscribed understanding of lawyers' ethical responsibilities, "counsels often develop a de facto loyalty to management that trumps their de jure duties."[18] Under such circumstances, apparently, changes in regulation and internal structures of firms are needed to ensure corporate lawyers' independent judgment, because otherwise not only does the public lose protection from organizational misconduct, but corporate clients also lose access to disinterested advice and lawyers lose moral autonomy.[19]

Hence, if from the perspective of conventional wisdom it is assumed that corporate clients will "behave badly," the question is "if lawyers, as members of the legal profession, have enough power, independence, awareness, consciousness, will, tools and a supportive environment to act according to their acclaimed professional ideals?"[20]

[17] *UAB 'Panevėžio spaustuvė' v. RŠ, AB and AG*, The Supreme Court of Lithuania, Civil Case No. 3K-3-19/2012.
[18] Stephen M. Bainbridge, *supra* note 2: 7.
[19] Deborah L. Rhode and Paul D. Paton, *supra* note 1: 651.
[20] Christopher J. Whelan and Neta Ziv, *supra* note 12: 9.

1.2. THE ETHICS OF INSIDE LAWYERS

In the study of the legal profession in-house lawyers are now a principal focus of attention[21], because as legal representatives of the entities they are working for, they face several principal–agent problems. The first problem is in maintaining professional independence. In-house lawyers usually have much at stake, because their job security depends on decisions of organizational management supervisors, which in practice are naturally viewed by legal counsels as their employer. Therefore, they "generally face the greatest pressures to maintain group cohesion ... and their position involves maximum information, maximum responsibility, and minimum job security."[22] So, they may be very psychologically "tempted to turn a blind eye to managerial misconduct or even to facilitate such misconduct."[23] For example, in Enron's case, at least two Enron attorneys had serious concerns about the company's financial conduct,"[24] but failed to blow the whistle on time. Moreover, the legal counsel of Enron's auditing company, Andersen, Nancy Temple, "emerged as a key figure in Andersen's demise"[25], because Andersen, as Enron's auditing company, played "a crucial role in creating and auditing questionable investment vehicles, and in certifying Enron's financial statements and public disclosures".[26]

Another principal–agent problem related to longstanding issues of professional independence and conflict of interests arises when an in-house attorney invests his own money into the entity he is working for. Kristina Mordaunt, Enron's in-house legal counsel, not only gave advice on structuring critical transactions, but also invested her own money in one of the Enron's entities specially created for financial chicanery.[27]

In contrast to legal ethics regulations in the United States, where all lawyers are bound by obligations of a very detailed Code of Professional Responsibility, under legal ethics regulations in Lithuania and most European countries, the in-house lawyers are not bound by obligations of any legal ethics codes, because as a rule they are not licensed attorneys, and thus they would not have any ethical obligation to blow the whistle even in the most blatant managerial misconduct cases. With respect to attorneys or in-house lawyers' right to invest in an entity they are working for, no regulation in Lithuania can deter lawyers from behavior which inflicts obvious conflict of interest on counsel.

[21] Donald C. Langevoort, *supra* note 5: 495.
[22] Deborah L. Rhode and Paul D. Paton, *supra* note 1: 651.
[23] Stephen M. Bainbridge, *supra* note 2: 7.
[24] Deborah L. Rhode and Paul D. Paton, *supra* note 1: 633.
[25] *Ibid*.: 637.
[26] *Ibid*.
[27] *Ibid*.: 633.

1.3. THE ROLE OF OUTSIDE LAWYERS

Apparently a lawyer's professional independence is the main issue that arises with corporations' outside legal counsel as well. It is often argued that the culture of legal services is "tainted with commercialism"[28] and lawyers are treated like any other "service providers." In fact, the "service provider" paradigm is replacing "the professional paradigm."[29] The client-centered approach of lawyers and adversarial practices has become the dominant value of the legal profession not only in America,[30] but in most European countries.[31] The obvious reasons for creating conditions that compromise a lawyer's independent professional judgment are first of all financial dependence on corporate clients' given jobs, as well as the competitive challenges of the market for legal services, which "made outside counsel acutely sensitive to client preferences."[32] In other words, due to competition, law firms and their services became easily fungible goods. For example, for Vinson & Elkins's law firm, Enron's primary outside legal counsel, Enron was the largest client, accounting for more than 7% of the law firm's revenues.[33] It is no secret too that the ranking of every lawyer in a law firm as well as his revenue as a rule primarily depend on the profits s/he brings in for the law firm, and not on broader criteria of social responsibility, such as adequate internal ethics structures, incidence of malpractice, etc.[34]

The commercial pressures of the marketplace for legal services, as well as risky and aggressive corporate culture in opposition to nebulous lawyers duties that supposedly arise from the role as an officer of the court,[35] have a great impact on lawyers' ethical conduct. Hence, the prevailing professional culture creates a crack between law, public expectations, acclaimed professional ideals, and the reality that in some cases "resolute fraud artists exploit."[36]

Accordingly, as studies indentify, the main corporate lawyers' problems are related to a lost or denied capacity for independent judgment. The moral autonomy of such a lawyer is compromised first, by pressures of management of the corporation to maintain the "conscience of the corporation," making corporate lawyers a "cog in a machine"[37]. In other words, the traditional model of lawyer as

[28] Christopher J. Whelan and Neta Ziv, *supra* note 12: 1.
[29] *Ibid*.: 4.
[30] Deborah L. Rhode and Paul D. Paton, *supra* note 1: 650.
[31] Julija Kiršienė, "Advokato nepriklausomumas teisinių paslaugų rinkos komercializacijos kontekste: reliktas ar būtinybė?" *Jurisprudencija-Jurisprudence* Vol. 21, No. 3 (2014): 685-687 // doi:10.13165/JUR-14-21-3-03.
[32] Donald C. Langevoort, *supra* note 5: 497.
[33] Deborah L. Rhode and Paul D. Paton, *supra* note 1: 641.
[34] *Ibid*.: 655.
[35] Christopher J. Whelan and Neta Ziv, *supra* note 12: 3.
[36] Stephen M. Bainbridge, *supra* note 2: 14.
[37] Christopher J. Whelan and Neta Ziv, *supra* note 12: 1.

an independent professional is displaced by commercialized professionalism or a lawyering-compliance role.[38] In turn, the pressures to preserve internal solidarity and conformity to group norms "encourage lawyers to underestimate risk and to suppress compromising information".[39]

1.4. THE IMPACT OF CONTEXT: PERCEPTUAL BIASES AND ORGANIZATIONAL CULTURE

Behavioral economists have identified a number of perceptual biases and cognitive errors that "may distort judgment notwithstanding proximity,"[40] because in routine business settings, moral thinking tends to be driven by intuition and feelings as much as (or even more than) explicit deductive or inductive reasoning.[41] In other words, moral thinking is more "utilitarian, not deontological, and is fairly gut-driven".[42] One of those well-documented cognitive errors is the *overconfidence bias*, which is especially viable during good times and "the longer the run of good times, the more entrenched this overconfidence becomes."[43] Psychologically, behavioral traits work to enable people to see what they want to see[44] and this phenomenon is called "motivated inference."[45] A famous set of experiments involving some combination of basketballs, umbrellas, and a gorilla is an illustration from cognitive psychology which demonstrates this vividly.[46] Exacerbating this problem, the tendency to rely heavily on others when one lacks confidence[47] or when there is information asymmetry[48] (what psychologists describe as social proof), is commonplace for corporate lawyers, because they usually assume better knowledge of the situation on the part of other business professionals: managers, auditors, accountants, etc.[49]

Another closely related bias is the *confirmatory bias*[50]. It is the "well recognized tendency of the mind to interpret new information so as to maintain consistency with past choices, preserving the sense that those choices were

[38] Donald C. Langevoort, *supra* note 5: 500.
[39] Deborah L. Rhode and Paul D. Paton, *supra* note 1: 651.
[40] Donald C. Langevoort, *supra* note 5: 495.
[41] *Ibid*.
[42] *Ibid*.: 505.
[43] *Ibid*.: 504.
[44] *Ibid*.: 496.
[45] *Ibid*.: 511.
[46] "Subjects were told to focus intently on a challenging cognitive task while watching a video, such as counting the number of times the basketball is passed among people in the video who are wearing white shirts. Once concentrating so heavily on this discrete task, most subjects will not even notice other fairly dramatic things going on in the video-like the presence of someone in a gorilla suit or a lady opening an umbrella– that anyone not engaged in the task would think was impossible to miss" (*ibid*.: 507).
[47] Stephen M. Bainbridge, *supra* note 2: 7.
[48] "Oftentimes the information necessary for accurate legal analysis is diffused throughout the organization, so that no one has a sufficient knowledge base" (Donald C. Langevoort, *supra* note 5: 508).
[49] *Ibid*.: 509.
[50] Stephen M. Bainbridge, *supra* note 2: 11.

justifiable rather than mistaken."[51] Therefore, "lawyers who made the decision to associate with a particular firm are less likely to recognize management misconduct."[52] So, once we voluntarily make a judgment, psychologically we have a tendency to ignore or dismiss the inconvenient evidences that are inconsistent with our prior commitments.

Additionally, "people are fairly adept at perceiving change when the cues are salient enough, but poor when change is slow and gradual"[53] and this is especially true when people are busy and cognitively engaged. So, in many ways, cognitive psychology explains why so many corporate lawyers "never saw any obvious gorillas" in their clients' disastrous stories.

A separate argument is related to the common traits of corporate lawyers' personalities. In many corporations "lawyers seem to be chosen because they exemplify the characteristics and traits associated with zealous and aggressive promotion of the company's best interests."[54] As previously mentioned, legal counsels are pressured by corporate clients to be "team players;" but, unfortunately, this incentive sometimes leads lawyers "to bless highly suspect management decisions."[55] So, as studies demonstrate, "an above-average tolerance for legal risk and a 'flexible' cognitive style in evaluating such risk are survival traits in corporate business settings where corporate culture is strongly attuned to competitive success."[56]

1.5. LACK OF FINANCIAL UNDERSTANDING

There is no doubt that often even the most well-trained lawyers lack financial expertise, accounting knowledge, and mathematical skills, as well as access and full understanding of risk related data. The complexity of financial products inhibits the ability of lawyers to serve as gatekeepers in situations of corporate collapse. At Lehman Brothers, for example, it was obvious that the firm was heading toward disaster well before the collapse, but lawyers, with their lack of financial expertise, were not well positioned to appreciate the gradual changes and to identify financial chicanery until it was too late.[57] Indeed, "many banks are engaged in margin lending to risky borrowers, securing the loans by shares of stock that the borrowers

[51] Donald C. Langevoort, *supra* note 5: 511.
[52] Stephen M. Bainbridge, *supra* note 2: 11.
[53] "The familiar reference here <…> is that frogs will jump out of hot water in which they are placed, but boil to death when put in warm water where the temperature is then gradually raised" (Donald C. Langevoort, *supra* note 5: 511).
[54] *Ibid*.: 501.
[55] Stephen M. Bainbridge, *supra* note 2: 8.
[56] Donald C. Langevoort, *supra* note 5: 505.
[57] *Ibid*.: 516.

purchased with the loan proceeds"[58] and other risky financial products. Together with "a failure to see and fully appreciate correlations in financial institution interrelatedness,"[59] as experience shows, it may trigger a downward spiral of the banking system.[60]

While risky behavior may not be unlawful, disclosure obligations should warn other affected stakeholders about the risk. However, because of the complexity of financial products, sometimes disclosure requirements do not help properly, because disclosure "can become inherently inadequate – either too lengthy or complicated for most to understand or too simple to explain all nuances."[61]

2. GUIDELINES FOR CHANGE

Although resisting client pressures can be financially risky for the lawyer, prudent goals and a course of action that are "legally sound, financially practical, and ethically defensible"[62] can be satisfying not only for the public, corporate lawyer, but also for the corporate client. Analysis of the underlying reasons for lawyers' complacency in the face of corporate misconduct and failure to take a gatekeeper's role, which is the one of the main arguments for lawyer–client confidentiality privilege, suggests that there are no easy cures that could be proposed in this regard. However, some conclusions and suggestions for change can be made. Under the circumstances analyzed here, some changes in internal corporate and outside legal professional regulation could be helpful as well as curricular changes in lawyers' and corporate managers' education.

2.1. GUIDELINES FOR REGULATION REFORM

2.1.1. PRIVATE REGULATION

As previously addressed in this article, corporate clients are gaining more and more influence and control over lawyers' practices. Therefore, if a corporate client would "see ethical behavior as important to their long-term commercial stability and profitability,"[63] then inside regulation could offer additional tools for encouraging and monitoring a lawyer's ethical responsibilities.

[58] Steven L. Schwarcz, "Keynote Address: The Role of Lawyers in the Global Financial Crisis," *Australian Journal of Corporate Law* Vol. 24 (2010): 2 // http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1532794.
[59] *Ibid*.
[60] *Ibid*.
[61] *Ibid*.: 5.
[62] Deborah L. Rhode and Paul D. Paton, *supra* note 1: 642.
[63] Christopher J. Whelan and Neta Ziv, *supra* note 12: 3.

Research shows too that, particularly "norms relating to lawyers' practice that had formerly been under the domain of professional and state bodies, or left to the discretion of lawyers and their firms, are increasingly incorporated into 'guidelines', 'procedures', 'codes of conduct', 'manuals' or 'best practices' memoranda, which lawyers are expected to follow."[64] Moreover, this private regulation as a rule is not the subject of negotiations between corporate client and lawyers, but imposed unilaterally upon retained by the corporate client's lawyers.[65] Of course, the content of this inside regulation can vary greatly.[66] Such regulation is particularly often in global corporations "turning private regulation into a transnational phenomenon."[67]

However, as Rhode observes, "most experts believed Enron had written one of the best codes of conduct in corporate and ethics policies in corporate America."[68] Therefore, private regulation can be effective only if commonly applied in everyday corporate business practice and in forming patterns for decision making and conduct.

2.1.2. OUTSIDE REGULATION

Lawyers' ethical judgments are usually made in private and possibilities for external observance and monitoring are limited. However, good rules "can encourage individuals to behave in socially defensible ways by framing the interests at issue in terms of accepted moral values."[69] There is no doubt that lawyers are able to "perform a useful gatekeeping role, such as by helping to counter the complacency, conflicts of interest, over-simplification about financial products,"[70] but the issue is how exactly they should perform it. Among others, outside auditors and lawyers should function as reputational intermediaries and gatekeepers, policing access to the capital markets. Additionally, "because the gatekeeper's business depends on its reputation for honesty, probity, and accuracy", it will normally not ruin that reputation to aid one client in cheating.[71] Furthermore, in most legal systems, lawyers have a duty not to assist a client in performing unlawful acts. "The lawyer should try to persuade the client to comply with the law and, if unsuccessful, ultimately may have to resign."[72] For lawyers who passively

[64] *Ibid*.
[65] *Ibid*.: 4.
[66] Namely fees and billing terms; conflict of interests, client confidentiality and professional conduct during litigation and discovery proceedings; even workplace employment diversity or "work-life balance/family friendly" employment policies, also guidelines that require lawyers to act as "gatekeepers" for the client, and to report misbehavior of corporate officers to management (*ibid*.: 3).
[67] *Ibid*.: 8.
[68] *Ibid*.: 27.
[69] Deborah L. Rhode and Paul D. Paton, *supra* note 1: 650.
[70] Steven L. Schwarcz, *supra* note 58: 8.
[71] Stephen M. Bainbridge, *supra* note 2: 5.
[72] Steven L. Schwarcz, *supra* note 58: 6.

acquiesce in client fraud, the risk of misconduct cases initiated by victims of the client's fraud for "willful blindness to client misconduct"[73] and failure duly perform professional duties may increase.

Under Lithuanian legal ethics regulations, attorneys have no incentive to take a gatekeeping role, foreseeing, preventing, and mitigating collapses, as mentioned in the disastrous cases of the collapse of financial institutions in Lithuania. The code of legal ethics for attorneys in Lithuania is very laconic; it provides just main principles and rules and fits into three pages. The rule of confidentiality as a privilege and a duty is regulated just in a few words and seems absolute because it does not provide for any exceptions.[74] As a contrast, the American Bar Association Model Rule 1.13 of Professional Responsibility gives lawyers an obligation to report the noticed violation to a corporate client's officer, director, manager, shareholder or other constituent, with whom he is working. If the violation is not addressed properly, then it invokes lawyers' right to report up the ladder.[75] This rule can be explained in the following way: "when the lawyer knows that the organization is likely to be substantially injured by action of an officer or other constituent…, [the] lawyer must proceed as is reasonably necessary in the best interest of the organization."[76] Moreover, a passage of the Sarbanes-Oxley Act in the United States changed lawyers' understanding of obligations towards a corporate client. Lawyers used to insist that they have duties only to the managers or board of directors of corporate clients, but not to shareholders or the investing public. Sarbanes-Oxley obligates lawyers to report "evidence of a material violation of securities law or breach of fiduciary duty," first to a company's general counsel, then to its CEO, and ultimately to its board of directors.[77] Many commentators complain that this law will diminish the quality of the attorney's representation of the client because counsel will lack unfettered access to information.[78] So, in this regard the balance between the lawyer's duties of candor and confidentiality is at issue.

[73] Deborah L. Rhode and Paul D. Paton, *supra* note 1: 648.
[74] Article 5 of Code of ethics for attorneys sets: "Confidentiality is the most fundamental and important right and duty of the lawyer. The lawyer shall ensure to the client that information provided will be kept as a professional secret." The second and the third part of same article deals with the content of the confidential information and responsibility of attorney's assistants and personnel (*Lietuvos Respublikos teisingumo ministro 2005 m. spalio 27 d. įsakymas Nr. 1R-345 "Dėl Lietuvos advokatų etikos kodekso skelbimo" [Ruling of Minister of Justice of Lithuania of October 27, 2005, No. 1R-345 "On the Proclamantion of the Code of Attorneys' Ethics"]*, Official Gazette (2005, no. 130-4681)).
[75] *Model Rules of Professional Conduct*, The American Bar Association Center for Professional Responsibility // http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/model_rules_of_professional_conduct_table_of_contents.html.
[76] *Ibid*.
[77] Deborah L. Rhode and Paul D. Paton, *supra* note 1: 628.
[78] Stephen M. Bainbridge, *supra* note 2: 13.

Another structural problem which was highlighted by the corporate scandals and which could be addressed by changes in regulation is the conflict of interest that arises when lawyers invest in clients. In Lithuanian legal ethics regulations, this issue is not regulated at all. Therefore, reconsideration of the circumstances under which lawyers may take equity interests in their clients is necessary.

As lawyers are a self-regulated profession, it is expected that first the advocate bar's involvement in regulatory reform would contribute to solving the problem. However, the experience of United States in this regard shows that similar efforts of the bar have "been compromised by its own self-interest in maintaining client relationships and minimizing professional liability".[79] As Rhode notes, lawyers have been involved in most of the leading corporate scandals in the United States, but "the bar's own regulatory responses have been demonstrably inadequate."[80] Public representation in formulating and enforcing lawyers' ethical obligations, as well as involvement in various regulatory committees, was also merely token. So, the question is whether it is realistic to expect that a self-regulatory body for advocates will have enough incentive to cooperate with other regulatory entities in establishing socially responsible rules and a professional culture that reinforces them.

Of course, given contemporary professional culture, prospects that lawyers would act as "'gatekeepers' on behalf of the 'public, and become watchdogs and whistleblowers of their clients"[81] is unrealistic and indeed undesirable. Reforming professional rules is not enough for transforming professional culture, because if those rules are working as criminal laws, it leads people "to focus on what is legal instead of what is right."[82] Therefore, the rules–bound approach to legal ethics is very limited. Jeffrey Garten, Dean of the Yale School of Management, has rightly noted that one of the risks of regulatory responses is that they "create a kind of 'audit' society in which there is the illusion that if there are enough [rules] and if you check off enough boxes, everything will be fine…."[83]

2.2. EDUCATION

One of the by-products of the recent corporate scandals in the United States is the increased curricular attention to legal and business ethics in professional schools.[84] Most research indicates that "dealing with ethical issues change significantly during early adulthood, and that well-designed curricular coverage can

[79] *Ibid*.: 647.
[80] *Ibid*.: 651.
[81] Christopher J. Whelan and Neta Ziv, *supra* note 12: 28.
[82] Deborah L. Rhode and Paul D. Paton, *supra* note 1: 649.
[83] *Ibid*.: 641.
[84] *Ibid*.: 652.

improve capacities for moral reasoning."[85] Non-lawyer academics observe "that something in the training, socialization, and professional identity of the lawyer interferes with the ability to generate an ethical corporate culture."[86] They explain this by reference to lawyers' obsession with lawfulness. This frustrates attention on ethical issues beyond minimal legal compliance, crowding out non-legal aspects of decision-making.[87]

Taking a course in legal ethics or professional responsibility is not obligatory in Lithuania, except at one university.[88] By contrast, legal education in common law countries such as the United States and the United Kingdom devotes substantial attention to lawyers' ethics and professionalism. Law students are required to take a course in legal ethics and practicing lawyers are often required to attend continuing legal education seminars on legal ethics.[89] The former requirement is supported by empirical surveys showing that adequate education may significantly contribute to students' development of moral values.[90]

Addressing the issue of misperception of obligations to corporate clients, lawyers and other corporate officers should be educated about who in corporate settings shall be regarded as the client and how their personal interests may conflict with the interests of their institution.

Moreover, students should learn how "rudimentary aspects of behavioral psychology that can distort strict economic rationality and foster complacency"[91] and to recognize that business people often have higher risk tolerance.[92] So, if lawyers are potentially to act as gatekeepers, they should learn how to see these appealingly benign traits as potential risk markers.

Furthermore, a better understanding of corporate business and finances can help to avoid oversimplifications with regards to financial instruments; this would broaden students' perspectives, enabling them to better identify and assess consequences.

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[85] *Ibid*.: 653.
[86] Donald C. Langevoort, *supra* note 5: 501.
[87] *Ibid*.
[88] Legal education is provided in five Lithuanian universities: Vilnius University, Mykolas Riomeris University, Vytautas Magnus University, European Humanities University, which is a Belarusian University in exile, and Kazimieras Simonavicius University. The law program at Vytautas Magnus University is an exception in this regard.
[89] Brock E. Barryand Matthew W. Ohland, "Applied Ethics in the Engineering, Health, Business, and Law Professions: A Comparison," *Journal of Engineering Education* Vol. 98, No. 4 (2009): 379; Joanna Harrington, "The New National Standard for the Canadian Common Law Degree: What place for internationalization in our Strategic Planning?" The Paper Submitted for the IALS Conference on Teaching, Legal Education and Strategic Planning, University of Buenos Aires, Argentina (April 13-15, 2011): 5 // http://www.ialsnet.org/meetings/teaching/papers.html.
[90] Russell G. Pearce, "Teaching Ethics Seriously: Legal Ethics as the Most Important Subject in Law School," *Loyola University Chicago Law Journal* Vol. 29 (1998): 732–735 // http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1611266.
[91] Steven L. Schwarcz, *supra* note 58: 12.
[92] *Ibid*.

However, it is unrealistic to expect that a few hours of classroom discussion will alter the values that students have acquired over a lifetime from families, schools, peers, and the general culture. Therefore it is not only the responsibility of universities or professional schools. As one Harvard Business School student put it, "Enron and WorldCom and Tyco didn't happen because CEOs ignored their Aristotle. […] They happened because they – like you and I – really wanted to get rich."[93]

CONCLUSIONS

From 2012 to 2014 the demise of the fifth- and sixth-largest banks in Lithuania and the collapse of four credit unions shattered Lithuania's fragile financial system. But despite the hefty institutional structures designated to supervise activity of financial institutions in Lithuania and the vast number involved in the business of these financial institutions and its administration and control, no one would blow the whistle. These and other corporate scandals highlight lawyers' professional ethics issues. These issues are: an unduly circumscribed perception (on the part of lawyers) of the corporate client; ethical pressures for inside and outside corporate lawyers; the impact of psychological biases in organizational culture; and a lack of financial expertise.

In contrast to the United States, under Lithuanian legal ethics regulation, attorneys have no incentive to take a gatekeeping role by foreseeing, preventing, and mitigating collapses. As lawyers are a self-regulated profession, it is expected that first the advocates bar's involvement in regulatory reform would contribute to solving the problem. Moreover, as corporate clients are gaining more and more influence and control over lawyers' practices, inside corporate regulation could offer additional tools for encouraging and monitoring lawyers' ethical responsibilities. Increased curricular attention to legal and business ethics in legal and business education can help to inculcate skills of decision-making that make help lawyers to avoid oversimplifications and to assess non-legal aspects of their work.

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