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Old Knights and New Champions: Kaye, Scholer and the Office of Thrift Supervision, and the Pursuit of the Dollar

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The story of Kaye, Scholer, Fierman, Hays & Handler and Lincoln Savings and Loan Association has entered legal mythology. Audiences can choose their heroes depending upon which of several versions of the tale resonates with deeply felt beliefs about how lawyers are supposed to act.

On one side, the tale is told of the powerful Office of Thrift Supervision, beloved of the gods and of Congress, led by its Chief Counsel, the steely-eyed Harris Weinstein, determined to cleanse the mess left by the savings and loans debacles and to recover as much of the lost money as possible from anyone who caused the mess, including greedy and unprincipled lawyers.

On the other side, we hear of brave Kaye, Scholer lawyers, stoutly denying wrongdoing, defending their knights-errant Peter Fishbein and Karen Katzman.1 These defenders call upon the holy order of the bar to witness that, far from being venal and grasping, Kaye, Scholer lawyers were representing deserving clients and acting in the highest tradition of the legal profession. They and their adherents accuse the OTS of misusing its awesome powers, of bludgeoning Kaye, Scholer into submission.

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1. For the purposes of this essay, women as well as men can be knights.
without regard for due process, and of pursuing the firm only because it was a deep pocket.

These narratives\(^2\) tend to be clear-cut, with the heroes and villains drawn in stark relief. The lawyers either acted properly\(^3\) or clearly violated ethical norms and statutory commands.\(^4\) The OTS either did what it had to do\(^5\) or abused its mandate.\(^6\) My story is fuzzier and concerns the interaction between lawyers and regulators. My purpose is first to sketch, by relying on the exchanges between OTS and Kaye, Scholer, some of the myriad statutory, regulatory, and ethical prescriptions, rules, and precepts that attempt to define the area inhabited by OTS regulators and by those lawyers representing thrift institutions. Thereafter, I make some observations about the incentives of regulators and lawyers under the current legal regime.

Let me briefly preview my concerns. The statutory enforcement tools available to regulatory agencies in the banking field recently have expanded greatly. Aided by these tools, regulators have begun to take over from the bar enforcement of ethical rules governing legal practice. The OTS claims against law firms, for example, are replete with allegations that the lawyers violated ethical rules and norms. At first glance, it is not obvious why agencies equipped with broad statutory powers would want to pursue alleged breaches of ethical rules, especially because some of the "ethical" claims, based on the agencies' own ethical rules or upon agency interpretation of the bar's rules, are novel and might invite litigation.

One answer lies in the relationship between ethical rules and malpractice claims. Despite disclaimers in the ethical codes,\(^7\) breaches of

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3. E.g., Hazard, supra note 2.

4. E.g., Beck & Orey, supra note 2.

5. E.g., id.

6. E.g., Goldberg, supra note 2; Lawyers Voice Concerns About Kaye, Scholer Action, supra note 2.

7. The drafters of the Model Code of Professional Responsibility and the Model Rules were HeinOnline -- 66 S. Cal. L. Rev. 986 1992-1993
ethical rules are often cited as evidence of malpractice. The OTS, charged with recovering money lost in thrift failures, has an interest in bringing malpractice claims against lawyers because such claims are usually covered by insurance.

The new enforcement rules and tactics affect the incentives both of agencies and of the regulated community. In addition to the OTS' responsibility to recover losses stemming from thrift failures, it also is statutorily obliged to supervise ongoing thrifts. OTS' recoupment role creates an incentive to chase the dollar, which may distract it from its other work and (more importantly for my purposes here) will inevitably skew enforcement decisions, most notably the choice of whom to pursue. The OTS' quest is for deep pockets, which nowadays include large law firms, especially those with comprehensive insurance coverage. Insurance companies have even deeper pockets than law firms.

For lawyers, unused to being targets, there are incentives to be more careful in choosing clients, less imaginative in giving advice, more limited and specific in defining the scope of engagements, and more thorough in keeping tabs on what everybody in the firm is doing. In addition—but not so clear in the legal literature about the OTS/Kaye, Scholer events—lawyers have an incentive to rethink the structure that makes them so tempting as targets and so vulnerable to pursuit. Lawyers now have good reason to think about making themselves less appealing targets by restructuring their firms so that fewer and smaller pockets are available for regulators to empty.

Insurance companies already have noticed which way the wind is blowing and have taken steps to reduce their own exposure by requiring

careful to state that violations of the rules were not intended to be used as bases for malpractice claims. Model Rules of Professional Conduct scope, at 115 (1991); Model Code of Professional Responsibility preliminary statement (1983). Those disclaimers are often honored in the breach. See Day v. Rosenthal, 217 Cal. Rptr. 89, 102-04 (Ct. App. 1985) (holding that an attorney's violation of the Model Rules of Professional Conduct established his negligence even in the absence of expert testimony); Beattie v. Firnschild, 394 N.W.2d 107, 110 (Mich. Ct. App. 1986) (holding that violations of the Code of Professional Responsibility create rebuttable evidence of malpractice but are not negligence per se; expert testimony is necessary unless the violation is so obvious that an expert is not required).

8. Under the federal savings association system, 12 C.F.R. § 500.3 (1992), [t]he office is authorized . . . to provide for the organization, incorporation, examination, operation, and regulation of federal savings associations. Under this authority, the Office's functions include, but are not limited to, regulation of the corporate structure of such associations, regulation of the distribution of their earnings, regulation of their lending and other investment powers, acting upon their applications for facility offices (including branch offices, limited facilities, mobile facilities and satellite offices), the regulation of mergers, conversions, and dissolutions involving such associations, the appointment of conservators and receivers for such associations, and the enforcement of laws, regulations, or conditions against such associations or the officers or directors thereof.
increased information about clients. In many cases, they have refused to write coverage for claims brought by regulatory agencies, even refusing coverage entirely for thrift representation. These insurance company policies in turn affect what kind of clients law firms are willing to represent.

All of the effects of the new enforcement regime are not yet known. While it is apparent that some of the incentives are salutary, it is less clear that all are, and at least some of the changes that are under way are not obviously in the public interest—as measured either from the vantage point of the thrift industry or that of law practice. For example, while large law firms may be appealing targets because of the capital available to be tapped, theirs may not be the worst instances of attorney failings. Economic pressures, however, keep OTS focused on the "big buck" rather than upon the worst behavior. Further, insurance practices drive attorney decisions on whom to represent; marginal but honest thrifts may lose qualified legal counsel as a result.

Insurance will not be the only source of change. Enforcement practices that cause law firms (presumably rational economic actors) to alter their professional structures, as well as their client base, may be counterproductive. While reconceptualizing law firms may be useful, restructuring firms to avoid large liability will not necessarily result in the most efficient and effective form of legal practice.

In short, my story has neither heroes nor villains. Rather, I am concerned that contemporary conversations have not yet focused on the strategic interaction that will result from enforcement proceedings of which the Kaye, Scholer case is emblematic.

I. KAYE, SCHOLER AND THE OTS: GOING FOR BROKE

A. THE CHARGES AND THE RESPONSES

A good place to begin the tale of Kaye, Scholer is with the charges brought by the OTS. These charges set forth the agency's view of the relevant boundaries that constrain lawyers working for banks and thrift institutions. The OTS made ten claims in all and sought $275 million in damages for Lincoln's losses.

Each claim alleged a set of facts and then charged that the conduct described violated one or several agency rules and regulations. In most of the claims, the charges were that the lawyers had simultaneously (a) violated agency disclosure regulations; (b) violated the regulatory prohibition against making false and misleading statements, failing to disclose material facts, or both; (c) broken agency rules of professional conduct; and (d) aided and abetted violations of agency laws and regulations.

The charges can be grouped under five major headings: direct violations of law by lawyers; misleading statements or omissions made by lawyers in their representative capacities; misleading statements or omissions made by lawyers acting as alter egos and therefore (according to the OTS) standing in the shoes of the client with respect to disclosure requirements; failure to follow ethical rules (either the agency's rules or those generally applicable to lawyers); and malpractice.

Exactly how Kaye, Scholer would have defended against these charges is not clear because the case settled almost as it was begun. As a result, Kaye, Scholer never filed an "official" response. The firm did, however, release to the press a document answering each charge. That response, widely republished in the legal community, provides some of Kaye, Scholer's side of the story.

In its response, Kaye, Scholer stressed that it had been retained as litigation counsel for Lincoln Savings and Loan. That role commenced, according to Kaye, Scholer, after an adversary relationship had developed between Lincoln and the Federal Home Loan Bank Board. Kaye, Scholer insisted that its actions followed a traditional litigatory path. Further, the response stated that the OTS had not alleged that Kaye, Scholer's actions were the proximate cause of any losses by Lincoln, that the firm had justifiably relied on accountants' reports, and that the OTS had raised only a handful of charges after examining more than 1000 pages of documents dealing with Lincoln's practices.

What is noteworthy about the OTS' charges and Kaye, Scholer's response is that, with a few exceptions, warring views of the lawyer's role are directly at issue throughout, with the regulators and the lawyers espousing radically different models. This clash of ideologies is, of

11. Id. at 772.
12. Id.
13. Id. at 773.
course, not news. The news was that Kaye, Scholer gave up without a fight. It will never be known whether Kaye, Scholer surrendered because of irresistible agency power, because it perceived that the new agency ideology about the proper role for lawyers was more powerful than the older doctrine, because, despite its protestations, it realized that its lawyers had stepped over the line, or because of other reasons. What is certain is that the new ideology, coupled with new and broad agency powers, will bring about changes in the way law is practiced in the banking and thrift field.

Underscoring that the case primarily involved a quarrel about the proper role of lawyers, Kaye, Scholer received support from a leading legal ethics expert, Professor Geoffrey Hazard of the Yale Law School. In what was titled Summary of the Expert Opinion of Geoffrey C. Hazard, Jr. Professor Hazard backed the theory that Kaye, Scholer was acting as "litigation counsel" because the matter had "become adversarial" and involved a "reasonable anticipation of litigation." According to Hazard, Kaye, Scholer, as litigation counsel, had a duty "to present Lincoln's case in its best light subject to the restriction against frivolous claims and contentions." Moreover, Hazard claimed that under generally accepted principles concerning the role of an advocate, Kaye, Scholer had no duty to "disclose weaknesses in the client's case," nor was "disclosure of [the client's] confidences" required. Further, Kaye, Scholer was not required to make "adverse characterizations of the client's conduct, even where the facts would permit such characterizations to be made."

14. Summary of the Expert Opinion of Geoffrey C. Hazard, Jr. (Feb. 25, 1992), reprinted in THE ATTORNEY-CLIENT RELATIONSHIP AFTER KAYE, SCHOLER 381 (PLI Corp. Law & Practice Course Handbook Series No. B4-7009, 1992). Note that the document is not actually an opinion by Professor Hazard. The document was prepared by Kaye, Scholer lawyers after discussions between Hazard and two attorneys at the firm. As the document states, Professor Hazard assumed a series of facts related to him by Kaye, Scholer lawyers. At the end of the document, Professor Hazard states that he has read the document and that it is an accurate summary of his opinions regarding Kaye, Scholer.

15. Id. at 396.
16. Id. (citing MODEL RULES OF PROFESSIONAL CONDUCT Rule 3.1 (1991); MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-101, -102 (1980); CALIFORNIA RULES OF PROFESSIONAL CONDUCT Rule 2-110 (1989)).
17. Id. at 397 (citing ABA Comm. on Ethics and Professional Responsibility, Formal Op. 314 (1965) (as modified on other grounds in ABA Comm. on Ethics and Professional Responsibility, Formal Op. 352 (1985)).
18. Id.
19. Id. at 381.
1. The Direct Violation Charge

In claim ten, the OTS alleged that Kaye, Scholer had violated federal regulations by participating in obtaining a loan under favorable terms for one of its partners—a direct violation of law by a lawyer. Kaye, Scholer did not contest this charge on ideological grounds, but on the facts. The firm stressed that the loan by Lincoln to a Kaye, Scholer lawyer had been made at competitive rates, that it was completely secured by a mortgage and by securities pledged, that all payments had been made, and that it caused no loss to Lincoln.

2. The Lawyer as Representative Charges

In what I have called the "lawyer as representative" charges, the OTS claimed that in documents filed on behalf of Lincoln Savings and Loan, Kaye, Scholer both had made false and misleading statements and had failed to disclose material facts. Peter Fishbein of Kaye, Scholer had sent documents to the FHLBB, in which he stated that the resignation of Arthur Andersen, the auditing firm for Lincoln and its parent, American Continental Corporation, "was not the result of any concern by AA with [ACC/Lincoln's] operations . . . or asset/liability management." The OTS claimed in claim two that the statement was false and misleading in violation of an FHLBB regulation because Kaye, Scholer had been told by Arthur Andersen personnel that Lincoln and ACC were high-risk clients for a variety of reasons related to their operating strategies.

In other "representative" claims, the OTS alleged that Kaye, Scholer, in its responses on behalf of its client to examiners and in examination reports, had failed to disclose facts material to the client's

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20. The allegation stated that Kaye, Scholer's and Lynn Toby Fisher's participation in obtaining the loan violated 12 C.F.R. § 513.4(a)(4) (1989), which prohibits aiding and abetting the violation of FHLBB laws.


22. The FHLBB was responsible for charters, examinations, and supervision of thrifts prior to being abolished by FIRREA in 1989 and replaced by the OTS for thrift purposes. Michael P. Malloy, The 12(i)'ed Monster: Administration of the Securities Exchange Act of 1934 by the Federal Bank Regulatory Agencies, 19 Hofstra L. Rev. 269, 272 n.10 (1990). The Resolution Trust Corporation, a unit of the OTS, became the successor in interest to Lincoln Savings and Loan when it was seized by the government. When a thrift goes under, the OTS appoints the RTC as conservator in charge of managing and cleaning up the failed thrift. Miriam Rozen, After Kaye, Scholer: Who's Next for OTS, AM. L. W., Apr. 1992, at 18.

23. In re Fishbein, OTS AP-92-19, claim 2. The regulation cited was § 563.18(b)(1)-(2). The claim also alleged record-keeping and disclosure violations, aiding and abetting violation of regulations, and violations of FHLBB regulations concerning professional conduct.

24. Id. claims 5-9.
(a) income and net worth;\textsuperscript{25} (b) loan and securities underwriting practices;\textsuperscript{26} (c) direct investments;\textsuperscript{27} and (d) participation in financing of a tax shelter for control persons.\textsuperscript{28}

Kaye, Scholer's response to the representational claims was to begin the duel of ideologies; it issued a blanket denial of wrongdoing, clothed in the presumption of the lawyer as zealous advocate. Kaye, Scholer saw itself as entitled, indeed obligated, to present the client's case in the most favorable way consistent with the facts and to accept the client's word or the word of other professionals about what the facts were.\textsuperscript{29}

Ideology again framed the specific responses to the next claims, with the accent on trusting the client. In claim six (failure to disclose underwriting deficiencies), Kaye, Scholer replied that the firm always acknowledged that documentation of underwriting was deficient, although it improved over time. Kaye, Scholer took refuge in the fact that Lincoln officials repeatedly told Kaye, Scholer, and Kaye, Scholer told the regulators, that substantive underwriting had in fact been done.\textsuperscript{30} Implicit in this response are the assumptions that Kaye, Scholer had no reason to doubt the word of its client on this point and, as a general matter, that lawyers have the right to rely on clients' statements. Similarly, lawyers' justifiable reliance is the heart of the defense to claim seven (failure to disclose facts material to direct investments): Kaye, Scholer stated that it had no reason to question four separate opinions by the accounting firms of Arthur Andersen and Arthur Young to the effect that the transactions in question were loans rather than joint ventures.\textsuperscript{31}

Claim eight is another example of the ideological dispute. The agency asserted that Kaye, Scholer had violated agency regulations by withholding material information. OTS charged Kaye, Scholer with giving an opinion that certain direct investments were properly

\begin{itemize}
  \item 25. Id. claim 5.
  \item 26. Id. claim 6.
  \item 27. Id. claims 7-8.
  \item 28. Id. claim 9.
  \item 29. Specifically, in responding to claim two, Kaye, Scholer recited that Arthur Andersen had filed a statement with the SEC giving its reasons for resigning and that Kaye, Scholer was entitled to rely upon those reasons as correct. Kaye, Scholer's Response to Notice of Charges, supra note 10, at 774-75. As to claim five (misrepresentations about the client's income and net worth), the law firm stated that it was told that the accountants had known about disputed transactions and had determined that they were properly accounted for. There was, therefore, no reason for Kaye, Scholer to believe that the accountants' certification of Lincoln's financial statements was unwarranted. Id. at 775-76.
  \item 30. Id. at 776.
  \item 31. Id. at 776-77.
\end{itemize}
grandfathered even though its lawyers knew that some documents substantiating the client's position had been backdated. Implicit in Kaye, Scholer's response (that the backdating was irrelevant) is a traditional view of the lawyer's role: that lawyers are not required to volunteer information that they do not consider relevant to an opinion, even if that information would raise suspicions about a client's behavior.

The dispute over claim nine reiterated the lawyers-don't-have-to-rat-out-their-client theme. The OTS alleged that Kaye, Scholer had failed to disclose material facts in connection with its client's (Lincoln's) participation in the financing of a personal tax shelter for its parent's (ACC's) control persons. Kaye, Scholer took the position that regulators knew enough from proxy statements and annual reports to tell who the parties were to the disputed transaction and whether it was an "affiliate transaction" and a safe and sound loan. Moreover, Kaye, Scholer pointed out that the examiners had in fact raised questions about the legality of the transaction—evidence in itself that the disclosure had been adequate. Kaye, Scholer claimed that it therefore could not be faulted for material omissions in documents prepared for Lincoln's parent, ACC, to submit to the SEC.

3. The Lawyer as Alter Ego Charge

As in the lawyer as representative claim, the alter ego claim also involves ideological differences about behavior common to litigators. When OTS sought information from Lincoln employees, as it had a legal right to do, Kaye, Scholer sought to stand as a buffer; it told OTS examiners to make their requests to Kaye, Scholer lawyers. In its notice of charges, OTS argued that by interposing themselves, Kaye, Scholer lawyers had stepped into the shoes of their clients and thus were subject to the same reporting requirements (the obligation to keep accurate records

33. Kaye, Scholer stated that its lawyers had no obligation to call attention to the redating of the documents. Kaye, Scholer claimed that there was an honest difference of opinion between its lawyers and the regulators about the validity of the grandfathering of direct investments. Kaye, Scholer said that it had even urged the regulators to join it in requesting a declaratory judgment by a court. Kaye, Scholer's position was that the alleged backdating of consents by the board of directors had no bearing on Kaye, Scholer's opinion that the grandfathering was legal. Kaye, Scholer's Response to OTS' Notice of Charges, supra note 10, at 777.
36. Id. at 777-78.
and to make these records available for inspection) and penalties as Lincoln. Thus, at the heart of this claim is the distinction (or lack thereof) between lawyer and client. In addition, under this theory, OTS was able to recycle its claims of misrepresentations and failures to disclose (described here as lawyer as representative claims) and charge additional, direct violations of reporting requirements.

Kaye, Scholer’s response insisted on a distinct and separate role for lawyers. To explain its actions, Kaye, Scholer relied on the ethical obligations of lawyers; it asserted its duty “under the Rules of Professional Responsibility to defend its client and present the client’s arguments and positions as persuasively as possible so long as they had a reasonable basis.” Kaye, Scholer’s defense was bolstered by Professor Hazard’s summary, in which he stated that Kaye, Scholer’s interposition of its lawyers with respect to receipt of requests for information and its participation on behalf of its client in discussions in an attempt to resolve issues “were integral aspects of the usual and expected functions of litigation counsel.” Therefore, “Kaye, Scholer did not assume its client’s record-keeping and disclosure responsibilities under the Bank Board’s regulations.”

4. The Malpractice Charge

In the malpractice allegation (claim one), the agency charged that Kaye, Scholer had committed malpractice by recklessly and incompetently advising Lincoln that its direct investments were legally grandfathered even though it knew that some documents purporting to reflect relevant board of directors action had been backdated. Once again, OTS recycled allegations to generate distinct violations; the underlying facts alleged were identical to those in claim eight, one of the lawyer as representative claims.

38. Id. claim 3.
42. Kaye, Scholer responded to this claim the same way it had responded to claim eight—by denying that the backdating of documentation of actions by Lincoln’s board of directors was relevant in any way to Kaye, Scholer’s opinion that the board’s actions satisfied applicable grandfathering regulations. Kaye, Scholer’s Response to OTS’ Notice of Charges, supra note 10, at 774. Professor Hazard concurred:

Kaye, Scholer was not required by the applicable standards of professional conduct to bring to the attention of Lincoln’s Board of Directors the possibility that the validity of the relevant actions by unanimous written consent of Lincoln’s directors could be subject to reasonable challenge . . . [because] the validity or invalidity of the consents would not have altered the conclusions reached by Kaye, Scholer concerning Lincoln’s compliance with the Bank Board’s direct investment regulation.
What is interesting about this claim is not only the ideology that frames it but also the peculiar posture of the OTS—we typically associate malpractice with arguments between client and lawyer, not lawyer and agency. But in the odd world of thrift regulation, agency can become client. The OTS had "standing" to make this malpractice claim, as well as the "ethical" claim detailed below, because the Resolution Trust Corporation, a branch of the OTS, was successor in interest to Kaye, Scholer's former client, Lincoln Savings and Loan. Thus, OTS was simultaneously Kaye, Scholer's governmental adversary and its former client.

5. The "Ethical" Violations Charge

The "ethical" claims return us to the ideological warfare. OTS (again standing in the shoes of Lincoln) alleged that Kaye, Scholer had breached its duties to its client by failing to advise Lincoln's board of directors that some of Lincoln's officers (Charles Keating et al.) were breaching their fiduciary obligations to Lincoln. In addition, the OTS charged that Kaye, Scholer had a conflict of interest because it represented the parent (ACC) as well as the subsidiary (Lincoln), and that the conflict had adversely affected Kaye, Scholer's representation of Lincoln.

This dispute turns on interesting questions about whether the directions given to lawyers by the American Bar Association's Model Rules of Professional Conduct are advisory or mandatory. Kaye, Scholer argued that it retained judgment and that it had exercised it wisely. Professor Hazard's summary echoed the themes of Kaye, Scholer's defense and stated that there was no conflict involved in Kaye, Scholer's representation of both Lincoln and its parent, ACC, because no disputed issues had been raised by the examiners regarding affiliate transactions, conflicts of interest, or holding company regulations. Further, Professor Hazard stated that Kaye, Scholer "could reasonably have concluded that it did


43. In re Fishbein, OTS AP-92-19, claim 4. In all of the claims, the OTS alleged overlapping violations. In most claims, there were charges of reporting violations, record-keeping violations, engaging in improper professional conduct before the FHLBB, and aiding and abetting violations by Lincoln. In separating out the claims for purposes of analysis, I have assigned to each claim what I consider to be the primary violation alleged.

44. Id. para. 56.

45. Kaye, Scholer argued that the positions taken on behalf of Lincoln, with full knowledge of the board of directors, were in Lincoln's best interests. Also, Kaye, Scholer saw no conflict of interest "in representing a parent [ACC] and its wholly owned subsidiary [Lincoln] in defending the subsidiary's conduct before a regulatory agency." Kaye, Scholer's Response to OTS' Notice of Charges, supra note 10, at 775.
not have the responsibility to directly advise Lincoln’s Board of Directors whether Lincoln was in compliance with Bank Board regulations."

B. ETHICAL RULES AND AGENCY VIEWS

The variety of charges brought against Kaye, Scholer illustrates the comprehensive array of enforcement options available to the OTS. These charges are interesting because they show how OTS relied not only on its own regulations but also on lawyers’ codes of professional responsibility, drafted not with liability in mind but as guides to lawyers’ conduct. While these codes have for some time been used against lawyers in malpractice suits (and OTS relied on them for that as well), OTS’ approach was to attempt to use these ethical directives to impose arguably new fiduciary obligations and liabilities on lawyers.

1. Expanding Obligations to Lincoln

For example, in the “ethical” claim, the OTS accused Kaye, Scholer of two separate ethical violations—continuing representation of two entities (the parent and a subsidiary) despite a conflict of interest and failing to notify Lincoln’s board of directors of legal breaches by Lincoln officers and employees. In the words of the OTS, these allegations (plus misrepresentations and omissions charged later in the notice of charges document) “constituted reckless unethical and improper professional conduct, reckless breaches of Kaye, Scholer’s duty of loyalty and duty to provide competent advice with due care, and demonstrated a lack of the professional character and integrity necessary for an attorney to practice before the OTS.”

46. Summary of the Expert Opinion of Geoffrey C. Hazard, Jr., supra note 14, at 400. The reasons given were (a) that Kaye, Scholer was not required to conduct a broad internal regulatory review of Lincoln’s practices, transactions, and books and records; (b) that Kaye, Scholer had not held itself out as having regulatory expertise, and Lincoln had retained other law firms with this expertise; and (c) that in view of an exit conference in which examiners had orally informed Lincoln’s board of significant findings and a report of examination that alleged substantial deficiencies, Kaye, Scholer could reasonably have assumed that Lincoln’s directors were aware of the criticisms and allegations by the Bank Board. Nor was Kaye, Scholer required to report results of loan file reviews by Kaye, Scholer associates to Lincoln’s board of directors—the directors already knew that the loan files could be criticized by the Bank Board examiners, and Kaye, Scholer had reported the results of its reviews to the people with direct responsibility for maintaining the files. Id. at 401-02.

47. “Kaye, Scholer failed to advise those officers and directors of their statutory and fiduciary responsibilities and failed to notify the board of directors of Lincoln of the officers and directors’ unlawful conduct.” In re Fishbein, OTS AP-92-19, para. 55.

48. Id. at para. 56.

49. Id. at para. 57.
OTS' ethical claim has a certain grab-bag quality. One aspect of it, the allegation of conflict of interest, fits within the traditional lawyer ethical and liability framework. The alleged conflict, if proved, would violate ethical rules. The claim is also, in essence, a run-of-the-mill malpractice claim, albeit made by an unusual "client"—OTS standing in Lincoln's shoes. OTS argued that Kaye, Scholer's representation of the parent, ACC, adversely affected its representation of Lincoln. Assuming that OTS could have established the adverse effect and the requisite absence of a valid waiver, then Kaye, Scholer would have been liable in malpractice for whatever damages flowed from this breach of loyalty to Lincoln.

The other charge is based on a theory that requires a stretch of ethical precepts. The position of the OTS, as set forth by its Chief Counsel, Harris Weinstein, was that "a lawyer must report unlawful client activity up the corporate chain of command, going as far as the corporate board of directors," citing ABA model rule 1.13(b). Lawyers in the regulated community point out that the rule in question does not require them to report unlawful activity to higher authority, but merely lists that avenue as one of several measures that might be taken, depending upon the circumstances. The lawyers would add that a rigid rule restricts flexibility in responding to a myriad of different situations, thus preventing them from using the informed professional judgment that they owe to the client. This chasm between the OTS interpretation and that of the

51. When an attorney represents two clients with conflicting interests, the attorney must disclose all relevant information to the clients so that they can make an intelligent decision about continued representation. An attorney who continues such a dual relationship without disclosure is civilly liable to a client who suffers a loss as a result of the attorney's failure to disclose. See, e.g., Purdy v. Pacific Auto. Ins. Co., 203 Cal. Rptr. 524, 534 (Ct. App. 1984).
52. Harris Weinstein, OTS Chief Counsel, Remarks Before the Pennsylvania Ass'n of Community Bankers (Mar. 23, 1992) (transcript on file with author).
53. Id.
54. The text of model rule 1.13(b) demonstrates its discretionary nature. The rule directs only that an attorney for an organization with knowledge that an "officer, employee or other person associated with the organization" is acting or intends to act in a harmful manner should "proceed as is reasonably necessary in the best interest of the organization." Model Rules of Professional Conduct Rule 1.13(b) (1991). "Referring the matter to a higher authority" is only one of several measures "among others" the attorney is advised to consider, but such action is not mandated by the rule itself. Model Rules of Professional Conduct Rule 1.13(b)(3) (1991) (emphasis added). Commentary on the rule indicates that only after the offending employee has been asked to reconsider and has refused or if the attorney feels "the matter is of sufficient seriousness and importance to the organization . . . may [it] be reasonably necessary for the lawyer to take steps to have the matter reviewed by a higher authority in the organization." Model Rules of Professional Conduct Rule 1.13 cmt. (1991) (emphasis added).
bar reflects the never-ending, never-to-be-settled dispute about lawyers’ duties and responsibilities in settings where they represent corporate or other artificial entities.

2. Expanding Obligations Beyond the Immediate Client

While the charges filed by the OTS do not specifically detail obligations of lawyers beyond those to their clients, the discussion that has surrounded the OTS/Kaye, Scholer tale has raised other possible duties of lawyers. OTS’ theory is that lawyers are like other agents; as such, they have duties not only to their clients (here, banking institutions) but to whomever their clients and fiduciaries of their clients (in this context, read employees, officers, and directors of banking institutions) owe duties.

According to the Chief Counsel of OTS, lawyers representing banking institutions must take responsibility for advising a vast array of individuals (such as corporation employees and officers) who are not technically their “clients” of those persons’ responsibilities to other parties (such as shareholders, depositors, and even the federal insurance fund) who also are not their clients.55 Both the advice-about-duties and

55. The banking lawyer advises corporate officers and employees who are fiduciaries for shareholders, depositors and the federal insurance fund. The fiduciary relationship is a creature of the legal system, and for its success must rely on the lawyer to interpret for the fiduciary what the law requires. . . . In banking, the lawyer must advise fiduciaries to observe their duty to the depositor’s interest and the duty to operate safely and soundly. The corporate lawyer who does not advise the corporate fiduciary of these duties, or fails to act when there is significant evidence of abusive conduct, breaches his duty to the institution that is the client.

Harris Weinstein, OTS Chief Counsel, Issues of Professional Responsibility Arising from the Savings and Loan Failures, Remarks at the University of Michigan Law School 5-6, 19 (Mar. 24, 1992) (transcript on file with author). Professor Hazard has advanced a theory that would support the OTS position:

Fiduciary obligation to a third party was part of what the OTS had in mind in its proceeding against the Kaye, Scholer firm. In my opinion, the . . . ground rules at the time of Kaye, Scholer’s engagement did not clearly implicate such an obligation. Nevertheless, such an obligation could be coherently formulated and on that basis could be justly enforceable. The essential idea would be that the government agency is a surrogate for other interests to whom the lawyer may have a duty of trust and confidence, specifically the depositors in the bank; that a duty of trust and confidence arises when the lawyer undertakes to deal directly for or with those other interests, or the surrogate acting on their behalf; and that the duty of trust and confidence includes conveying whatever information is necessary to permit the recipient to make a reasonably informed decision about the matter in question.

Extension of a lawyer’s legal responsibilities along this line clearly would go beyond established law. However, such an extension is not beyond the range of judicial imagination. An obligation of this kind was clearly contemplated by Judge Sporkin in his famous dictum in the Lincoln Savings case: “Where . . . were the outside accountants and attorneys when these transactions were effectuated?”

the failure-to-act components of the OTS formula imply at least some duty on the part of lawyers to keep tabs on clients' doings, with an eye to making sure that no laws are being broken and that corrective action is taken when necessary. While some legal ethicists might conclude that OTS' position is not an expansion of current duties, most would agree that OTS' mandated methodology—a duty to report violations "up the line" to the board of directors rather than to use informed judgment in context—is expansive.

Lawyers' objections to the OTS position take several forms. First is the classic "I am not my client's keeper, but merely her servant" argument. This approach follows Lord Brougham's famous dictum\(^5\) but also relies on a concept of confidentiality that arguably forbids lawyers from divulging fraudulent conduct by clients\(^6\) and on an ethic of respect for client autonomy coupled with the lawyers' duty of zealous advocacy.\(^7\) Lawyers also bring to bear a less rigid argument: When lawyers are required to monitor their clients' actions for violations of agency rules, some of which are subject to varying honest interpretations, a real chilling effect may occur, to the clients' detriment. For example, zealous advocacy that is neither unethical nor unlawful from the attorney's perspective may be "misleading" from the regulator's standpoint.\(^8\)

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56. [A]n advocate, in the discharge of his duty, knows but one person in all the world, and that person is his client. To save that client by all means and expedients, and at all hazards and costs to other persons, and, amongst them, to himself, is his first and only duty; and in performing this duty lie must not regard the alarm, the torments, the destruction which he may bring upon others. Separating the duty of a patriot from that of an advocate, he must go on reckless of consequences, though it should be his unhappy fate to involve his country in confusion.


57. The question of what lawyers should do about client fraud has a long and complicated history in the evolution of ethical rules. The bar has been very reluctant to fashion ethical rules that dilute the lawyer's obligation of confidentiality. In 1974, the ABA amended a section of the Model Code (disciplinary rule 7-102(B)(1)) that had previously contained a duty to reveal unrectified client fraud. The amendment qualified the duty to reveal with the phrase "except when the information is protected as a privileged communication." Later, the ABA issued an ethics opinion, Formal Opinion 341, that interpreted the amendment as negating the duty to reveal fraud. Model rule 1.6, as proposed, would have allowed—but not required—lawyers to reveal frauds committed against a third party. The proposed rule generated much debate, and the rule as ultimately adopted forbids disclosure of client fraud. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 (1992). But there is an escape clause. The comment to rule 1.6 allows a lawyer to "send a signal" that something is amiss—a lawyer may withdraw, give notice of the fact of withdrawal, and "withdraw or disaffirm any opinion, document, affirmation, or the like." Id. Rule 1.6 cmt. For an excellent description of the history of these rules and the controversies surrounding their adoption, see Susan P. Koniak, The Law Between the Bar and the State, 70 N.C. L. REV. 1389, 1431-47 (1992).

58. This is typified in the ethics code by MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.3 cmt. (1992); MODEL CODE OF PROFESSIONAL RESPONSIBILITY Canon 7 (1981).

59. COMMITTEE ON PROFESSIONAL RESPONSIBILITY, ASSOCIATION OF THE BAR OF THE
the uncertainty about line drawing and massive agency power, plus agency incentives to focus prosecution on deep pockets, lawyers fear importing an agency's version of ethical rules into the enforcement arena.

C. THE OUTCOME

How Kaye, Scholer's defenses would have played out in the fulsome course of litigation will never be known. At the same time that the OTS issued its notice of charges against Kaye, Scholer, it played its "terrifying trump card," a freeze order placing restrictions upon Kaye, Scholer's assets and finances. Kaye, Scholer capitulated six days later, agreeing to pay $41 million to OTS and accepting a series of conditions specifying in great detail the policies to be followed by the firm when representing banking or thrift institutions. Peter Fishbein and Karen Katzman


60. Stevens & Thomas, supra note 2, at 1.

61. OTS' temporary cease-and-desist, or "freeze," order barred Kaye, Scholer from selling, transferring, or encumbering any funds or assets except as necessary to meet ordinary business expenses. Capital expenditures of more than $50,000 required prior OTS approval. Firm assets could be used to pay interest and principal on prior indebtedness or on indebtedness incurred under terms of the order. Partners of Kaye, Scholer were prohibited from selling or transferring assets in which they or their immediate families had a legal or beneficial interest without receiving adequate consideration, and from transferring such assets outside the United States. Kaye, Scholer partners Peter M. Fishbein, Karen E. Katzman, and Lynn Toby Fisher were prohibited from selling or transferring assets in which they or their immediate families had a legal or beneficial interest, except if the proceeds would be used to pay for ordinary living expenses and the assets were valued at less than $5000. Members of the firm who were partners prior to December 1, 1987, were also required to place 25% of their earnings into an escrow account. Individually named defendants Fishbein and Katzman had to place 50% and 33% of their earnings into escrow, respectively. In lieu of these provisions, Kaye, Scholer and the named respondents could have provided security by one or a combination of means approved by OTS.

Kaye, Scholer was also barred under the order from changing its method of accounting or the terms of its insurance coverage without notice to OTS. Notice was also required for the termination, resignation, or withdrawal of any partner, and any withdrawing partner had to provide security for her or his potential liability under OTS enforcement proceedings. Any discussion or consideration of partnership dissolution or modification required notice to the OTS. In addition, any entity holding assets of Kaye, Scholer or the named respondents was prohibited from transferring or withdrawing those assets. Respondents Fishbein, Katzman, and Fisher were additionally required to submit (a) financial statements for themselves and their immediate family disclosing any assets of legal or beneficial interest; (b) their federal, state, and local tax returns for 1989, 1990, and 1991; and (c) quarterly financial statements prepared by a certified public accountant disclosing respondents' assets and liabilities. Members of Kaye, Scholer could request relief from provisions of the freeze order if they could show that abiding by them would cause undue hardship.

62. Some $25 million was covered by insurance. Gillers & Simon, supra note 10, at 730.

63. With respect to new insured depository institution clients and new matters regarding such existing clients, the firm agreed, pursuant to the order to cease and desist, to review (a) the client's financial situation; (b) the existence of conflicts of interest; (c) whether Kaye, Scholer was replacing another firm in the matter, and, if so, why; and (d) whether attorneys assigned had proper expertise and whether the firm had sufficient staff to handle the work. Furthermore, a qualified partner had to
were suspended from practice before the OTS and prohibited from engaging in banking or thrift practice. Another Kaye, Scholer lawyer, Lynn Toby Fisher, was the subject of an order to cease and desist, which specified in detail the procedures she was to follow if she was ever engaged to represent a thrift or banking institution.

D. A PARADIGM CASE?

The categories of claims raised against Kaye, Scholer illustrate the OTS' view of the various sources of liability for lawyers. The claims also demonstrate the parties and institutions to which (under the OTS theory) lawyers arguably owe some duty. According to the OTS, lawyers must themselves obey the law, obey the rules of courts and regulatory agencies, accept regulatory reporting requirements when acting as agents for their clients, follow ethical rules (including the agency's ethical rules), and provide competent representation. The lesson the OTS wants to teach is that violating any of these strictures can lead to substantial civil or criminal penalties, including restitution of monetary losses deemed to be caused by the lawyers' conduct.

Lawyers respond that they always knew the perils of lawbreaking and of malpractice, but that the OTS, by expanding the theories of agent-principal and of what constitutes aiding and abetting, wants to make lawyers watchdogs and finks, all in derogation of their duties as zealous advocates. Lawyers also bemoan the importation of ethical violations as independent grounds for liability, arguing that ethical rules should be supervise all work done regarding thrifts, and attorneys had to be regularly evaluated regarding compliance with firm procedures.

When Kaye, Scholer acted as general, banking regulatory, or securities counsel to a thrift, acted as counsel to a thrift in regard to any federal regulatory exam, or performed more than $600,000 in legal services for a thrift in a single year, a banking partner with at least 10 years of banking law experience was required to be in charge of supervising the matter. This partner would also review the preceding year's reports for any such client that were subject to the Securities and Exchange Act of 1934 and other available reports for clients not subject to the Act.

In giving its opinion on unsettled matters that were not predictable, Kaye, Scholer had to advise its clients of the importance of considering the effects of the transaction on the thrift and the prudence of seeking advice from federal regulatory authorities. In addition to explicit instructions to avoid various conflicts of interest, the firm was explicitly prohibited from misleading regulatory authorities in any manner. Any Kaye, Scholer attorney with knowledge of improper fiduciary activities was required to take the matter to higher authorities.

The order also explained the terms of Kaye, Scholer's restitution payments.

64. In re Fishbein, OTS AP-92-25 (Dep't Treasury 1992) (order of prohibition from participating in the conduct of the affairs of an insured depository institution and order of debarment from practicing before the Office of Thrift Supervision); In re Katzman, OTS AP-92-26 (Dep't Treasury 1992) (same).

administered by the bar and that violations should be punished by disbarment or lesser sanction, not by fines or restitution penalties.  

There is no reason to believe that the gulf will narrow between the views of the OTS and those of the bar about the appropriate role for lawyers, or that the OTS will cease using its power to put maximum pressure on law firms, accountants, or any entity it considers liable for thrift losses. The job of the OTS, it bears repeating, is to collect money as well as to regulate. Important questions suggested by the OTS' dual role of enforcer and bill collector are whether the powers of the OTS are too broad and whether its responsibilities are in such conflict with each other that new regulations are necessary. Another question is whether and how law practice will change as the agency continues to pursue long-pursued law firms.

II. AGENCY INCENTIVES AND TOOLS

A. THE AGENCY'S MULTIPLE AND CONFLICTING ROLES

We are not used to having the same officials decide whom to prosecute, determine how much to claim in restitution or to assess as fines, negotiate for settlements and, if settlement talks fail, issue asset freeze orders, and then, if surrender has not occurred, adjudicate the merits of the case. Yet these are the powers of the OTS.

There is also something disquieting about making an agency responsible for cleaning up the S&L mess and imposing administrative controls upon the thrift industry, while at the same time making that same agency responsible for recovering money lost by the federal deposit insurance fund when savings and loans fail. Any agency placed in such a position will inevitably have a somewhat schizophrenic attitude toward its regulated community. On the one hand, there is the agency as helper—setting up rules and regulations and conducting audits to ensure safe and sound operation. On the other hand, there is the agency as repo agent—pursuing the same people whom it formerly assisted in order to recover funds lost to the federal deposit insurance fund.

66. Roger C. Cramton & Lisa K. Udell, State Ethics Rules and Federal Prosecutors: The Controversies over the Anti-Contact and Subpoena Rules, 53 U. PITT. L. REV. 291, 312 (1992) ("Professional ethics, or the 'bar's law,' traditionally have been understood as relating to obligations apart from the requirements of the state's 'other law.' . . . Although the bar accepts the postulate that its law merely supplements the state's other law, its acceptance is modified by the professional claim that a substantial arena of action should be left to professional self-regulation.").

Admittedly, many other agencies combine regulation and enforcement powers; indeed, the term "regulation" implies the power to force the regulated community to abide by whatever rules the agency promulgates. But no other agency has as one of its primary responsibilities the recovery of money lost through mismanagement by its supervisees. And no other agency (with the exception of prosecutors) has as much power to coerce surrender.

The statutory powers of the OTS thus raise questions about its impartiality. The risk is that its judgment on what is bad behavior will be affected by its knowledge of the wealth of a potential target. While the situation is not the same as that which arises when judges have a direct pecuniary interest in the fines they assess, the parallel is worth exploring. The reality is that the performance of the OTS is evaluated, at least by itself and probably by Congress, according to the amount of money it collects. At any rate, OTS officials do not let an opportunity to trumpet the agency's successes in big-ticket recoveries slip by.

The agency's dual role engenders conflicts in several areas of decision making. When a thrift fails, the OTS begins to search for dollars to make up the losses to the public fisc. In those instances, the OTS resembles plaintiffs' lawyers in mass disaster cases. The objective is to identify any party with a pocket deep enough to repay the expense of pursuing it. As plaintiffs' lawyers in hotel fire cases, for example, look to the owners, the builders, the architects, the companies that supplied insulation, paint, wallpaper, and other materials, anyone who supplied services, and the insurers of all of the above, so does the OTS look to the officers and directors of the failed institution, the accountants, the lawyers, and anyone else who furnished professional services, and the insurers of all of the above.


69. Even federal prosecutors must get judicial approval to freeze assets in a criminal proceeding. See 21 U.S.C. § 881(b) (1988) (seizure of property by Attorney General requires judicial process, with limited exceptions). The OTS can issue asset freeze orders, as it did in the Kaye, Scholer case, on its own authority and without judicial knowledge or approval.

70. See Tumey v. Ohio, 273 U.S. 510 (1927) (finding a denial of due process where the judge was the mayor of the town that received money in proportion to the fine assessed by the court).


72. See In re San Juan Dupont Plaza Hotel Fire Litig., 907 F.2d 4 (1st Cir. 1990).
"Building the pot" is not a phrase limited to the tasseled-loafer set. And building the pot risks focusing enforcement activities on those parties who have resources, whether their participation in the failure of a thrift institution was significant or minor. Large amounts of money can be extracted from minimally responsible parties when agency power and leverage are great. The conflict that arises within the agency is whether to expend resources on chasing the dollar or in undertaking a more broad-based strategy in which it pursues a greater number of those directly responsible for thrift failures regardless of whether recovery of losses is possible.

Arguments about which course the agency should take to engage in effective oversight can be made on both sides. Big-ticket recoveries like the one obtained from Kaye, Scholer can be viewed as good deterrents, likely to keep everybody in line, especially lawyers and accountants. On the other hand, an increased number of enforcement actions against thrift officials (and, I hasten to add, lawyers and accountants who are directly responsible for thrift failures) might be a better deterrent systemwide. Regardless of the strategy chosen, one thing is clear. Once the OTS has identified its targets, it has a vast array of enforcement weapons to employ.

B. THE ARMAMENTARIUM OF ENFORCEMENT

Apart from the power to freeze assets so vividly illustrated in the Kaye, Scholer case, the OTS, and other agencies having jurisdiction over banking institutions, can bring plenty of pressure to bear upon bankers, their lawyers, and their accountants. Recently enacted statutes as well as long-standing provisions can be used to pursue lawyers who are suspected of being involved in illegal actions, including in advisory capacities.

Most important, the world is changing even as lawyers argue about what their duties should be. While the focus remains on whether OTS should import ethical duties into the regulatory arena and whether ethical rules should, as a general matter, be translated into rules of law, Congress and the courts have answered the question—affirmatively. For example, in 1983 the U.S. Supreme Court promulgated amendments to rule 11 of the Federal Rules of Civil Procedure that permitted courts to sanction attorney misbehavior, in part defined by ethical codes. More

73. See Kirk Victor, The Long Hello, 24 NAT'L J. 2829 (1992) (quoting President Bush claiming that Gov. Bill Clinton's campaign "is being backed by practically every trial lawyer who ever wore a tasseled loafer").
recently, Congress has passed laws that have essentially incorporated the OTS' view of the ethical responsibilities of lawyers and has made violations or neglect of these responsibilities grounds for liability.

1. Court-Made Rules of Procedure as Ethical Rules

The 1983 revisions to rule 11 of the Federal Rules of Civil Procedure went a long way toward requiring lawyers to monitor their clients in ways they had long thought unnecessary and perhaps even contrary to ethical rules. Traditionally, the primary limitations on zealous advocacy by lawyers were the causes of action for malicious prosecution and abuse of process. These actions were available only in the most egregious instances. Although codes and model rules forbade lawyers from asserting frivolous positions in litigation, the frivolity standard was satisfied only in extreme cases of unwarranted litigation. Reasonable inquiry was not required before filing suit or asserting a defense.

Rule 11 changed that regime by imposing a higher standard of objectively reasonable conduct than the lawyer codes. Monetary enforcement sanctions included the payment by those found to have breached rule 11 of the fees of their opponents. Enthusiastic (some, including myself, would say overenthusiastic) enforcement by the federal courts has recently resulted in some moderation of the provisions of the rule. As redrafted in the summer of 1992 and now pending before the Supreme Court for promulgation, the 1993 version of rule 11 maintains


76. Restatement § 156 cmt. b, supra note 74.

77. The rule 11 standard reads as follows:

The signature of an attorney or party constitutes a certificate by the signer that the signer has read the pleading, motion, or other paper; that to the best of the signer's knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed primarily for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

Fed. R. Civ. P. 11. The advisory committee's note to the 1983 amendment to rule 11 states:

Experience shows that in practice Rule 11 has not been effective in deterring abuses . . . . The new language is intended to reduce the reluctance of courts to impose sanctions . . . by emphasizing the responsibilities of the attorney and reinforcing those objections by the imposition of sanctions . . . . The new language stresses the need for some prefiling inquiry into both the facts and the law to satisfy the affirmative duty imposed by the rule. The standard is one of reasonableness under the circumstances . . . . This standard is more stringent than the original good-faith formula and thus it is expected that a greater range of circumstances will trigger its violation.

obligations of inquiry into the bases of clients’ factual claims but modifies the sanctioning power of federal judges. The preferred penalty is a payment into court, which diminishes the interest of adversaries to pursue rule 11 claims.\textsuperscript{78} Many states have adopted rules similar or identical to rule 11.\textsuperscript{79}

The federal courts do not have only rule 11 upon which to rely. In 1991, the U.S. Supreme Court concluded in \textit{Chambers v. Nabsco} that judges have inherent powers to sanction lawyers for bad faith conduct for filing false or frivolous pleadings or for perpetrating fraud upon a tribunal.\textsuperscript{80}

2. \textit{Legislation and Ethics}

a. Recent prohibitions: Banking lawyers will feel substantial impact from the Financial Institutions Reform, Recovery \& Enforcement Act of 1989,\textsuperscript{81} known by the acronym FIRREA. In FIRREA, Congress restructured the regulatory scheme by which agencies can pursue enforcement actions involving all federally insured financial institutions. Congress plainly intended to cast a wide enough net to snare both lawyers and accountants. Under FIRREA, agency enforcement powers extend to a class of persons described as “institution-affiliated parties.”\textsuperscript{82}

In addition to directors, officers, employees, and controlling stockholders of federally insured depository institutions, the definition of institution-affiliated party includes

\begin{itemize}
\item (4) any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in—
\begin{itemize}
\item (A) any violation of law or regulation;
\item (B) any breach of fiduciary duty; or
\end{itemize}
\end{itemize}


\textsuperscript{79}. \textit{Restatement § 156 cmt. b}, \textit{supra} note 74.

\textsuperscript{80}. 111 S. Ct. 2123, 2136 (1991). Other rules and statutes have also been used to import ethical requirements. For example, Federal Rule of Appellate Procedure 38 authorizes awards of “just damages and single or double costs” for frivolous appeals. 28 U.S.C. § 1927 (1988) gives courts authority to sanction lawyers for “multiplying the proceedings unreasonably and vexatiously.” Rule 16(f) of the Federal Rules of Civil Procedure authorizes judges on their own motion to sanction parties or attorneys for failing to obey a scheduling or pretrial order, or if no appearance is made on behalf of a party at a scheduling or pretrial conference, or if a party or attorney is substantially unprepared to participate in a pretrial conference, or if a party or party's attorney fails to participate in good faith. \textit{Fed. R. Civ. P.} 16(f).


(C) any unsafe or unsound practice, which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution.\textsuperscript{83}

Obviously, including "unsafe and unsound practices" in the list of possible violations is troubling to banking lawyers, given that what is unsafe or unsound is generally decided retrospectively\textsuperscript{84} and, when an institution has failed, the tendency is to believe that unsafe and unsound practices caused the failure.

Once a lawyer or law firm is defined as an institution-affiliated party, liability under civil penalty provisions can ensue for any such party who

(i) violates any law or regulation;
(ii) violates any final order or temporary order issued pursuant to [FIRREA's cease-and-desist authority];
(iii) violates any condition imposed in writing by the appropriate Federal banking agency in connection with the grant of any application or other request by such depository institution;
(iv) violates any written agreement between such depository institution and such agency; . . . or
(II) recklessly engages in an unsafe or unsound practice in conducting the affairs of such insured depository institution, or
(III) breaches any fiduciary duty [which] is part of a pattern of misconduct; causes or is likely to cause more than a minimal loss to such depository institution; or results in pecuniary gain or other benefit to such party.\textsuperscript{85}

"Violate" is defined very broadly to include "any action (alone or with another or others) for or toward causing, bringing about, participating in, counseling, or aiding and abetting a violation."\textsuperscript{86} Civil penalties for lawyers caught in the toils of this regulatory anaconda can amount to $1 million or more.\textsuperscript{87}

\textsuperscript{83} Id.
\textsuperscript{84} "Probabilistic causation confuses prospective and retrospective risk analyses. A bolt of lightning is highly improbable viewed from before its strike, but it is 100 percent probable in retrospect. Indeed, every cause or contributory cause is 100 percent probable if the probabilities are retrospective." Mark C. Weber, Beyond Price Waterhouse v. Hopkins: A New Approach to Mixed Motive Discrimination, 68 N.C. L. Rev. 495, 529 (1990) (footnote omitted).
\textsuperscript{85} § 907, 103 Stat. at 473.
\textsuperscript{86} Id.
\textsuperscript{87} Generally the amount of the civil penalty shall not exceed $1 million. 12 U.S.C. § 1833a(b)(1) (Supp. III 1991). However, in the case of continuing violations, the penalty may exceed $1 million, but may not exceed the lesser of $1 million per day or $5 million. Id. § 1833a(b)(2). When the violator has gained from the violation, or when the violation results in pecuniary loss to a person other than the violator, the amount of the civil penalty may exceed the stated limits but may not exceed the amount of such gain or loss. Id. § 1833a(b)(3).
Though FIRREA was enacted after the acts alleged in the OTS notice of charges against Kaye, Scholer occurred, the "institution-affiliated party" language seems to codify the agency theory that the OTS used against Kaye, Scholer—that lawyers acting as agents can also be held responsible for violations by thrift institutions. Note that there is no longer any need to allege, as the OTS did, that by interposing itself between the client and the regulators, Kaye, Scholer stepped into the shoes of Lincoln and became equally responsible for following the reporting regulations. The statute already treats as principals lawyers who provide assistance to clients who break laws.

FIRREA has also expanded the cease-and-desist authority to require institution-affiliated parties to make restitution or provide reimbursement, indemnification, or guarantee against loss if

(i) such depository institution or such party was unjustly enriched in connection with such violation or practice; or
(ii) the violation or practice [that was the basis of the cease-and-desist order] involved a reckless disregard of the law or any applicable regulations or prior orders of the appropriate Federal banking agency.

These "cease-and-desist" powers allow regulators to claim damages against law firms or lawyers defined as institution-affiliated parties without alleging violations of ethical rules or malpractice (as was necessary in the Kaye, Scholer case). The law defines the lawyer's role, and this definition is not one of a zealous advocate defiantly standing between the client and the regulators. The "institution-affiliated party" legislation obviously reaches deeply into the lawyer-client relationship and will affect the ways lawyers practice in both regulatory and advocacy settings.

One of the most controversial actions taken by the OTS in the Kaye, Scholer case was the issuance of a freeze order upon the partnership's assets. Congress has, in its cease-and-desist provisions described earlier, authorized this kind of litigatory noose preventing a respondent from dissipating its assets. An unusual feature of the freeze power is that there is no provision in the statute for a prior hearing of any kind. Moreover, the facts necessary to support the issuance of a freeze order are made in

88. FIRREA was enacted August 9, 1989, and Kaye, Scholer provided services to Lincoln only through April 1989. In re Fishbein, OTS AP-92-19, paras. 4, 6.
89. § 902, 103 Stat. at 450; John K. Villa, Emerging Theories of Liability for Lending Counsel, in The Attorney-Client Relationship After Kaye, Scholer, supra note 14, at 93, 159.
90. Stevens & Thomas, supra note 2, at 1. See § 902(a)(2), 103 Stat. at 450 (amending 12 U.S.C. § 1818(c)(1)).
the first instance by the agency itself, not by an independent administrative law judge. Under FIRREA, the agency head (in Kaye, Scholer's case Timothy Ryan, the director of the OTS) signs the temporary cease-and-desist order.\textsuperscript{92}

b. \textit{Long-standing prohibitions:} There are other laws in the criminal code, heretofore seldom used against lawyers or accountants, that in the current atmosphere could have substantial effects upon lawyers and other professionals who work for depository institutions. For example, 18 U.S.C. § 1517 prohibits obstruction of or attempts to obstruct any examination of a financial institution by any agency (obviously including the OTS) with authority to conduct such an examination. The penalty for violation is a fine or imprisonment of up to five years.\textsuperscript{93} Section 1032 prohibits concealing or attempting to conceal assets or property from the FDIC, Resolution Trust Corporation, OTS, or the National Credit Union Administration Board. The penalty for violation is a fine or imprisonment for up to five years.\textsuperscript{94} Section 1007 prohibits making or \textit{inviting reliance} on a false, forged, or counterfeit statement, document, or thing for the purpose of influencing in any way the actions of the FDIC.

\textsuperscript{92} There are opportunities for postdeprivation challenges to freeze orders. 12 U.S.C. § 1818(c)(2) (Supp. III 1991) provides authority to apply within 10 days to district court for an injunction setting aside or modifying the order. However, judicial review is adequately carried out if an agency presents a prima facie case of illegality based upon the agency's demonstrated compliance with its procedures and the statutory grounds for issuing a temporary order. Such a prima facie case requires a verified statement of specific facts giving rise to the violation, but it does not require an evidentiary hearing unless there is a materially disputed fact. Parker v. Ryan, 959 F.2d 579, 583 (5th Cir. 1992). Appeals to the agency itself are also available. 12 U.S.C. § 1818(b)(1) (Supp. III 1991). The agency must hold a hearing within 60 days, \textit{id.}, and render its decision within 90 days after the hearing is completed. \textit{Id.} § 1818(h)(1).

\textsuperscript{93} "Whoever corruptly obstructs or attempts to obstruct any examination of a financial institution by an agency of the United States with jurisdiction to conduct an examination of such financial institution shall be fined under this title, imprisoned not more than 5 years, or both." 18 U.S.C. § 1517 (Supp. III 1991).

\textsuperscript{94} 18 U.S.C. § 1032 (Supp. III 1991). This section states that whoever—

(1) knowingly conceals or endeavors to conceal an asset or property from the Federal Deposit Insurance Corporation, acting as conservator or receiver or in the Corporation's corporate capacity with respect to any asset acquired or liability assumed by the Corporation under section 11, 12, or 13 of the Federal Deposit Insurance Act, the Resolution Trust Corporation, any conservator appointed by the Comptroller of the Currency or the Director of the Office of Thrift Supervision, or the National Credit Union Administration Board, acting as conservator or liquidating agent;

(2) corruptly impedes or endeavors to impede the functions of such Corporation, Board, or conservator; or

(3) corruptly places or endeavors to place an asset or property beyond the reach of such Corporation, Board, or conservator, shall be fined under this title or imprisoned not more than 5 years, or both.

\textit{Id.}
The penalty is stiff: a fine up to $1 million and a prison sentence of up to thirty years.95

3. Are Ethical Rules Relevant?

Given the rules and statutes detailed above, it might seem to the average legal observer that lawyers' distress about potential agency reliance on breaches of attorney ethical rules for enforcement purposes is misplaced, even irrelevant. Laws and rules of practice now on the books should obviate the need for prosecutors or regulators to use allegations of ethical violations as bases for liability, thus mooting the argument about the relevance of lawyers' own rules.

Moreover, given the difficulties involved in putting regulatory teeth into general ethical prescriptions,96 regulators seemingly should realize, if they haven't already, that statutes are the easiest enforcement tools. Finally, if the tool box is not full enough, the agencies themselves can promulgate ethical rules for lawyers who practice before them, and enforce these rules to discipline or disbar wayward lawyers,97 if not to extract damage verdicts from them.

95. 18 U.S.C. § 1007 (Supp. III 1991) states:

[W]hoever, for the purpose of influencing in any way the action of the Federal Deposit Insurance Corporation, knowingly makes or invites reliance on a false, forged, or counterfeit statement, document, or thing shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both.

Another statute, 12 U.S.C. 1467 (1988), puts pressure on thrifts to be careful in letting their lawyers interpose themselves between the institution and the OTS's examiners. The statute provides that

if any affiliate [read lawyer] of any savings association . . . refuses to permit any examiner appointed by the Director [of the OTS] to make an examination; or . . . refuses to provide any information required to be disclosed in the course of any examination, the savings association shall forfeit and pay a civil penalty of not more than $5,000 for each day that any such refusal continues.

96. FIRREA is not the first regulatory scheme to clash with lawyer's tenets of professional responsibility. Courts in the past have not been eager to uphold displacement of ethical norms by agency regulations. Susan Koniak has written an illuminating discussion of the SEC's ultimately unsuccessful efforts in the National Student Marketing case to obtain injunctions against lawyers who had violated SEC regulations that arguably were contrary to ethical norms. Koniak, supra note 57, at 1461-69. Not that the SEC has not been on occasion open to charges of weak enforcement: see In re Carter, Exchange Act Release No. 17,597, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847 (Feb. 28, 1981) (SEC reverses suspension of two attorneys, holding that ethical responsibilities of lawyers with knowledge their clients are engaged in securities fraud were not so unambiguously established that lawyers could be held to a standard of generally recognized norms).

97. SEC rule 2(e) governs Commission administrative disciplinary proceedings against professionals, such as attorneys, who practice before the Commission. 17 C.F.R. § 201.2(e) (1992); see also In re Keating, Muething & Klekamp, Exchange Act Release No. 15,982, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,124 (July 2, 1979) (SEC finds law firm to have engaged in improper professional conduct under rule 2(e)).
But life in the real world is not so simple. There is a reason for regulators to continue to allege general ethical violations, and it relates to the bill-collecting responsibility of the OTC and its partner, the RTC. While FIRREA permits what most people would perceive to be large monetary fines, the issue is not only the fines allowed but also the capacity to pay them. Agencies like to pursue claims arising from wrongdoing that is insured, and malpractice—often tied to ethical breaches—is an indispensable part of their armory. Insurance companies (deep pockets) cover malpractice but usually not fraud or criminal acts.

C. THE DESIRABILITY OF LIMITS

The collection responsibility of the OTS, together with its power to put tremendous and highly publicized pressure on law firms and accountants through the use of asset freezes, strongly suggests that the agency will tend to use its massive powers to coerce settlements. Law firms can find themselves in an unfortunate position analogous to that of a criminal defendant who is told by a prosecutor, "You have two felony shoplifting convictions. Plead guilty to a misdemeanor on this alleged theft, with no jail time, or go to trial on a felony charge. If convicted at trial, you will go to prison for life." It takes a stout heart to insist on the opportunity to be heard in such a situation.

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98. The OTS is responsible for supervising and regulating all federally insured savings and loans, while the RTC is responsible for managing and cleaning up failed savings and loans. Thus, although the two agencies are independent, their responsibilities may overlap. When a savings and loan fails, the OTS appoints the RTC as conservator. The director of the OTS serves on the RTC's board. The OTS continues to have jurisdiction over failed savings and loans for which the RTC has been appointed conservator. Rozen, supra note 22, at 18.

99. See supra note 87.

100. See infra part III.B; see also Sherry R. Sontag, Law Puts FDIC's Claims in Peril, NAT'L L.J., Feb. 24, 1992, at 1 (explaining how FIRREA provision allows insurers to avoid paying government claims against directors and officers of failed banks and thrifts).

101. See Bordenkircher v. Hayes, 434 U.S. 357 (1978) (holding that the Due Process Clause of the Fourteenth Amendment is not violated when a prosecutor carries out a threat made during plea negotiations to have accused reindicted on more serious charges if the accused refuses to plead guilty to present charges).

102. Some suspect that the $275 million claimed as damages by the OTS in the Kaye, Scholer case was a ploy analogous to overcharging by a prosecutor in a criminal case. Overcharging allows the prosecutor maximum discretion in fashioning a plea bargain—the more charges filed, the more that can be used as threats to obtain guilty pleas. In the Kaye, Scholer case, the settlement of $41 million leads to the conclusion either that the original claim was not legitimate or that the OTS abused its discretion by settling for about 15 cents on the dollar. One obvious value of the original $275 million claim was that it made banks think twice before extending credit to Kaye, Scholer. See Rozen, supra note 22.
The point is not that innocent people are being forced to plead guilty to crimes they did not commit (although such instances do occur). In the context of criminal sentencing, guilt or innocence is rarely the issue. Rather, massive power combined with broad discretion engenders fear of prosecutorial overreaching. In the criminal law and in the OTS arena, defendants and respondents may not be able to claim complete innocence, but prosecuting them based on their election to go to trial in the criminal context and upon the search for deep pockets in the OTS cases can lead to punishment far in excess of what is appropriate.

1. **Limitations Currently in Place**

   It must be admitted that in the OTS situation, unlike the case of an individual facing imprisonment, capitulation might not be so bad. Law firms can agree to pay substantial (but not backbreaking) sums of money and at the same time deny all wrongdoing. Under a kind of agency-as-Robin Hood ideology, wrongly enriched individuals pay back something. Moreover, there are practical brakes on OTS' overreaching. First, OTS does not want to kill the goose that can lay golden eggs. To put a law firm out of business would only encourage determined resistance by other law firms. Compromises—with high dollar figures—are likely.

   Second, remember that all of the participants in the OTS/Kaye, Scholer drama were lawyers. Judges are lawyers. Large law firms are currently a fixture in the legal landscape, and partnership in one or another of these big firms is a common experience both for regulators like Harris Weinstein (formerly and once again a partner at Covington & Burling in Washington, D.C.) and for many judges who would be called upon to hear and decide whether a particular OTS action was justified. There is simply too much shared history and experience among the regulators, the judiciary, and the lawyers in the regulated community for regulators to contemplate a slash-and-burn campaign to put law firms out of business, or for such a campaign to succeed.

2. **Adding Limits**

   It is not wholly attractive to rely on a sense of being members of the same club or on the kindness of prosecutors for protection against agency overreaching. Many, especially lawyers, are calling for a campaign to rein in the OTS by limiting its discretion in various ways.

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103. Experienced criminal defense lawyers often explain a light sentence after a close trial with the adage, "Innocence is a factor to be considered in sentencing."
The general complaint, ever since Kaye, Scholer capitulated six days after the OTS issued the freeze order, is that OTS has misused its power.\textsuperscript{104} While rhetorically compelling, I believe that such arguments lack force, given long-standing tolerance of prosecutorial discretion when exercised within statutory limits.\textsuperscript{105} Courts may find some actions by agencies distasteful, but deference to agency decisions within the sphere of agency competence is a bulwark of the law.\textsuperscript{106} In addition, trying to curb agency actions by appeals to the agency itself on the basis of justice, equal treatment, the meaning of congressional intent, or similar bench marks is unlikely to succeed. Some regulators will sincerely believe that they are duty bound to push the outer envelope of the powers entrusted to them; others will be restrained by their own idiosyncratic notions of fairness.\textsuperscript{107}

Lawyers would do better to concentrate their efforts toward ensuring that basic notions of due process are imported into one key facet of the regulatory system.\textsuperscript{108} It seems to me that critics of the current scheme are right\textsuperscript{109} when they call for legislation requiring judicial approval prior to issuance of asset freeze orders. The combination of total discretion and absolute power in the hands of the prosecuting

\textsuperscript{104} For example, here is part of the statement released by the President of the Association of the Bar of the City of New York soon after Kaye, Scholer's capitulation:

The recent freeze order issued by the Office of Thrift Supervision against the law firm of Kaye, Scholer, Fierman, Hays & Handler illustrates the danger of giving virtually unchecked power to federal agencies. . . . In the case of Kaye, Scholer, OTS confronted the firm with the choice of settling promptly or going out of business. The effect of this order apparently has been to deprive Kaye, Scholer of its right to defend itself in court on the merits. The grant of such power to an agency is of questionable constitutionality. The imposition of such orders on lawyers threatens to deprive a client of the opportunity to secure lawyers who can meet their ethical duties to act loyally to the client, keep the confidences and secrets of the client, and represent the client zealously within the bounds of the law.


\textsuperscript{105} See Bordenkircher, 434 U.S. at 357; United States v. Valenzuela-Bernal, 458 U.S. 858 (1982) (holding that deportation by prosecutor of illegal-alien eyewitnesses to the defendant's crime before interview by defense counsel was irrelevant absent a plausible showing of materiality because prompt deportation of illegal aliens is an overriding duty of the executive branch).

\textsuperscript{106} See KENNETH CULP DAVIS, ADMINISTRATIVE LAW TREATISE 520 (Supp. 1982) (stating that courts avoid substituting their judgment for an agency's on all questions of law except when the court is more qualified to rule).

\textsuperscript{107} A regulatory arena with large areas of discretion in which to roam invites disparate enforcement practices, which in turn create massive uncertainties for (and perhaps skew the professional judgment of) those in the regulated community.


agency with respect to freeze orders presents a temptation for prosecutors to coerce unjust settlements, which offends basic notions of fairness. Combining the functions of judge and prosecutor has always been looked upon with some suspicion.\(^1\) Even in criminal cases, when there might be cause for swift action, we are used to having impartial actors, like judges or magistrates, passing on prosecutorial applications for asset freeze orders.\(^1\)

III. AS THE WORLD CHANGES

Judging by the number of conferences held, speeches made, and stories reported in the media in the wake of the Kaye, Scholer surrender,\(^1\) the combination of massive OTS power and the agency's concentration upon pursuing deep pockets is causing great concern in the legal community. What are the likely responses? There has already been a blizzard of advice to law firms on how to clean up their act, limit the scope of their representation, and pick responsible and law-abiding clients to represent.\(^1\)

Other actions merit discussion. Lawyers are starting to ask the question, "How can we stop providing such a tempting target?" The answers generally fall into two categories: The first is a possible change in the structure of law firms, and the other relates to insurance coverage.

A. CHANGES IN LAW FIRM STRUCTURE

To avoid being a deep pocket and thus an inviting target, law firms may make their pockets shallower. One way to decrease target size is to incorporate, thus arguably shielding the employee/shareholders' personal assets from seizure.\(^1\) Professional corporations and limited liability partnerships have been authorized by legislatures in many states.

\(^{110}\) Coffee, *supra* note 108.


\(^{112}\) See, e.g., Lester Brickman, *Has the Office of Thrift Supervision Changed the Relevant Ethics Rules by Its Actions in the Kaye, Scholer Matter, in The Attorney-Client Relationship After Kaye, Scholer, supra* note 14, at 79; Mary C. Daly, *Lawyering After Kaye, Scholer: Preventing the Problems Before They Arise, in id. at 183; OTS Chief Counsel Defends Action Against Kaye, Scholer, Laws. Man. on Prof. Conduct (ABA/BNA) 8, at 1 (May 6, 1992); Seminar, *supra* note 9.


\(^{114}\) This assumes, of course, that courts and agencies will be unable to pierce the corporate veil to reach personal assets. This is unlikely, given that there are many valid reasons for law firms to adopt a corporate structure.
These structures offer limited liability protection similar to that of regular corporations.\textsuperscript{115}

Another way to decrease the target size is to change the firm structure more drastically, splitting large firms into smaller units. Imagine a 400-lawyer firm with offices in several cities and with all of the departments—tax, probate, banking, litigation, etc.—that such large firms are likely to have. Why not use a "hospital"\textsuperscript{116} model, with each department becoming a small (say, twenty-person) law firm responsible for its own insurance coverage but with an understanding that the various firms would continue to look to each other for help with clients, splitting fees as necessary. Perhaps a separate corporation could be set up to hire young lawyers (formerly called "associates") who would be furnished on an as-needed basis to one or another of the minifirms. These junior lawyers would be understood to be candidates for partnership at any of the minifirms for which they had worked and with which they had a good professional relationship.

There would be at least two advantages to such a move. Each firm would be a smaller target for regulators; firm assets would be smaller and could be made even less vulnerable if the firm was incorporated rather than structured as a partnership. In addition, each partner would be much more likely to know what all of his or her partners were doing and whether the firm could be in trouble because of failure to follow agency rules and regulations. Imagine the poor\textsuperscript{117} partner at Kaye, Scholer, concentrating on her international trade work in some far-flung outpost, suddenly finding that her salary and partnership share were "frozen" because one of her New York partners (perhaps a partner she had never met) had run afoul of the OTS.

There are admittedly many possible drawbacks to such a move by large firms. Let me sketch a few of the concerns. First, incorporation may not fully shield personal assets of lawyers. Second, the "hospital" arrangement requires agreements to refer cases, which might run afoul of the antitrust laws. Third, remodeling firms might dramatically affect the deployment of associates, who probably could not be exploited as efficiently as they are under the current system. Further, the idea of all

\textsuperscript{115} The possibility of large-scale shifts from partnerships to corporate structures is being discussed in the wake of the Kaye, Scholer case. See William Schull, \textit{Malpractice Threat Forces Reevaluation of Partnerships}, 1992 ABA SEC. LITIG. NEWS 1.

\textsuperscript{116} The hospital model consists of separate medical corporations or partnerships for anesthesiologists, surgeons, pediatricians, etc., all operating out of the same hospital, all cooperating with each other, but each responsible for its own governance and its own insurance coverage.

\textsuperscript{117} I use "poor" in the sense of unknowledgeable, not in the financial sense.
lawyers as employees of a legal corporation may give some pause, for the profession is full of claims that it is just that, a profession, not a business.\footnote{118. At one conference, I was told by a senior partner in a large national law firm that he had long advocated the move toward a corporate structure, but that his partners objected because they "didn't want to be employees."} Fourth, the various groups in the separate firms might not cooperate with each other as efficiently as they do now (even though they might inhabit the same building as they currently do). Fifth, the capital necessary to run a large law operation might not be raised as easily. Finally, perhaps the necessity for each group to obtain insurance coverage would make a combination of two or three groups that had worked together on a big case almost as inviting a target as the parent firm is now. Nevertheless, this idea and others like it have occurred to lawyers in the wake of Kaye, Scholer and will continue to be discussed,\footnote{119. See, e.g., Schull, supra note 115.} and perhaps acted upon.

B. Changes in Insurance Coverage

While law firms may just be beginning to explore how to regroup, insurers already are. Many insurers of small firms now exclude coverage for claims brought against their clients by regulatory agencies.\footnote{120. Donald J. Brayer, Attorney's Representation of Financial Institutions: An Insurance Perspective, in BUSINESS LAW SECTION, STATE BAR OF CALIFORNIA, ETHICAL OBLIGATIONS OF ATTORNEYS REPRESENTING FINANCIAL INSTITUTIONS IN THE 90's 4 (1992).} Some insurers decline coverage for malpractice arising from the representation of a client if one of the insured attorneys sits on the board of that client.\footnote{121. Id. at 3, 14.} Large insurance firms like Lloyd's and ALAS (the captive insurance company of a number of large law firms in the United States) do not use regulatory exclusions but pick their clientele carefully,\footnote{122. Id. at 4.} probably not offering insurance to small law firms or to firms representing financial institutions with less than gilt-edged profiles.\footnote{123. Id.}

All of these insurer-driven strategies operate to decrease the number and depth of the pockets available to the OTS. The general leeriness of insurers may also impede access to "straight" malpractice insurance—that is, insurance containing the regulatory exclusion. As a result, a situation can easily develop in which only those firms that could get coverage without the regulatory exclusion could afford to represent banking institutions, and the only institutions they would represent would be those in excellent financial condition. Small firms as well as large firms unable to
get insurance free of the regulatory exclusion may effectively be barred from the banking and thrift markets. Banking and thrift institutions not classified as "solid" may find it difficult to obtain representation, and it can be argued that institutions at risk need competent representation most of all. It would be ironic if the agency practice of pursuing deep pockets results both in drying up the deep pockets and in preventing institutions from getting competent advice from lawyers and accountants.

IV. CONCLUSION

In several crucial areas, new laws and new procedural regulations have replaced the bar's ethical codes and rules. In particular, lawyers who represent banks and thrift institutions are mandated by statute to exert more control over their clients, and to monitor their clients' behavior more closely, than is required by the bar's ethical rules. All lawyers who litigate have been affected by rule 11 of the Federal Rules of Civil Procedure and its various state analogs, which require more investigation into both facts and law before filing documents than was required by the bar's ethical codes. Other statutes that apply to all lawyers, not just banking lawyers, impose ethical requirements on lawyers in addition to, or in conflict with, the bar's ethical codes.

Perhaps the bar has been perceived by Congress and the public as a lax enforcer. Perhaps the perception is that the ethical rules promulgated by the bar emphasize confidentiality and adversarial zeal at the expense of protection of third parties. Perhaps Congress, spurred on by executive agencies, thought that some areas, like banking, were so vulnerable to fraud upon the public that traditional concepts of professional responsibility simply did not provide enough protection to innocent third parties. Whatever the causes, it is clear that regulation of lawyers' practice and enforcement of lawyers' ethical rules is slipping away from the bar and into the hands of agencies and courts. This trend appears to be irreversible.

These changes are causing shifts in behavior by all of the players in the legal arena, and none more so than those in the banking and thrift field. The challenge for lawyers and for regulators is to make sure that the power of courts and agencies is used wisely, not employed in such a way that lawyers cannot provide independent and objective counseling. Lawyers cannot, in the end, become enforcement agents. Agencies that have multiple and conflicting mandates (like OTS' responsibility for recovery of losses and for regulating thrift institutions) must respect due
process requirements; otherwise, their enforcement efforts will simply become searches for the deepest pockets. And enforcement focusing on deep pockets will cause market changes that may be counterproductive for both lawyers and the agencies.

Finally, the bar must come to understand which way the wind is blowing. All too often, lawyers close their eyes to fraudulent behavior by clients and then provide the necessary legal assistance to enable the fraud to be consummated or to continue. Unless the bar writes appropriate rules to protect innocent third parties in these situations and then enforces those rules, regulation of the ethics of the legal profession will become the exclusive province of courts and agencies.