

*International Society*  
*of*  
**Barristers**

Volume 43

Number 3

JUSTICE IN THE U.S. TORT SYSTEM—  
FACT OR FICTION?  
*Robert A. Clifford*

MASSIVE, PASSIVE, AND PATIENT . . .  
OR NAUGHTY KNIGHTS TO OUR RESCUE  
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A NEW ERA OF CONFLICT  
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LESSONS FROM THE ENRON ERA  
*James B. Comey*

*Quarterly*

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## JUSTICE IN THE U.S. TORT SYSTEM— FACT OR FICTION?†

**Robert A. Clifford\***

The American formula for doing business has been stunningly successful. It has produced more wealth and technological progress than may be found just about anywhere else in the world. Important components of that formula have been a willingness to allow largely unrestricted access by new competitors into markets and a commitment to embrace innovation without substantial pre-introduction regulation. These steps have helped to constantly renew and invigorate competition. This approach stands in stark contrast to the command-and-control economics that has retarded entry, crippled growth, and stifled innovation in much of the world—holding progress captive to the whims of risk-averse, corrupt, and incompetent regulators.

Why America went this route is no mystery. Since before the time of the Revolution in 1776, Americans have resisted government regulation. In fact, the Revolution itself was motivated in significant part by a desire to throw off British imperial regulation and bureaucracy. In its place Americans established a government restrained by a series of checks and balances designed to prevent the accumulation and exercise of official power. To an overwhelming degree, private interaction through the marketplace has been the preferred American solution to social challenges.

Modern industrial experience teaches, however, that no market works to perfection, that competitors will not always act fairly, that not every business will be honest, and that not every enterprise will look out for the safety of its customers or those who consume its products. Corporations are profit maximizers, and greed may all too easily distract them from good practices. If markets are not to degenerate into a ruinous race to the bottom, experience teaches that there is need for significant regulation of business conduct. In fact, nowhere in the industrialized world is there a complete absence of regulation.

The challenge for America has been how to achieve the necessary regulation while, at the same time, maintaining limited government control and respect for the workings of the market. As early as the 1830s Tocqueville noted that the American solution to this, and a range of other governance challenges, has been to rely on private litigants suing in America's courts.<sup>1</sup>

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† Paper presented at the Ninth Beaumont International Aviation Conference, London, England, June 25, 2008.

\* Clifford Law Offices, Chicago, Illinois; Fellow, International Society of Barristers.

<sup>1</sup> ALEXIS DE TOCQUEVILLE, *DEMOCRACY IN AMERICA* (1835).

Thus, citizens suing in response to injurious conduct has come to be relied upon as a bottom-up, after-the-fact form of regulating wrongdoing. This sort of approach makes enormous sense in a market-oriented society. Private actors with a serious stake in the correction of a wrong done to them are provided the opportunity to pursue a personal remedy. At the same time, if the consequences of the litigation are sufficiently weighty, the litigants' efforts can be used to advance the broader social objective of deterring misconduct. This is a core concept of the U.S. tort system.

#### PREREQUISITES FOR AN EFFECTIVE SYSTEM

To make such a system work there are a number of prerequisites. First, an adversarial form of justice is needed—one which allows aggrieved litigants great latitude in framing claims and adducing proof. Otherwise, a court bureaucracy, rather than the litigants, is likely to impose its agenda, and the benefits of privately driven regulation are likely to be reduced. For the same reason the courts must provide the most neutral, open-minded, and essentially passive decision makers possible to pass on party-initiated claims. The more passive and neutral the adjudicator the better—hence American dedication to the lay jury, a body less entangled in the litigation than is ever possible for the professional judge who must manage the progress of the case. The system also requires a set of open-textured legal concepts that can be used to respond to the great variety of ways in which wrongdoers, especially those organized as powerful corporations, can misbehave. Elastic concepts like “reasonableness” and “proximate cause” are particularly important if a flexible and responsive adjudicatory mechanism is to work. This regulation-by-litigation system must be friendly to claimants. It must allow them easily to establish jurisdiction over their opponents and make ample information available through discovery and otherwise (e.g., freedom of information legislation) for the prosecution of their claims.

Since injured parties will find this sort of litigation demanding and costly, a range of incentives will be needed, hence requiring recognition of an array of damage categories including pain and suffering and, perhaps, punitive damages. Penalties for the bringing of unsuccessful claims (such as a loser-pays fee shifting rule) must be avoided. Since the prosecution of such cases will often be forensically challenging, ways must be found to insure that highly skilled advocates will be attracted. One of the most sensible solutions to this problem, and one that relies on market forces, is a contingency fee arrangement allowing the advocate to share in the monetary recovery obtained. This solution offers the added benefit of facilitating the represen-

tation of impoverished claimants who might otherwise be unable to afford representation.

The system outlined is, more or less, the present U.S. tort system. It is well designed to encourage and support private party legal action. It frees enforcing parties from dependence on bureaucratic intervention and provides substantial incentive for the pursuit of remedies. It secures governmental action (through official verdicts) without a central bureaucracy. It mobilizes private resources to pay for oversight rather than relying on governmental funding, which is often subject to budgetary constraints. It can reach into every corner of society and is not limited by a lack of bureaucratic expertise. It is as diverse as the citizenry and can identify new problems as they arise. Unlike governmental agencies, it is not subject to capture by politically powerful or wealthy groups. It is operated by members of an independent and well-heeled bar and governed by the decisions of non-professional jurors who are substantially insulated from improper influence.

#### GOALS OF THE TORT SYSTEM

This tort regime has a variety of goals, the most prominent of which are compensation for injury, deterrence of future wrongdoing, and the visible correction of injustice. While the system aims at obtaining compensation for those who have suffered losses, this is far from all that it is intended to do. The elaborate and costly litigation process is such that only limited numbers of parties will pursue their claims. It is hardly the sort of streamlined mechanism one would choose to insure the swift distribution of circumscribed benefits. Yet, it does place real emphasis on the objective of seeing to it that losses, assessed as damages, are compensated. Beyond this lies the systemic goal of deterrence, which is at the heart of the process's regulatory functioning. For economic analysts from the great Learned Hand to Richard Posner, this is the tort system's core objective. In this context, adjudication identifies problematic conduct, exposes it to thorough factual and legal analysis, and then, if warranted, makes awards that are sufficiently large and publicized well enough to discourage wrongdoers and others similarly situated from continuing their improper behavior. At least that is the theory. Whether it works this way, in reality, is a matter to be explored below.

The system also serves a third goal, corrective justice. When people suffer serious wrongs at the hands of others, both they and society desire more than compensation and the cessation of harmful conduct. People desire that the wrong be corrected in a public and personal way. The American tort system facilitates calling wrongdoers to public account. Where such an accounting is not allowed, there are likely to be serious political and social

consequences that may threaten the peace and stability of society. In Japan, where there has never been an adequate system to respond to the injuries caused by careless automobile drivers, victims have turned to gangsters (Yakuza) to secure justice. In part, this reliance on thugs is about compensation, but it is also about overcoming powerlessness and the strong desire to see that corrective action is required of wrongdoers.<sup>2</sup> Where there is no legitimate outlet for such desires, extra-legal methods may be employed. The American tort system seeks to address the desire for corrective justice. It often speaks in a language filled with moral purpose, seeking to impose “duty” and insisting on “reasonable care.” Payments are required as a way of making the victim “whole,” and the premise is that injury creates a relationship between wrongdoer and victim that can be made right only by corrective action.<sup>3</sup>

#### NEED FOR THE TORT SYSTEM

One of the first questions that might be posed is whether there is a serious need for the sort of tort scheme described above. While the vast majority of this paper will rely on the best available empirical data so that facts rather than rhetoric will guide appraisal, at this point an anecdote may not be out of place. This story is intentionally drawn from the tales tort reformers have attempted to use to challenge the American tort system. The story involves a \$145 million award against the State Farm Mutual Auto Insurance Company for its bad faith refusal to pay an insurance claim made by one of its customers.<sup>4</sup> How could it ever be possible that an alleged error in the representation of an insured motorist could lead to a jury awarding \$145 million against the largest auto insurance company in America? Surely this could not be anything other than a gross injustice, a jury run wild, an outlandish imposition on a deep-pockets business corporation.

Consider the following facts drawn from the various court opinions in the case. The elderly Mr. and Mrs. Campbell were insured by State Farm. They were involved in an auto accident that resulted in the death of another motorist. Their insurance-company-provided attorney refused to settle the case for their policy limit (\$50,000) though their liability was clear. They then suffered an adverse judgment that substantially exceeded the limits of their policy. That judgment threatened to force them to sell their small home

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<sup>2</sup> See Peter Hill, *Heisei Yakuza: Burst Bubble and Bōtaihō*, 6 SOC. SCI. JAPAN J. 1 (2003).

<sup>3</sup> This relationship can be weakened by the existence of liability insurance, especially if rates are not experience-based.

<sup>4</sup> *Campbell v. State Farm Mut. Auto Ins. Co.*, 65 P.3d 1134 (Utah 2001), *rev'd*, 538 U.S. 408 (2003).

and deplete their retirement savings, despite State Farm's prior assurances that "their assets were safe."

You might be tempted to suggest that this was all part of the risk attendant to tort litigation and neither corporate bad faith nor wrongdoing. If you are inclined to so conclude, consider the following: In discovery regarding the bad faith claim made by the Campbells against State Farm, it was revealed that the insurance company, despite its contractual promise to pay for damages done by its clients (up to the contractual limit), instructed its employees to refuse to settle, no matter how reasonable the offer, so as to intimidate future claimants from pressing claims against State Farm if there was any other option; State Farm would provide its insureds with only what it called "mad dog" attorneys and instructed those "mad dogs," in violation of their absolutely clear fiduciary duty, to ignore the interests of the insureds and pursue those of the insurance company; State Farm rewarded employees who avoided paying justified claims and punished employees who properly paid them; State Farm prohibited the filing of written reports with the home office about any of the above-described activities so that it could claim that it had no knowledge of employee misconduct; and State Farm had been playing this outrageous game for more than twenty years.

These facts would suggest that regulatory deterrent action of the most forceful sort was needed. The jury so concluded and made its punitive award. The Supreme Court of the United States disagreed and found the award excessive. What is hard to doubt, however, is that State Farm had grossly misbehaved and that public insurance regulators had for twenty years failed to curb the insurance behemoth. The tort system confronted the wrongdoer and sought to put a stop to the harm. It did so at the instance of Mr. and Mrs. Campbell and their lawyer, who served not only their interests but those of the entire community.

The huge jury award in the Campbell case might be seen as a dangerous inducement to further similar tort litigation. Indeed, it is often claimed that the American approach to torts has led to a flood of claims. Here empirical data about the system becomes critical. Rhetoric notwithstanding, there is no litigation explosion in the United States and there has never been one. A careful analysis of judicial filings by Professor Marc Galanter, among others, demonstrates that the alleged litigation explosion is a figment of tort critics' imaginations.<sup>5</sup> Analysis suggests that America has a surprisingly small tort caseload considering the number of injuries suffered. The RAND Corporation studied disabling injuries and found that eighty-one out of every one

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<sup>5</sup> Marc Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (and Think We Know) About Our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4 (1983); Marc Galanter, *Real World Torts: An Antidote to Anecdote*, 55 MD. L. REV. 1093 (1996).

hundred such injuries resulted in no legal or other sort of action whatsoever.<sup>6</sup> Only seven of a hundred seriously hurt individuals in the RAND study consulted a lawyer. Only four of those hired a lawyer and only two ever filed suit.

Most American victims flee from litigation. This is nowhere more dramatically illustrated than in the medical malpractice area.<sup>7</sup> The best and, by far, most influential study of medical error and malpractice injury was carried out at Harvard University in 1990, based on New York State medical records.<sup>8</sup> At the time the study was undertaken, the claim within the medical profession was that there was no malpractice problem, only a problem of an excess of lawsuits. What the researchers found shocked them. They discovered that four out of every hundred patients admitted to the hospital suffered serious iatrogenic injury. At least one of these four injuries was clearly the product of medical negligence. The cost in terms of lives, extrapolated to the nation's population as a whole, was 75,000 hospital patient deaths a year caused by medical malpractice. More recent scholarly research has suggested that the true fatality figure may be two or three times the original estimate. Yet with all the deaths and serious injuries being suffered, less than ten percent of those seriously harmed file medical malpractice suits. The conclusion reached by researchers was that Americans tend not to complain. And even when they do, they succeed in only twenty-six percent of the cases that get to juries. The most sophisticated analysts have recently begun to ask whether there are too few medical malpractice claims being filed to deter medical malpractice.<sup>9</sup>

#### EVALUATING THE EFFICACY OF THE SYSTEM

An appraisal of the efficacy of the tort system must consider whether it is serving its central goals: compensation, deterrence, and corrective justice. As already noted, the system is not a particularly efficient or expansive compensation vehicle. It is expensive, relatively slow moving, and prone to a number of distortions. Its costs make it most practical when damages are likely to be high. It is, however, critically important in catastrophic cases where the absence of national health insurance often leaves victims without other recourse to meet a lifetime of substantial medical bills. It has been said that the tort compensation mechanism is a "lottery" won by a lucky few.

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<sup>6</sup> DEBORAH R. HENSLER ET AL., COMPENSATION FOR ACCIDENTAL INJURY IN THE UNITED STATES 31 (1991).

<sup>7</sup> The high quality and extensive volume of research on medical malpractice make it, perhaps, the most fruitful area in which to find useful data on the American tort system.

<sup>8</sup> See PAUL C. WEILER ET AL., A MEASURE OF MALPRACTICE (1993).

<sup>9</sup> See Michelle M. Mello and Troyen A. Brennan, *Deterrence of Medical Errors: Theory and Evidence for Malpractice Reform*, 80 TEX. L. REV. 1597 (2002).

Those who have looked most carefully at the data disagree. They remind us that the majority of cases settle, thereby providing at least partial compensation.<sup>10</sup> The costs and technical demands of litigation tend to distort results in the settlement context, leading to some overcompensation in smaller cases and some undercompensation in more serious ones. This is a source of concern, as is the high overhead the tort system imposes on the compensation process. Be that as it may, the salient question is: “What other source is available to take care of the needs of the seriously injured?” There is no national health insurance scheme. There is no effective protection against catastrophic injury. In America, the tort “something” is better than the societal “nothing” that is presently on offer.

A key question in evaluating the effectiveness of the tort system is whether it achieves regulatory deterrence. Scholars of law and economics believe that the tort system is fundamentally about deterrence and that under the proper conditions the tort process works in a systematic way to deter misconduct. That is the contention of Judge Richard Posner, along with a prestigious group of like-minded scholars and judges. Yet, in the real world, the deterrence argument has been controversial and deterrence effects difficult to prove. Seldom do real world data confirm a systematic sort of deterrence where each dollar charged to tortfeasors produces increased safety. That said, the general academic consensus (with some dissenters) is that while not systematic, a “moderate” form of deterrence is clearly discernible.<sup>11</sup> The costs imposed on tortfeasors do tend to encourage increased caution, especially if those costs are borne by the wrongdoer rather than met by insurance coverage. The fear of litigation, often wildly exaggerated (as in the case of the medical profession), has also been found to be a fairly powerful deterrent. In addition, the public disclosures caused by successful lawsuits, especially when there is a large monetary award, produce some degree of deterrence.

Case studies in the medical malpractice area tend to confirm these deterrent effects. In the late 1970s and early 1980s, anesthesiology was one of the most troubled areas in medicine. Patients frequently suffered iatrogenic injury and the cost of insurance for anesthesiologists soared. The specialty decided to take an unusual step: It committed itself to examine closed tort claim files and, based on that examination, to improve the way anesthesia care was managed. By 1989, 1,000 such files had been scrutinized, and within another ten years 4,000 were reviewed. What the specialist doctors

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<sup>10</sup> See Michael J. Saks, *Do We Really Know Anything About the Behavior of the Tort Litigation System—and Why Not?*, 140 U. PA. L. REV. 1147 (1992).

<sup>11</sup> See Gary T. Schwartz, *Reality in the Economic Analysis of Tort Law: Does Tort Law Really Deter?*, 42 UCLA L. REV. 377 (1994).

found was that approximately one-third of all anesthesiology problems were adverse respiratory events—difficulties that were largely preventable. So the experts went about shifting the way anesthesiology was practiced. Based on the problems identified in litigation, the anesthesiologists redesigned their equipment and changed the protocols regulating the delivery of care. The results were striking: Iatrogenic injury and malpractice claims tumbled; anesthesiology went from being one of the unsafest specialties to one of the safest; insurance rates dropped and, eventually, anesthesiology became the first medical practice area to achieve “six sigma,” a safety rating seen only in the very safest of industrial settings.<sup>12</sup>

Unfortunately, the medical profession has not generally followed anesthesiology’s lead. There are many reasons, but the bottom line is a tragically high rate of patient injury due to medical error. Why has deterrence failed in the healthcare industry at large? The answer is not at all clear, but expert examination of the data suggests that doctors have not generally taken safety to heart as anesthesiologists did. This would suggest a serious failure of tort litigation deterrence. That conclusion, however, is simplistic. Most physicians are insulated from the effects of litigation. Their insurance pays the vast bulk of expenses and adverse judgments. Moreover, a sympathetic public tends to give doctors the benefit of the doubt—juries find no liability in about three quarters of all cases tried. The system for evaluating and disciplining doctors is woefully inadequate. Experience rating for insurance premiums does not focus on individual doctors but on medical specialties as a whole. All this, when combined with a medical culture that emphasizes hierarchy and denigrates admission of mistakes, tends to shelter problem doctors from identification and from the deterrent effects of litigation.

Still, anesthesiology is far from the only deterrence success story. The Congress used the litigation remedy to deter injury to railway workers by enacting a broad warrant for tort suits in the Federal Employers’ Liability Act (FELA). Scholarly analysis has suggested that the result of this effort was the saving of 32,000 railway worker lives over the course of seventy years.<sup>13</sup> Famous tort cases have powerfully influenced specific practices. Over the course of the years, judicial insistence on informed consent, beginning in *Canterbury v. Spence*,<sup>14</sup> has transformed the way doctors talk to patients.<sup>15</sup> *Tarasoff v. Regents of the University of California*<sup>16</sup> has led psy-

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<sup>12</sup> See TOM BAKER, *THE MEDICAL MALPRACTICE MYTH* (2005).

<sup>13</sup> See LARS A. STOLE, *THE ECONOMIC EFFECTS OF LIABILITY RULES ON RAILROAD EMPLOYEE ACCIDENTS: 1890-1970* (1992), cited in Schwartz, *supra* note 11, at n.65.

<sup>14</sup> 464 F.2d 772 (D.C. Cir. 1972).

<sup>15</sup> See Schwartz, *supra* note 11, at 400-01.

<sup>16</sup> 551 P.2d 334 (Cal. 1976).

chotherapists to provide warnings of serious threats to third parties.<sup>17</sup> It has been suggested that interventions like these cause overdeterrence, leading to useless steps which in the medical field are referred to as “defensive medicine.” The question of excessive precaution has been exceptionally carefully studied, and virtually all the experts agree that defensive medicine simply does not exist.<sup>18</sup>

It is hard to leave the issue of deterrence without considering the question of punitive damages. These were awarded in the Campbell case and in a number of other high profile matters. The United States Supreme Court has, in recent years, narrowed their use in a series of decisions. Yet, both in terms of economic theory and in light of real world effects, they are an important adjunct to tort law for the promotion of deterrence. It was the awarding of punitive damages that got both State Farm’s and the public’s attention. The same may be said of the \$128 million award of punitives made in the *Grimshaw* case,<sup>19</sup> where horribly burned automobile accident victims sued Ford Motor Co. for its decision not to incorporate inexpensive gas tank safety measures in its Pinto automobile despite its awareness that this choice would lead to a substantial number of burn deaths and injuries. There, as in many other punitive award cases, the judgment was reduced by the reviewing court. Yet, the original judgment sent a powerful deterrent signal indicating that jurors and tort law were not prepared to sit idly by while automobile occupants were burned to death for want of inexpensive design improvements. While in Europe the gnomes of Brussels might require design change, in the United States it was the burned victims and a jury’s reaction that did the trick—with the help of an eye-catching punitive award.

A third major goal of tort litigation is corrective justice. Lawsuits keep people in the justice system and provide a societally sanctioned outlet for their righteous anger. The alternative to litigation, all too often, may be political disruption or resort to unsavory self-help alternatives. Litigation allows for the balancing of the moral equation, a correction of the imbalance caused by a harmful act. Critics have not only denied these points but suggested that corrective justice is a hoax because plaintiffs are, generally, undeserving malingerers and their attorneys are greedy parasites who hypocritically exploit tort victims. As to the charge of false claims, the data are once again quite clear—most awards are well supported by facts and law.<sup>20</sup> As to the

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<sup>17</sup> See Daniel J. Givelber et al., Tarasoff, *Myth and Reality: An Empirical Study of Private Law in Action*, 1984 WIS. L. REV. 443.

<sup>18</sup> See Randall R. Bovbjerg et al., *Defensive Medicine and Tort Reform: New Evidence in an Old Bottle*, 21 J. HEALTH POLITICS, POLICY & L. 267 (1996).

<sup>19</sup> *Grimshaw v. Ford Motor Co.*, 119 Cal. App. 3d 757, 174 Cal. Rptr. 348 (1981).

<sup>20</sup> For data regarding medical malpractice claims, see David A. Hyman & Charles Silver, *Medical Malpractice Litigation and Tort Reform: It’s the Incentives, Stupid*, 59 VAND. L. REV. 1085 (2006).

greed of the plaintiffs' bar, the story is much the same. Careful analysis by Professor Herbert Kritzer has demonstrated that, translated into an hourly rate (from contingency fee awards), plaintiffs' lawyers' compensation is virtually identical to that of defense counsel.<sup>21</sup> Moreover, there is no evidence that contingency fee arrangements lead to improper behavior by plaintiffs' counsel. As Professor Kritzer points out, the stock in trade of the successful plaintiffs' lawyer is his or her good reputation which generates a regular flow of referrals. Anything that harms reputation jeopardizes business. This serves powerfully to deter improper conduct.

The American tort system provides other benefits as well. One of the most significant arises out of the flexibility and responsiveness of the system. Unfortunately, the legislative branch of government in the United States has proven itself incapable of responding to a range of serious challenges. It has failed to enact legislation to address the problem of the asbestos-related injuries suffered by hundreds of thousands of American workers—often knowingly inflicted by asbestos manufacturers. It has a similarly abysmal record in regulating the use of cancer-causing tobacco products. Agencies of the executive branch have shown similar ineptitude, failing effectively to regulate dangerous environmental pollutants and flawed pharmaceutical products like Vioxx and the Dalkon Shield I.U.D. Faced with this abdication of legislative and regulatory responsibility, victims might have been left unprotected. The courts, however, agreed to step in and respond to properly framed tort and other sorts of claims. Their response has been neither elegant nor perfect. The litigation has been slow, costly, and cumbersome. But when a gridlocked legislature or a captured regulatory body could or would not act, the courts have done so. They have begun to clean up these social disasters. Their work has not been pretty, but when compared to that of the legislatures and agencies, it has been immeasurably better.

What does the world think of the American approach? There are more than a few foreign critics who suggest that the American system is a dangerous mess and should be avoided at all costs. Yet, when serious problems involving potential torts arise, it is to the United States that many litigants look. One significant example is provided by the Bhopal disaster. There, as many as 200,000 residents of the city of Bhopal, India, were killed and many more injured by a gas leak at a Union Carbide chemical plant. Not only a host of individual victims but also the Indian government concluded that America's courts offered a better forum for the resolution of the case than did those of India. The reasons for India's choice were fairly clear, including the availability of effective discovery tools, a speedy process (at least by

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<sup>21</sup> HERBERT M. KRITZER, *RISKS, REPUTATIONS, AND REWARDS: CONTINGENCY FEE LEGAL PRACTICE IN THE UNITED STATES* (2004).

When social scientists turned their attention to judges as decision makers, they came to the not surprising conclusion that judges, like jurors, are human and heir to the same sorts of cognitive limitations that confront jurors. Judges can be distracted and influenced by inadmissible prejudicial evidence.<sup>25</sup> They are vulnerable to hindsight bias.<sup>26</sup> They have trouble with statistics.<sup>27</sup> And, they may be misled by information that provides improper anchors for the fixing of monetary awards.<sup>28</sup> Judges face an additional problem when compared with juries. They sit alone in American trial courts. They have no collegial body to help them avoid error. Jurors, by contrast, sit in groups ranging from six to twelve. Their very number helps them avoid prejudice and arrive at less variable verdicts. Social scientists in examining jury deliberations have confirmed the old adage that “two [or twelve] heads are better than one.”<sup>29</sup> Kalven and Zeisel also found that jurors generally do as well in terms of agreeing with judges in complex cases as simple ones. The scholars concluded from this that jurors understand complex cases as well as simple ones and perform similarly in both.

Critics who know little about the data on juries are quick to suggest that juries are pro-plaintiff in tort cases. The information on this question is extremely interesting and, as summarized by leading jury expert Professor Shari Diamond, demonstrates that jurors are not pro-plaintiff.<sup>30</sup> Rather, they are highly skeptical of those who seek money damages for injuries. They tend to reject injury claims especially in areas like medical malpractice where only one in four plaintiffs succeeds (this despite the appalling medical malpractice base rate). When the state of Indiana switched to a professional medical malpractice evaluation panel, that body was more likely to find malpractice than were juries in surrounding states.<sup>31</sup> On the question of the looting of deep-pocket defendants the data are equally clear—juries just do not do it.<sup>32</sup> Both simulation and real world assessments indicate that juries do not think or act like Robin Hood. In fact, when insurance companies are involved in lawsuits, jurors show great reluctance to make large awards because they are fearful that their action might cause insurance rates to rise. Finally, social scientists have recently sought to examine the “hell hole” claims made by tort reformers. Again, they have found the claims gen-

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<sup>25</sup> See Stephan Landsman & Richard Rakos, *Preliminary Inquiry into the Effect of Potentially Biasing Information on Judges and Jurors in Civil Litigation*, 12 BEHAV. SCI. & L. 113 (1994).

<sup>26</sup> See Chris Guthrie et al., *Inside the Judicial Mind*, 86 CORNELL L. REV. 777 (2001).

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> See Phoebe Ellsworth, *Are Twelve Heads Better Than One?*, 52 L. & CONTEMP. PROBS. 205 (1989).

<sup>30</sup> See Shari S. Diamond, *Beyond Fantasy and Nightmare: A Portrait of the Jury*, 54 BUFF. L. REV. 717 (2006).

<sup>31</sup> See Saks, *supra* note 10, at 1273.

<sup>32</sup> See VALERIE HANS, *BUSINESS ON TRIAL: THE CIVIL JURY AND CORPORATE RESPONSIBILITY* (2000).

erally unsupported by the data.<sup>33</sup> Juries are effective and reliable decision makers that breathe life into the American tort system and facilitate its pursuit of the core goals of compensation, deterrence, and corrective justice.

#### SUMMARY

Is justice achieved in the American tort system? Based on all the data available, the answer is a hearty “yes.” Does this mean that the system is perfect? Of course not, but the evidence indicates that the present system beats the available alternatives. The burden falls on those who seek change to prove the superiority of their proposals.

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<sup>33</sup> See Neil Vidmar et al., “Judicial Hellholes”: *Medical Malpractice Claims, Verdicts and the “Doctor Exodus” in Illinois*, 59 VAND. L. REV. 1309 (2006); Mary R. Rose & Neil Vidmar, *The Bronx “Bronx Jury”: A Profile of Civil Jury Awards in New York Counties*, 80 TEX. L. REV. 1889 (2002).

## **MASSIVE, PASSIVE, AND PATIENT . . . OR NAUGHTY KNIGHTS TO OUR RESCUE?†**

**Philip Lader\***

What I want to talk about today is a phenomenon that has become a matter of great interest to me over these last seven years, as I've been swimming in international companies and global finance. I call these sovereign wealth funds a massive, passive, patient phenomenon, but we might also refer to them as naughty knights to our rescue. This phenomenon is something that should cause all of us, Americans and everyone around the world, to raise some serious questions. It is a three trillion dollar phenomenon. This isn't a partisan issue, and I hope that none of my comments will suggest otherwise. My friend Chris Cox, former Republican congressman from California and now Chairman of the SEC, refers to these sovereign wealth funds as challenging the conventional assumptions about the respective roles of government and the private sector. Six months ago, when Marti Robinson invited me to speak to you and I suggested this topic, not many people were talking about the sovereign wealth funds. Today, there are articles in all the newspapers; and yet I think there is a different set of perspectives we might bring to the issues.

I submit to you that when we talk about the sovereign wealth funds, the policy question we must ask is this: What do we really think of government bailouts? Secondly, the broader question becomes: Is America for sale?

### **THE GROWTH OF SOVEREIGN WEALTH FUNDS**

If you looked at a graph of the size of sovereign wealth funds, you would see amazing growth, especially since 2003. There's no question that these funds are massive, and they're changing the face of global finance. There has been a global buying spree by these sovereign wealth funds; \$21.5 billion of the \$41 billion invested by foreign entities in the United States last year came from these funds. These funds today hold \$75 billion of equity in American financial institutions. Some of us perhaps first became aware of these funds when a Chinese sovereign wealth fund took a stake in the Blackstone private equity firm. We saw Abu Dhabi do the same with the Carlyle

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\* Chairman, WPP Group; former Ambassador to the Court of St. James; former White House Deputy Chief of Staff; former Deputy Director, Office of Management and Budget.

Group, and Singapore invested in TPG. Then a number of Wall Street's major financial institutions started going to the funds for cash when they had need. And the sovereign wealth funds have now begun to invest in operating companies, and in countries other than the United States. For example, Abu Dhabi has a stake in the semiconductor firm AMD, and Dubai in the European plane maker EADS. Then there was the \$12 billion cash infusion in the Swiss bank UBS.

What's amazing is that so much attention has been given to hedge funds and to the private equity world, but the sovereign wealth funds today hold about the same amount as all the hedge funds and private equity firms combined. The sovereign wealth funds of China, Kuwait, Norway, and Singapore each manage more than \$200 billion, and Abu Dhabi alone has almost \$900 billion. In the aggregate, all the funds manage more than \$2.8 trillion, which is why I call it a three trillion dollar phenomenon. And it's estimated to be growing at \$400 billion annually. By the year 2015, as Middle East oil receipts and Asian trade surpluses grow, it will total approximately \$12 trillion.

There are six states in the Middle East—Abu Dhabi, Dubai, Kuwait, Oman, Qatar, and Saudi Arabia—that account for half of the world's sovereign wealth fund assets today. And lest we think this is just a phenomenon of that part of the world, I have to point out that our Alaska Permanent Fund, which enjoys the benefit of the oil revenues from Alaska, today has more than \$40 billion. So we have our own sovereign wealth funds.

As we have seen, these funds can be investors, they can be partners—and they can be aggressive suitors. In fact, in recent months some of these sovereign wealth funds have joined forces with other entities in the takeover attempts at the British food company Sainsbury, in the ABN Amro deal, and in the effort by Nelson Peltz to shake up Cadbury Schweppes.

#### HOW THE SWFS ARE DIFFERENT

As we look at these funds and consider them in relation to hedge funds and private equity funds, a key question arises: Are the sovereign wealth funds (SWFs) different from the hedge funds and private equity funds? Are they different from U.S. pension funds? Are they different from CalPERS, for example? Are they different from the endowment funds of most private universities? And I have to say yes, they are different. We are talking about unprecedented massive aggregates of wealth, and aggregates of state wealth rather than market capital. But now, as we transfer our wealth to the oil-producing nations, and as Wall Street thirsts for more and more capital, these SWFs seem to be an inescapable oasis, a solution to our problems.

The United States has always depended on foreign investment. What's different today is that the rest of the world owns more of America than America owns of the rest of the world. Five million Americans who go to work today are working for foreign companies, and the jobs provided by those foreign companies in the U.S. pay thirty percent more than the equivalent jobs at American companies.

As you well know, the United States is the world's largest external borrower. We require more than three billion dollars per working day of capital inflows into our country to fund our massive current account deficit. As a result, foreigners hold tons of our bonds. They have become nervous that we might make our debt load less onerous through inflation, making the dollar less valuable. What should they do? To hedge their bets on their investments in our bonds, they have decided that they should buy hard assets—real assets, not simply our bonds. They are concluding that foreign direct ownership of U.S. property and businesses is not only in their self-interest but also in the best interest of the dollar. They claim that it is a vote of confidence in the United States economy.

Many Americans are nervous about foreign ownership. But wouldn't it be hypocritical if we were to erect barriers to foreign investment at the same time that the United States is seeking free entry for our companies in all the emerging markets of the world? There's little question that the shaky economy has made the United States and Europe more open to the sovereign wealth funds; if foreign governments hadn't made investments in the U.S., Western governments would have had to put in the capital themselves or face a still sharper credit squeeze. We might conclude that this is simply the latest chapter in globalization. (There is some irony in the fact that globalization has been driven by capitalism but now this critical role is being played by governmental funds, not private ones.) We have to ask, then, how passive and patient are these sovereign wealth funds? We could argue that most are long-term, sophisticated investors, and therefore less sensitive to market conditions. As arms of foreign governments, they are especially concerned not to seem intrusive, lest they generate a political backlash. But they are investors. How would you react if your investments were underperforming? We have to wonder how patient these sovereign fund investors will be.

We also have to ask ourselves whether we really know what they're doing. Norway is a unique model. It has \$380 billion in assets, the second largest after the Abu Dhabi sovereign wealth funds, but it has a strict set of regulations. Norway publishes all of its holdings, and it insulates itself from politics by using asset management firms that make the actual investment decisions. It restricts all of its investments to no more than five percent of any

company, and the average stake is less than one half of one percent. Also, sixty percent of the portfolio is in bonds, not in equities. How does that compare to those six Middle Eastern funds or the Chinese sovereign wealth funds? We don't know, because those funds are secretive, and there is no transparency. Can they escape U.S. government scrutiny simply by staying under the ten percent or five percent limit that triggers disclosure requirements, which is the case with the Chinese investment in Morgan Stanley and with multiple Middle East sovereign wealth fund investments in Citigroup? Isn't it naive to think that limiting ownership to five or ten percent is going to make a great citizen out of someone who doesn't have to disclose where they are investing?

My former colleague Felix Rohatyn, who was Ambassador to France when I was in London and was one of the giants of Wall Street, has raised this question: "Why isn't Warren Buffet investing in Citigroup? Can we truly believe that sovereign wealth fund investments are purely financially motivated?" Felix concludes that there has to be a political objective, beyond the financial. This reminds me of the 1991 novel *Something to Die For*, by Jim Webb, now a United States Senator from Virginia. His plot was that the Japanese were using their national wealth to influence policy in Washington.

#### SWFs IN CONTEXT

Before I arouse irrational suspicions, let me put the sovereign wealth funds phenomenon into a larger context of the global economy and financial markets. The sovereign wealth funds still constitute a tiny percentage of all assets traded globally—less than two percent of all such assets. Also, the U.S. economy is still the world's largest and most productive. Our economy is larger than the economies of the next four combined—the economies of Japan, China, Germany, and the UK. The Russian economy, for example, is the same size as that of Texas, and California's economy is twice the size of India's. Moreover, if we look at the full context of this phenomenon, globally, the sovereign wealth funds may be more stabilizing than alternative investments would be. They don't depend on borrowed funds as much as private equity, so the portfolio companies are less leveraged.

It is important, too, to recognize that most of the SWFs' assets are used at home. Of the twenty largest publicly traded companies in the world, eight are state owned. PetroChina, for example, which now has a market capitalization larger than Exxon Mobil's, has only twelve percent of its shares in public hands. The remaining shares are owned by the government. Contrary

to some fears, most of the petrodollars are staying home. They are financing the high-rises in Dubai and various massive infrastructure works, and creating a thirteen-billion-dollar start-up endowment for a new research university in Saudi Arabia.

I submit to you that the most important context we must focus on in relation to the SWFs is what I call an implicit bargain that our nation has with China. For the twenty-five years that China has been engaged in world trade, its leaders have, as you know, deliberately held down the standard of living of the Chinese people and propped up our standard of living by investing its trade surpluses in U.S. treasuries. China's U.S. dollar assets probably account for seventy percent of China's foreign holdings today. Never before has America been so deeply in debt to one country. Over the past ten years, every American effectively has borrowed about four thousand dollars from those people our parents used to call the "poor starving kids in China." On the one hand, China can't stop because its own dollar holdings would be devastated. On the other hand, though, how long will the Chinese people support a government that holds them down and lets us enjoy the good life? This is what Larry Summers, our former Treasury Secretary, calls the balance of financial terror, and it makes me think of the Cold War doctrine of mutually assured destruction.

#### OUR FUTURE

We have to ask ourselves whether we Americans really understand what's going on. As their trade surpluses and oil and commodities revenues grow exponentially, the sovereign wealth funds are likely to be increasingly willing to make high-profile investments directly in public companies. Could the growing participation of sovereign wealth funds change the nature of U.S. markets? Will investments by sovereign wealth funds affect the pricing of assets and the allocation of resources in our domestic economy? What will happen to everyday investors like you and me? What will happen if we start to believe that we have less access to information about the companies in which we invest than the sovereign wealth funds? Will that affect our investment patterns? Is ownership by foreign governments a form of inadvertent socialism? Paul O'Neill, my friend and former Treasury Secretary under George W. Bush, told Congress in 2001, "Government has no business owning private companies." Yet, we are making little noise about foreign governments owning significant stakes in our companies.

Economist Joseph Schumpeter applied the notion of creative destruction to capitalism; essentially, our economy stays strong only if we allow the weak to fail. But if you are a CEO with a major block of passive investors

who do not hold your feet to the fire, what will drive you to improve the performance of your company? Also, what will America be like when we are no longer the world's capital provider and become a nation of wage earners? As other countries own more and more U.S. assets, we will pay them more dividends and interest, which will allow them to buy more U.S. assets that will pay them more dividends and interest, which will allow them to buy more U.S. assets . . . Doesn't this have an endless compounding effect? More than four years ago, Warren Buffett cautioned that a country that goes too far down this road can be "colonized by purchase rather than conquest."

#### POLICY

Turning to policy, what should we do to acknowledge the realities of our need in the sovereign wealth arena? Will its dangers be self-correcting? Will the response of the foreign governments halt political criticism? Should we prohibit governments from exercising voting rights? We certainly need to address the issues of transparency, of independent regulation, of depoliticizing investment decisions, and of conflicts of interest.

The Bush administration takes the view that the solutions should be purely voluntary. Senator Schumer and Senator Bayh think that we should have a code of conduct. The IMF has asked Singapore, Norway, and Abu Dhabi to draw up a disclosure benchmark, but I suggest to you that the IMF is not the appropriate body to deal with the SWFs; as a multinational organization lacking enforcement powers, it is not the answer.

So what is my conclusion? The cash is desperately needed by us. I think this is an inevitable consequence of globalization and of America's self-indulgence. It is probably naive of us to think that these massive, passive, and patient knights coming to our rescue are entirely benign. Ultimately, it will be history's verdict, which reminds me of something Zhou Enlai reportedly said when he was asked to comment on the French Revolution: "For me, it is too soon to say." Maybe that's the most we can say about the sovereign wealth fund phenomenon. But there is one thing about which I am sure, regarding this sovereign wealth phenomenon: We are going to have surprises.

#### QUESTIONS AND ANSWERS

Q: To what extent do you think or could you foresee that a sovereign wealth fund such as China's might influence American foreign policy—for example, with respect to Taiwan?

A: You've put your finger on probably *the* essential issue, when we look at the Chinese fund's investments. (I should mention that the agency that holds the foreign reserves of China is not technically a sovereign wealth fund.) Recently, we learned that it has acquired significant interests in three Australian banks. Why would a government agency that is charged with the management of foreign reserves make direct investments of that sort?

There is no question that there is the potential peril that the SWFs will influence foreign policy. The funds and the governments have made total disclaimers in this regard, and there is no immediate suggestion that they have such intent, but I come back to Felix Rohatyn's question: Why isn't Warren Buffett making these investments? There has to be some political element.

The benign view, of course, is that the funds simply see themselves as responsible world citizens and that, in appreciation for our granting them an unprecedented transfer of wealth, they are helping us stabilize our economy. But I've been accused of being naive before, and this benign view might well be naive. Particularly with respect to Israel and Taiwan, and other geopolitical hot spots, it's difficult to deny that when government-related entities own sufficient stakes in major institutions, particularly financial institutions, there is some form of subtle influence. But I don't know what the alternative is right now.

Q: Thank you for your enlightening—and frightening—presentation. The last time I was frightened in this same vein was probably about twenty years ago. I read a book titled *Yen*,<sup>1</sup> and the premise was that the Japanese were taking over America; any time the Japanese didn't show up to buy Treasury bonds, we were virtually out of business. It sounds like today's theme is basically the same, but the main character now is China, and I wonder two things: First, is it a much larger problem today with the Chinese than it was twenty years ago with Japanese; and, second, what can we do?

A: The fellow who wrote *Yen* has a current best seller called *Secrets of the Code*,<sup>2</sup> and he probably is as correct on the Da Vinci Code observations as he was on the yen situation. (To put this comment into context, I should mention that the author is a personal friend.) The distinguishing factor today is that we have several rising or restored empires. What we Americans fail to realize or remind ourselves is that China is simply restoring itself to the global economic position that it had several hundred years ago. This is not a new situation. And in an era of globalization, we are seeing the rise of the

<sup>1</sup> DANIEL BURSTEIN, *YEN!—JAPAN'S NEW FINANCIAL EMPIRE AND ITS THREAT TO AMERICA* (1988).

<sup>2</sup> *SECRETS OF THE CODE: THE UNAUTHORIZED GUIDE TO THE MYSTERIES BEHIND THE DA VINCI CODE* (Dan Burstein ed., 2004).

Russian empire, of the Asian empires, and of the Middle East aggregate empire, as a result of the trade surpluses and petrodollars.

I don't want to seem protectionist about this; I'm a great believer in globalization. I just want to share my anguish with you about what we should do as Americans who have taken pride in and benefitted from America's leadership in the world economy, leadership that is now declining. To what extent will our children's lives be impacted? What will happen if the cultural inclinations and the value systems of those who succeed us in leading the world economy are vastly different from our own? I'm not saying better or worse, but different. How can we deny that that will have an impact on the state of world affairs?

It often is said that America gained and can regain its leadership through innovation, and I trust and pray that that is the case. We take pride in how many Nobel laureates we have had at the forefront of science and technology. If we are honest, though, in looking at the list of American Nobel laureates in the twentieth century, we will realize that most of them were people who fled from Eastern Europe or the children of those people. Are we generating the same level of innovation today? And do the foreign students now studying in American higher education institutions have the same reason to remain in this country rather than return to India or Russia or China? It is a different playing field. Please don't interpret my comments to mean that I'm pessimistic about America or that I feel that we are giving away our world leadership. But I do think we are letting it dissipate, and I don't yet see how we will recover it.

Q: The port authorities apparently are off-limits to foreign investment or foreign control. Would you endorse the federal government having a program whereby it segregates certain strategic industries as simply off-limits to sovereign wealth funds, or at least limits the amount of SWF investment and/or requires full and complete disclosure? Shouldn't we absolutely and unequivocally be able to protect our ports, our defense industries, and our communication industries?

A: Certainly, and it is for that reason that the Committee on Foreign Investment in the United States has the authority to review foreign investment and advise the President of the United States whether a foreign investment raises a potential threat to national security. What is interesting is that the Dubai port situation passed review by that Committee and by the President, only to hit a terrible political backlash. An issue here is how we determine what is the true definition of national security. What's more important to national security—the operation of ports, or influencing the major investment houses or commercial banks of the United States? Is there a valid dis-

tion? Some would argue there is, and I can understand the argument; but I would also submit that perhaps there isn't. In the current era, economic security perhaps is, if not paramount, tantamount to military security.

Q: It strikes me from what you have said that there is a certain inevitability to this. Fundamentally, it's something that has happened, and it's going to keep happening. If we were to strengthen the economy, we might encourage more investments. As the other economies in the world get bigger, they are going to invest here. A lot of commentators seem to take an isolationist stance, but clearly we can't adopt an isolationist perspective when there's a certain inevitability to the SWF investments. How do you educate the public about this so that the general population is informed and knowledgeable, and even accommodating and welcoming to this, rather than resisting it?

A: How do we bring this to higher public attention? We talk about it as widely as we can, especially in situations that might generate responsible publicity. That will engender broader discussion of the issues. How do we achieve the solutions? That is much more difficult, because we will have to go through a period in which jobs are imperiled and states like Michigan and Ohio genuinely suffer. You can't simply say, "Your suffering doesn't count because the philosophy, the theory, works." I don't have a solution.

I'm reminded of *Zorba the Greek*, Nikos Kazantzakis's novel and a film. There was Zorba, living a joyful, free life, and along came a young Englishman, an Oxford graduate, who had inherited a mine. Zorba and the young man became close, and the young man came to revere and love the joy of life that Zorba had. Then Zorba's lady friend died, and Zorba turned to the young Englishman and asked, "Why did she die? Why does anybody die?" The young Oxford graduate replied "I don't know." And Zorba said, "Then what good are all those damn books, if they can't answer questions like these? What good is pursuing knowledge, in fact?" The young Englishman sadly responded, "The knowledge only tells me of the agony of men who can't answer questions like yours." I think we have to strive, in policy circles, to find the best solutions to the SWF phenomenon, but I have to say that there are a lot of folks who have a lot of agony about what the right solutions are.

## A NEW ERA OF CONFLICT†

Henry A. Crumpton\*

Early Sunday morning, I was sitting in the lobby working at my computer, and Bob King from Minneapolis introduced himself. During our brief chat, Bob asked me what I was going to talk about, and I said, “The future of war.” He looked at me and said, “That’s a *narrow* topic, isn’t it?” The implication of his question was right, of course; it *is* a broad topic, and it is perhaps even broader than he realized, because war is evolving and expanding in terms of whom it involves, and how we think about war, and the consequences of conflict.

Let me ask all of you this: Do you think we are a nation at war? In the course of your normal activities, how many here think of us as a nation at war? I see a few hands—maybe five or ten percent. I ask this question often when I speak, and that’s about the response I usually get, around five to ten percent. Yet, we’re spending a lot of money on war: twelve billion dollars every week. By some estimates, by 2012 we will have spent \$1.2 to \$2.7 trillion on the wars in Iraq and Afghanistan. And think, more importantly, of the human sacrifice. Every night and every day, brave men and women from the United States and from many other countries are engaged in conflict.

Given the enormous cost, in lives and injuries as well as money, why don’t we have a greater and broader sense that we are at war? I think, in large part, it’s because the nature of war is evolving rapidly, and our reference points are shifting. There’s a great deal of confusion and a great deal of honest ignorance; and there’s a great deal of anxiety because of this ignorance and uncertainty. The American way of war has been depicted most heroically, and perhaps most accurately, in World War II. We think war means raising an army and sending our troops to battle, with nations fighting nations, national armies fighting other national armies. Then we are victorious, we bring our troops home, and we celebrate our victory. But that is not the kind of conflict we face now, and we don’t have any sense of certainty or assurance. Sometime between the fall of the Berlin Wall in November 1989 and 9-11, I think we stumbled across a threshold into a new era of conflict. Are we going to be victorious? How do we define victory? There are a lot of variables at play here, and the whole situation is exceedingly complex.

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I am going to begin by distilling the variables down to three that are key, and then discuss what this means for us, as a nation, as a society, and as a community of nations.

### THREE KEY VARIABLES

One of these variables is the degree of asymmetry that we now see in warfare. What does that mean? It means that a small group of operatives, or even individuals, can cause more death and destruction than ever before in the history of human conflict. One striking possibility is one operative with a radiological or nuclear bomb—and they *are* that small now; one person can carry a nuclear weapon. I refer to these as micro-actors with macro-impact. And that trend is growing. Think of the suicide bombers in Iraq and increasingly in Afghanistan; think of the impact they're having. And lethality is not the only impact. Think of a single cameraman that works for al Qaeda in Iraq, capturing horrible images on the battlefield and uploading them into cyberspace. He is a single operative, a micro-actor, but think of the global macro-impact. We have never seen this in the history of warfare.

Moreover, our societies are increasingly complex, and infrastructure, I believe, is increasingly fragile. Consider how sophisticated our communications networks and transportation networks are, and how easily disrupted. So when you have micro-actors who are attempting to influence or to cause destruction and death, their impact is going to be greater because of the increasing fragility of this battlefield in which they're operating.

The second variable is the relative importance of nonstate actors in this conflict. When we think of the war on terrorism—a name I don't like, because I think the conflict is much more nuanced and specific than that, and it's hard to wage war against a tactic—we recognize that our primary enemy is al Qaeda. Al Qaeda is not a nation-state; it does not have a conventional army; it is a nonstate actor. And many of its affiliates—al-Jama'a al-Islamiya in southeast Asia, Hezbollah and Hamas, the LTTE in Sri Lanka, the FARC in Colombia—are nonstate actors. The threat of states has not gone away, sadly; Iran and North Korea, in particular, pose threats. But more and more, we're looking at conflict from a different perspective, and we're looking at different enemies.

Not only are enemy forces nonstates, but some of our most effective allies in the last few years have also been nonstate actors. Tribal leaders in Afghanistan and Iraq, nongovernmental agencies such as Doctors Without Borders, trade associations, entrepreneurs, religious institutions, universities, and multinational corporations are increasingly a part of this conflict. Why is that? One important reason is that they are increasingly the target of

forces such as al Qaeda. A comment attributed to Lenin is apropos: “You might not be interested in war, but war is interested in you.” And I think that will increasingly be the case.

The third key variable is that the battlefield truly is global. The outstanding presentation yesterday on sovereign wealth funds made clear how freely and quickly capital and labor and ideas flow across borders and around the world now. Tom Friedman in his book *The World Is Flat* captures that with example after example. And much of this today applies to conflict and warfare. The micro-actors bounce around the global battlefield with amazing speed and agility and stealth; we’ve never before seen this in warfare. Of course, this is true at the strategic level, but we’re seeing it at the operational and even the tactical level. A small team can plot and plan on one side of the world, and execute on the other side of the world in a matter of days or hours—or even seconds, if you’re talking about cyberspace activity. Here’s another example of a micro-actor with macro-impact: one hacker with the right kind of virus, attacking our infrastructure. In the Defense Department, perhaps as much as eighty percent of all its logistics, command, and control is in unclassified cyberspace. Talk about a fragile target!

#### THE RESULTING CHALLENGES

The emergence and convergence of these three variables are challenging us in many ways. Intelligence is one area. Think about how hard it is to find these nonstate actors—say, a team of six, traveling with false documents, under aliases, using good cover and good trade craft. How do you find them? And how do you determine their intent? Are they coming to blow up a particular city? Are they coming to collect intelligence? Are they engaged in subversion? Are they engaged in propaganda? What’s their mission? You need to know that, to define them as a threat. That’s an intelligence challenge, a challenge that in some respects is growing, despite some of the progress we’ve made. Moreover, still from an intelligence perspective, if you can find the enemy and define the enemy, what’s the best way to engage, to have the consequences that are most favorable to us as a nation? That’s another intelligence challenge.

Yet another major challenge is how we wage this kind of war. What are the instruments of statecraft that we employ? When we think of war, we think of the military. But the military really isn’t structured to go after a team of three traveling from Thailand via Frankfurt to Chicago. What about diplomacy? Well, if you’re in the Department of State, you want to have a mirror-image of the world; if you’re a diplomat, you want to engage in diplomacy with someone from the foreign ministry of the other country. That’s

how diplomats are trained, and that's how they're rewarded. But how do you engage in diplomacy with Hezbollah or al Qaeda? How do you deploy that instrument of statecraft with these nonstate actors?

We often use economic power as an instrument of statecraft, but how can we use economic power in this kind of conflict? Imagine the economic power of Hamas in Gaza, and compare that to the economic power of the U.S. or Israel. Why haven't we won this battle yet? Because we're not thinking of this conflict in the right way, and we're certainly not organizing ourselves, or resourcing ourselves, in the right way.

How do we use law enforcement, another instrument of statecraft? And beyond that, how do we think about the rule of law? Think of the challenges we face in that arena alone—for example, the debates we're having about enhanced interrogation techniques. How do we classify particular captives? Should they go to or stay in Guantanamo or be brought to the U.S.? And what about the laws of our allies? Indonesia, the largest Muslim country in the world, has laws that are not very complementary to those of Malaysia or Singapore. They're working through that right now. There are conflicts between laws even in the E.U. Spain suffered a horrible bombing in Madrid, and one of those responsible fled to Germany. It took more than two years for extradition to occur, because Spain and Germany had incompatible laws. We also have to think about international law, the Geneva Conventions, especially. It's a big challenge.

The biggest challenge for us, I think, as individuals, as citizens, and as leaders, is to develop a philosophy of war. If this new era of conflict is so dramatically different, how do we wage war and remain true to our values, true to ourselves, true to our nation, true to our sons and daughters? What does it mean for us to engage in this kind of conflict? These are big questions. And I am disappointed that we don't have the kind of national debate that I think they demand. I've heard very few political leaders raise these issues. Those leaders focus on the specific issue that needs to be resolved today, not on where we want to be five years from now, or ten years from now. We need to think more about that longer and broader view, and soon, because this change is not only evolving but also accelerating, I think. It's moving at the pace of globalization, and that's moving pretty quickly.

#### SOME IMPROVEMENTS

There are some signs of success out there. The different parts of the U.S. government are cooperating, and they are working more and more with local partners, at a tactical, operational level. For example, if you go into Iraq, you see the CIA, Delta Force, FBI, NSA, and others working together every

day and every night, to capture and kill enemies. It is remarkable; it really is like something in the movies. Consider how a handful of CIA leaders who were deployed into Afghanistan after 9-11, working with small Special Operations forces and with Afghan allies, were able to operate and to succeed. That really does set an example, I think, when we look to the future of war. On December 7, 2001, when Kandahar, the last Taliban stronghold, fell, we had only 410 Americans on the ground in Afghanistan—110 CIA officers and 300 Special Operations troops. About a quarter of the al Qaeda leadership had been captured or killed; more than twenty laboratories, including anthrax laboratories, had been found, secured, and exploited for intelligence; the Taliban leadership was on the run. All of this, less than ninety days after 9-11, with 410 Americans. More American troops were killed in Afghanistan in the last couple of months than we lost in the 2001 “invasion” of Afghanistan. How did 410 people accomplish so much in such a short time in 2001? How was that possible? I think the reason was that those team leaders, both CIA and Special Forces, understood the evolving nature of warfare. They understood that they had to be flexible. They knew that they had to look at the enemy leadership; they had to think about safe havens; and they had to think about the local conditions that al Qaeda and its Taliban allies were exploiting.

Let me give you an example. Each CIA team leader that was deployed into Afghanistan was backed up by six or seven other CIA officers. The first ones who went in were alone—teams of seven or eight CIA officers. In the next few weeks, they were integrated with some Special Operations Forces, so each group had a total of about twelve. They were dropped in behind enemy lines throughout Afghanistan. There were many keys to their success—some great intelligence that was collected over the years, very precise bombing, great technical skills, their understanding of the nature of the enemy—but the most important key was that they understood the nature of their allies and prospective allies, the Afghan tribal leaders. Think about this from the perspective of an Afghan tribal leader, an Afghan *warrior*, who has been living under the harsh regime of the Taliban: You’re surrounded by the enemy, and half a dozen CIA guys drop out of the sky. The CIA leader says, “We can bring some air power to bear on the enemy. We can help you in other ways, too. We can bring you weapons, we can bring you ammunition, we can bring you intelligence.” The Afghan tribal leader says, “That’s great, but I’ve got a thousand of my clansmen back here, including women and children, and winter’s coming on. They’re cold, they’re hungry, and they’re sick. I need to think about them and take care of them before I engage in warfare.” The CIA officer says, “Okay, give me a list of what you want.” The list is transmitted back to Washington. Within forty-eight to seventy-

two hours, what was requested is falling out of the sky—tents, food, medical supplies, toys, warm clothing. It was about empathy, understanding what your allies and prospective allies needed, and then responding to that at a very local level.

That's how you wage a war today. Of course, you must identify the enemy, find the enemy, and engage the enemy with great determination and, in some cases, lethality. But that's only the first ten or twenty percent. That buys you space and time. Where you really win the conflict, the enduring solution, is the eighty or ninety percent of other measures that must come in, either when you engage the enemy or the next day. When we think of warfare, we have to think of more than the enemy and the battlefield. How do we find enduring solutions? How do we integrate all the instruments of statecraft? That's the challenge for us when we look to the future.

#### ACTIONS WE CAN TAKE

There are some specific things we can do. In World War II, Franklin Delano Roosevelt exhorted Americans to understand where our troops were, to get maps of Germany, Japan, the Pacific, Italy, and North Africa. Today, we all need to know where Waziristan is. Waziristan is a mountainous area in Pakistan, hard on the Afghan border. That remains a key safe haven for al Qaeda leadership. Bin Laden is probably there, somewhere along that frontier area. And right now, the surviving al Qaeda leaders are plotting and planning the next attack in the U.S. homeland. We need to know where Waziristan is, because it can have an impact on our country, and even on our particular communities.

We also need to understand the Muslim faith and realize that this isn't a war between Christians and Muslims. In fact, if anything, it is about the future of Islam. It is a conflict and a discourse within Islam, one of the world's great religions. We tend to think it's about us, but it's really more about the Muslims, because they're fighting the war every day. We need to forge and secure partnerships with Muslim allies.

We need to engage our politicians, and I would encourage you to do that. Ask them what they're doing about the conflicts in Iraq and Afghanistan and why we are spending so much money.

Let me give you another example. Today, there are more men and women in Department-of-Defense-funded military marching bands than there are foreign service officers in the Department of State. Do you know how much it costs to build an aircraft carrier? Or how much it costs to build a bomber?

Do you know how little we're spending to subsidize the crops of farmers in Helmand Province in Afghanistan, how little we're doing to draw them away from the production of poppies, which is what the Taliban encourages, because that brings in illicit profits that they can use to wage war against our troops? It also pulls those farmers in Helmand Province away from the central government in Kabul. It's a form of subversion through economic power that the Taliban is exercising. We're not using that instrument of statecraft very well in Afghanistan.

Let me conclude now, before I open up to questions, with a story that was poignant for me. About eighteen months before 9-11, I met with Ahmad Shah Massoud, a great Afghan warrior. He was known as the "Lion of the Panjshir." The Panjshir is a valley north of Kabul that the Soviets had invaded repeatedly, but the Soviets were never able to establish a foothold in that valley. Massoud drove them out every time. He was a tough, hard man, and he was our partner, starting in 1999. I sent teams into Afghanistan to work with Massoud's people to collect intelligence about al Qaeda, about bin Laden, and to engage in some limited covert action. And I met with Massoud in a safe site in the borderlands of Afghanistan. We had a long conversation. He was a very intelligent and charismatic man. (You might recall that he was assassinated by al Qaeda just two days before 9-11. Al Qaeda understood the strategic importance of the partnership between Massoud and the United States government.) In this conversation, we talked about a lot of things. We talked about increased collection of intelligence, we talked about covert action, we talked about the geopolitics of Central Asia. Toward the end, Massoud asked me, in a very polite and gracious manner, "May I ask you a question?" I said, "Of course." He said, "Your government, when you're thinking about Afghanistan and about war and about al Qaeda, does your government really care more about finding and killing bin Laden, or about the people of Afghanistan?" I told him the truth; I said, "Look, the only person that you're talking to from the U.S. government is me. I'm from the CIA, and I have a singular mission. And it's not about the economic development or the welfare of the people of Afghanistan." He gave me a very sad smile, and he nodded. He knew the answer before I said it; I think he was testing to see if I had the gumption to tell him the truth. But I think he also was educating me. His lesson was that, to wage this kind of war, you've got to do both—find and kill the enemy that's trying to kill you and destroy your communities but also care about the people, whether it's the people of Afghanistan, or Iraq, or Colombia, or our own communities.

## QUESTIONS AND ANSWERS

Q: I read Steven Coll's book *Ghost Wars*,<sup>1</sup> which I thought was really a pretty incredible book. It strikes me that the roots of the conflict really go back to the late 1980s, as consequences of our abandonment of Afghanistan after the Soviet Union pulled out. The Taliban moved in and filled the vacuum. It seems that we lacked then what you seem to be talking about now, the ability to look five and ten years down the road. How much evolution have you seen in the sophistication of our ability to think ahead—to identify areas that may be problems in five or ten years, to identify allies, to identify ways to spend money to avoid the situations that we've gotten into in the last five or ten years?

A: Good question. I echo your comments about Steve Coll's book; it really is outstanding in every respect, and I can confirm that the parts of it dealing with matters with which I am familiar are accurate. In terms of missing an opportunity after the Soviet troops withdrew in Afghanistan, I agree; that was a huge opportunity. I would mention another book, which became a movie—*Charlie Wilson's War*.<sup>2</sup> That's the point he makes at the end: We did a great job, but then we sort of quit mid-stride. When I went into Afghanistan in the fall of 2001, I had many questions from our Afghan allies, but the questions that resonated most deeply were about that, specifically: "Are you going to stay this time?" And it's a bit disconcerting when an illiterate Afghan tribal leader with no teeth and bad breath is in your face calling you a liar and challenging the integrity of your country—and you know he's correct. I think we have learned that lesson; I think we are going to stay in Afghanistan. We don't have a choice. We cannot allow al Qaeda to reestablish a foothold there.

Where I am disappointed is in our inability to look farther into the future, for five or ten years. What *should* Helmand Province in southern Afghanistan look like? Why don't we organize ourselves to be more effective in helping the *people* fight the enemy and in helping them engage in profitable, legitimate economic activity. The importance of that goes beyond economics, beyond just earning a living. As far back as Thucydides, in his opus on the Peloponnesian War, people have recognized that the most powerful incentive on the battlefield is pride, prestige, honor; and al Qaeda and Hamas and other such organizations exploit this. If you're an eighteen-year-old kid in Gaza right now, what kind of pride or prestige do you have? The

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<sup>1</sup> STEVE COLL, *GHOST WARS: THE SECRET HISTORY OF THE CIA, AFGHANISTAN, AND BIN LADEN, FROM THE SOVIET INVASION TO SEPTEMBER 10, 2001* (2004).

<sup>2</sup> GEORGE CRILE, *CHARLIE WILSON'S WAR: THE EXTRAORDINARY STORY OF THE LARGEST COVERT OPERATION IN HISTORY* (2003).

terrorist leaders sell these young people false hope, saying that a suicide vest will give them pride and prestige and honor. The exploitation of these young men and women is horrible.

Although it has taken too long, in my view, I do think that in time we will learn to project where we should be in five years and how to inoculate areas that may be at risk of exploitation. There is one good example, a place where we have made progress, and that's in the Horn of Africa. The U.S. State Department, working closely with U.S. military and intelligence forces, has done some really good work out of Djibouti. There are some really good projects there in agriculture and microfinancing. Also, if you look at the provincial reconstruction teams in Iraq and Afghanistan, there are some good tactical operational examples. But that is happening in the field; the U.S. government leadership, frankly, has done very little. Where we've succeeded, it has been because of our men and women on the scene, working in partnership with others in local areas. Our leaders in Washington have to rethink war, and we're not there yet.

Q: I read the book *Jawbreaker*,<sup>3</sup> which was both fascinating and frustrating. Was the failure to capture bin Laden simply a result of bureaucratic breakdown?

A: You're referring to the battle of Tora Bora, I assume, when bin Laden was pushed to the very edge of Afghanistan on the border with Pakistan. There was a bureaucratic glitch, but that was relatively minor. The CIA had a really close relationship with General Franks, and he took some great bureaucratic risk in working with the CIA in Afghanistan. When the Pentagon and the civilian leaders in Washington were confused, uncertain, and resistant to some of the things that we were doing, General Franks took a leadership role, and I have enormous regard for him. But the U.S. military can be slow and cumbersome in their planning, and more planning, and then in the deployment of forces. They're definitely slow compared to six CIA guys in a pickup truck with some Afghan allies. The command structure is different, the expectations are different, the culture is somewhat different, although that's changing, especially in the Special Ops community. In fact, the CIA and Special Ops community are doing more and more together. So what is the significance of this in relation to Tora Bora and bin Laden's getting away into Pakistan? We thought that Pakistan, as a nation-state and an important ally, would be able to deal with it if bin Laden escaped into Pakistan. It's that mirror image assumption again; we think that Pakistan con-

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<sup>3</sup> GARY BERNTSEN & RALPH PEZZULLO, *JAWBREAKER: THE ATTACK ON BIN LADEN AND AL-QAEDA: A PERSONAL ACCOUNT BY THE CIA'S KEY FIELD COMMANDER* (2006).

trols its borders and has sovereign rights throughout its county. But it also has sovereign responsibilities that it cannot exercise in that part of Pakistan. That is a tribal area. It is not ruled by Islamabad. There are different laws, different cultures, different barriers. And bin Laden understood that far better than our people in Washington did. So he was able to escape, and that's why he's still there, in that part of the world.

Again, we were thinking nation-state to nation-state, not about how we could deal with locals. Some of us, including myself, argued for going across the border and working with some of the tribal groups, as we had in Afghanistan, if we couldn't get the U.S. forces into Tora Bora as soon as we wanted. The decision, which I made in concert with General Franks, was that we go in with what we had because we couldn't wait for two or three weeks to get organized and then deploy Army Rangers or other forces. So it was a question of force versus time, and we opted for time but we missed him that round. I am still confident that we will get him.

Q: We were in Jordan about a year ago and came into contact with an individual who was a Sunni. He was married to an English woman who is a Christian, and his father had been a powerful sheik in Jordan. He had contracted with a news network to go into Iraq and serve as a translator. He said that it had finally gotten to a point where it was too dangerous to continue his work because the Shiites could tell, from his name, that he was a Sunni, and if they encountered him and pulled him out of the car, they'd kill him on the spot. How can we ever achieve success and peace in that war-ravaged country when the two major sects can't get along?

A: I'm afraid it's even harder than that, because you forgot to mention the Kurds in the north. You've got Kurds, Sunni, and Shia; and you also have some smaller groups, such as Turkmen, who have a stake in this, too. Where it works—and I'm repeating myself—is at a local level. I'll give you an example. This was one of the benchmarks in the fight against al Qaeda in Iraq. Al Qaeda was trying to coerce a Sunni tribe to help them, and they killed one of the tribal leaders. Well, that Sunni tribal leader happened to be married to a Shia, and his Shia spouse belonged to a prominent Shia family. Within a matter of two days, Sunni and Shia came together and wiped out al Qaeda in that particular valley. And there are other examples like that. You really have to work from a grassroots level. For that reason, I don't think that an Iraqi constitution drafted by American experts and imposed on the Iraqi nation is going to work. You have to break it down to a community effort.

Let me conclude with one brief comment. We owe a great debt of gratitude to our men and women overseas. I'll give you an example. When I was

at the State Department, I had a special assistant. She was in the Civil Service, not the Foreign Service; she had a Master's degree; and she was real skinny and ran marathons. She had never served overseas, and she was really bright. She came to me one day and said, "I want to go to Afghanistan. I want to join one of the provincial reconstruction teams." I looked at her, a small young lady, blonde, who had never been to Afghanistan, and I thought, "Well, that'll be a big leap." But I said to her, "Absolutely. We can get you the training, and I think you'd be terrific." She's now finishing a one-year tour. That's just one small example of the kind of service that we have. And despite my pessimism and my disappointment in some areas, I am optimistic in the long run, because we have so many young Americans like my special assistant. Please let me close with this: Keep them in your thoughts and prayers, and let's be thankful, because there are some great Americans doing some great things.

## LESSONS FROM THE ENRON ERA†

**James B. Comey\***

A period of time that I call the Enron Era began in the fall of 2001. You'll remember that Enron imploded in October, and then came intensive investigations by the SEC and the Justice Department and the FBI. As those were really heating up, WorldCom popped. There was a collapse and an exposure of the largest accounting fraud in American history at WorldCom. Then Adelphia. Then ImClone. Then Rite Aid. A number of white-collar, corporate fraud cases came all at the same time and created the period that we call the Enron Era—an era of unprecedented attention and focus of energy on white-collar crime. Maybe that is over now, or maybe it is not; but I want to focus on what we as enforcers tried to do, in the summer of 2002, and on what I think are the lessons that grew out of that effort.

### WHAT WE TRIED TO DO

I was the United States Attorney in Manhattan when the Enron Task Force was assembled. Then the WorldCom case and the ImClone case, which involved Martha Stewart and her friend Sam Waksal, blew up at the same time. And I was asked then, and have been asked many times since then, if there was a sudden explosion of corporate criminality in this country, some contagion of wrongdoing in corporate suites. (“Crime in the suites” was a term we heard all the time.) My answer then, and my answer even now, with six years of hindsight, is this: “I’m not sure, and I don’t really care.”

Let me explain first why I’m not sure. People who had a longer view than I said to me at the time, “Look, you’re always going to have crooks. People are flawed; people are going to get themselves in tight spots; and they’re going to commit crimes. Especially when you have a run-up in a market, a bubble that bursts suddenly, you’re going to have a variety of crimes exposed.” Remember the period of the late 1990s? Tech stocks were always going to go up, just as housing prices, we thought, were always going to go up. Not only were tech stocks going to go up, but new subscribers were going to come in, fiber optic would be filled, and cable would boom. That whole market sector was going crazy in the late 1990s. Then the bottom fell out. And a wise man said something to this effect: “Just as a rising tide lifts

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\* Senior Vice President and General Counsel, Lockheed Martin Corporation; former Deputy Attorney General of the United States; former U.S. Attorney for the Southern District of New York.

all boats, a quickly receding tide exposes those who have been swimming naked.”

There were people in the water, in the late 1990s, who had lost their suits. They weren't hitting their goals for new subscribers for their cable networks. They weren't getting the kind of volume on their fiber optic systems that they had hoped for. The business model was not working. Some of them raised their hands and said, “I need a towel here; I have a problem”; but some stayed in the water, telling themselves that they would find their suits somewhere in the dark water, that they would get to the next quarter and hit their targets. Their thinking went something like this: “We just need to get over this little hill, and everything will be fine. If I tell the markets that it's not working out, the stock's going to crash, and people are going to lose their jobs. I'm going to lose *my* job. It's going to work; I'll stay in the water.” And then the tide went out and left some naked people standing on the beach. (I used to say those were my guys, but it came to my attention that John Ashcroft didn't like that particular metaphor.) Was there an explosion of corporate criminality? I don't know. But there certainly was a confluence of cases unlike any we had ever seen before, and attention unlike anything we had ever seen before.

The attention was amazing. White-collar prosecutors are used to their cases being covered in the *Financial Times*, and they're really excited if they get into the *Wall Street Journal*. They have to breathe into a paper bag if they get on television, on CNBC maybe. But in early 2002, these cases were in *People* magazine, for heaven's sake. *Parade* magazine. Regular television. All over the place. And white-collar prosecutors were *sexy*. For the first time ever.

That leads me to the “I don't really care” part; I don't really care whether there was a sudden explosion of corporate criminality. Let me explain. Despite what your mother taught you, when you are a public prosecutor, you have to care what people think, because the faith of your fellow citizens in the markets and in the criminal justice system matters an enormous amount. Therefore, it matters tremendously, and should matter, to a public prosecutor if people are worried that rich guys are getting away with wrongdoing, that the system is somehow tilted and unfair. That's what mattered to me, not whether there actually was an unusual level of corporate crime. People believed, in 2002, that there was something fundamentally wrong not just with our markets but with our criminal justice system, and that nothing was going to be done. And we in the government felt tremendous pressure to respond to that and counter it.

I had felt that pressure before, in a very different circumstance. I was in charge of a U.S. Attorney's office in Richmond in the late 1990s, and we

had some very violent bank robberies. In one of those, a beautiful young college student, who was working part-time as a teller, was shot point-blank by some robbers, for no reason at all. They killed her and then took a small amount of money. As you might expect, this generated tremendous attention in the Richmond community, and the public had the sense that it was dangerous to go into banks. I asked the head of the FBI to come in and bring bank robbery stats, and what he showed me surprised me. Bank robberies were actually down, as against the year before, and the year before that. But as we talked about it, it became clear to both of us that that didn't matter, that what mattered was the public perception. We needed to find the bank robbers, lock them up, and make sure the world heard about it, because people were worried that the criminal justice system wasn't protecting them.

That's the same pressure we felt in 2002, when we formed the President's Corporate Fraud Task Force, and we set out to make cases within what I call the "memory cycle." The challenge of white-collar criminal investigations is that they take forever to build, and by the time a case is made against the bad guys, the good folks have forgotten about the crime. But in the meantime they have internalized doubts about the criminal justice system and the markets. So we said to all the prosecutors, "We want enforcement within the memory cycle. We want you to bring us cases, not five years from now, when you have locked in ninety-nine counts against a hundred defendants, but this year against the clearly guilty people. Bring us the five strongest counts, and let's get on with it, so we can send a message that the criminal justice system is responding." So we set out to send two shock waves: one of deterrence to the bad guys, and one of reassurance to the good people. In order to monitor how well we were progressing, we did something unusual: We collected an inventory of all the cases and started to age them; we kept an eye on them so that we could ask the responsible prosecutors, "Why aren't they moving faster?"

As I said, one of the shock waves we intended to send was one of deterrence. In the white-collar world, prosecutors believe—I think rightly—that deterrence is a model that fits much better than it sometimes fits in violent crime or in drug crime. Violent crimes can be difficult to deter because people are committing them high on crack, or in an emotional state, or in other circumstances where they're not thinking about what they're doing. White-collar crime is different. You have actors who think before committing an offense, who read the papers (which is not true, I can tell you, about drug dealers and most violent criminals), and who watch CNBC. They pay close attention to what is being done about things, and they have a lot to lose. These are people with reputations, roots in the community, and assets. They are responsive to some of the things the government can do. So we in the

white-collar enforcement world believe that people who are thinking about committing corporate fraud can be deterred.

As is implicit in the fact that it usually takes a long time to build a white-collar criminal case, it is hard to make a white-collar criminal case, and it should be. The reason it's so hard is that a white-collar criminal case is about proving what is inside someone's head. It is the reverse of a drug case. If DEA agents find a kilo of heroin on a table in a motel room, it is not open to anybody sitting at that table to say, "My lawyer has looked at this kilo and given me a comfort letter," or, "My accountant is fully aware of this kilo," or, "This is illegal?" Those defenses are not open in a drug case. The mission in a drug case is to connect the people to the stuff. If you're at the table where the heroin is, you're going to jail. White-collar cases are actually the reverse. No matter how complicated the transactions, how many special purpose entities or off-balance-sheet transactions there are, the investigators will know who was at the proverbial table. The question will be what they were thinking when they took part in the transactions, and whether they knew that what they were doing was against the law. In this situation, it is open for people to say, "My lawyer looked at this transaction," or, "My accountant reviewed this transaction," or, "It never occurred to me that this might be illegal." And the mission of the government is to prove that, inside the participants' heads, they knew that what they were doing was wrong—and to prove it beyond a reasonable doubt to the twelve members of a jury, who must agree unanimously that it was proven. That is a very high hurdle and that's the way it should be. But that's the challenge in making a white-collar criminal case.

Fortunately, in the Enron Era, we in law enforcement enjoyed what I believe is the twentieth century's greatest gift to law enforcement, and that is e-mail. E-mail is a window into the mind. People say things on e-mail that they would not say to their best friends while whispering through oxygen masks at the top of Mount Everest. I liken it to people in cars, sitting in traffic and surrounded by glass. Drivers will groom themselves in unbelievably repugnant ways or make obscene gestures. People feel safe when they are sitting in cars—and when they're sending e-mails. It's so easy to respond hastily by e-mail, and it's gone. Or it seems to be gone. But it's never truly gone. It can always be found, and it provides an extraordinary window into the mind.

Everybody in law enforcement has a favorite story. I have one from my time in Richmond. In a fraud scheme, brokers were ripping off investors by telling them, "We will lend you money; you just have to pay an advance fee, and we'll help you get your investing career off the ground." These brokers were e-mailing each other, and in one e-mail, one fellow said, "I just hope

the SEC doesn't find out what we're doing here." The other genius responded, by e-mail, "Forget the SEC; when the FBI comes, I'm out the window." For that case, I didn't have to be a talented prosecutor.

During the Enron Era, when I was with the government and making speeches from that perspective, people would ask, "Why isn't Bernie Ebbers in jail? Why isn't Ken Lay in jail?" In reply, I would say two things: First, you don't want to live in a country where I could go out and lock up somebody just because we're all excited and think he must have done something wrong; and second, "Carlo Gambino died a free man." (You can see why I didn't get invited back very often.) Carlo Gambino used to talk about "family business" only outdoors, only when whispering, and to just two people. How do you make that case? Even if you get both of those people, and flip both of them, how do you make a case against Carlo Gambino? You knew that Carlo Gambino was the boss of the Gambino crime family, yet he died a free man.

Bernie Ebbers didn't use e-mail. (Neither did Ken Lay.) The case against Bernie Ebbers was built brick by brick, but it wasn't finally made until a fellow named Scott Sullivan, who was Ebbers's number two, was charged and flipped. He said, "We committed a huge fraud, and Bernie knew about it because I talked to him about it." The government's mission then was to corroborate that. That took us to the coffee. Bernie Ebbers went to jail because of coffee. His defense was, "I was at that table, but fraud never occurred to me. I was a big picture guy. I thought globally and strategically. I missed an \$11 billion fraud because I wasn't involved in the details." However, as he traveled around to company offices, Bernie Ebbers noticed that in the break rooms all over the country, there was Starbucks coffee, which is very expensive. When Bernie Ebbers got back to headquarters, he issued a directive that Starbucks coffee should be replaced with generic coffee in all of the company's offices.

Why was the coffee so important to the case against Ebbers? Because my prosecutors argued to the jury, "How do you know Bernie Ebbers didn't miss an \$11 billion fraud? Because he screwed his employees on their coffee, because it cost too much." That was not the act of a big picture guy, and Bernie Ebbers did go to jail.

It is important to point out that government investigations depend upon an honor system; we in the government send out subpoenas that essentially say, "On a quiet Saturday afternoon, please gather and print out all the e-mails that will allow us to screw you to the wall. And if you could put them in searchable form on a CD, we'd really appreciate it." The government, and the citizens of the United States, have to count on the fact that when those people are gathering the e-mails and see the ones that make them go, "Oh

my God,” they will still produce those e-mails. The government simply can’t go to all of the offices to seize documents. The government can’t even be there to put every witness before a grand jury all the time. The government has to be able to count on the fact that people will be truthful when we ask questions and ask for documents. And when the government has evidence that someone has violated the honor system, the government will pursue that very aggressively.

#### THE LESSONS

So we set out in the summer of 2002 to send shock waves to both the bad actors and good people. What did we accomplish? I think we did send a shock wave of reassurance to good people, and I think we sent a scary message of deterrence to the morally challenged who might want to commit accounting fraud or securities fraud. But I knew then, and I know even better now, that we prosecutors were not the answer then, and we’re not the answer now. In the violent crime area, you cannot arrest your way to a healthy urban neighborhood. You cannot make a neighborhood healthy by locking up young black and Hispanic kids for dealing drugs. You have to lock them up, but the reason you do it is to create space in the community for the good people and the institutions in that community to build something positive and fill that space. If all you do in that community is lock people up, you’re going to lock up generation after generation.

The same is true with white-collar crime. You cannot arrest and prosecute your way to a healthy corporate culture. The prosecutor is not the answer. The answer is raising your employees in such a way that they will not do things that would bring them to the attention of the prosecutor. My role as prosecutor is like what my wife has taught me about my role as a dad. I’m a backup. I have five children, including two beautiful daughters who are nineteen and eighteen. I say to them, “When you go out and somebody wants to give you a beer or a joint, or some boy wants to express his admiration for you in inappropriate ways, you should say no because of who you are, because of the way we raised you, because of your character, because of your culture. But if you just can’t do that, or if you’re still being pressured, let me help you out. You tell that boy or the people that are pressuring you that your father is a lunatic. You say, ‘My dad would kill me. He’d kill you first, then he’d kill me.’” That’s my role as a dad, and that’s the role of a prosecutor—to be a backup. If we ever get to the point where our corporate culture is shaped by the fear that a prosecutor engenders, something is terribly wrong.

As I traveled around when I was in the government, I met with corporate executives, and they would say, “We get it. We are all about compliance.” I responded, “That’s wrong. Compliance is important, but compliance is the sideline on the field. Compliance means ‘you’re out of bounds if you step over that chalk line.’ There’s a part of the field, where all of your employees are living, where ethics are governing their conduct. What’s right, what’s wrong, what’s decent, what’s fair, what’s kind, what’s not kind, what’s respectful—all of those values are much more important than the sidelines. Convey good values to your employees. Trying to create a good, healthy corporate culture by talking about compliance and the rules is like trying to raise good, healthy kids by having them read the penal code. It’s important that your employees know where the sidelines are, but they must know how to conduct themselves on the field.” Corporate executives got a little queasy about this, because their sense was that values were kind of a church deal or a synagogue deal, something that people should get on the weekends; but that attitude is an enormous mistake, because culture matters.

Culture is like air. Ethical culture determines the future of your enterprise. Enron and WorldCom had extraordinary compliance manuals. The best definition of culture that I’ve ever heard is that culture is the way things are really done around here. Every organization has a culture. And executives who want to protect against ever meeting the prosecutor need to focus on it in a maniacal way.

The problem with culture is that, like air, it can go bad without your being aware of it. Think about stepping into a room where someone was doing something particularly stinky, like cutting fish. When you step into the room, you are overwhelmed by the stench and say, “Whoa lordy, what are you doing?” The guy cutting fish says, “What are you talking about? What’s the problem?” He doesn’t realize how stinky it is because it got stinky gradually, and he got used to it. That can happen with an organization, too. When you stepped into WorldCom from the outside, it stank like a thousand fish were being cut; but a lot of good people inside that entity didn’t smell it or feel it, because it went bad bit by bit by bit. Culture is shaped, both positively and negatively, by thousands and thousands of looks and encounters and e-mails and gestures and small comments and memos. That’s what anybody who wants to protect an institution needs to realize; you have to be attentive and work at it, in a positive way, constantly.

Again, I want to use the analogy of raising children. Children learn primarily by observing what their parents do. Children see how their parents treat other people, how honest they are, how they react to good and bad events. Thousands of little moments shape children and create their culture. Employees are much like those kids. They watch those in authority and are

shaped by what the leaders do, what they signal, what they say, how they act.

As a practical matter, how do you establish the right kind of culture in a large organization? I know how we do it at my company, which has a hundred forty thousand employees. (One of our former CEOs said, “The problem with a company our size is that every city of a hundred forty thousand has a jail because people are flawed, and some are going to do bad things.” That’s true, but the answer is to try to create and reinforce a healthy culture so that if you do meet a prosecutor, you’re able to say, “Bad guy, good place; bad apple, good barrel,” and save that enterprise.) At my company, we do it through maniacal marketing of ethics to our people.

I will give you two quick examples. We hired actors to act out mini soap operas of ethical dilemmas, and we call the series the “Integrity Minute.” We e-mail them to all of our people. Each one takes a minute to watch. The characters’ names are Javier, Victoria, and Randy. They act out the situation that raises an ethical dilemma—for example, there’s pornography on somebody’s computer—and then they say, “What will Randy do? Tune in to the next episode of the Integrity Minute.” So our people have to wait a month, perhaps thinking about what Randy should do, and then they get the next episode and see what happened. Our people feel as if they know Randy, Victoria, and Javier, and recognize the actors on commercials for other things. Most importantly, our employees eagerly watch “Integrity Minute” every single month.

They also read a police blotter. We send a glossy newsletter to every employee once a month. On the back is a police blotter, with the names stripped out, of people who did bad things, how they were investigated, and what happened to them. I don’t know about you, but I grew up in a town that has a little newspaper called the *Town Journal*, which carries a police blotter right inside the first page; and even now, when I visit my folks, the first thing I do when I get the *Town Journal* is open to the police blotter to see if any of my friends got taken in for drunk driving or if there’s been a burglary in my folks’ neighborhood. That’s what our employees do. They read the police blotter and learn from it, and it shapes them.

In summary, the Enron Era was characterized by extraordinary attention to white-collar crime, but I’m happy to tell you that the days of white-collar prosecutors being sexy have ended. We in the government worked hard to send the waves of deterrence and reassurance, and I think we succeeded there. But the most important lesson of the Enron Era is that culture matters, and that ethical culture is the responsibility of the leaders of any enterprise. The leaders must constantly protect and reinforce that culture, to raise their employees the way they would raise their children. That way, those employees should have the character to resist what would lead to their facing the

prosecutor. And, at the end of the day, I'm happy to report that I think corporate America understands the importance of their responsibility.

#### QUESTIONS AND ANSWERS

Q: I don't know that this applies to your corporation, but how do you expect the little people working in a corporation to take ethics seriously if the chief executive officer makes hundreds of millions of dollars in salary and stock options while they're working for a relative peanut?

A: That's a great question. I'm not sure it bears so much on ethics, but it is relevant to the morale of employees, and maybe at some point morale and ethics merge. You're right: When there is an extraordinary gap between the compensation of the chief executive and the regular folks, I think it starts to undermine people's confidence in the institution. And it might affect how receptive employees are to ethics messages from management. I'm not sure, though, that it affects their basic sense of what's right and what's wrong, because I think that good people are going to care about doing the right thing, no matter how much money they make.

Q: My question relates to deferred prosecution agreements. They appear to be the corporate sanction du jour. Are they here to stay?

A: I think so. I cut out some of what I was going to say, to stay within the time limit, but one of the other things I would have talked about is Arthur Andersen and the lessons from that situation. The inquiry, when you're trying to decide whether to charge an entity, is what the nature of that entity is. Is it a fundamentally healthy place that has been the victim of a few bad people and can be fixed? Or is it a fundamentally flawed entity that really can't be repaired? The reason that distinction is so important, at least to me, is that I didn't want to swing at a wrongdoer and knock down fifty-thousand innocent people by putting them out of work, unless it was unavoidable. So I always viewed charging an entity as the last resort. As a responsible public prosecutor, you can't swear off ever charging an entity—you have to have that tool—but it's got to be a last resort that you use only when the entity cannot be repaired. One of the legacies of the Andersen case, with its horrific collateral damage, was that the Department of Justice will look for ways to fix an entity so the good people aren't punished for the crimes of the wrongdoers. That is where the deferred prosecution agreements come into play.

This collateral damage problem is not unique to white-collar crime, by the way. I've had drug cases where both the mother and the father were involved in the drug dealing, and I had to think about what effect it was going

to have on the kids if we locked up both parents. I would consider whether there was a way we could stagger the prosecutions or sentences, or whether the family unit was so screwed up that the children would be better off if we did put both parents in prison. These are things that prosecutors deal with all the time.

