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Opening Statements

I first came across the Cornell Pre-Law Journal as a freshman in the Martin P. Catherwood Library. It was not the most attractive publication, printed as a black and white broadsheet periodical, but I knew that it was something special. Last produced in the Spring of 2010, the Cornell Pre-Law Journal served as a platform for undergraduate students to share their perspectives on the ever-evolving legal profession.

Hoping that it would be possible to become a contributor, I mustered the courage to contact its Editor-in-Chief. I explained how I had some previous editorial experience, and would be able assist the publication. Being a freshman, I realized, did not work in my favor, but the Editor-in-Chief did not blink an eye. Within hours, I was accepted into the organization, and added to its electronic mailing list. I had found a home.

But, when I went to submit my first piece on Enron Corporation weeks later, the Editor-in-Chief informed me that he had decided to push back the deadline for article submissions. Recognizing his considerate gesture, I thanked him for the additional time to expand upon what I had written. But then, the Editor-in-Chief decided to push back the deadline again.

Boasting a membership of over two hundred undergraduate students, there were, in fact, two or three individuals active in the entire organization. The Cornell Pre-Law Journal was not what it seemed or was supposed to be, and it soon became apparent that the organization did not have enough content to create the Fall 2010 edition. Contacting some colleagues, the Editor-in-Chief secured some last-second stories, and the publication was printed. But, when I learned about all of the concealed chaos and corrosion as the Copy Editor months later, I spoke up, and made a change.

The three professionals spotlighted in the present issue also spoke up and made a change. H. David Kotz, the former Inspector General at the U.S. Securities and Exchange Commission, recognized flaws in how the financial regulator responded to allegations of a Ponzi scheme at Bernard L. Madoff Investment Securities LLC, and authored a detailed report full of recommendations. Mark Harris, the Chief Executive Officer at Axiom Law, noticed the inefficiencies in how traditional law firms operate, and created his own business to offer affordable, efficient, and effective legal services to corporate clients. Sherron S. Watkins, the former Vice President of Corporate Development at Enron Corporation, discovered significant accounting irregularities, and brought them to the attention of the Chief Executive Officer. All three individuals made a difference, and I hope that readers of the Cornell Pre-Law Journal will find their stories to be fascinating, and be inspired to likewise speak up and make a difference. The next generation of leaders does not need to wait to make their mark on the world.

Several individuals made their mark on the present publication of the Cornell Pre-Law Journal, and I would like to recognize them for making it all possible. Communicating with H. David Kotz at Berkeley Research Group, Mark Harris and Liana Douillet-Guzman at Axiom Law, and Sherron S. Watkins could not have been more pleasant, and I thank them all for their time, cooperation, and participation. I also wish to express great gratitude to Brandon B. Tenzer, the Executive Editor, for spending endless hours revising and refining the submitted content, and Professor Michael E. Gold, the Academic Advisor, for his invaluable insight and advice. In addition, I would like to acknowledge all members of the Editorial Division, Business Division, and Design Division for their critical contributions. Their collective commitment to the success and betterment of the organization is encouraging, and instills confidence in me for the future.

Marc J. Hershberg
Editor-in-Chief
“I went to see 12 Years a Slave, because I thought it was the story of a lawyer on partner track in a ‘Biglaw’ firm. Lots of cruelty in the flick, but no lawyers.”

- Anonymous Attorney
“Part of being a good lawyer is knowing to keep your mouth shut. But those aren’t the types of people who go to law school.”

- Evan R. Chesler, Chairman at Cravath, Swaine, & Moore LLP.
The status quo in professional sports is adjusting rapidly, and changes are occurring across all levels and sports. There are wide-ranging calls for NCAA athletes to be paid. Technology, like video review, is replacing traditional officiating. Professional sports leagues are expanding into new, global, markets, as seen in the NFL’s overtures towards adding a franchise in London.

It is surprising, then, that one of the more puzzling and antiquated aspects of sports has been left largely untouched: the tax-exempt status of pro sports leagues. It seems odd that the National Football League (NFL), which earns more than $9 billion in annual revenue, retains Federal Tax-exempt status under Section 501(c)(6) of the Internal Revenue Code, as this designation is typically reserved for charitable or not-for-profit organizations. How is it that a league whose commissioner, Roger Goodell, had a total compensation of $29.4 million in 2012, does not have to pay Federal income Tax?

The NFL’s tax-exempt status can be traced back to 1966, when it was legislated to help facilitate the merger between the then-competing American Football League (AFL) and NFL. The specific language of businesses eligible under 501(c)(6) reads:

(6) Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.2

Since 1966, this 501(c)(6) exemption has applied to garner tax-exempt statuses for numerous other pro sports leagues, notably the National Hockey League (NHL) and the Professional Golfers’ Association (PGA). Major League Baseball (MLB) enjoyed tax-exempt status under 501(c)(6) until 2007, when the league forfeited the status to avoid disclosing the salaries of top executives. Although the National Basketball Association (NBA) says it has never claimed 501(c)(6) status, 3 out of the 4 major pro sports leagues in the United States have avoided paying Federal Income tax for several decades, depriving the government of precious revenue.”

“Three of the four major professional sports leagues have avoided paying Federal Income Tax for several decades, depriving the government of precious revenue.”

For the Love of the Game
has led to both a considerable break for the leagues and a sizeable loss in potential tax revenue for the government.

The tax-exempt status of pro sports leagues, most notably the NFL, received limited attention earlier in 2013 following the national controversy regarding the IRS’s inconsistent 501(c) review process. Since, critics have increasingly questioned how appropriate the NFL’s exemption is today. A popular online petition to revoke the NFL’s tax-exempt status on Change.org has received media attention, and has more than 300,000 supporters. In September, Senator Tom Coburn, (R-OK), introduced the PRO Sports Act, which would bar professional sports leagues with annual revenues exceeding $10 million from retaining tax-exempt status under 501(c)(6). The public attention has followed a long line of academic skeptics, and there is no shortage of publications criticizing the NFL’s continued tax-exempt status.

Although the NFL’s exemption may seem, initially, inappropriate, upon further review we can find that there are many facts and considerations weighing in favor of the league retaining its exempt status.

First, simply put, the tax-exempt status is in the letter of the law. Each of the pro sports leagues filing for tax-exempt status under 501(c) (6) meet the requirements that statutorily entitles them to Federal tax exemption. An IRS-published analysis of 501(c)(6) lays out 7 clear characteristics that an organization must possess for exemption:

1) It must be an association of persons having some common business interest and its purpose must be to promote this common business interest;
2) It must be a membership organization and have a meaningful extent of membership support;
3) It must not be organized for profit
4) No part of its net earning may inure to the benefit of any private shareholder or individual;
5) Its activities must be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons;
6) Its primary activity does not consist of performing particular services for individual persons; and
7) Its purpose must not be to engage in a regular business of a kind ordinarily carried on for profit, even if the business is operated on a cooperative basis or produces only sufficient income to be self-sustaining.

In reviewing these criteria we can see that sports leagues are not, as some critics suggest, simply earmarked into 501(c), as they must meet stringent criteria for exemption.

A second important point is the distinction between the pro sports leagues, like the NFL, and the pro sports franchises that compete within the leagues, like the New York Giants. The teams themselves, which generate substantial revenue, are taxed far more conventionally than the leagues that serve to bring them together. This distinction helps to defend pro sports leagues’ inclusion under 501(c)(6), which is in place to protect such “business leagues,” defined by the IRS as:

“an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit.”

The argument follows that professional sports leagues are not necessarily profit-driven business themselves; rather, they exist to promote competition and financial success for their member teams, complying with 501(c)(6).

While these technical arguments stand largely on letter alone, there are additional considerations that show how the NFL’s tax-exemption is defensible within the more general purpose and intent of 501(c).

Professional sports leagues organize a collection of businesses, operating across the country, that would, absent such structured competition, likely fail independently. As a result of collecting within a league, these organizations in turn offer many public benefits, both tangible and otherwise. Sports franchises all provide considerable employment, offer economic stimulus to cities through merchandise sales and tourism, and produce positive externalities in the form of regional pride and public entertainment.

Without organizational bodies like the NFL, none of these benefits would be realized, which serves to justify the seemingly out-of-place exemptions.

While it seems odd that a multi-billion dollar business like the NFL is considered, for Federal tax purposes, no different than charities like the United Way, an examination of the law and unique circumstances of pro sports leagues illustrates the true complexity of the issue. It is easy to criticize these exemptions, but it is important to realize the applicable nuances in the tax code exist for a reason: to protect organizations that stimulate business beyond themselves and provide benefits to the community as a whole.

Philip Andriole is a Senior in the School of Industrial and Labor Relations.
Are Millennials and Securities-based Crowdfunding Matches Made in Heaven?

As thousands of 20 year olds opt to become struggling entrepreneurs, several commentators think that the future of millennials is in crowdfunding. They call us socially adept, “hip,” and risky. Regardless of how “post-modern” we may seem, giving over a chunk of our dreams to the first couple of investors does not sound like the behavior of the “narcissists” *TIME* called us. It seems rather unintuitive through the lens of someone with the Generation Y stereotype. Crowdfunding is a web-based solution for raising capital for people with ideas or causes but especially for business owners. Of course, everyone loves gifts, so there will be little talkback from millennials. Crowdfunding is not the problem. However, securities-based crowdfunding involves a more complex arena of economic opportunities and liabilities. While the consensus seems to advocate that millennials and securities-based crowdfunding are matches made in heaven, is our elders’ advice sound or nonsense?

Securities-based crowdfunding rewards investors through an exchange of unregistered securities for a particular dollar amount. Typically, investors are given a share of a bond or stock in return for their investment. This method of crowdfunding was introduced under the Obama administration. A year ago, this financial activity was illegal. Under the Securities Act of 1933, shareholding caps outlawed securities-based crowdfunding. The aim was to shield investors from several risks. The Jumpstart Our Business Startups Act or the JOBS Act signed into law on April 5, 2012, is the umbrella legislation, which amended the Securities Act and started the Crowdfund Act (S. 2190). This legislation allows micro-investors and small-time entrepreneurs to break into an industry in a manner that does not measure their eligibility by any amount of money. Micro-investors can legally partake in the success of an entrepreneur by owning a share of their business or idea.

Although the new legislation promotes more freedom, there are stipulations. For entrepreneurs, no more than $1 million received within 12 months is permitted, (Sec.2.a.A). Investors are prohibited from giving more than 10% of their annual income or net worth without exceeding $100,000 per investment (Sec.2.a.B.i). Investors with a net worth or annual income of less than $100,000 are only permitted to give 5% or less of the value without exceeding $2,000 (Sec.2.a.B.ii). In addition to entrepreneurs and investors, the third party is the platform. The Securities and Exchange Commission (SEC) requires registration and regulation of crowdfunding platforms such as Kickstarter. In order to reduce vulnerability to fraud, history checks and screening of crowdfunding activity verify that people are not exceeding the investing limitations of the law (Sec.4.A.a). Overall, the Crowdfund Act focuses on increasing entrepreneurs’ access to capital, but the regulations take the place of the now nullified parts of the Securities Act, which aim to protect investors.

Securities-based crowdfunding is an attractive option because it is both legal and a great fit for high-risk, high-potential and low-capital companies. There is little to no cost for access to crowdfunding platforms, which means that risk-taking companies in desperate need of backers for their project only have capital to gain. The extra benefit is that investors become representatives of the business as they have a stake and naturally want the company to succeed. In the end,
securities-based crowdfunding boosts small business and provides the opportunity for a tangible and direct return on investment.

Regardless of the benefits, it is safe to say that a positive relationship between securities-based crowdfunding activity and exposure to risks exists. Securities-based crowdfunding increases the difficulty in detecting fraud. Even under the supervision of the SEC, there are no audited financial statements, which lead to misinformed entrepreneurs and investors. In regards to patents, the openness of the Internet discloses the entrepreneurs’ ideas, which may be unpatented worldwide, and thus, exposes the companies to pilfering of their name and logo. Perhaps one of the worst setbacks is the myth that crowdfunding gives access to all. Even with an abundant amount of time and effort, it is extremely arduous to raise a lot of money through Internet platforms. There is a limited supply of money among the ranks of microinvestors; with the limitations of the law, it becomes even more challenging to comply with the law by every dollar funded. Therefore, the liabilities increase, especially as there is no mandatory guidance from seasoned investors and entrepreneurs. To add to the drawbacks, another researcher suggests that securities-based crowdfunding will not be beneficial to the welfare of society:

Crowdfunding will almost surely generate social loss by relaxing traditional regulations associated with the sale of securities (e.g., enabling new forms of fraudulent activity as well as new ways for inexperienced or reckless individuals to make poor allocation decisions for their savings).³

In cost-benefit analysis, securities-based crowdfunding begs this question: Are the risks necessary?

As one might guess, there are several listed, unspecified, and needless risks for millennials who already have a perplexing financial future. As a result, other solutions have been brought to the forefront, such as the conjecture made by a crowdfunding researcher: “debt [or debt-holding] may be preferable.”⁴ Who better than millennials to appreciate this statement? Millennials already take too many risks, whether it be the job[less] market or expensive 4-year degrees with only some guarantee on the return on investment; can we afford more? Even though President Obama said, “When we find rules that put an unnecessary burden on business, we will fix them,” the case for crowdfunding investing in relation to millennials is not as promising as expressed in the media and by the government. The only way that securities-based crowdfunding will expand the influence and longevity of small businesses is if people, with disposable income, take on the risks, blindly, (but not actually). The legitimacy of securities-based crowdfunding relies on honest, smart and ambitious microinvestors and entrepreneurs. Millennials’ best bet is to dabble in regular crowdfunding and continue the “hustle” lifestyle we have inherited from our ever-so-future-oriented elders, the baby boomers.

Cornell Pre-Law Journal Fall 2013

Olivia Davis is a Junior in the School of Industrial and Labor Relations.
Social media serves as a global connection force between billions. Different social media platforms constantly communicate information. Facebook alone has over one billion users and new mediums for information sharing are constantly created. These users are able to exercise their First Amendment rights via status updates, comments, likes, pages, and other forms of online expression. Often, their views on politics, policy, religion, and other relevant happenings are displayed online.

Social media sites can be used as a positive tool to disseminate information. They are a means to cheap and quick communication. However, the issue is that these same sites can provide a platform to achieve many less than wholesome motives. Twitter and other networking sites have proven useful for those involved in organized crime. The sites provide a forum where many can connect in order to orchestrate robberies, mobs, and other large scale crime activities. In addition, terrorist organizations, both domestically and abroad, can use social media sites to cultivate new followers.

The power of social media is apparent, but authorities are unsure as to how they should regulate illicit activity without infringing on personal freedoms. The dilemma involves First Amendment rights. Social media can be used as an effective investigative method by utilizing it to monitor suspicious activity. However, this can be construed as a blatant invasion of privacy.

Currently, there is no uniform policy on how law enforcement officials can use social media to investigate suspicious activity. Under the assumption that much of what is published on the internet is public domain, a strategy must be employed so investigations can use social media without infringing upon First Amendment rights. Police officials know that many with a criminal bent use social media to plan drug deals and other illegal activities. No search warrant is needed if an online “friend” decides to share incriminating posts with law enforcement. The term friend indicates a mutual sharing of information, so there is no infringement of privacy when a friendship is initiated. However, it has become common practice for law enforcement officials to develop undercover profiles and “friend” suspects. Several police departments have already addressed the use of undercover social media usage.

According to the New York City Police Department social media policy:

Data contained on the Internet within social network sites may assist law enforcement in gathering timely information in furtherance of crime prevention, including the preservation of public order and the investigation of criminal activity, including suspected terrorist activity. To effectively fulfill these duties, it may be necessary for members of the service to access social network sites using an online alias. No prior authorization is ever required for information contained on publicly available internet sources.

This policy gives law enforcement officials the ability to use an alias to investigate suspicious activity in times of exigent circumstances without authorization. This may include circumstances involving time sensitive investigation proceedings, the protection of life or substantial property, or the threat of a terrorist act. No authorization from a superior is ever required for non-fake alias
inquiries. For example, if a law enforcement official uses their real information online to access public domain, then the official does not need to seek departmental approval.

The policy is predicated on the fact that the internet is “public domain”. The police department defines public domain as “information accessible through the Internet for which no password, email address, or other identifier is necessary to acquire access to view or collect such information.” If a law enforcement official can access a profile without withholding or developing false information, monitoring potential illicit activity is permissible.

The Georgia Bureau of Investigation has a slightly different policy on social media usage for law enforcement officials. They communicate that “while social media is a new resource for law enforcement, employees must adhere to this policy to protect individuals’ privacy, civil rights, and civil liberties and to prevent employee misconduct.” The policy includes a provision that online aliases may only be used after authorization. A supervisor must assess the request to validate law enforcement purpose. The work unit supervisor must maintain the requests for the online alias for two years from the date of deactivation. These stipulations are meant to protect the validity of the request.

Although many individual police departments are devising policies, there is no universal standard that has been developed. Perhaps it is the responsibility of a body of the government, such as the FBI or Department of Justice, to write such a policy. The Bureau of Justice Assistance (BJA), with the support of the Global Justice Information Sharing Initiative, Advisory Committee, a Federal Advisory Committee to the U.S. Attorney General on justice-related information sharing, and the Criminal Intelligence Coordinating Council have suggested such guidelines. The Developing a Policy on the Use of Social Media in Intelligence and Investigative Activities: Guidance and Recommendations is a conglomerate of different policy suggestions designed to protect civilian privacy and validate law enforcement usage of social media. However, this is only a resource, not a policy that is to be implemented uniformly, leaving gaps in procedures around the nation.

It is shocking that there is currently no enforced protocol for using social media because it is such a powerful societal force that it can be used to disseminate public information that could affect the integrity of an investigation. For example, social media profiles in widely followed cases have been made public in the media before an investigation had been completed. Information contained in the profiles could be persuasive in influencing public opinion, including that of a jury.

A prime example of the public case that exploded on social media is the Casey Anthony trial. The nation followed the happenings on television, read status updates on Facebook, and shared their every thought on Twitter. Public reaction was all over social media. However, the main issue was that Casey Anthony’s social media profiles were shared at a rapid rate across the nation. The case, which was referred to as the “social media trial of the century”, was inevitably influenced by peer to peer opinions of evidence that was available on Casey Anthony’s Facebook page leading up to the alleged murder of her daughter, Caylee. The “online jury”, and opinions pouring in from all over the internet led to the difficult selection of the actual jury that was intended to be fair and unbiased.

Social media is affecting the legal process, both in gathering evidence and shaping public opinion. If a law enforcement official or organization has reasonable cause to suspect illicit online activity, they should have the ability to investigate the situation. First Amendment rights may be compromised when the safety of others comes in to question. This has been a persistent concern in our nation. Often there is a tradeoff between privacy and safety. Policy should be implemented in order to facilitate a nation-wide standard for addressing investigations on social media websites. The procedure should be the same across various departments so there is an accepted protocol of investigation.

“If a law enforcement official or organization has reasonable cause to suspect illicit online activity, they should have the ability to investigate the situation”

Courtney Sokol is a Junior in the School of Industrial and Labor Relations.
Cornell Pre-Law Journal (PLJ): Which specific elements of your undergraduate experience at the University of Texas most prepared you for the rigors of law school?

Mark Harris (MH): The simple fact is that nothing is really going to prepare you for law school. Simply said, law school is a beast - but worth it. It’s going to be a lot of work regardless of your undergraduate background. My experience was that it involved more reading than my English classes, more critical thought than my philosophy classes, and more analytical thinking than many of my math classes.

What is going to be most helpful is an undergraduate experience that teaches you to love learning and to be a focused, diligent, organized student who truly wants to learn the law. Law school simply requires too much work and commitment to be worthwhile if you don’t really want to be there. There are no shortcuts. If you don’t love learning, and for that matter if you don’t love learning the law, you’re not going to want to stay in the program.

PLJ: What was the greatest lesson that you learned from your clerkship at the United States Court of Appeals for the Ninth Circuit?

MH: What I learned from my clerking experience was that no matter how intelligent they may be, surprisingly few law clerks or applicants have a clear idea of why they want to clerk. For most of my peers, perhaps the majority, it was a rung in the ladder that follows Law Review and precedes a sought after position in public or private practice. A good clerkship looks great on one’s resume and opens doors. For other peers, a clerkship provided a way to defer career choices for a year or two, or maybe rethink one’s priorities. There’s no doubt that these are realistic (perhaps even valid) reasons people seek clerkships.

However, a clerkship is more than a way to pad one’s resume before joining the real world. A good clerkship is part advanced academic seminar and part finishing school. No matter what you know or think you know, no matter what talents you have or believe you have, a good clerkship will challenge you, elevate your skills, and make you a better person both personally and professionally. If you are thinking about applying...
for a clerkship or are beginning one, you should be aware of these broader implications. A clerkship is much more than a way station or resume-padder.

PLJ: Which specific aspects of your tenure at Davis Polk & Wardwell LLP inspired you to establish Axiom Law?

MH: When I was an associate at Davis Polk, I was asked to prepare a client’s monthly bill. Putting it together, I realized the charge was equal to my entire annual salary. From that point on, I was obsessed with making observations about things that seemed inefficient and wasteful.

“The legal industry is one of the world’s largest, most important, and, we believe, most inefficient service economies.”

The question I kept coming back to was, in a world where everyone is trying so hard to be efficient, why does a law firm – with its partner pyramid and costly overhead – get to be inefficient?

PLJ: How has the direction of Axiom deviated from your initial expectations?

MH: Since our founding in 2000, Axiom’s direction focused on “insourcing.” Clients insource Axiom Attorneys in the form of seconded lawyers who plug into the clients’ existing infrastructure, handling complex, sophisticated legal work, either onsite or remotely. While this model eliminates traditional overhead and flattens pyramidal economics thereby reigning in costs, it retains the clients’ processes and departmental structure.

As the financial markets imploded, the demands on and of our clients changed, we recognized a need for more fundamental innovation of the business of law and we expanded from pure-play insourcing to legal services outsourcing. Unlike our secondment model, outsourcing clients task Axiom to re-design, re-engineer and deliver entire functions across the legal value chain.

While we are on the same mission that we’ve always been on – to inspire, facilitate and participate in the transformation of the legal industry - the work we are doing through our outsourcing business is challenging the pre-existing models in a much more profound way than ever before.

PLJ: In Axiom’s first few months of operation, the entrepreneurial firm struggled to attract corporate clients. What actions or external developments made it easier for the business to sell its services?

MH: Getting large companies to entrust high-end work to Axiom, even under the insourcing model, was extremely challenging. When we first launched there was only one other alternative provider - it focused on niche research and had been hanging around the industry for years.

Today, the legal industry is hardly a well-spring of entrepreneurship. But thirteen years ago, the most common response to entrepreneurial thinking was either outright hostility or complete indifference. Our struggles were rooted in the industry’s aversion to risk and change and a real skepticism about new models.

Timing compounded these challenges: only months after getting started, September 11 struck; the economy was in a slump and law department demand for outside legal services was contracting. By December 2002, we had just a few months of capital in the bank.

Axiom was saved from bankruptcy (narrowly) by a timely municipal grant targeted at downtown companies impacted by 9/11. In January of 2003, after knocking on hundreds of doors and experimenting with different pricing structures and forms of engagement, clients finally began to give Axiom a try. But, in August of 2008, the financial system imploded and the economy ground to halt. Investment banks comprised over 60% of our revenue and four of the nine we served dissolved or merged out of existence.

We diversified our client base and opened offices in geographies to support that diversification. But, most importantly, we capitalized on a newfound willingness among General Counsel to break (finally and meaningfully) with tradition and find far more innovative ways to handle larger flows of legal work, leading to the launch of our outsourcing practice.

PLJ: What makes Axiom Law more efficient than other large firms?

MH: The legal industry is one of the world’s largest, most important and, we believe, most inefficient service economies. That inefficiency translates to a staggering level of hidden cost to consumers, shareholders, and the great majority of people who
work in the industry. We think that’s wrong and unnecessary and we’re on a mission to change it. We’ve created an entirely new category of firm: by eliminating most of the overhead of a traditional firm and by flattening the pyramidal economics, we’ve stripped 70% of the cost-structure from the delivery of sophisticated legal services, which enabled rates that look too good to be true but aren’t.

PLJ: Aside from similar companies offering legal services, which business in another sector would you consider to be your counterpart?

MH: To be totally frank, there really are no clearly comparable companies. Instead, I would say that we’ve adopted and tweaked best practices from many other sectors and businesses to better serve our corporate clients.

PLJ: Graduating from the University of Texas School of Law, would you have opted to practice law at a firm like Axiom Law?

MH: Absolutely. Ultimately, the very things that drove me to found Axiom would have driven me to work for the firm had such options existed for recent graduates then.

PLJ: How will the present landscape of law firms transform within the next two decades?

MH: There is, and will always be, an elite group of top firms who handle matters so big that price is immaterial. For the rest of the industry, however, disruptive change looms and a growing number of law firm managers are eager to evolve. Some are making strides but the overwhelming majority is struggling to implement meaningful change.

Law firms are change averse by nature (they manage risk for a living, after all) and by design. Most law firm partners pay brutal dues for up to twenty years to land atop the pyramid and any investment in redirection comes from their own pockets.

Even if willing to invest, firm managers face a larger problem: partners can take clients from one firm to another. By reducing today’s profits, outlays of any kind risk inciting an exodus by the firm’s top earners.

Law firms are also hamstrung by their fidelity to the industry’s chief success metric: profits-per-equity-partner (PEP). PEP has become shorthand not just for earnings power, but for status and, often, quality. Unfortunately, the most common ways for law firms to improve PEP have been by raising rates, decreasing the percentage of partners, or increasing billable hour requirements for associates. All three are bad for clients.

Change has to come to the legal business but, for the most part, it’s not coming from the dominant firms, despite their earnest intentions. So, now what?

Overseas outsourcing of legal work is enjoying an improbable bump. Where three years ago, off-shoring was a rare experiment, 2013 marked the fifth consecutive year of explosive growth for the industry.

Onshore, new model firms that operate without the overhead and partnership of the traditional firm (like Axiom) are cutting into law firm market share. Electronic discovery specialists and software companies are stealing much of the lowest level litigation work from big firms. None of these alternatives existed at any meaningful scale five years ago.

The shape of the industry that will emerge isn’t entirely clear. But for the first time in nearly 100 years, the legal industry has to do what every other industry has been doing by reflex: become more efficient.

PLJ: What advice would you offer to undergraduate students interested in both the legal profession and entrepreneurship?

MH: With respect to your education, take advantages of the reforms that are beginning to penetrate the traditional legal education. Look for universities and courses that offer a hybrid legal and business education.

With respect to your entrepreneurial drive, understand the dynamics of the industry as it exists today, but don’t feel boxed into the industry as its currently defined.
DO CORPORATE INSIDERS HAVE THE RIGHT TO REMAIN SILENT?
The present issues in enforcing insider trading provisions

SAC Capital. Galleon Group. Level Global Investors. What do these three firms have in common? All are hedge funds, and the Securities & Exchange Commission (SEC) prosecuted chief managers at these funds for illegal insider trading practices. Now, consider this list: Bridgewater Associates, D.E. Shaw & Co., and BlackRock Advisors. These four firms are hedge funds as well, but all four avoided being targeted for tolerating insider trading. Interestingly, associates at all eight hedge funds manage their funds very similarly, and they generate hefty profits—usually in the hundreds of millions of dollars every year—by doing it. Why, then, are some hedge fund managers found guilty and others innocent of insider trading practices? This question is at the root of the “grayness,” or ambiguity, associated with identifying insider trading.

The SEC’s definition of insider trading lies in the Securities Exchange Act, which bans “the purchase or sale of securities on the basis of material, nonpublic information in breach of a duty of trust or confidence that is owed, directly, indirectly, or derivatively, to the issuer of that security or the shareholders of that issuer.” In light of this clause, what exactly is ‘material, nonpublic information’? Nonpublic information is any internal data or information that relates to a firm and is held solely by associates of that firm. In other words, it is information that has not been disclosed on an earnings report or in a public forum, more generally. Regarding the content of that information, the Supreme Court considers information to be material if “there is a substantial likelihood that a reasonable shareholder would consider it important in deciding [whether or not to trade a security].”

Additionally, how are we to interpret ‘a duty of trust or confidence that is owed’ to multiple parties? It is best to equate this ‘duty of trust or confidence owed to shareholders’ with the fiduciary responsibility of associates possessing insider information. To clarify, the associates and executives of a firm are obliged to serve the ‘interests’ of the shareholders, who usually influence the decisions of the board of directors. The primary interest of shareholders is reaping profits from their shares. Thus, any associates or executives who possess insider information that may change the firm’s share price are obligated by their fiduciary responsibility to disclose this information. They may release this information via publicly viewable earnings reports so that the shareholders know if the stock is overpriced or underpriced.

Clarifying the aforementioned phrases—namely, ‘material, nonpublic information’ and ‘a duty of trust,’—seem straightforward and ultimately helpful in identifying red flags that might bring about an SEC case. Yet, ambiguity remains, as the Supreme Court employs two different definitions of insider trading liability. For one, the language of the ‘classical theory’ of insider trading mirrors that of the ‘duty of trust.’ More specifically, the duty to disclose arises when one party has information that the other party is entitled to know because of a fiduciary trust and confidence between them. This relationship gives rise to a duty to disclose because of the necessity of preventing a corporate insider from taking unfair advantage of the uninformed minority stockholders.

According to this clause, a corporate insider has to abstain from trading or disclose inside information at a designated time before trading. One might believe that the classical theory should prove sufficient for easily identifying and, thereby, minimizing insider trading schemes. Nevertheless, the Court has recently noticed a rise in a different insider trading approach that operates outside of the language of the classical theory. The Court has yet to determine if a corporate ‘outsider’—an individual entrusted with inside information from a corporate insider—violates the law by trading on inside information. Applying the ‘misappropriations theory,’ the Court has found, in most cases, that the corporate outsider’s actions constitute insider trading. Yet, the Court seems to have failed in attaching specific conditions to the misappropriations theory, namely, the intent of the insider or outsider to profit illegally. Consequently, in some cases, the Court has argued that for an outsider or ‘tippee’ to be liable, “the insider [, or the ‘tipper,’ must have] personally benefited, directly or indirectly, from his disclosure.” At
other times, the Supreme Court has disregarded the aforementioned rule. Thus, an outsider, not the insider, may be liable if he trades on information provided by an insider who lacks the intent to conduct insider trading practices.⁸ Though these two approaches clearly contradict each other, the Supreme Court has avoided fixing this. Instead, in every case, the Court establishes if the insiders or outsiders acted with “scienter,” or with the intent to deceive, manipulate or defraud. Then again, making the case for scienter by considering the insider or outsider’s demeanor has reasonably been a tough task for the Court.

Additionally, the Court has not determined the legality of the ‘mosaic strategy’ that hedge funds and other firms employ. The strategy’s name derives from the ability of analysts to form a ‘mosaic’ of presumably material, nonpublic information from nonmaterial bits of information. For example, financial analysts may casually ask a storeowner of a national restaurant franchise how business is faring. The SEC would not think that the storeowner’s answer constitutes material, nonpublic information because any individual could ask the owner the same question, thereby concluding that such an answer is available to the public, in theoretical terms. Moreover, the SEC reasons that because the profitability of one branch of the restaurant does not reflect the profitability of the entire franchise, it would be unwise for an analyst to trade securities solely on that information, thereby concluding that such information is nonmaterial. However, analysts commonly disperse and ask the same question to forty, sixty, or even eighty percent of all of the restaurant owners from the same national franchise. If diligent enough, then, the fund or firm may be able to trade on the aggregate information before the restaurant franchise releases its earnings report. Given the strategy’s ability to transcend the processes and rules outlined in the Court’s two theories, the SEC and the Court have not yet reached consensus on the possible unjust nature of the mosaic strategy.

To the disappointment of some financial regulatory advocates, the unanswered questions regarding the misappropriations theory and mosaic theory remain unresolved by the SEC and the Court. It is important to note that we, like the regulatory advocates, should be inclined to discourage most forms and degrees of insider trading altogether. After all, a ban on insider trading eliminates adverse selection costs, increases liquidity, improves confidence in the market, reduces interference in corporate plans, maximizes investments and welfare, and motivates large shareholders to monitor management instead of seeking to profit from inside information.⁹ For these reasons, we may be quick to conclude that outsiders that trade with scienter and that corporate insiders that trade via creation of a ‘mosaic’ commit trading violations. However, one may argue that this approach may disregard the impetus for investment. For one, we know the efficient market hypothesis—that it is impossible to “beat the market” because stock market efficiency causes existing share prices to always incorporate and reflect all relevant information—to be inaccurate. After all, if the hypothesis were true, minimal gains, if any, could be reaped from the stock market. This is not the case because asymmetries of information exist and these imbalances of information cause some stocks to be undervalued or overvalued. This phenomenon allows investors to achieve financial gain or minimize financial loss when stocks correct themselves. Thus, some regulatory critics argue that by cracking down on hedge funds and firms, we restrict their avenues to maximize profit and, thereby, to invest in the local and global economies, which limits economic growth. As always, the future trajectory of the public’s, the SEC’s, and the Court’s feelings towards insider trading will reflect these value judgments, ones that may value investment over economic equity or vice versa.

As I have pointed out, arguments may be made that too much or too little financial regulation over insider trading practices is detrimental for society. Therefore, I propose that specific company policy may circumvent this dilemma and achieve a ‘happy medium.’ Such a policy begins with top management conveying a clear message to its lower level financiers that the firm does not tolerate any kind of insider trading practices. On this note, executives must put in place a formal policy which highlights examples of trading that operate in the “gray areas.” The section of the policy that deals with gray areas must establish parameters with respect to information that could be deemed material and nonpublic. Additionally, it is important that a policy establishes mechanisms like an information inventory or database that monitors the flow of information between the firm and its clients and third parties. Along with an information inventory, surveillance mechanisms—such as a technological one that screens correspondence for particular words associated with insider trading intentions—must be installed. Such a surveillance device must be put in place with a violations procedure that outlines the investigatory procedure that management follows if the surveillance device identifies sufficient evidence that points to an intent to violate trading rules. Finally, with all of these technical measures, it is essential that employees are, first, aware of these monitors and procedures and, second, that they are adequately trained to identify immaterial, nonpublic information. While the policy that I have recommended promotes awareness and deters insider trading, it still promotes investment. However, it is by no means a panacea. Indeed, the construction of a more effective and efficient policy requires diligent research that seeks such an outcome and the willingness of regulators and firm executives to consider adoption of such a policy.

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Glatt v. Fox Searchlight Inc., a recent court ruling involving the legality of unpaid internships, has brought to light an important issue that corporate America has ignored for some time. Before entering into a work relationship, both “employers” and interns should understand the legal criteria that must be met in order for an internship to be unpaid.

After Fox Searchlight Pictures released the film Black Swan in 2010, two unpaid production interns, Eric Glatt and Alexander Footman, claimed that Searchlight treated them as employees, thus entitling them to fair compensation. They sued Searchlight for violating minimum wage laws set under the Fair Labor Standards Act of 1938.

The Fair Labor Standards Act (FLSA) sets forth conditions that legally define “employment.” The FLSA also provides six requirements for distinguishing unpaid internships from employment:

1. The internship, which includes actual operation of the facilities of the employer, is similar to training that would be given in an educational environment
2. The internship experience is for the benefit of the intern
3. The intern does not displace regular employees but works under close supervision of existing staff
4. The employer that provides the training derives no immediate advantage from the activities of the intern; on occasion, its operations may actually be impeded
5. The intern is not necessarily entitled to a job at the conclusion of the internship
6. The employer and the intern understand that the intern is not entitled to wages for the time spent in the internship.

These criteria prevent interns from serving as free laborers for firms in competitive industries. In the case of Glatt and Footman, the state of New York determined that all criteria, except numbers five and six, were violated. As a result, “Glatt and Footman’s motion for summary judgment that they were ‘employee’ covered by the FLSA and NYLL and that Searchlight was their joint employer was granted.”
Michael Harper, a Barreca Labor Relations Scholar at Boston University, explains that this ruling encompasses the broader, “primary beneficiary” paradigm. This suggests that although employers can receive some benefit (from unpaid interns), the interns, not the company, must be the primary recipients of the relationship.  

However, the conditions that the FLSA established, and thus the ruling in the Searchlight case, exclude a key component of the unpaid internship issue. Glatt and Footman’s views, although legally and logically justified, do not represent the views of all unpaid interns. 

Since Glatt and Footman clearly did not learn anything, they rightfully demanded monetary compensation. However, in many other cases, unpaid interns find it permissible to provide free labor in order to gain a toehold into an industry. For some, the exposure and connections are beneficial enough. Internships such as these are common in the world of entertainment and sports. 

Although there are many instances in which both employers and interns happily partake in these types of internships, they do in fact violate FLSA standards. This leaves the employer with an unfair amount of liability. 

Regardless of each party’s willingness to enter into an illegally unpaid internship, any intern can sue their employer if they are not the primary beneficiaries of an internship. Thus, there should be some way to limit company’s liability while still encouraging them to provide unpaid internships. 

The logical course of action is to create three distinct classes of internships. 

The first is an unpaid internship in which both the interns and employers sign a waiver stating that they understand and agree to the FLSA standards. This is in accordance with the law as it currently stands. 

The second, which is also currently in accordance with federal law, is a traditional paid internship. In this case, interns acts as employees, and the firm can ask them to perform whatever type of labor the firm requires, liability free. 

The final type of unpaid internship, which does not legally exist, would require the unpaid interns to waive their rights to pursue the illegality of the relationship. In many ways it can be seen as “opt-out clause.” This type of internship fulfills the needs of those that are willing to provide “free labor” for the aforementioned connections and exposure. 

Even though this “hybrid” unpaid internship negates the purpose of the six criteria listed in the FLSA, it legally provides both parties with their desired compensations. The employers receive unpaid interns without having to adhere to a specific curriculum. The interns understand that they are not the primary beneficiaries of new knowledge, but receive valuable, connectional benefits and exposure in an industry. 

Despite its benefits, this hybrid internship has a few negative legal and economic implications. 

One problematic aspect of the “opt-out clause” is that it turns an unpaid intern back into an employee. Even if an intern were willing to “opt-out” and provide benefit to a firm for free, the FSLA would still require the company to pay minimum wage. Yes, the intern has waived their rights to pursue legal actions, but that does not necessarily change their status in the eyes of the law. The tasks they perform and their role in the company still categorize them an “employee” under the FSLA. 

Unless the court system legalizes this free labor internship, or congress passes a bill proclaiming it legal, it is still merely an employee working for below minimum wage. But, that does not mean these two courses of action should not occur. 

Economically, the opt-out clause may incentivize employers to shift away from both paid internships and the current legal format of unpaid internships. Why would a firm unnecessarily use monetary resources or open itself up to increased liability? The more rights the students waive, the less the companies must give up. 

This issue is less problematic as paid and “primary beneficiary” internships naturally attract higher caliber applicants. Presumably firms want the best interns they can find, and government approved training or actual monetary payment serve as incentives. Although firms give up resources by not offering the limited liability internship, they gain resources in a higher quality of candidate. 

If this hybrid internship were to be implemented, it would provide both employers and interns more flexibility. Interns would be guaranteed a “primary beneficiary” internship, but have the option to seek out one that is not. If a company wants to provide neither of these, the company would be forced to offer a paid internship. 

This flexibility is a necessity in the world of internships. Each applicant is looking for something different, so there should be a way to provide options without increasing the liability of the firms to which they are applying. 

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This article investigates the state of student loan discharge under the bankruptcy code and, more specifically, the state of law in the Northern District of New York, which will be offered as an example of the messiness of the current regime.

First, the article will recount the standard for undue hardship under the student loan discharge statute. In that section, it will also shed light on the many, varied factors that courts can use when interpreting the prongs of the Brunner test. Then it will turn to the state of the law in the Northern District of New York, with an eye on the court’s ability to partially discharge student loan debt. In this section, it will be shown that, while some Second Circuit Districts have decided to not allow partial discharge, others have, and the Northern District thus has the ability to choose whether or not the court has the power and discretion to partially discharge loans to avoid undue hardship on a debtor while still acting equitably with regard to the creditor.

I. The Brunner Standard for Discharging Student Loans

The Second Circuit, and most other circuits, uses the three-prong test established in In re Brunner in order to determine whether or not a student loan is dischargeable due to undue hardship, pursuant to 11 U.S.C. 523 (a) (8). The Brunner test requires showings that:

1. Paying back the loans would, when viewed in light of income and other obligations, force the debtor to live below a “minimal standard of living”.

2. The inability to pay the loan, from the first standard, is “likely to persist for a significant portion of the repayment period”.

3. The Debtor previously attempted to pay the loans in good faith.

Each Brunner prong must be met in order to grant relief. The Brunner test, as will be shown below, creates an untenably factually driven, case by case form of adjudication that ends up creating more discretion and less predictability than it initially seems.

In order to determine whether a debtor has met first prong, the inability to pay the debt and maintain a minimal standard of living, courts look at six elements of a minimal standard of living:

1. “Shelter”
2. “Basic utilities”
3. “Food and personal hygiene products”
4. Vehicles, including gasoline, insurance, and regular maintenance
5. Medical insurance or funds to pay for medical treatments
6. The ability to have “small diversion[s]” or a modicum of a “source of recreation”

The essence of the first prong is a “common sense approach” that involves “case-by-case analysis” into the ability of the debtor to live without undue burden.

The inquiry into the second prong, that the repayment problem arising in the first prong is not brief and temporary, is more malleable and allows for the unique factors of each case to govern. The twelve factors that are often used are:

1. Mental or physical disability
2. Obligations for dependents
3. Limited education
4. Poor education
5. Lack of marketable or usable skills
6. Underemployment
7. Maximized potential in the debtor’s educated field
8. The age of the debtor
9. Factors preventing retraining or relocation
10. Lack of assets
11. Increasing expenses that outrun the ability to earn more money
12. Lack of viable financial options elsewhere

As for the third and final prong, good faith efforts to pay the loan, courts tend to look at the debtor’s attempts to pay the loans before filing for bankruptcy, including any administrative or contractual remedies they may have to defer or restructure payments.

All in all, the variety of factors affecting each prong, combined with the diversity of those factors, means that courts are given incredible discretion to adjudicate cases. As a practical matter, it also means that legal decisions are not nearly as predictable as they should be. There are simply too many factors to help practitioners, clients, and even judges, determine if there is a right decision, and what the chances...
of reaching that decision are. The question remains, however, in what manner do courts relieve debtors when they decide to? In other words, whether a debtor may receive a partial discharge of student loans, or whether courts must simply make an “all or nothing” determination as to a debtor’s student loans.9

II. Partial Discharge and Full Discharge

Although it is not universally accepted as a remedy, the Northern District of New York,10 along with a substantial number of other jurisdictions,11 acknowledges the bankruptcy court’s ability to partially discharge student loan debts instead of using the all or nothing approach.12 This seems to be the most equitable solution, since it is the only eventuality where both the Creditor and Debtor gain some mutual relief: the Debtor is not unduly burdened by being forced to repay the debt, and the Creditor receives reasonable repayment instead of nothing.

There are two other approaches to the discharge of student loans. The first is an “all or nothing” approach, which deals with all student loans as one obligation, and either discharges the loans as a group or does not discharge any of them. This can be clearly inequitable, because the debtor may be able to pay some of the loan back without undue hardship, but the creditor does not get the chance to receive those payments. The other approach is a hybrid; it looks at each loan and chooses to fully discharge some loans while leaving others outstanding.

This position can be more equitable for the debtor, achieving the same result for the debtor as a partial discharge, but it is inequitable for creditors, because some are prioritized despite holding the same loans, sometimes even executed at the same time.13

The Northern District of New York has long recognized the inequity of discharging all of a loan just to relieve an undue hardship that could just as easily, and more equitably, be remedied by partially discharging or restructuring the loan. Citing the Northern District’s decisions and approving their rationale, the District of Vermont has explained that:

A partial discharge is appropriate where, as here, the debtor has demonstrated that undue hardship would result if [the debtor] were required to pay the entire obligation (applying all three prongs of the Brunner test but the record also reflects that it would not be an undue hardship for the debtor to pay a portion of the student loan debt[.]14

In this small subset of cases, “the interests of justice require that the Court determine whether a partial discharge is appropriate by examining how much a debtor would be able to repay” without undue hardship.15 Notably, the “interests of justice” here is not per se acting for the debtor, but it is just as much acting in the interest of the creditor, who receives a reasonable repayment as opposed to a total loss.16

III. Conclusions

On its face, not being able to discharge student loans seems reasonable. The concept is, broadly, that the loans are not given based on qualification but on a bet regarding the future. This is, however, inequitable. Courts have a tendency to strictly construe the Brunner test, so that debtors lose the benefits of bankruptcy by being burdened with massive amounts of debt that cannot be discharged. Perhaps more problematically, however, is that debtors and their attorneys, who have a claim, cannot discern whether or not their claim is solid. Judges, when faced with a potential discharge, must sift through many cases and weigh many factors, which makes their decisions harder and less predictable. Instead of a messy system, the bankruptcy code needs to be amended to provide a clear test for dischargability of student loan debt.

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David Kotz

Cornell Pre-Law Journal (PLJ): What specific elements of your undergraduate experience at the University of Maryland, College Park, most prepared you for the rigors of law school?

H. David Kotz: The government and politics classes I took in college which involved debate and analytical reasoning were helpful in law school. I also studied abroad during my junior year and had the opportunity to take several classes in which the “Socratic” method was used.

Where did you develop the courtroom presence and expertise essential to serve as a litigation associate at Graham & James, Stults & Balber P.C., and Pepper Hamilton LLP?

I was fortunate in that early on in my legal career, I had the opportunity to have significant hands-on litigation experience. I tried several administrative hearings and pro bono cases as a junior associate which gave me very valuable experience at a young age. Courtroom presence and expertise are best obtained through repetition and practice. I encourage undergraduates and law students to take advantage of clinics and other programs that get you into courtrooms and involved in actual cases.

Q&A:

For our Fall 2013 Edition, the Cornell Pre-Law Journal sits down with H. David Kotz, former Inspector General at U.S. Securities and Exchange Commission

Coming from a position at the Peace Corps, how was your initial transition to the Securities and Exchange Commission?

It was not as difficult as I thought it would be. When I first arrived at the SEC, many SEC officials informed me often that the SEC was very different than the Peace Corps and that it would be a challenging transition. However, the first few audits
audits and investigations I did as Inspector General of the SEC involved procurement fraud, inappropriate use of the computer and some employment issues, which were very similar, if not identical, to ones I analyzed as IG of the Peace Corps. Later on, as I starting looking into why the SEC failed to uncover complex frauds such as Bernie Madoff’s Ponzi scheme, the uniqueness of the SEC became more obvious.

As the work I was conducting was often high-profile, it was a significant challenge to make sure my findings were complete and accurate. Many of the reports I was writing were read carefully and heavily scrutinized by SEC officials and Congress, as well as the media and the investing public. Our quality review/quality assurance process was painstaking and we placed a great deal of effort on ensuring that testimony and documents were accurately cited and conclusions flowed from the evidence we found. I am proud to note that while anytime you do something in the public eye, there will be criticism, none of the many reports we prepared during my tenure at the SEC were found to be inaccurate in any way, and no one ever really disputed the findings we made.

What do you consider to be your most important accomplishment at the Securities and Exchange Commission?

My office provided the SEC with thousands of recommendations to improve their programs and operations. Nearly 99% of them were not only agreed to, but implemented fully. In just the case of the Madoff scandal, in addition to the 450-plus page report analyzing why the SEC failed to uncover the scandal, my office issued 3 additional reports providing nearly 100 recommendations on how to fix both the SEC Enforcement Division and Office of Compliance Inspections and Examinations (OCIE). All of them were implemented and the SEC was in a much better position to uncover fraud after they were implemented than before. Overall, I believe that I left the SEC more efficient and less wasteful than it was when I arrived there.

How did your approach to independent investigations and audits differ from the approach of your experienced predecessor, Walter Stachnik?

My predecessor placed a high premium on providing positive and encouraging information to SEC management and not embarrassing them in public. He also believed that if negative information came out of an audit or investigation, it would be preferable to work out an arrangement with SEC management to fix the problem in an informal manner without putting too much negative language in an official report. When I arrived at the SEC, I found this approach was not necessarily leading to significant change or increased efficiencies. I also believed that I had an obligation to Congress and the public to provide all the information about my reviews of SEC operations and programs, whether positive or negative.

What was the most significant challenge that you encountered as the Inspector General of the Securities and Exchange Commission, and how did you endeavor to overcome it?

As the work I was conducting was
disciplined even where they engaged in serious misconduct. It was necessary to take an aggressive approach to ensure that SEC employees were acting properly and the government was not wasting taxpayer money. In the role of Inspector General, if you are doing your job, you can expect some backlash. If you shrink in the face of criticism, being an internal watchdog is not the position for you.

Why didn't the Securities and Exchange Commission execute “the necessary, but basic, steps to determine [whether or not] Madoff was operating a Ponzi scheme?”

There was a combination of factors. First, SEC officials were simply overmatched by Madoff and his associates. They simply did not have the necessary expertise or training to conduct competent exams or investigations. Uncovering a Ponzi scheme is actually not that difficult an assignment for a regulator like the SEC. One simply has to check a third-party source to confirm that trades were being executed. A 15-minute telephone call at any point in time in the nearly 20 years in which the SEC was examining utilized by the SEC in its exams and investigations and insufficient challenging of Bernie Madoff when he gave answers to SEC questions. For example, SEC investigators accepted at face value Bernie Madoff's explanation that his remarkably steady returns were achieved by his personal “gut feel” for the market.

Of the many cases that you referred to the United States Department of Justice, only a minority of them were prosecuted. What factors influenced the Department of Justice not to take further actions?

As Inspector General, I was required by the Inspector General Act of 1978 to refer all matters expeditiously to the Justice Department whenever I had reasonable grounds to believe there has been a violation of Federal criminal law. My practice was prior to undertaking a referral, we would contact the Department of Justice to ask whether they were interested in the referral or would be willing to provide us with a formal declination. In about 20 cases in 4 years, the Justice Department asked that we formally refer the matter to them. In many of these cases, the Justice Department conducted full-blown investigations (sometimes over a several-year period) but decided, in the end, not to prosecute. I believe it was a matter of resources and that the bar is often very high in connection with a criminal indictment, as it should be.

What is the greatest lesson that you learned from your tenure at the Securities and Exchange Commission?

I learned that conducting meaningful oversight as an Inspector General is not easy and requires a tremendous amount of fortitude and dedication. I learned that systems are not easily changeable, particularly, in the U.S. Government. The most common phrase I heard while encouraging changes or reform was “This is just the way we have always done it.” This attitude is very difficult to overcome but can be very gratifying when achieved.

Given the size of the Securities and Exchange Commission, are professional improprieties inevitable?

Certainly, any large organization is going to have its share of issues. The test is how the organization deals with these improprieties. Does it take responsibility for its actions and engage in real reform? In the Madoff case, the SEC has a mixed record. There were significant policy and procedural changes as a result of my office’s findings in the Madoff case. But on the employee side, no one was terminated from their job as a result of the Madoff fiasco. It is hard to imagine if an equivalent event had occurred in a private sector company that the same result would be allowed to occur.

“If you are doing your job, you can expect some backlash. If you shrink in the face of criticism, being an internal watchdog is not the position for you.”
In the United States of America, the number of incarcerated individuals has exploded over the past few decades, growing from 200,000 in 1973 to 2.2 million today. Since 2002, the U.S. has had the highest incarceration rate in the world. This has put an increasing strain on the economy as the average cost of housing an inmate is approximately $20,000 to $30,000 per year. This expenditure means that less public money is available to be spent on public education, medical care and public assistance. For example, California spends about 2.5 times more money housing and feeding its inmates than it does educating students. Additionally, mass incarceration means higher unemployment in the America. A significant percentage of incarcerated individuals plead guilty because they do not understand the long-term collateral consequences of having a felony record. For the over 650,000 inmates who are released each year, these consequences are serious barriers to a successful reentry into society.

After individuals have served their time and are released, the stigma attached to their records can significantly inhibit their social, political, and economic lifestyles. Felons lose their rights to serve on juries, to hold elective office, and to vote. In particular, the loss of voting rights is a visible symbol of the costs of a felony conviction. Many see their plans to become helpful and active citizens as unrealistic. They also become ineligible for public benefits such as assisted housing, federal student aid, food stamps and cash assistance. Many have their drivers’ licenses automatically revoked. A felon record means parental rights are threatened. The ability to be a foster or adoptive parent is significantly worsened, and a child’s prospects for economic mobility are reduced. Felons lose their privacy as virtually anyone with internet access can find information about someone’s conviction history online without consent or the knowledge to interpret or use the information.

Economically, ex-offenders are 50 percent less likely to be hired than job seekers without a criminal record. This is because employers in most states can deny jobs to anyone with a criminal record, regardless of individual history, circumstance, or business necessity. Former prisoners are paid less than those who have not been to prison. Many prisoners feel that they have lost the right to get a good job that pays

“Felons think that the world is against them, and are often re-arrested.”

Two of Three Felons are Re-Arrested After Entering Society
more than minimum wage.\textsuperscript{15} “Felon” is not just a term. It is a generalized label with wide ranging consequences.

Many felons want to improve their lives and be better citizens, but they resort to crime to gain money and survive when faced with these consequences. This additional crime happens in core counties located primarily in urban centers and puts additional strain on those communities.\textsuperscript{16} Felons think the world is against them and are often rearrested. In fact, approximately two-thirds of released individuals are rearrested within three years.

To stop this cycle that harms the offender and the community, systemic changes must be made. Before an individual pleads guilty to a crime, he must be informed of the collateral consequences that result from imprisonment. Although embedding collateral consequences into the criminal process will burden the courts and lawyers, it is in the best interest of the defendant and therefore must occur.

Additionally, there must be a better transition system in place to help individuals adapt to society before they are even released. Studies show that individualized prerelease planning is correlated with successful re-integration.\textsuperscript{18} This could include a special civics curriculum for prisoners to prepare them for what awaits upon release.

Once felons are released, they must have access to reentry centers that aid them legally, economically, and socially. These centers must have more federal money to minimize the effects of the collateral consequences that can seem overwhelming to felons without any help. Hopefully, this will stop the cycle of felons being rearrested, and ultimately reduce the number of incarcerated individuals in the United States.

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“Many felons want to improve their lives, and be better citizens.”
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s a student from a home of blue-collar workers, the economic environment of Cornell University continues to shock me on a regular basis. From Orientation week, when there were various activities planned only for “new students of alumni,” to hearing a student in class admit to the TA her dream career is to be an elitist “like my daddy,” I have faced many situations in which I can only drop my jaw in silence. I am not attempting to paint a picture that illustrates “legacy kids” as spoiled students who aren’t grateful for the opportunity they are given here. Rather, I find most legacy kids to be extremely grateful of the opportunity to study here. However, I find the admission process that accounts for legacy to be flawed and grounds for legal review.

About ten years ago, Chief Justice Rehnquist decided in Gratz v. Bollinger that the University of Michigan’s use of race in its admission process was unconstitutional as the “automatic distribution of 20 points to every single underrepresented minority applicant solely because of race was not narrowly tailored and did not provide the individualized consideration” necessary.¹ This process of using a non-individually tailored approach to admissions was found unconstitutional. 20 points given to every minority student, in an attempt to increase diversity in the university, was rejected. While the overall goal of increasing diversity may have been beneficial, the means to do so were found illegal.

Let’s now use this ruling in terms of the benefits legacy students receive in admissions. They are automatically distributed a certain benefit for having alumni as families; this process could certainly not be narrowly tailored or individualized. In order to
determine whether or not this process is individualized, we must analyze any available data we have on how these students are treated in the admission process.

In an article recently published in *The Cornell Daily Sun*, being a “legacy” student can add the equivalent of 160 SAT points to one’s college application. Similarly, we see the use of a system that gives an inherent advantage to individuals belonging to a certain group. 15% of Cornell’s undergraduate population consists of legacy students. In 2015, 33% of the applicants offered a seat in Princeton’s class were legacy students.

A research done at Harvard University evaluating the effects of legacy in the admission process, found that any legacy gave the applicant a 23.3% increase in the probability of his admission. If an applicant has primary legacy, in that one of his parents went to the university, his chances increased by 45.1-percent. In fact, 13-percent of Harvard’s own undergraduate population is legacies.

An offered reason for this legacy advantage is the motivation for alumni donations. In an interview about the legacy admission rates, Yale University President, Rick Levin, stated, “private institutions depend on resources provided by their alumni” and “Legacy students are on average significantly more generous donors.” In fact, the administration does “advise the admissions office about applications coming from the children or grandchildren of significant donors and of alumni who have given significant volunteer service.”

Legacy status of applicants clearly has a huge impact on top University’s admission decisions. However, this admission process is grounds for legal review and should be litigated further.

Richard D. Kahlenberg, a senior fellow at the Century Foundation and a graduate from Harvard Law School, has been very open about his aversion for the alumni preference in university admissions. He claims this process is in violation of the 14th Amendment and the Civil Rights Act of 1866 as “both prohibit discrimination based on lineage and ancestry.” Kahlenberg claims, “Congress should outlaw alumni preferences at all universities and colleges receiving federal financing, just as the Civil Rights Act of 1964 outlaws racial discrimination at them.” If this does not occur “it will fall to lawyers to bring suit to enforce the 14th Amendment and the 1866 Civil Rights Act to put an end to this form of discrimination in higher education.”

Lawyers Steve Shadowen and Suzi Tulante, who share this point of view, published a paper concerning the unlawfulness of legacy preferences in the admission process. They claim that these preferences also go against the Civil Rights Act of 1866 his can be interpreted as discrimination based on family lineage. In relation to the *Gratz v. Bollinger* case reviewed above, they also point out that “legacy preferences cannot survive strict scrutiny because the universities’ justification for legacy is not legally cognizable.” “There is no correlation between legacy preferences and increased university revenues.” If revenues are the basis for legacy admission, the data that shows no correlation reveals that this admission tactic is baseless.

I am proud to say that I gained admission to this university in a process that is considered legal. My experiences, and even the reputability of my education, are certainly meaningful as they represent my own hard work and achievement. I transferred into this school after my Freshman year from a nearby state school. I cannot help to wonder whether or not I would have been accepted as a Freshman at Cornell University if I had an alumni in the family.

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The Effects of NFIB v. Sebelius

In 1787, life expectancy was under 40 years; today, it averages 77 years. The near doubling of the American lifespan signals a great deal of advancement in healthcare and represents the extensive change the healthcare has undergone. When the Constitution was written, the framers could not have imagined universal healthcare because healthcare as we know—the preventive treatments, surgeries, and other procedures that Americans now rely on to stay alive—did not exist. Yet despite all that has changed in the past 226 years, Chief Justice Roberts’ decision in National Federation of Independent Business v. Sebelius insists on a strict adherence to a puzzling construction of what the framers would have wanted. The decision in Sebelius centered on the constitutionality of two main provisions of the Patient Protection and Affordable Care Act (also known as “ObamaCare”): an expansion of Medicare, and an “individual mandate” requiring all people to obtain minimum health coverage or pay a “shared responsibility” penalty. This paper will focus on the latter issue, which the court upheld as part of Congressional authority to tax and spend money. By analysing the unique economic nature of the health care market within the context of interstate commerce, the use of the taxation power, and the practical implications for healthcare reform, I will argue that Roberts’ constructionist and overly formal interpretation of the constitution deviates from previous interpretation of the Constitutional Commerce clause but only barely narrows the opportunity for much needed health care reform.

I. Health Care and the Interstate Commerce Clause

Roberts argues that the Commerce clause, which allows Congress “to regulate commerce with foreign nations, and among the several states…” does not allow for the individual mandate because it merely prescribes the power to regulate existing commerce, but not to compel it. Roberts acknowledges that all individuals will eventually have healthcare needs requiring that they participate in the health market. However, he regards as unthinkable the notion that Congress has the power to regulate this future or anticipated commerce within the healthcare market by mandating that citizens purchase insurance. Roberts and his colleague Justice Antonin Scalia analogize the individual mandate to a hypothetical mandate within the vegetable market, arguing that while mandating broccoli purchase would also act as “a means of financing health-care consumption and covering universal risks,” it would be far outside the rights of Congress to mandate such a purchase. Roberts argues that laws demanding certain health-related behaviors would lead to an unjustifiable expansion of Congressional power and limit personal rights. Additionally, he argues that the mandate is particularly repugnant to the Constitution because it has never been done before, saying “for over 200 years both our decisions and Congress’s actions have reflected this understanding. There is no reason to depart from that understanding now.” By interpreting the Commerce clause in this way, Roberts not only reduces the complexities of healthcare ad absurdum but also posits an argument that is both constitutionally and historically flawed.

The main example cited of regulating inactivity within the NFIB decision is Gonzalez v. Raich. In Raich, the court contemplated whether Congress acted within its power under the Commerce Clause to criminalize marijuana grown for personal use, even though the drug was not explicitly produced for interstate commerce. In other words, the court considered the question: Can Congress regulate activities which prospectively but do not currently effect interstate commerce? The court upheld the law under the logic that marijuana grown at home could easily be diverted into the market and become interstate commerce, thereby subverting the legitimate Congressional goal of criminalizing interstate marijuana sales.

The analogy between regulating the anticipated purchase of medical care and the anticipated sale of marijuana is obvious. In both cases, Congress relies on a prediction of what will eventually constitute interstate commerce in order to regulate this potential activity. Roberts claims that the two cases are distinct because while in Raich the law was a “concededly valid” exercise of the commerce clause that did not involve the “substantive power” he believes to be exibited in Sebelius. I argue that the opposite is true. In Raich, Congress made the assumption that a person growing marijuana for his or her own consumption would inevitably sell it on the open market, thus falling under the jurisdiction of Congress to regulate interstate commerce. In Sebelius, Congress made the assumption that an uninsured person would eventually purchase health care out of necessity. The difference between the cases is that while a person will indisputably need to access health care at some point, person growing marijuana will never need to distribute marijuana in the same way. Thus, contrary to Roberts’ opinion, the assumptions underlying Raich are much more of a logical and constitutional leap than those underlying Sebelius. Strangely, this is a comprehensive leap that Roberts takes, despite the fact that Congress’s regulation was based on empirical proof that the uninsured, as a group, are in fact very active in the health services market.

This proof, cited by Congress and reiterated by Justice Ruth Bader Ginsberg in her joint concurrence, demonstrates one of the most unique features of the healthcare market: use of the healthcare system by a person who cannot pay affects other participants in the healthcare system. Before passing the healthcare law, “Congress found that $43 billion of uncompensated health care services were provided to the uninsured in 2008 and over 60% of the uninsured visit
a hospital or doctor’s office each year.”

Due to the highly privatized nature of the US healthcare system, hospitals do not simply absorb these additional costs into their profit margin. Instead they raise prices, leading to an increase in insurance premiums by “an average of $1,000 a year.” This is not, as Roberts argues, an imagined or prophesied problem, which may one day effect interstate commerce, but a very real and measurable free-rider dilemma. Unless the US is to dramatically change the basic rules of medical ethics, which require doctors to treat those in need regardless of ability to pay, the individual mandate enforces payment for a system that the uninsured already have access to and will inevitably need. The Affordable Care Act protects the other participants in the healthcare market from sustaining large increases in their premiums.

II. The Power to Tax and Spend

Despite dismissing the ACA as a legitimate exercise of the Commerce Clause, Chief Justice Roberts still upholds the individual mandate under the Congressional power to tax and spend. In his decision, Roberts declares that the “shared responsibility” payment that acts as a penalty for not obtaining health insurance is in fact a tax. Roberts explains his decision, positing that the taxation power “gives the Federal Government considerable influence even in areas where it cannot directly regulate.” This position, while upholding the ACA, allows Congress to hide behind taxation even if that may not be the most efficient way to achieve its goals.

Ironically, utilizing the taxation power as a roundabout way of preserving the ACA suggests a possible expansion of Congressional power. By allowing that taxation gives Congress “considerable influence,” Roberts simply describes the act of compelling commerce in more politically convenient terms. Even the conservative justices’ fears of the so-called “broccoli horrible” could be made possible under this line of logic: So long as the tax is not so high as to really afford no choice to the individual, Congress could, in Roberts’ farcical world, induce us all to buy broccoli by taxing those who didn’t.6

Clearly, Roberts did not uphold the mandate under the commerce clause for fear that this would expand the powers delegated by the commerce clause. However, as Ginsberg argued in her concurrence, Roberts did not need to write Congress a “carte blanche” to regulate economic inactivity in order to uphold the mandate under the commerce clause. Rather, he could still put successful constitutional limitations on the role of Congress in the economy by recognizing that healthcare is economically unique. Because of the indispensable nature of health care, no one is really “inactive” in the market. The framers of the Constitution could not have possibly imagined such a marketplace when drafting the original document. And by limiting the decision to healthcare, Roberts could still have made a sufficient political compromise without conflicting with the principles set forward in Raich and similar cases before it.7

III. The Future of Reform

In light of the NFIB decision, policy makers must consider what this will mean for future health reform. The reform apparently advocated by the majority opinion regarding the limitations of the Commerce Clause is state-funded healthcare. Roberts, once again adhering to a constructionist view, articulates the belief that powers such as health care which, “in the ordinary course of affairs, concern the lives, liberties, and properties of the people [would be] held by governments more local and more accountable than a distant federal bureaucracy.” However, clear evidence exists as to why local funding of health care could not be successful. The case of health care reform which led to a classic race-to-the-bottom commodum in Massachusetts most obviously exemplifies this fact. After establishing a health care scheme similar to the ACA within the state, thousands of uninsured patients flooded Massachusetts Hospitals seeking care. The influx of the uninsured forced the state to raise taxes for those actually covered by the program, driving the businesses and healthy people who sustained the system needed to sustain the system out of the state. Thus, from an economic standpoint, healthcare reform is unlikely to benefit an individual state. If it is to be undertake it must be done on a national level. From a constitutional standpoint, the mere fact that so many people crossed state lines gives a Congressional authority to address such a situation through federal legislation.

Another option implicit within the majority’s decision to uphold the mandate under the taxation power is an intriguing, but politically unfeasible, one. As Justice Ginsberg mentions, Congress unquestionably could have established a single-payer system similar to Social Security through the power to tax and spend. This would eliminate the need to regulate the private market in order to extend health coverage. However, as the majority of Americans—54 percent — are strongly opposed to government-run healthcare, this is clearly not an option.9

The existing mandate actually aligns more with the will of the majority in retaining almost complete reliance on the private sector.

Finally, there is simply the option to continue regulating the private market, treating the Sebelius decision on the individual mandate as largely inconsequential. Despite the overwhelming controversy over the majority decision, this viewpoint has a great deal of merit. In terms of limitations, the majority opinion only restricted the commerce power insofar as they could not compel people to purchase a product. As law Professor Douglas Laycock of the University of Virginia School of Law points out, so long as the individual mandate is upheld as a tax imagine a future situation in which Congress will need to compel commerce again.10 Extending coverage is an important feature of ensuring affordability and accessibility of health care for those who aspire to a healthier and more equitable society. However, it is important to keep in mind the regulations of the ACA that passed without any judicial scrutiny, including the protection of patients with preexisting conditions and extension of dependent status for children under 26. Thus, while the majority opinion indicates a heavy resistance to change despite extraordinary advancements in healthcare as a whole, the practical impact of the decision, while still unclear, is not likely to be terribly significant.

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Cornell Pre-Law Journal (PLJ): What is the most troubling misconception of the scandal at Enron Corporation?

Sherron Watkins: Probably the most troubling misconception of the Enron scandal is the broad-brush conclusion that the company’s businesses weren’t viable. Partly this misconception originated internally, from Jeff Skilling, Enron’s former COO and CEO, who complained about the low rate of return on capital at Enron International, run by Rebecca Mark, his chief rival at Enron. However, there seemed to be a push among business advocates to categorize Enron as an example of failed business leadership, and not an example of failed accounting, internal controls, auditing or risk management of derivatives. By pushing for the former instead of accepting the latter, the business advocacy group, was in my opinion, advancing the idea that no new corporate legislation or regulation was necessary because Enron was just a case of bad business judgement.

PLJ: What about Enron Corporation attracted or cultivated corruption?

SW: Enron was named “Most Innovative Company in America” by Fortune Magazine for six or seven years in row (that seventh year is iffy, as it was 2001, the year Enron collapsed in bankruptcy). Our individual and corporate strengths can at times or in certain circumstances be our weaknesses as well. The charismatic leader borders on narcissism and an inability to hear bad news. The take-that-hill general also has a take-no-prisoners management style that pushes away talented employees. In Enron’s case, the push to innovate, to advance new business ideas, to constantly meet ever-growing earnings targets, to create trees that grew beyond the skies, resulted in innovation’s dark side, fraud.

I believe Jeff Skilling admitted his primary weakness in a meeting I attended in late 1993. I thought his statements chillingly foretold of Enron’s fraud, so I included a detailed description of the meeting in the 2003 book I wrote with Mimi Swartz, Power Failure, the Inside Story of the Collapse of Enron.

The meeting is described in Chapter Four. Basically, Skilling wanted insight into the collapse of Metallgesellschaft AG’s New York trading operations, where a $1.3 billion oil trading scandal was bringing down the German parent company in late 1993. Since I’d just left Metallgesellschaft (MG) for Enron in October of 1993, Skilling called me and another former MG employee to his office to discuss what really happened. I explained the circumstances as I understood them at MG, concluding that it was an intentional trading move, somewhat of a desperate trading move, by desperate managers hoping to reverse some recent financial downturns. Skilling did not like that answer one bit, and replied that ‘we could get desperate one day.’ He wanted bulletproof controls that would prevent anyone, including himself, from putting pressure on a trader to take on unauthorized risk. Later, as I thought back about that meeting, Skilling wanted controls in
place that even he couldn't get around, but no one thought to put bulletproof controls around the finance department, since that department typically encourages banks to take on risk in lending to us, and rarely involves an ability to take on risk that is unknown or unreported within the company.

PLJ: Jeffrey Skilling was often credited for constructing a culture of innovation at Enron Corporation. Do you think that his influence facilitated the creation of creative accounting practices?

SW: The issue with Jeff Skilling was his almost cult-like following at not only Enron, but among the Wall Street analysts as well. No one wanted to disappoint Jeff. In 1994, Enron’s trading group (started and run by Skilling), monetized a chunk of it’s net trading receivables in off-balance sheet funding vehicles that mimicked collateralized mortgage obligations, or more simply, accounts receivable factoring. Both examples are standard practices within business and banking. The first few monetization deals were very straightforward, whereby Enron ‘sold’ or transferred the performance risk of its counterparties to the banks. I’ve included a photo of the ‘deal toy’ for the second one, done in 1995. (No Plexiglas deal toys for Enron’s finance group). The securitizations were aptly named CASH I, CASH II, and so on; CASH stands for Contractual Asset Securitization Holdings Trust. However, by 1996 and 1997, Enron was still looking to monetize its sizeable trading assets, yet the counterparty creditworthiness in the remaining contracts was not attractive to the banks, so Enron began to sweeten the deals with clawbacks to Enron’s balance sheet via promises of Enron stock if the counterparties failed to perform. These debt transactions started out as plain vanilla deals, moved to aggressive deals, and ended up being fraudulent.

The Permanenent Subcommittee on Investigations of the Committee on Governmental Affairs of the US Senate investigated and reported on ‘The Role of The Board of Directors in Enron’s Collapse.’ The report is dated July 8, 2002. The longest standing investigative committee of the US Senate had this to say about Enron’s board oversight of Enron’s highly structured finance transactions:

“All of the Board members interviewed by the Subcommittee were well aware of and supported Enron’s intense focus on its credit rating, cash flow, and debt burden. All were familiar with the company’s “asset light” strategy and actions taken by Enron to move billions of dollars in assets off its balance sheet to separate but affiliated companies. All knew that, to accomplish its objectives, Enron had been relying increasingly on complicated transactions with convoluted financing and accounting structures, including transactions with multiple special purpose entities, hedges, derivatives, swaps, forward contracts, prepaid contracts, and other forms of structured finance. While there is no empirical data on the extent to which U.S. public companies use these devices, it appears that few companies outside of investment banks use them as extensively as Enron. At Enron, they became dominant; at its peak, the company apparently had between $15 and $20 billion involved in hundreds of structured finance transactions.”

“Finding (1): The Enron Board of Directors failed to safeguard Enron shareholders and contributed to the collapse of the seventh largest public company in the United States, by allowing Enron to engage in high risk accounting, inappropriate conflict of interest transactions, extensive undisclosed off-the-books activities, and excessive executive compensation. The Board witnessed numerous indications of questionable practices by Enron management over several years, but chose to ignore them to the detriment of Enron shareholders, employees and business associates.”

“Finding (2): The Enron Board of Directors knowingly allowed Enron’s use of high risk accounting practices.”

Certain personnel within Enron’s accounting, finance and legal departments expressed concern about the growth of Enron’s off-balance sheet funding mechanisms, while others eagerly jumped aboard the specialty finance and accounting team that worked these deals, as this group tended to receive sizable bonuses come year-end.

Since it was a specialty team that ‘monetized’ Enron’s deals and assets, this group acted like a virus that would travel here and there among Enron’s business units, hence the ‘spread’ of the corruption.

To add another factoid to this pile, Chase, Citibank and CIBC settled shareholder litigation for $2 billion a piece for their participation in these debt deals, because they had discussed the troubling aspect of the transactions in internal emails and meeting documents, recognizing that, while the deal was looked upon as Enron debt from the bank’s perspective, Enron was treating the debt as free cash flow from sale of assets.
PLJ: What was your initial impression of Jeffrey Skilling, and how did it evolve during your career at Enron Corporation?

SW: Jeff Skilling was charismatic and had a cult-like following among employees and Wall Street financial analysts. He was a hard person to say no to. If he believed a risk could be hedged, he did not want to hear otherwise; just make it happen. Both Andy Fastow, Enron’s CFO, and Rick Causey, Enron’s Chief Accounting Officer, wanted to please Jeff Skilling. The Raptor transactions that occurred within Andy Fastow’s investment partnership, LJM, were fraudulent hedging strategies developed because Jeff Skilling could not accept that multi-year restricted equity positions in volatile stocks cannot be hedged at current market highs.

I was still shocked when I learned of Skilling’s resignation on August 12, 2001, barely over seven months after getting the CEO position he’d so craved. When researching Power Failure, the book referred to above, Mimi Swartz interviewed several top executives at Enron who revealed that Skilling lacked stability and had ‘resigned’ numerous times before. Leadership is tough, all eyes are on you from within the company and outside; why would Ken Lay and Enron’s board select such a person for leadership? (For evidence of his instability, I make reference to his NYC meltdown on April 8, 2004, discussed in a Houston Chronicle article by Mary Flood, dated April 21, 2004, among other publications).

PLJ: Considering that men occupied almost all of the principal positions at Enron Corporation in 2000, did you ever encounter difficulties working there as a woman?

SW: Although it was easier for a white male to move up at Enron, the company promoted women in sufficient number that I never felt like I was hitting a glass ceiling. At times I have wondered if my concerns about Enron’s accounting were ignored partly because I was a woman, but after all the dust settled in Enron’s legal cases, it came to light that a few men protested the structures I was worried about, among them, Vince Kaminski, Jordan Minz, Jeff McMahon and Cliff Baxter. They were all ignored or had job responsibilities diminished or threatened.

PLJ: In an article published on the website of TIME Magazine, Frank Pellegrini exclaimed that, despite your characterization as a courageous whistle-blower, you “never really blew a whistle; a whistle-blower would have written [a] letter to the Houston Chronicle, and long before August.” Why did you send the letter to Mr. Lay, who was later convicted for his role in the scandal, rather than alert the public?

SW: When a company manipulates its own financial statements, its best path back to financial health is to come clean itself with appropriate plans to mitigate and rectify the situation. Reporting to the outside first, before giving Ken Lay a chance to right the ship, would have torpedoed the company - something I would not have wanted on my conscious. My goal was to have Ken Lay investigate, discover the fraud, and form a crisis management team to address it. He did not really hear what I was saying, and he conducted what could only be called a whitewash investigation meant to ensure he would only hear good news. Lay was counseled to write off the Raptor transactions that I was concerned with, because if he didn’t, I would likely go outside the company. Enron wrote the structures off in a way that is not acceptable, and a number of things happened, as outlined below:

a. Enron wrote off the Raptors via a third quarter earnings announcement on October 16, 2001, describing the write off as a non-cash, unwind of a previously disclosed related party transaction. The market went crazy by Friday of that week. The company did not clear up the matter in the sole investor call held later in October of 2001. The write-off was very significant, greater than 2/3 of total earnings from the year before, so the speculation about what was happening at Enron, the rumored ‘black box’ accounting, Skilling’s abrupt resignation – all those rumors – resulted in a ‘run on the bank’ more or less from Enron’s trading counterparties.

b. On October 17, 18 and 19th, 2001, The Wall Street Journal (WSJ) hit Enron with front-page exposé articles on Enron’s questionable accounting practices and related party transactions. It was clear the WSJ had a whistleblower inside of Andy Fastow’s partnership, LJM, but the Journal
appears to have lacked the courage to report what they knew until Enron drove themselves over the cliff. By that Friday, October 19, 2001, the SEC informed Enron that it was conducting an informal investigation into the company's financial reporting.

c. Enron had a multi-billion dollar amount of trade receivables on its balance sheet and a similar but smaller multi-billion dollar amount of trade payables, as is typical of trading companies that are primarily in the middle of companies looking to lay off opposing risks in commodity-based businesses. The monies to be received or paid from these trading activities would flow when the contracts so indicated, but for Material Adverse Change (MAC) clauses that Enron negotiated into all its trade contracts believing Enron would be the one to trigger said clauses, not its counterparties. With all the financial speculation, Enron's counterparties on the payable side began exercising their MAC clauses and demanding payment immediately. From late October to late November, approximately $6 billion poured out of Enron, stressing its liquidity to the breaking point. The company lost its investment grade credit rating and that downgrade, combined with lower stock prices meant the company was in default on two major debt vehicles. The debt was called and Enron declared bankruptcy.

As for Ken Lay, he was convicted on his actions after August 2001, when he was alerted to fraud within the company, yet continued to state positive but untruthful things about the company and effectively sell Enron stock via his borrowing activities with the company. (Lay borrowed cash from Enron under a $7 million revolving line of credit and would repay the company with Enron stock; he sold over $20 million of Enron stock in this manner after I met with him. Lay's Enron stock sales were not known to the public or employees until reported in February 2002). His actions up to August 2001 were not included in his indictment. The question posed above seems to imply that I was warning the bank robber he was about to get caught, while I have always maintained that Skilling, Fastow and Causey were the bank robbers and Lay was the bank owner leaving his cash drawers unlocked and unmanned. The analogy is not flattering for either group, however, there is a clear distinction that non-Enron folks might miss. Additionally, I discovered the fraud in late July, Skilling's departure on August 14th cemented for me that what I'd found and concluded was very likely true, and hence my meeting with Lay on August 22, 2001. The question posed above would seem to indicate that I was privy to the fraud at a much earlier time than August of 2001. I continued to urge Ken Lay to come clean, report the wrong doing all the way up through our last meeting in late October of 2001. However, after the squirmily way Enron conducted the October 16th write-off announcement, the end for Enron was already a done deal.

One word of caution I have for students, non-financial journalists, and investors alike: there seems to be this belief that all one needs to do is report to the financial press or the SEC, and wrongdoing would be stopped immediately. (Please see Harry Markopolos’ reports to both the SEC for 8.5 years and the WSJ for 3.5 years about Madoff’s Ponzi scheme, all to no avail). Additionally, I am fairly certain an Enron or LJM employee was reporting to the WSJ in the summer of 2001 and maybe even earlier, (see August 28, 2001 ‘Heard on the Street’ comment on Enron), but that employee and whistleblower got nowhere, since the WSJ did not report on Enron until after October 16, 2001.

**PLJ:** In retrospect, did Kenneth Lay during your meeting provide subtle clues or indications of his knowledge that the firm was “a crooked company?”

**SW:** I met with Ken Lay for approximately 30 minutes; I was armed with seven pages of memos I had written trying to articulate the accounting issues as I saw them. I also had a board presentation that I thought strengthened some of my arguments as well as an equity spreadsheet from the internal structuring and risk management group showing that the Raptor transactions had no outside equity invested in them.

One of the memo’s included a quote from one of our employees, that at times she wished we’d get caught – we were such a crooked company. He winced when he read that, looking like he’d been slapped in the face to have someone say that about Enron.

Lay was polite, but he commented that these structures had gone all the way to the board, been reviewed and okay’d by Arthur Andersen and Vinson & Elkins. He seemed fairly certain that those firms ‘okay’ was good enough for him. I asked him to check into one thing: the Raptors owed Enron over $700 million at this time, but how would the Raptors pay Enron? Just find the answer to that question. If it was from accessing a pile of Enron stock, then Enron had a problem. He asked me to give him time to look into the matter. I knew I was speaking to someone who did not get involved in the details of running Enron. I was optimistic, naive and stupid, because I truly believed he’d get honest advice from those around him since Skilling had resigned.

**PLJ:** During a recent conference of the ‘Association of Certified Fraud Examiners,’ Andrew Fastow asserted that “Enron did not have to go bankrupt when it went bankrupt.” Do you agree with him, and, if so, then which decisions expedited the firm’s demise?

**SW:** Yes, I do agree somewhat. See my response to question 6 above. Enron was a very fat carcass on the bankruptcy gurney. Over $1 billion of consulting fees were paid in Enron’s bankruptcy. I think making it the largest fee producer for a bankrupt company in U.S. history. The Enron executives who tended to Enron’s bankrupt estate make the same claim as Andy does. They suggest that our first mistake was in allowing the Enron trading folks to take over the company and safeguard their counterparty relationships by allowing those MAC clauses to be exercised. We should have fought the MAC clause claims, hoarded cash, and cut the trading business loose as trading businesses rarely survive a financial hiccup, much less a meltdown anyway. Then looked to convince the banks that putting good money after bad was in their best interest.
(i.e., avoid all those shareholder settlements and bankruptcy settlements of 15 cents to the dollar). There is a small chance Enron would have survived, similar to the way the Wall Street firms made it through 2008 with government bailouts.

PLJ: Discussing the collateral consequences of convictions, Professor Ellen S. Podgor of the Stetson University College of Law suggests that Arthur Andersen LLP might still exist had its management chosen to cooperate with the government. Do you believe that its proclamation of innocence contributed to its eventual death?

SW: I think by the time of Enron's demise and the failed auditing by Arthur Andersen, the issue of cooperation or potential for cooperation was too late. The best explanation I saw on Andersen and the Department of Justice (DOJ) relationship was a PBS FRONTLINE piece called "Bigger than Enron," done by FRONTLINE correspondent Hedrick Smith. It is good journalism! The piece goes back to Andersen's failed audits at Sunbeam and Waste Management, where the DOJ supposedly wanted to indict the audit partner or team, but Andersen worked a probation type arrangement to avoid that. It was more of strike one, strike two, strike three deal, with Enron being the last straw. The reporting seems to indicate that even the DOJ realized the deal was sour, that they should have indicted the individuals in case one, or case two, but now to have to say, that's it – you did it again, despite all the probation promises, we indict the firm now – turned out bad for too many innocent people. I don't think you'll see the DOJ indict a firm again – they will stick with individuals.

PLJ: Do you think that there were some innocent individuals engulfed in the ensuing tide of criminal and civil prosecutions?

SW: No. At least not at Enron. I do think at times the low man on the totem pole was caught rather than his or her boss at some of Enron's peer companies. But in Enron's case, the DOJ went for the chiefs, and for the most part got them. Some claim prosecutorial abuse of power, but I have come to realize one thing through my Enron DOJ experiences: the DOJ is the basdest, meanest cop in the whole wide world. You are not sitting across the table from a lawyer who earns less than you; you are sitting across the table from the United States of America. You do not mess with the DOJ. They will absolutely use every tool in their tool kit, and you do not lie, you do not 'forget', you do not play coy with the DOJ.

For those executives at Enron that felt compelled to plea out verses risk a trial (i.e., go for shorter period of prison time verses decades), that is a valid point to make. However, in the long run, it is akin to calling foul on the speed trap just over the hill on the expressway. Yes, it feels like a trap, but you aren't caught in it if you aren't speeding.

PLJ: In light of the malfeasance exposed following the most recent financial downturn, which specific educational, legislative, or regulatory actions should be taken to recalibrate the moral compass of American companies?

SW: When the corporate scandals of 2001 and 2002 first occurred (Enron, Worldcom, Adelphia, Health South, etc.), Congress looked at the excessive use of stock options as the issue that resulted in too much risk-taking. They actually talked of expensing stock option grants in income statements. There was backlash from the business advocacy groups, and we ended up with the Sarbanes Oxley Act (SOX) in July of 2002. Although I have no complaints about the legislation itself, I do believe the accounting firms went overboard in their interpretation of the type of internal controls they said the law required. A set of internal controls should rarely be bulletproof as that is too costly; internal controls should be sufficient to identify ethically challenged employees, so that the organization can get rid of them.

When SOX did not prevent the 2008 Wall Street meltdowns, we passed the Dodd-Frank legislation. Once again, business advocacy groups fought it, but when it was apparent it would be passed, they 'helped' legislators by providing more and more suggestions for what the law should include. In the end, we have, as reported by Eleazor David Melendez, International Business Times, July 19, 2012 issue, a statute that "has metastasized into 8, 843 pages of complex, loop-hole ridden rules." The law is so loop-hole ridden that Chase Bank claims they were not in violation of the 'Volker Rule' preventing/limiting speculative trading positions when they lost over $6 billion in the summer of 2012 in the now infamous 'London Whale' incident. The resulting legislation is basically now toothless, which brings to mind a rather well known story we discuss down here in Houston, Texas of a wealthy socialite crying to her divorce lawyer that she'd get all the money she wanted, that it wasn't over yet, asking 'how many pages is this pre-nup?' She heard from her lawyer that she'd get nothing as her estranged husband had her sign an iron clad 'pre-nup.' Her lawyer reassured her that it wasn't over yet, asking 'how many pages is this pre-nup? She reminded him that 'it was iron-clad; it was at least 185 pages.' He quickly concluded that she'd get all the money she wanted, no problem, 'now if you'd said 2 pages, you'd be sunk, but 185 pages, no problem, I'll find enough contradictory clauses and terms that pre-nup won't stand for anything when I'm done with it.'

The solution to our over-the-top risk-taking in the 2002 corporate scandals, as well as the 2008 meltdowns, is actually easy and somewhat pain free. I just pray we have the backbone to make it happen. In 1993 period, we passed a law in this country that salaries of corporate executives in excess of $1 million could not be deducted on corporate tax returns. At the time, we were concerned that CEO pay had climbed too high – from 26 times above the average factory floor worker in the 1970's, to 42 times above the average hourly worker by 1980, to 85 times the average hourly worker in 1990. So, we passed the Revenue Reconciliation Act of 1993, limiting deductible corporate pay to $1 million. Worse law ever. By that time, many CEO's were making in excess of $1 million in pay, so corporations had to make up the difference, and they did so with stock options. Stock options cannot be in the money when granted to avoid...
several consequences to the company, so to give an executive anything of value, the stock options are significantly larger than the cash foregone. (The CEO has the time-value of money to consider, his ability to stay alive and stay employed as the CEO, as well as general market conditions to consider, so generally the stock options were quite high relative to the cash lost in salary). Stock options were deployed to such a degree in the 1990’s that by 2000, CEO’s made more than 531 times the average hourly worker. The figure has not declined in the 2000’s; in 2010, it was about the same. Academic research shows that excessive use of stock options incentivizes risky behavior within companies. There were both risk managers and whistleblowers inside many of the Wall Street banks warning about the excessive risk within the companies, but with the exception of Goldman Sachs, upper management had become tone deaf to those warnings. I believe the lore of those stock option riches had them gambling the company. It is extremely difficult to legislate risk management from without – the companies hire the best and brightest, they understand their risks – we just need management incentivized to listen and heed their own risk managers.

The solution was proposed by Paul Volker once a few years ago. It’s simple. Just repeal the 1993 prohibition on the deductibility of $1 million salaries, and require that public companies compensate their C-class executives with cash only, no stock options, no stock grants. There would be no limits on the cash salaries and preferential buying programs would allow those executives to still be rewarded monetarily for increases in their company’s stock prices. It’s simple and easy to legislate and regulate, and it puts the right incentives back in place for upper management. It is even somewhat pain free as there is no limit on that dollar salary. I firmly believe this is the solution to prevent more Enron, Worldcom, Bear Stearns, and Lehman Brother debacles.

PLJ: If the whistle-blower provisions and protections of the “Dodd-Frank Wall Street Reform and Consumer Protection Act” existed in 2001, then would someone else at Enron Corporation have blown the whistle, and informed federal authorities?

SW: It’s too early to say. I think the best thing about the bounty provisions for whistleblowers in the Dodd-Frank legislation is that the possibility of them attracting legal talent to support the whistleblower, something that is much needed.

PLJ: What is the most significant challenge confronting whistle-blowers right now, and what advice would you offer them to overcome it?

SW: When someone is speaking truth to power, or declaring that the Emperor (Bernie Madoff) is wearing no clothes, no one wants to hear it. I often use quotes and observations from Charles Mackay, the Scottish historian from the 1800s, in my business talks around the country. He said, “Men, it has been well said, think in herds; it will be seen that they go mad in herds, while they only recover their senses slowly, one by one.” He also remarked that “Of all the offspring of time, Error is the most ancient, and is so old and familiar an acquaintance, that Truth, when discovered, comes upon most of us like an intruder, and meets the intruder’s welcome.”

No one wants to be wrong, or careless, or seen as too stupid to have seen that one coming, so they’d rather stay in denial. Whistleblowers that we know of, we know of because they were ignored. Here’s hoping that thousands upon thousands speak up about wrong doing, or wrong courses of action every year, and their companies or governments listen to them and make corrections, and we are blissfully unaware of the disaster they helped avert. For all those who are ignored, it’s never good for them or those that didn’t listen to them. If we are relying on whistleblowers to be our check and balance, then our system is already broken.

My advice to would be whistleblowers is to state your truth, and then get out as quickly and painlessly as you can.
EVIDENCE

Front Cover

Membership

Hearsay

For the Love of the Game: Reasons to Preserve The Tax-Exempt Status of Professional Sports Leagues
2. 26 U.S.C §501(c)(6).

Are Millennials and Securities Based Crowdfunding Matches Made in Heaven?

Social Media as an Investigative Tool

8. See United States v. Gansman, 657 F.3d 85, 93 (2d Cir. 2011); United States v. Evans, 486 F.3d 315, 323-24 (7th Cir. 2007).

Will Work For Free: The Legality of Unpaid Internships and Possible Future Options
“Office Cleaning Prank Played On Janitor In Frederick, MD,” Sean Mulgrew, and “Manhattan Sunset,” Rachel H.

Discretion and Discharge: The Student Loan Mess in Bankruptcy Court.
1. 11 U.S.C. 523 (a) (8)/
2. 831 F.2d 395 (2 Cir. 1987). The Second Circuit succinctly affirmed the Southern District of New York District Court Decision, in which the rationale for the test was more robustly laid out. In re Brunner, 46 B.R. 752 (S.D.N.Y., 1985).

3. Id., at 396.

4. In re Kenny, 313 B.R. 100, 106.


6. Id., at 258.


9. This is an area of extreme uncertainty, as will be discussed below.

10. The Second Circuit is silent on the partial discharge debate.

11. Circuit Courts of Appeals that have acknowledged a bankruptcy court's ability to partially discharge (including deferral or restructuring) a student loan: Ninth Circuit (In re Saxman, 325 F.3d 1168, 1173-1174 [2003]), Sixth Circuit (In re Hornsby, 144 F.3d 433, 439 [1998]; see also In re Miller, 377 F.3d 616, 620 [2004]).


13. See In re Grigas, 252 B.R. 866, 870-874 (D.N.H. 2000) (discussing the three approaches that courts have used).


15. Specifically, this passage seems to mirror a statement in the Wetzel case, wherein a Northern District judge held that “the court has the discretion to consider the extent to which [student loans] are dischargeable” and, where partial but not full discharge is warranted, the court said that it would be a preferred remedy. 213 B.R. at 227.

16. Even though the District of New Hampshire ultimately reached a different conclusion as to the proper approach to the student loan discharge statute, it acknowledged that this was perhaps the most mutually equitable solution. In re Gringas, 252 B.R. 866, 872. The Gringas court, however, was not making a first impression ruling, but rather faced a split within the district (and, at any rate, the District of New Hampshire is within the First Circuit), and it was also not making a ruling where, as in the Northern District of New York, the case law was well settled on an approach. (Id., at 873, n. 7) In our District, the partial discharge case law is uncontroverted. There is no split and no binding appellate precedent that comes to a different conclusion as to partial discharge.

Exclusive Interview with H. David Kotz


2/3 of Felons are Rearrested after Entering Society: Why?


The Legacy Advantage: Admission on Illegal Preferences
3. Id.
4. Id.
6. Id.
9. Id.
13. Id.

The Effects of NFIB v. Sebelius
2. Interestingly, Roberts’ contention that it was not within the founder’s intent to compel commerce is also factually questionable. Even if we are to accept the argument that legally, we must act within the

intent of the Constitution, this not sufficient to block the individual mandate. According to Einer Elhauge, who wrote an amicus brief in favor of the ACA, many of the Constitution’s original authors were part of a Congress which voted not once, but twice to legally require that citizens make purchases in the private market. In fact, twenty of the original framers were on a Congress in 1790 which passed a law requiring ship owners to provide health insurance for their employees. Einer Elhauge. “If Health Insurance Mandates Are Unconstitutional, Why Did the Founding Fathers Back Them?” The New Republic. 13 April 2013.
6. Id.; As per the requirements of Bailey v. Drexel Furniture Co., 259 U.S. 20 (1922).

Exclusive Interview with Sherron Watkins

Final Words
My Favorite Fictional Lawyer is ...

Vincent Gambini. Because even a mediocrity can win if he works really hard.
- Jack A. Goncalo, Associate Professor, Department of Organizational Behavior

Daniel Kaffee, Tom Cruise’s character from *A Few Good Men*, comes to mind. I like that he is smart and has a lot of integrity, and I especially like that he “speaks truth to power.”
- Bruce C. Monger, Senior Research Associate, Department of Earth and Atmospheric Sciences

Ally McBeal! She was a single young woman looking for fulfillment in career and love, something I think many of my students relate to. Plus, the show portrayed the legal setting as a fun place to work, and I think it changed the way some thought of lawyers and firms for the better.
- Sahara E. Byrne, Associate Professor, Department of Communications

Ben Matlock. That one is simple: he was always tough, but at the same time fair, something that I think is supremely important; and you can’t do it if you are self-centered, only if you look beyond yourself at the whole picture. In my opinion, that’s what the law should do.
- Christina M. Homrighouse, Senior Lecturer, Department of Human Resources Studies.

A top candidate for my favorite would be from Stanley Kubrick’s 1957 film, *Paths of Glory*: the French military lawyer Colonel Dax, played by Kirk Douglas. The movie takes place during World War I, with fighting between French and German forces having stalled in the trenches, where neither side can make an advance against the barbed wire and machine guns of the other side. A French unit is ordered to attack the German line against impossible odds and most of the soldiers are killed. The remaining ones retreat. The French High Command decides to make an example of three soldiers, chosen at random, by trying and executing them for cowardice and disobeying orders. Colonel Dax attempts to defend them, but the trial is clearly a political one, intended to protect the reputations of the generals who are clearly corrupt and incompetent. *Paths of Glory* is a strong indictment of war and a cautionary tale about the weakness of law in the face of political power.
- Matthew A. Evangelista, President White Professor of History and Political Science, Department of Government

Atticus Finch from *To Kill a Mockingbird*. A small-town lawyer in the segregated South of the 1930s, Atticus shows quiet courage in defending a black man falsely accused of raping a white woman. More than that, he embodies the conviction that, however imperfectly, the law serves a moral purpose—namely, to secure justice, including protecting the rights of the powerless. Moreover, while living in a society where prejudice is an accepted fixture of life, Atticus somehow recognizes that empathy is critical to living a moral life.
- Dana M. Radcliffe, Senior Lecturer, S.C. Johnson Graduate School of Management.

My favorite fictional lawyers were, collectively, the lawyers on *L.A. Law*. However unrealistic was their portrayal of “real lawyers,” they gave millions of folks with no prior experience with law the idea that being a lawyer might be a fun and interesting profession, and the show coincided with a massive increase in applications to law school.
- George Alan Hay, Edward Cornell Professor of Law, Cornell Law School.