

“FROM THE TRENCHES AND TOWERS”:

The Kaye Scholer Affair: The Lawyer’s Duty of Candor and the Bar’s Temptations of Evasion and Apology

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The charges brought by the Office of Thrift Supervision against the law firm of Kaye, Scholer, Fierman, Hays, and Handler, in 1992 generated the most prominent legal ethics controversy of the decade. Despite massive attention to the case, the substance of the OTS charges has received little analysis and has been often mischaracterized. This article analyzes the charges and the bar’s response to them. It concludes that the charges were plausible prima facie. It argues, further, that the response by bar organizations and leaders has been pervasively disingenuous and irresponsible. It also identifies and analyzes some broad ethical issues raised by the case about the participation of lawyers in financial scandals. The article concludes with an appendix reporting and assessing Kaye Scholer’s response to the charges.

For three years, lawyers from the New York firm of Kaye, Scholer, Fierman, Hays, & Handler devoted themselves to keeping the government off the back of Charles Keating while he engaged in financial and political exploits that eventuated in criminal convictions for Keating and several of his associates, billions of dollars in civil liability for Keating and a larger group of associates, formal criticism by the United States Senate of five of [*244] its members, and a loss to the federal banking insurance system estimated at \$ 3.4 billion (Resolution Trust Corporation 1994, 5-6, 26-29; Thompson 1990, 37-43).

Of course, this fact alone is no discredit to the lawyers. The legality of Keating’s conduct was then - and in some aspects remains today - a matter of dispute. (Both Keating’s own criminal convictions have been reversed, though billions of dollars in civil judgments against him and various civil and criminal judgments against his associates still stand [Sterngold 1996; Zagorin 1997]). Moreover, as the bar often reminds us, “unpopular” people are entitled to representation too, even people who are unpopular because they

are crooks. n1

But this case took an unusual turn. Succeeding Keating to ownership of the defunct Lincoln Savings & Loan, the banking agencies found themselves with access to records of confidential communications between the Keating crowd and the Kaye Scholer lawyers and, from this intimate vantage point, concluded that some of the lawyers’ conduct went beyond the legitimate bounds of representation. The Office of Thrift Supervision (OTS) charged the lawyers with misconduct in a case the firm settled for \$ 41 million and injunctive relief.

Although widely publicized, these charges against the best-known lawyers for the most notorious figure in the largest financial scandal in American history have received little direct discussion within the profession. Not that the bar doesn’t have a lot to say about Kaye Scholer. Lawyers like to talk about the “freeze” of the firm’s assets that OTS, on questionable grounds, mandated. They like to talk about how the agency’s authority to regulate lawyers relates to that of the bar and the courts. They like to talk about what the case has done to insurance rates. But they don’t particularly care to talk about what OTS alleged Kaye Scholer did and whether such conduct is wrong.

Unpleasant as some may find the prospect, there are good reasons to consider the charges against Kaye Scholer in detail. First, the effort can help clarify the issues. OTS’s charges were widely portrayed as radical and, in particular, as challenging traditional notions of confidentiality. In fact, as I show in part I, though the charges were occasionally ambiguous and innovative, most rested in substantial part on the notion that a lawyer who cannot do anything for a client that would not further his frauds should withdraw. This proposition is in no way radical, but the Kaye Scholer debate has left great confusion as to whether the mainstream bar rejects it as a matter of principle, disputes its applicability to the particulars of the Kaye Scholer matter, or simply emotionally resists its enforcement against prominent lawyers.

[*245] Second, the bar’s performance in the Kaye Scholer affair should be counted as a large mark against it in the current debate over the appropriate allocation of regulatory responsibilities between public authorities and professional institutions (see generally Wilkins 1992). Kaye Scholer indicates limitations on the profession’s willingness and ability to set and enforce plausible standards of practice. Its instincts throughout the affair appear to have been self-protective rather than self-regulatory. Part II shows that a broad range of professional leaders and institutions failed to seriously confront the issues raised by the OTS complaint, instead producing a panoply of evasions.

Third, the case raised important issues about the participation of lawyers in the kinds of events that turn out to be major scandals. Professional responsibility discussions most often focus on discrete episodes of lawyer behavior in relatively clearly and narrowly defined practice contexts. Issues that arise from lawyer involvement in financial and political scandals typically involve longer courses of conduct in broader and more ambiguous contexts. In such situations, disputes can arise both about the proper characterization of relevant norms and conduct and about allocations of responsibility to individual lawyers for outcomes that result from complex interactions of many people. Kaye Scholer's partisans deserve credit for raising a variety of issues of this sort that are rarely discussed, but as I show in part III, their arguments have been often unpersuasive.

A major obstacle to appraising Kaye Scholer's conduct that may have inhibited discussion, especially by those inclined to be sympathetic to the charges, is that we have limited knowledge of the facts. Thus, one risks both doing an injustice to Kaye Scholer and looking foolish in the event one's inferences prove mistaken. Nevertheless, the issues are too important to pass over. The stakes in the immediate case are large; the charges are representative of those found in several S&L failures, and the alleged conduct is emblematic for many of a morally disturbing style of professional conduct.

Moreover, it's not unusual in our system for important points to be established on the basis of pleadings, and most of the arguments defending Kaye Scholer have challenged the facial validity of OTS's charges rather than disputed the facts. Thus, throughout most of the article I focus simply on the OTS allegations and their prima facie validity.

Kaye Scholer does, however, dispute many of OTS's factual allegations, and in an appendix, I report and briefly appraise the firm's claims. Kaye Scholer's response asserts important mitigating facts, identifies key ambiguities in the charges, and denies many of the particulars of the charges. It seems impossible to reach definite conclusions about the ultimate merits on this mooted record, but the firm's response, even if assumed to be factually accurate, leaves standing at least some of the concerns raised by the charges. [*246]

I. OTS'S DUTY-OF-CANDOR CHARGES AGAINST KAYE SCHOLER

A. Some Background

Lincoln Savings & Loan was a California-chartered bank wholly owned by American Continental Corporation (ACC), a holding company headquartered in Phoenix controlled by Charles Keating. The charges against

Kaye Scholer arose from its representation of Lincoln and ACC between 1986 and 1989 in connection with examinations by the Federal Home Loan Bank Board, the predecessor of OTS. This work was supervised by two Kaye Scholer partners - Peter Fishbein and Karen Katzman - who were members of the firm's litigation department and had no prior experience with banking law.

The Bank Board administered a pervasive regulatory scheme designed to protect depositors and the Federal Savings and Loan Insurance Corporation (FSLIC), which guaranteed nearly all savings-and-loan (S&L) deposits. The banking field has long been subject to intense regulation. The Bank Board, moreover, had the status, not only of regulator but, as FSLIC's affiliate, of guarantor of most of the banks' debts. The banking laws thus gave the agency almost unrestricted access to information about insured banks and imposed on the banks and their agents unusually strong duties of candor. n2

In 1986 when the Kaye, Scholer litigators went to work, the S&L industry was in the midst of a crisis of astonishing magnitude (see, e.g., Fischel 1995; Macey 1989; Scott 1990). Two important problems arose from the structure of the thrift industry created by the New Deal banking legislation. The first was a mismatch in the "term structure" of the thrifts' liabilities and assets. Thrifts were envisioned as community banking centers, drawing their deposits from local residents and lending to them primarily for home mortgages. A thrift's typical liabilities - savings deposits - were short term, but its typical assets - home mortgages - were long term. This meant that when rates went up, its depositors could insist on the current rates, but its borrowers continued to pay at the old rates. Thus, when the tight-money policies of the late 1970s generated large interest-rate shocks, the thrifts were thrown into turmoil. By some estimates the entire industry was insolvent by the early 1980s.

The second structural problem was the incentive structure created by federal deposit insurance. Since their money was insured, depositors were indifferent to the soundness of the banks. Shareholders had an interest in preserving their capital, but once the banks neared insolvency, this interest became limited and skewed. Since income went first to creditors, relatively [*247] high-risk/high-return projects would have the strongest appeal to shareholders, though such projects would not be in the interests of creditors or the insurance fund. In situations of insolvency the insurance fund was the real residual claimant (owner) and entitled to take control. But such situations might be difficult to identify (or acknowledge), and until then, the operators could gamble with what was effectively the public's money. If they hit the jackpot, they could pay off the depositors and make themselves rich; if they lost, the public would bear the cost. The main safeguards against such

strategies were the regulatory limits on deposit interest rates, restrictions of investments to relatively safe areas, and licensing requirements that inhibited competition. These constraints were swept away by the reform legislation of 1980 and 1982.

Congress saw an industry dying from an interest-rate squeeze and competition from new financial products, such as money market funds. It responded to these problems by deregulation, lifting restrictions in order to foster competitiveness. In doing so it aggravated the incentive problem. Operators could attract deposits by raising interest rates and put them in relatively high-risk/high-return types of investments, knowing that the government bore much of the risk.

Confronting the incentive problem would have required raising insurance premia or capital requirements for relatively risky institutions, and this would have pushed many into explicit insolvency. While the costs of doing so would have been far less than the costs of not doing so turned out to be, the former costs seemed too large for the Reagan administration and the Congress, which in the early 1980s were struggling to justify tax cuts. n3

One consequence of the reforms was that, as Daniel Fischel puts it, a “new breed of thrift owners who saw the value of financing their existing or planned business ventures with government-insured thrift deposits entered the industry” (1995, 196). The worst of this new breed displayed to breathtaking extremes speculative passion, contempt for law and government, dishonesty, and brazen arrogance. Some of them got away with murder until the drop in the real estate and junk bond markets at the end of the 1980s and then succumbed. In doing so they contributed a major fraction of the \$ 200 billion cost to the public of the S&L crisis.

B. The Allegations

The Kaye Scholer litigators were asked to represent Lincoln in its dealings with the Bank Board in June 1986, after examiners had raised what [*248] turned out to be largely valid concerns about the soundness of the bank and the propriety of some of its practices. They represented the bank until it was finally seized in 1989. Kaye Scholer immediately set an aggressive tone and asserted a degree of control that everyone agrees was unusual in the bank examination process. It wrote the Bank Board insisting that all requests for information be funneled through its lawyers. The firm billed Lincoln \$ 13 million for work done between 1985 and 1989 (OTS, PP 6-10, 16-19).

Here are the principal specific instances of misconduct toward the Bank Board alleged in OTS’s Notice of Charges.

1. The “Grandfathered” Loans. Kaye Scholer made misleading

representations regarding whether certain otherwise-prohibited Lincoln investments were allowed under a “grandfathering” exception. Whether the investments were grandfathered depended on whether Lincoln had made “definitive plans” for them by a cutoff date. Many documents Lincoln used to support its grandfathering claim had been prepared after the cutoff date in a manner designed to give the impression that they were contemporaneous records of a pre-cutoff decision. They were backdated and written in the present tense. Unauthorized signatures were appended to some documents, and some falsely recited that other documents had been presented to the Board prior to the cutoff date.

Beside its general participation in the examination, Kaye Scholer associated itself with Lincoln’s fraud in two specific ways. First, it gave Lincoln an opinion, which it knew Lincoln intended to use to shore up its position with the Bank Board, that various investments met the “definite plans” requirement of the grandfathering exception. The opinion recited as grounds for its conclusion that the “Board of Directors had directed” that the investments be made prior to the relevant date. In fact, the documentation of Board action provided to the examiners consisted of the written consents that were prepared after the grandfathering date but backdated to before it. Second, the lawyers transmitted the misleading documents to the Bank Board and asserted repeatedly that they supported Lincoln’s position, again without disclosing the circumstances of their preparation (OTS, PP 22-33, 140-51).

2. The Arthur Andersen Resignation. Kaye Scholer transmitted a Lincoln SEC “8-K” filing requested by the Bank Board that reported the resignation of its accounting firm, Arthur Andersen, and stated that the resignation “was not the result of any concern by AA [Arthur Andersen] with [ACC/Lincoln’s] operations ... or asset/liability management.” Although the Arthur Andersen firm approved this statement, members of the firm had expressed concerns about operations and asset/liability management, and Kaye Scholer was aware of at least one of these statements. A few days before transmitting the form to the Bank Board, Fishbein wrote to Keating, enclosing a memorandum of a conversation with a senior Andersen partner named [*249] Joseph Kresse, which he characterized as containing “some insight into what may have motivated Andersen’s decision [to resign].” The memo reports various reservations about Lincoln’s operations, for example, “Lincoln looks like most of the other S&L’s that have failed.... Andersen views Lincoln as a high risk client.” Kaye Scholer did not disclose this statement in connection with its transmission of the SEC form. (OTS, PP 37-42).

3. The “Linked” Transactions. Keating inflated the book value of Lincoln’s assets by a series of “linked” transactions. He would sell property

to an ally for a price higher than Lincoln had paid for it, recording the increase as a capital gain. In fact, Lincoln or ACC sometimes had loaned the ally the money to buy the property, promised to repurchase it, or simultaneously purchased an overvalued property from the ally. The records of the sale would be separated from the records of the loan, repurchase obligation, or concurrent purchase in the hope that the regulators would not notice the “link.”ⁿ⁴ These practices were a major focus of the criminal charges that resulted in Keating’s federal conviction, as well as various civil charges against Lincoln executives (Granelli 1992; SEC 1991).

Kaye Scholer was aware of this activity and repeatedly expressed concern internally that the regulators would discover it, once for example referring to “Linked transactions” as “a powder keg which could explode if FHLBB analyzes them carefully.”ⁿ⁵ The firm made general representations to the Bank Board about Lincoln’s financial circumstances that were misleading without disclosure of the links. For example, they argued that the earnings figures on Lincoln’s financial statements demonstrated “managerial skill” and “prudent underwriting,” knowing that these figures reflected the “linked transactions” (OTS, PP 58-71).

4. Underwriting Defects. Kaye Scholer’s study of Lincoln’s records revealed a pattern of loans made without formal loan applications, with little or no analysis of collateral, with unexplained negative-credit-verification material, and without appraisals or cash-flow histories. In an internal memo, a firm lawyer characterized one set of loan files as running “the spectrum from disaster to non-existent.” Yet in defending the firm’s underwriting to the Bank Board, the firm made statements such as the following: “In making real estate loans, Lincoln has always undertaken very careful and thorough procedures to analyze the collateral and the borrower. What is unusual about Lincoln’s underwriting is its particular emphasis on, and the thoroughness of, its underwriting of the collateral.”

Similarly, Kaye Scholer lawyers had privately concluded that Lincoln’s junk bond underwriting was “very weak, and there is little or no evidence in the files of proper underwriting.” Yet they made representations to the Board to the effect that there was “no basis for the ... conclusion that Lincoln’s high yield bond underwriting is inadequate.” The lawyers used as examples two junk bond investments that they had selected privately “to show Lincoln’s underwriting in its best possible light” but represented to the Board that “a similar process is undertaken for all of Lincoln’s investments” (OTS, PP 76-103).

5. The Doctored Loan Files. Kaye Scholer knew but failed to disclose that Lincoln had altered loan documentation files produced for the examiners. Information that reflected negatively on loans had been removed.

Information supporting the loans had been added subsequent to the decisions to make them. Much of this information had not been obtained from borrowers or verified in accordance with customary underwriting practices but had been pulled from the borrowers’ advertising and the public media. “Repayment analyses” coinciding with the payment obligations of the loan were invented without analysis and verification of the borrowers’ actual circumstances. Underwriting summaries prepared after the decisions were written in the present tense, as if they were contemporaneous with the loan decision, and placed, undated, in the files.

Kaye Scholer transmitted some of the misleading documents to the Board and made numerous representations defending Lincoln’s underwriting without disclosing these facts (though the Notice of Charges concedes that the principal written responses to the 1986 examination report did acknowledge briefly that some material had been added to some files subsequent to the loans) (OTS, PP 74-93).

6. Rancho Vistoso. Kaye Scholer made misleading representations about a large land development transaction that Lincoln had classified as a loan in [251] an effort to comply with limits on equity investments. In fact, Kaye Scholer knew facts suggesting that the classification was improper, and many people within Lincoln had expressed doubts about it.

Arthur Andersen and its successor, Arthur Young, had signed off on the classification, but Kaye Scholer knew that they did so in ignorance of the facts, first, that Lincoln controlled the project, and second, that the putative borrower was dependent on further uncollateralized loans and “sham land ‘purchases’” by Lincoln in order to make the payments. Without noting either these facts or the accountants’ lack of awareness of them, Kaye Scholer repeatedly asserted that the opinions of the accountants, whom they described as having “carefully reviewed” and “closely scrutinized” the transactions, established the validity of the classifications (OTS, PP107-35).

7. Hotel Pontchartrain. Kaye Scholer made misrepresentations about a \$ 20 million line of credit granted by a Lincoln subsidiary to a limited partnership formed by Keating and other ACC insiders to hold the Hotel Pontchartrain. The loan was an illegal “affiliated transaction.” It was made without collateral to an entity experiencing serious operating losses at a below-market interest rate. A Kaye Scholer internal memo reported these facts and noted that the “file lacks virtually all required materials” and the “loan has serious problems concerning (a) safety and soundness and (b) affiliate transactions.”

Kaye Scholer securities lawyers prepared SEC filings, which by law had to be filed with the Board as well, from which several specific facts reflecting on the quality and legality of the loan were misleadingly omitted. These facts

included the liberal terms of the loan, which the internal memo had suggested might make it a “gift of assets,” and the severe operating losses and negative net worth of the borrower.

When the California Department of Savings and Loan questioned Lincoln’s disclosure, Kaye Scholer wrote a letter insisting that it was adequate and specifically referring to a letter from Lincoln that asserted that the borrower was running an operating profit, when in a nearly contemporaneous in-house memo one of its lawyers noted that “although an ‘operating profit’ of \$ 60,037 was achieved, this failed to account for \$ 2,192,760 of expenses for interest, property taxes, depreciation, management fees and other expenses.... It seems disingenuous to fail to deduct [these expenses] when the relevant figures are so easily obtainable” (OTS, PP 153-69).

C. Standards

The OTS charges have been portrayed as based on novel, even radical, conceptions of professional responsibility. While some of the agency’s contentions did depend on innovative legal propositions, many did not. Most of [*252] the conduct OTS alleged seems wrongful in terms of familiar, mainstream notions of deceit that legal ethics rules, and in turn the Bank Board’s regulations, incorporated. n6

Claims under disclosure or misrepresentation norms typically require an element of knowledge and an element of conduct. Claims against lawyers most often fail for want of proof that the defendants understood that the statements or conduct in question were misleading (Langevoort 1993, 92-94). Nonclient claimants have little access to relevant evidence, most of which is shielded by confidentiality commitments. The Kaye Scholer case was extraordinary in this respect because, by virtue of Lincoln’s bankruptcy, the deposit insurance system had been transformed from a party adverse to [*253] Lincoln into Lincoln’s institutional successor. It thus had access to the confidential communications of its lawyers.

For the few who have read it, OTS’s Notice of Charges is likely to have had a dramatic impact because of its extensive quotations from memos that the Kaye Scholer lawyers never expected outsiders to see indicating detailed knowledge of - and suggesting a complacent attitude toward - Lincoln’s reckless and deceptive practices. To be sure, the evidence of the memos is not conclusive, and Kaye Scholer disputes many of OTS’s allegations about the extent of its knowledge. But the Notice of Charges states an unusually powerful prima facie case on the issue of knowledge.

Turning from knowledge issues to conduct issues, we find some ambiguity about the levels and kinds of lawyer conduct that incur liability

under disclosure and misrepresentation norms. We can distinguish three standards that might be applied.

At one pole, a minimal standard prohibits only explicit misrepresentation and direct assistance in explicit representation. An example of such direct assistance might be drafting a document incorporating client statements that the lawyer knows to be false. No one doubts that at least this minimal duty applied to the Kaye Scholer lawyers.

At the other pole, we have a maximal standard that would require the lawyers to themselves fulfill the client’s affirmative disclosure duties, or at least resign if the client refused either to authorize them to do so or to do so itself. In the banking context, this would entail exceptionally strong duties, because banking regulations require banks not only to respond to regulatory requests for information, but to volunteer material information even if it’s not asked for. n7 The Notice of Charges could be read to suggest that Lincoln’s lawyers had such a duty, and this suggestion provoked a good deal of controversy. There are two arguments for applying such a maximal standard to the Kaye Scholer lawyers.

First, OTS argued that Kaye Scholer acquired its client’s disclosure duties by virtue of having taken control of the examination process or having “interposed” itself between its client and the regulators (OTS, P 45). n8 This seems plausible in principle. Indeed, participation considerably short of [*254] complete control or “interposition” should be sufficient to impute the client’s duty to the lawyer. The critical factor is whether the lawyers were making the relevant compliance decisions themselves on behalf of the client or were executing decisions made by officers. If the lawyers accepted or exercised decision-making responsibility for the client with respect to a particular compliance matter, they should be held to the client’s duty on that matter regardless of whether they had control over other matters and regardless of whether the regulators had independent access to the client. n9 The major problems with such claims in Kaye Scholer are factual. The lawyers denied that they took control of the examination process, or precluded access to Lincoln, or had decision-making responsibility with respect to Lincoln’s noncompliance. n10

The second argument for the maximal standard is that as long as Lincoln was violating its duty of disclosure to the regulators, any assistance Kaye Scholer gave Lincoln in dealing with the regulators should be deemed assisting illegal activity, which lawyers are forbidden to do. This argument suggests that the lawyer assists illegal activity even when the activity is merely passive noncompliance with affirmative disclosure duties and even when the lawyer’s assistance is not directly related to the noncompliance - for example, if the lawyer is facilitating full and accurate disclosure over

matters different from the ones with respect to which the client is withholding information. In this view, if the lawyer finds the client engaging in any noncompliance - or at least any clear noncompliance affecting matters of substantial importance - the lawyer has to see that the client rectifies, or withdraw from any representation involving dealings with the agency. In the banking context, this means that the lawyer who comes across a piece of undisclosed material information has to press the client to disclose.

This seems extreme; it comes close to saying that insured banks must waive confidentiality vis-a-vis the regulators in order to obtain legal representation. However, the apparent extremity is partly a function of the unusually strong disclosure duties of insured banks, which are in turn a function of the government's unusually strong stake, as both regulator and insurer, in their soundness. If lawyers are rarely obliged to press their clients to volunteer information to adverse parties, that is partly because clients usually do not have duties to volunteer such information.

[*255] As a matter of policy, the maximal duty seems defensible in the banking context. However, neither before nor since the Kaye Scholer case has such a duty been proclaimed. n11 Where lawyers themselves make compliance decisions on behalf of the client, such a duty would find some support in general agency principles and in professional responsibility norms in analogous contexts, including civil discovery. n12 However, if we credit Kaye Scholer's insistence that its role was more executory, the maximal standard would seem anomalous in this case.

In any event, none of the duty-of-candor charges depends on this standard. All of them allege either active deception by the lawyers or lawyer assistance to active deception by Lincoln. Not a single charge suggests that Lincoln should have resigned because of client wrongdoing consisting solely of the passive nondisclosure of material information to the Board.

Now consider an intermediate standard that would prohibit the lawyer from both directly and indirectly misleading conduct and from providing any services substantially related to active unlawful client conduct. The intermediate standard differs from the minimal one in prohibiting indirect as well as direct deception and assistance to client wrongdoing. It differs from the maximal standard in limiting liability to situations where the wrongdoing involves more than passive nondisclosure and the assistance bears a substantial relation to the wrongdoing.

Obviously, this standard requires difficult judgments about what conduct is indirectly misleading and about how closely related the lawyer's services have to be to the client's illegality. But these judgments are of the sort that the law makes routinely in many areas. Indeed the intermediate standard represents substantially the requirements of the tort law of deceit, n13

which are applicable to our context both directly and by virtue of their incorporation in both the banking law and the professional responsibility codes. n14 It approximates as well disclosure duties supported by authority under the securities acts. n15 Although applications of this intermediate standard will often be controversial, there is nothing remotely radical about its invocation in the Kaye Scholer context.

The duty-of-candor allegations of the Notice of Charges state a weak case under the minimal standard and a strong case under the maximal standard. However, it is most plausible to read the allegations as invoking something like the intermediate standard. I think the allegations make out a moderately persuasive prima facie case under the intermediate standard. n16

Three sorts of activity can be distinguished: First, the allegations indicate that the lawyers made their own misrepresentations. Their statements about Lincoln's "definite plans" for the allegedly grandfathered investments (the "Grandfathered" Investments), Lincoln's "careful underwriting" (Underwriting Defects), the accountants' "careful review" and approval of the loan classification (Rancho Vistoso), a losing investment showing an "operating profit" (Hotel Pontchartrain), and the inflated accounting figures reflecting "managerial skill" (the "Linked Transactions") seem to have been statements the lawyers knew "to be materially misleading because of [their] failure to state additional or qualifying matter." Such statements are fraudulent misrepresentations within the meaning of ordinary tort law (American Law Institute 1977, 529). n17

[*257] That some statements might be true in light of some interpretation the lawyers did not assert at the time would not necessarily excuse them. Substantial (though not uncontested) authority suggests that if the lawyers knew - or under some authority, were simply indifferent to the possibility - that the regulators would understand the statements in a misleading way, the statements were misrepresentations. n18 Nor is the conclusion affected by the fact that some of Kaye Scholer's statements involved opinions as well as factual assertions. In these cases, it's the implied factual assertions, not the opinions, that constitute the misconduct. Thus, when the lawyers argue that fraudulently inflated accounting figures show "managerial skill," they imply that they have no strong reason unknown to the recipient to doubt that the figures are legitimate, and that's the misrepresentation. n19

As we will see, some of Kaye Scholer's defenders have treated these statements as argumentative rather than factual assertions. n20 Argumentative assertions are characterizations of circumscribed bodies of fact or evidence available to the people to whom the assertions are addressed - for example, a closing argument at trial. Because they do not imply, and

even disclaim, any independent knowledge of the underlying facts, such statements are not considered misrepresentation, even when erroneous or in bad faith. The Lincoln bank examination, however, was not a formal, trial-like proceeding with a clearly defined record. OTS alleged that the Kaye Scholer lawyers had acquired extensive independent knowledge about Lincoln, and the statements quoted in the Notice of Charges seem to imply the authority of such knowledge. If the Board reasonably understood them that way, they should be treated as factual rather than argumentative assertion. n21

Second, allegedly, the lawyers knowingly transmitted misleading material prepared by Lincoln concerning Arthur Andersen's resignation, the grandfathered loans, underwriting, and the Hotel Pontchartrain. This conduct seems like the kind of direct assistance to client illegality forbidden by ethical and tort norms. n22

Third, some of Kaye Scholer's alleged activities wrongfully assisted Lincoln's frauds indirectly. This is the most controversial claim, and the one most difficult to delimit. However, it rests on the solid intuition that activities, though innocent when viewed in isolation, are culpable when the actor knows they are integral to client wrongdoing. n23

Take, for example, Lincoln's conduct in doctoring files to obscure underwriting failures and the relation between the parts of the "linked" transactions. Assume that the transactions involved a large number of files and a large amount of money, but that Kaye Scholer scrupulously avoided participating in the transactions or their documentation and made no representations relevant to them. Would Kaye Scholer's pervasive involvement in other aspects of the examination be acceptable (if it involved no separate wrongdoing)? Though the answer is not certain, I'd say such involvement should not be acceptable, even under the intermediate standard. The examination, after all, is an integral process. The acceptability of lawyer participation ought to be assessed with reference to the whole process, and large-scale client wrongdoing ought to preclude even indirect lawyer participation.

On the whole then, the OTS allegations of breach of duty of candor toward the Bank Board seem prima facie valid under the most strongly supported substantive standard - the intermediate one. n24 [*259]

II. EVASION

Although Kaye Scholer did dispute the OTS allegations, the main emphasis of its campaign of self-exoneration, executed with the help of a public relations firm (Goldberg 1992, 51), was to characterize OTS's charges as a radical departure from established norms and as an assertion of

disclosure duties that would infringe confidentiality. These characterizations fit poorly with the specifics of the allegations, but many prominent lawyers proved happy to talk about the case with little or no reference to the specifics.

The resulting literature often either crudely misstates or delicately sidesteps the key allegations of the case. At the same time, it shows a concern with the "asset freeze" so obsessive and parochial as to call to mind a discussion of the sinking of the Titanic preoccupied with a claim for overtime pay by the navigator. Throughout much of it, we find barely a hint of concern that lawyers might have contributed to the worst financial disaster in American history.

A. Geoffrey Hazard

A few days after OTS filed its action, Kaye Scholer released to the press a 22-page statement describing an expert opinion of Geoffrey Hazard supporting its position in the case (PLI 1992, 381-402). Hazard is a professor (then at Yale), a drafter of the Model Rules, and author of numerous works on professional responsibility. He had established an extensive practice as a consultant and expert witness and was the academic authority on legal ethics best known among practitioners.

[*260] The statement released to the press was written by Kaye Scholer as a summary of an opinion Hazard had expressed in meetings. Hazard formulated the opinion on the basis of oral summaries by Kaye Scholer of OTS's charges and the firm's response at a time prior to the filing of the charges. He was subsequently quoted as describing the statement as "kind of preliminary" (Beck and Orey 1992, 75).

The half of the statement reciting the factual premises of the opinion describes specifically the facts that support the firm's claim that it was "litigation" rather than "regulatory" counsel but is otherwise largely vague and glosses over most of the particulars of OTS's allegations. The concluding half of the statement begins with a ringing endorsement of the theory that, as "litigation counsel," Kaye Scholer was subject to a lower standard of public responsibility than it would have been as "regulatory counsel." It then proceeds to a series of exonerating generalizations, such as "Kaye Scholer did not have a duty to disclose weaknesses in Lincoln's position," without making clear what particular allegations the generalizations refer to. It says that the "disclosures and representations that the OTS alleges should have been made to the Bank Board" would have violated Kaye Scholer's ethical duties to its client, but it doesn't say what "disclosures and representations" it assumes OTS alleges should have been made.

The opinion makes no specific reference to OTS's charges that Lincoln

made direct misrepresentations, misleadingly incomplete representations, and knowingly transmitted misrepresentations from its client. It contains the conclusion that “in the conduct described above, Kaye Scholer did not violate existing standards of ethical conduct,” but since so little of the disputed conduct is “described above,” the reader is left uncertain as to what Hazard is referring to.

Although a strong source of solace to Kaye Scholer, the Hazard opinion has puzzled and troubled many others. First, while the haste with which it was prepared and publicized may have fit Kaye Scholer’s strategic purposes, it was an unseemly way for one of the nation’s leading ethics authorities to opine on what even then was clearly a momentous case. Second, the “litigation counsel” argument was widely (and as we shall soon see, correctly) considered implausible. n25 Third and most important, the selective vagueness of the opinion and its omission of some of the strongest OTS allegations suggested either that it was formed without knowledge of the full extent of OTS’s charges or that it was crafted to convey an impression of general support while withholding doubts and qualifications.

As discussion continued in the aftermath of the settlement, people looked for clarification from Hazard, but none came. In a later law review [*261] article discussing some of the broader doctrinal issues of lawyer liability to nonclients, Hazard declined to discuss the OTS charges on the ground that “my prior involvement in the matter requires that I forego discussion of these specific issues as much as possible” (Hazard 1993b, 398). n26

Whatever one thinks of Hazard’s view of Kaye Scholer’s role as bank counsel, this remark reflects an untenable conception of his own role. Kaye Scholer presented Hazard as an expert, not an advocate, and as such, Hazard was obliged to express his views independently of Kaye Scholer’s interests. Unlike advocates, experts imply personal conviction when they express opinions, and they lend these opinions the authority of their reputation and that of the institutions with which they are associated. Withholding qualifications and reservations is thus a form of misrepresentation. Experts owe it to their reputations and that of their institutions to see that their views are not distorted for partisan purposes. Once it decided to go public with Hazard’s views, Kaye Scholer had no expectation of confidentiality. If Hazard had testified, he would have been subject to full-scale cross-examination. The firm had no legitimate expectation that an opinion offered in a press release be immune from challenge.

Thus, when the firm chose to invoke his authority directly before the mass media and to characterize his ambiguous statement as a full exoneration, Hazard had a duty to clarify ambiguities, correct mischaracterizations, and supply any reservations. It was not consistent with

his role as an expert to give Kaye Scholer control over the dissemination and characterization of his views.

B. Marvin Frankel

A few days later Marvin Frankel rushed in with a New York Times op-ed piece that the editors entitled “Lawyers Can’t Be Stool Pigeons” (Frankel 1992). Frankel is a New York lawyer and former federal judge. In the 1970s he wrote a famous law review article advocating that lawyers assume stronger duties to forgo deception (1975). He became identified as the most prominent critic of the more aggressive forms of adversary advocacy. One might have expected Frankel to welcome OTS’s initiative, which was perhaps the most highly publicized effort since his own to discourage lawyer deception. One would have been wrong.

Frankel asserted that “laced through the more than 80 pages of charges are repeated assertions that the firm knew of evidence that would contradict or weaken positions” of its client and claims that the information “[*262] should have been disclosed to” the Board. Although this is not a fair characterization of any of the OTS charges (which all involve active participation as well as nondisclosure), it was all Frankel said about the substance of the complaint. He proceeded to homilies about the importance of confidentiality and a quotation from Geoffrey Hazard to the effect that OTS was all wet.

C. The New York Bar Associations

The Association of the Bar of the City of New York is a voluntary bar association without official disciplinary powers but with a long history of activity on professional-responsibility issues. Within a few weeks of the initiation of OTS’s case against Kaye Scholer, the association’s Committee on Professional Responsibility weighed in with a statement vigorously condemning the asset “freeze” as an abuse of OTS’s powers (Adams 1992, ABCNY 1992). n27 It has never issued a statement concerning OTS’s charges against Kaye Scholer.

A few days later the New York State Bar Association followed suit with a resolution urging Congress to prohibit freeze orders without prior hearings (Spencer 1992). It, too, has made no response to the substance of the OTS charges.

D. Legal Journalism

Two themes dominated in reporting on the case. First, especially in the legal press, there was a preoccupation with remedial issues, especially the “asset freeze.” Second, the substantive charges, which were rarely discussed

in detail, were characterized as a radical departure and as principally demanding increased disclosure or “whistle-blowing.”

For example, in July 1992, the ABA Journal featured three articles on Kaye Scholer. The cover had a picture of a building shaking in an earthquake and the title “The Tremors Continue After Kaye Scholer.” One article was devoted to the freeze (De Benedictis 1992); another entitled “Changing the Rules” was devoted to a series of competing sound bites on the abstract issue of disclosure duties (Podgers 1992); the third was called “Welcome to the New Uncertainty” and included a few paragraphs on the allegations, following a suggestion that the merits were unfathomable and “[*263] the truth probably lies somewhere in between” the lawyers’ view that they are being scapegoated and the regulators’ view that they are wrongdoers (Goldberg 1992, 52). n28

E. The ABA and Its Working Group

In March 1992 the president of the American Bar Association appointed the “Working Group on Lawyers’ Representation of Regulated Clients.” The group included 27 prominent practitioners, nearly all from the corporate bar, and a law professor, Lawrence Baxter of Duke, who served as its reporter. After apparently extensive meetings and staff work, the group produced a report of over 200 pages in January 1993.

The report has been perceived widely as a vindication of Kaye Scholer’s representation of Lincoln. Daniel Fischel, for example, describes the Working Group as a “special task force to investigate the OTS charges” and says that it “concluded that the charges against Kaye, Scholer were baseless” (Fischel 1995, 323). This view has been encouraged by Lawrence Baxter, the reporter, who has made statements to the press, such as, “It certainly looks as if O.T.S. and the Justice Department took a cheap shot at a law firm to satisfy an angry public” (Margolick 1993). In fact, the Working Group made no investigation of the OTS charges, and while its report bristles with hostility to OTS, it has almost nothing to say directly about the propriety of Kaye Scholer’s conduct.

Predictably, the report focuses on the agency’s remedial powers, and especially the freeze order, and is disapproving of OTS’s efforts on many grounds. Then, two thirds of the way through, when we finally reach a lengthy discussion of “Professional Responsibilities of Counsel for Insured Depository Institutions,” it turns out to be Hamlet without the prince. It offers virtually no analysis of the facts OTS alleged about Kaye Scholer. Although the report characterizes itself as a response to OTS’s action against the firm and summarizes OTS’s allegations near the beginning, its discussion of the applicable legal ethics norms refers specifically to only two relatively

unimportant OTS charges - those alleging that Kaye Scholer should have informed Lincoln’s board about its officers misconduct and that the firm violated conflict-of-interest norms in representing both the bank and its holding company. n29

[*264] While the report is vehement in expressing disagreement with OTS on these minor matters, it artfully sidesteps discussion of the merits of all the charges involving deception. Instead of an analysis of the charges, the report offers discussion of a series of “hypothetical” scenarios. For the most part, the scenarios involve less aggressive conduct and more limited representations than the OTS allegations about Kaye Scholer. The discussion is frequently murky and inconclusive, especially at the points that seem most relevant to Kaye Scholer. The analysis of the hypothetical that most resembles an OTS charge - one alleging transmittal of a form containing a misstatement from accountants about the reasons for their resignation - offers by way of conclusion only, “This is a difficult issue which deserves fuller consideration” (ABA Working Group 1993, 157).

“It is the merit of the common law that it decides the case first and determines the principle afterward,” Holmes once said (1931, 726), describing a long-standing core premise of American jurisprudence. The Working Group’s report stands this premise on its head. It is preoccupied with the principle - the potential outer limits of OTS’s interpretation - and relatively uninterested in the substance of what OTS regards as the core case. The report expresses innumerable dissents and doubts about OTS’s position in hypothetical situations, but it neither condemns nor defends most of its allegations against Kaye Scholer. By ignoring OTS’s strongest claims, the report makes its position seem more ambiguous than it otherwise might, and it leave us in the dark about the Working Group’s position.

The Working Group concluded its efforts by recommending a resolution that was subsequently endorsed by several ABA sections and adopted unanimously by the House of Delegates, the ABA’s legislative body, in August 1993. The resolution has three sections. The first condemns the use of “freeze orders” except in extreme situations and with judicial authorization. The second calls for more clarity and prospectivity in defining obligations under the banking laws. The third takes issue with four interpretations of lawyers’ professional responsibility that it imputes to the OTS, including the notion that lawyers have a duty to volunteer information adverse to client interests or report the wrongdoing of corporate officers to their boards. n30

Of course, the resolution does not dispute that lawyers have a duty to refrain from misrepresentation and assistance to client fraud, but neither does it affirm this principle. Although only a few of OTS’s charges would be

precluded if the resolution's views were adopted, the resolution says nothing about the remaining ones. Neither here nor anywhere else has the ABA [*265] supported investigation of any charges against Kaye Scholer or the other lawyers accused of misconduct in the S&L disaster. Judging by the Working Group's report and the resolution, the ABA's exclusive concern about the disaster is that it may increase lawyer exposure to liability. n31 That some lawyers might be culpable in the matter is a possibility that the ABA either cannot conceive or is indifferent to.

F. The New York Supreme Court

General official disciplinary authority over New York lawyers resides in the first instance in the Appellate Division of the New York Supreme Court, the state's principal trial court. In August 1993, Hal Lieberman, chief counsel of the court's disciplinary committee, wrote to the Kaye Scholer lawyers stating that the committee had investigated Kaye Scholer's conduct and found no basis for professional discipline. Kaye Scholer showed the letter to the press, and Lieberman subsequently said in an interview that the OTS charges were "thin at best" and "didn't hold up" (Margolick 1993; BNA Banking Report 1993).

Lieberman's letter indicates that the investigation, while lasting over a year and involving extensive interviews and examination of documents, was oddly circumscribed. It considered only three charges against Kaye Scholer, and only two of the charges made by OTS - the "Grandfathered Loans" and the "Arthur Andersen Resignation." n32 The letter says that these charges were chosen because the conduct they alleged was more "provable" and "egregious" than that involved in the other charges. n33 This explanation is puzzling. If "provable" means "easily investigated," why should these two charges be deemed more so than the others? More important, how could anyone consider the conduct alleged in the two charges more "egregious" than the conduct alleged in the "linked transactions" charge, which implicated conduct for which the Keating people were charged criminally?

Aside from Lieberman's brief conclusory remarks, the committee made no explanation of the scope of its investigation, its understanding of the facts, or the legal premises of its conclusion. Although it is not usual for disciplinary authorities to explain the basis of their decisions not to bring charges, Kaye Scholer was not a usual case. It was a matter of intense interest to the bar and the public, and the committee's decision predictably had an influence on discussion of the case.

[*266] Although, as I argued above, the "intermediate" standard was best supported in authority and policy, some Kaye Scholer supporters invoked something like the "minimal" standard, and some people interpreted

the OTS charges to invoke something like the "maximal" standard. Without knowing which standard the committee assumed, its conclusion is of little value. If the committee assumed the "minimal" standard, it is not surprising that its investigation exonerated Kaye Scholer, but the conclusion would be of little interest to those who reject the "minimal" standard. By failing to explain the basis of its decision, the committee gave Kaye Scholer the benefit of its authority without giving the public an opportunity to assess the plausibility of the decision, and it sacrificed an opportunity to contribute to the clarification of disclosure standards.

G. The ABA Standing Committee

The ABA Standing Committee on Ethics and Professional Responsibility is an appointed body of prominent ABA members that issues occasional advisory opinions on the interpretation of the Model Rules of Professional Conduct. Many bar associations have similar committees, but the ABA's is the best known and most influential.

In August 1993, in the midst of the most intense public discussion of Kaye Scholer, the committee published an opinion entitled "The Lawyer's Obligation to Disclose Information Adverse to the Client in the Context of a Bank Examination." Doubtless many people expected it to offer some interpretation of the Kaye Scholer charges, but they were largely disappointed.

The opinion focuses on a hypothetical scenario apparently based on a different S&L case than Kaye Scholer. Early on, the opinion arouses interest with a pronouncement bearing on a central OTS contention in Kaye Scholer: When the lawyer is "the only individual to deal directly with the bank examiners," takes "full responsibility" for disclosure compliance, and "cuts off the regulator from access" to the client, "the lawyer may well have taken on the client's" disclosure obligation (ABA Standing Committee 1993, 3). This statement presumes a degree of control far greater than anything Kaye Scholer conceded and probably greater than anything OTS intended to allege in the Lincoln case. Instead of elaborating its principle with respect to more pertinent circumstances, however, the opinion proceeds to walk away from the control issue by stipulating that its scenario involves an "indirect and attenuated" representation in which the lawyer "is functioning only as an advisor to the client." Since Kaye Scholer's role in Lincoln was unquestionably far greater than that, the stipulation has the effect of distancing the opinion from the Lincoln case.

[*267] Later on, the opinion pricks our interest by hypothesizing that the lawyer learns that the client has fraudulently deceived the regulators, thus raising the issue, quite pertinent to OTS's Kaye Scholer charges, of when the

lawyer is obliged to resign in order to avoid assisting unlawful client activity. Again, however, the opinion disappoints us, this time by lapsing into timorous ambiguity: “If the client refuses to correct his lie ... the lawyer may be required to consider whether or not to terminate the representation,” it concludes without elaboration (ABA Standing Committee 1993, 8).

H. Law Reviews

In 1993, the Southern California Law Review offered a symposium ostensibly on Kaye Scholer with articles by six of the biggest academic names in legal ethics and banking law. The editors’ introduction defines three “fundamental issues”: “Was Kaye, Scholer’s conduct in its representation of Lincoln ethical? What is the proper role of a lawyer who represents a client in a regulated industry or before a government agency? Should any government agency have the power to issue asset-restriction orders?” (1993, 978).

In fact, the articles turn out to have almost nothing to say about the first two questions. When it comes to these questions, the authors tend to stake out a position above the fray, preferring to speculate abstractly on the broader issues of the allocation of authority over lawyers among courts, agencies, and the bar and the technical problems of implementing a regime to sanction lawyers. The only exception is a piece by Jonathan Macey and Geoffrey Miller, which does include an analysis of Kaye Scholer’s conduct, but only after insisting that the “critical issue was the freeze placed on Kaye, Scholer’s assets” (1993, 1116).

The symposium initiated what has become a large and exceptionally rich literature on the case. Most of it, however, has continued to forgo discussion of the specifics of the charges. Some articles have continued to focus on the “freeze” (for example, Crawford 1993; Liebold 1993). Others have theorized about the relative institutional capacities for lawyer regulation of courts, agencies, and professional associations (for example, Schneyer 1994). Still others have theorized at a fairly general level about the implications of the regulatory structure of banking for lawyer regulation in that arena (for example, Baxter 1993; Brown 1994). The articles that have addressed disclosure issues have tended to do so with only general reference to the charges, and some continue to portray them as radical, with little or no supporting analysis. n34 [*268]

III. APOLOGY

When the bar did reach the merits, it was usually to excuse Kaye Scholer with arguments whose plausibility was rarely proportionate to the eminence of their proponents. The proponents offered various apologies: The rules

weren’t clear; Kaye Scholer was acting as “litigation” rather than “regulatory” counsel; everybody else was doing the same thing; they didn’t do any harm; the “government” was the real culprit; confidentiality forced them to do what they did.

Aside from implausibility, these arguments have in common that they point to aspects of ambiguity in the assessment of individual conduct in large scandals. Scandals generally involve both innovative behavior and complex interaction. The primary wrongdoers typically think that their schemes make some improvement over the failed chicanery of the past, and the consequences of wrongdoing typically depend on the conduct, not just of the prime mover, but also of many knowing and inadvertent collaborators. In a strictly libertarian system, it would be impossible to hold anyone responsible under such circumstances. Libertarianism requires that norms be fully specified in advance and liability be imposed only where a definite link between individual action and harmful consequence is demonstrated, neither of which is possible in the type of case we are considering. However, our legal system is not libertarian. Its standard analytical practices are more than adequate to deal with the problems of innovation and collective action posed by scandals.

A. The Rules Weren’t Clear

A leitmotif of the Working Group report is bewilderment and distress at the perceived novelty and indeterminacy of OTS’s interpretation of counsel’s responsibilities. Where the analysis does not flat out disagree with OTS, it throws out rhetorical questions about the meaning of its interpretation in innumerable circumstances. It repeatedly demands that OTS specify just how the standards would apply in various circumstances and that it use various procedures, especially administrative rule making, to specify the [*269] standards (ABA Working Group 1993, 143-50, 153-54, 202-04, 212, 220-23).

The dominant theme of the discussion is not an effort to make the standards more workable, but rather to suggest that the novelty of OTS’s view makes its prior applications illegitimate and that the indeterminacy of its standards makes their coherent elaboration impossible. You would think that the group had never heard of the common law! Case-by-case reinterpretation and elaboration of general standards is, of course, the essence of the common law process. Retroactivity and indeterminacy are the age-old complaints of those whose innovative wrongdoing the common law has caught up with. They are the prices we pay for flexibility and adaptability. n35 OTS’s complaints were based on statutes and regulations, but these statutes and regulations incorporated familiar common law terms and were of

a sort routinely developed by courts and regulators in the manner of the common law.

Of course, notice is a legitimate concern, but in our system, notice has never meant certainty, and it has connoted advance knowledge of governing principles, not prior specification of how they will apply in every particular situation. This seems especially appropriate in the case of a group of professionals who often characterize themselves in terms of a superior capacity for complex contextual judgment. n36

At least with respect to the duty-of-candor claims, what was new in the Lincoln case was not the principles but the circumstances. Those who speak about the novelty of OTS's approach do not point to past bank failures of comparable magnitude involving similar conduct in which lawyers were treated more leniently. There was nothing radical about the notion that lawyers ought not to assist fraud. What was new, other perhaps than the degree of aggression of Kaye Scholer's advocacy, was the banking system's vulnerability to fraud. The disastrous changes of the 1980s had exacerbated the system's long-standing precariousness. A lawyer operating in the 1980s on automatic pilot might have been surprised to find that the risk that improper conduct might implicate her in a huge disaster was as high as it turned out to be. Some such experience may explain the otherwise mistaken sentiments of many insurers that the case created a new ball game. But a lawyer who, before the fiasco, gave some thought to how traditional responsibility and disclosure norms should apply in the changed circumstances of the day would not have been surprised. [*270]

B. They Were "Litigation Counsel"

While the assertion that OTS's claims were radical was grossly exaggerated, one prominent claim in the Kaye Scholer debate was extremely radical. This was the firm's and Geoffrey Hazard's argument that because the firm was "litigation" rather than "regulatory" counsel, it had a lower standard of responsibility to the Bank Board.

The argument had two parts. The first was that although a bank examination is not itself litigation, the Kaye Scholer lawyers should be considered "litigation" counsel because Keating designated the lawyers as such and hired them in plausible anticipation of litigation with the Bank Board. The second part of the argument was that since they were litigation counsel, the propriety of their statements and responses to the Bank Board should be judged under the standard of Model Rule 3.1, which applies to the lawyer as "advocate" rather than as "counselor" and asserts that in a "proceeding" the lawyer shall not "assert or controvert an issue therein, unless there is a good faith basis for doing so that is not frivolous."

Fortunately for the dignity of the bar, this argument has been widely dismissed (for example, ABA Standing Committee 1993, 10). Skepticism has focused, however, on the first part, whereas the most disturbing and implausible feature is the second.

With respect to the first part, if any important ethical consequences turn on designation as litigation counsel, that designation cannot reasonably turn on either the client's characterization or the likelihood of litigation. The client should not be given the power to determine unilaterally the lawyer's obligations to third parties. And since the likelihood of litigation is strongly correlated with whether the client has behaved wrongfully, the argument comes far too close to asserting that the more clearly the client has misbehaved, the lower the counsel's responsibilities to third parties.

In any event, characterization as litigation counsel would have been helpful to Kaye Scholer only if one accepted the further claim that its conduct would then be judged under the Rule 3.1 "not frivolous" standard. Under this standard, any Kaye Scholer action would be permissible as long as the firm could come up with a nonfrivolous argument that the response was truthful and complete. This approach would give Kaye Scholer latitude in exploiting ambiguities in the examiners' requests to withhold information they knew the examiners would regard as material and ambiguities in their own statements that they knew would mislead the examiners.

Suppose an examiner asked a Kaye Scholer lawyer for the "underwriting documents for loan X," and the lawyer handed over a file, knowing but not disclosing that the file had been recently altered to remove negative information present at the time the loan was authorized and to add favorable information obtained since authorization. Suppose further that the lawyer knew or should have known that this response would mislead the [*271] examiner because the examiner understood this request to call for all the contemporaneous underwriting documents and would interpret the lawyer's response in the light of this understanding. (Assume further that the examiner's understanding was reasonable and consistent with bank auditing practice.) Under the Kaye Scholer/Hazard position, the fact that Kaye Scholer knew the examiner would be misled is irrelevant as long as there was some nonfrivolous interpretation under which its response would not be misleading. Kaye Scholer would contend that it would not be "frivolous" to interpret "underwriting documents for loan X" to mean "whatever documents happened to be in the X file at the time of the request," and thus its response was not misleading (PLI 1992, PP 3-6).

Professional responsibility doctrine provides no support for this position whether or not we call the lawyers "litigation counsel." The argument's spurious force depends entirely on its disregard for the distinction between

factual assertion and argument. Rule 3.1 and its “not frivolous” standard applies to the latter; it governs positions that counsel takes, not assertions containing information. In a pleading, brief, or argument in court, the lawyer refers to evidence that has been or will be presented to the tribunal. Argument involves assertions as to how this evidence should be interpreted or characterized. Since the evidence is, or will be, of record, opposing counsel is equally able to argue for an interpretation, and the judge or jury can make its own assessment of the arguments by comparing them to the evidence. The dangers of deception are limited, and counsel can be given wide latitude.

Note also that argument is usually optional. Typically, neither lawyers nor clients are under a duty to third parties to raise legal issues or provide legal theories and characterizations.

The situation is different if the lawyer provides information, especially under a disclosure duty. This can occur both outside and inside litigation. For example, within litigation the discovery process creates a broad range of disclosure duties, and even though the information rights of the Bank Board were stronger than the discovery rights of the typical civil litigant, there are in fact some analogies between Kaye Scholer’s role in responding to the examiners’ requests and “litigation counsel’s” role in responding to civil discovery requests. In these situations, counsel’s task does not consist of suggesting characterizations for evidence of record but rather of providing information within their control in response to the other party’s requests. When counsel represent expressly or implicitly that they have provided all the information responsive to the request, they put their credibility in issue in ways that they do not in argument. Moreover, while the record provides a safeguard against distortions in argument, there is no analogous check on inadequate discovery compliance. The process depends heavily on honesty of counsel.

[*272] It should thus not be surprising that the courts have consistently rejected suggestions that the adequacy of litigation counsel’s responses to discovery requests should be measured by anything resembling the “not frivolous” argument standard. On the contrary, they consistently condemn “incomplete,” “evasive,” and “misleading” responses. n37

The ethics rule most relevant to Kaye Scholer’s conduct is not Model Rule 3.1 on positions, but Rule 8.4(c), which forbids “conduct involving ... fraud ... or misrepresentation.” These terms are not defined in the rules, but they have a familiar common law meaning different from the “not frivolous” standard. For example, the Restatement of Torts puts it this way:

A representation that the maker knows to be capable of two interpretations,

one of which he knows to be false and the other true is fraudulent if it is made:

- (a) with the intention that it be understood in the sense that it is false, or
- (b) without any belief or expectation as to how it will be understood, or
- (c) with reckless indifference as to how it will be understood. (1977 527)

n38

Responding to the distinction between argument and factual assertion, Kaye Scholer suggests that much of its work for Lincoln more resembled trial argument than discovery compliance. n39 Several of the OTS charges were based on statements in memoranda Kaye Scholer produced to respond to the examiners’ reports of their examinations. At this point, the examiners already had had extensive access to Lincoln’s records and personnel. The point of the memoranda was not to provide new information but to assess the inferences to be drawn from evidence the examiners had seen, they say.

I find this unpersuasive. The bank examination did not involve a circumscribed record, and the Kaye Scholer statements OTS objected to did not purport to be characterizations of evidence of record. They appeared to be statements of fact. The formal, adversarial norms of the trial had not been prevalent previously in the examination process, and lawyers had no [*273] traditional distinctive role in this process. It thus seems likely that the examiners reasonably believed that lawyers were as bound as anyone else by the norms prohibiting knowingly misleading, even if “not frivolous,” statements. n40

C. Everybody Was Doing It

Some have suggested that Kaye Scholer’s conduct did not differ materially from that of many other lawyers in banking and analogous regulatory contexts. It is far from clear that this is factually correct. The Kaye Scholer lawyers were litigators without prior banking experience, and even the Working Group report concedes that it was unusual for counsel to take control of a bank audit to the extent that Kaye Scholer did (1993, 155). Nevertheless, Howell Jackson suggests that it can be inferred from the large number of lawyers charged with misconduct that “a substantial segment of the legal community - much more than a few bad apples - operated throughout the 1980s under a different conception of professional obligations from the one the government now advances” (1993, 1024).

If this is true, it is not insignificant but should not weigh heavily. One consideration is whether the lawyers engaging in this conduct did so under the impression that it was proper. Contrary to Jackson’s assumption, it does not follow from the fact that many people engage in an activity that they think they are justified in doing so. For example, among restaurant workers,

the practice of underreporting tip income to the IRS is so widespread that you often hear it said that “everybody does it.” But when someone gets caught, he doesn’t expect to be excused on these grounds because while everybody may have been doing it, everybody also knew it was wrong.

Even if we grant that the practices were both widespread and legitimate within the profession, the claim of the Working Group and others that only prospective reform would be appropriate is not well supported by the dominant judicial practices in the area of civil liability. In situations where, as Learned Hand put it, “a whole calling [has] unduly lagged” behind the norms of the surrounding society, we do impose liability retroactively. Some [*274] actions, Hand continued, “are so imperative that even their universal disregard will not excuse their omission.” n41

Finally, the appeal to long-standing practice is least plausible where the institutional setting of the practice has changed. This happened with a vengeance in the S&L field in the 1980s. The stakes were much higher, and the government’s interests as insurer were much more vulnerable than they had been before. Those who appeal to custom in such circumstances ought to have some responsibility to assess whether the customary practices serve their traditional purposes in their altered settings.

D. They Didn’t Do Any Harm

Kaye Scholer has seemed understandably ambivalent about defending its conduct on the ground that it caused no harm. The harm alleged by OTS is the delaying of the seizure of Lincoln, and it’s indisputable that Kaye Scholer was trying to do that. If the lawyers didn’t have any effect, what were they charging all that money for?

However, others have felt less constrained to push this line of argument. Notably, Jonathan Macey and Geoffrey Miller argue that even if Kaye Scholer misbehaved, its conduct did not aggravate the public’s losses. Their point is that despite the lawyers’ obfuscations, the Bank Board indicated that it had determined that Lincoln was insolvent by April 1987; yet the institution was not seized until nearly two years later. “These facts make it clear that bureaucratic timidity and ineptitude, rather than Kaye, Scholer’s machinations, are primarily to blame for the unconscionable delays in closing Lincoln” (Macey and Miller 1993, 1119; see also Moore 1992; Douglas and Train 1992).

To their great credit, Macey and Miller are among the few lawyers willing to discuss directly whether conduct the OTS charged was wrongful, and their discussion concludes that on some points it was. Moreover, their primary concern is with the efficacy of the “freeze” order in protecting the financial interests of the insurance system. Nevertheless, particularly given

the moralistic, conclusory denunciations of public officials that pervade it, their discussion implies some exoneration of Kaye Scholer, and as such, there are two objections to it.

First, Kaye Scholer may indeed have delayed the seizure. Perhaps without Kaye Scholer’s efforts, the agency would have made its determination before April 1987, and the earlier determination would have led to an earlier seizure. Kaye Scholer had been working to forestall seizure for nearly a year before April 1987. The Bank Board’s field-office regulators who first pushed for action against Lincoln asserted that Kaye Scholer’s efforts “played a major role in preventing the government from seizing Lincoln until ... some 23 months after San Francisco first sounded the alarm” (Beck 1990, 40).

The fact that the agency “knew” of Lincoln’s insolvency in April 1987 does not mean that Kaye Scholer’s efforts had no effect in delaying action. Government officials, especially “timid,” “inept” ones (Macey’s and Miller’s characterizations) often lack the confidence to act on their beliefs. The fact that highly paid, highly credentialed lawyers from a prestigious law firm were vigorously disputing their determination might have led them to hesitate or wait for more substantiation before proceeding.

Another quality associated with timid, inept bureaucrats is complacency. The regulators might have concluded that Lincoln was insolvent but still felt inclined to let things slide in the belief that as long as the facts were not totally clear and the institution was insisting on its soundness, they had excuses for not intervening. (Or, if as Macey and Miller suggest, key regulators anticipated short tenures with the agency, perhaps they were hoping things could be contained until they had escaped to the private sector.) From this perspective, Kaye Scholer’s efforts could have been important. Even if additional indications were unnecessary to convince the regulators of Lincoln’s disastrous state, they may have been necessary to convince them to intervene. On this theory, which resonates with Macey’s and Miller’s contemptuous view of government officials, the officials would intervene only when the evidence available to them was so great that they could no longer disclaim responsibility.

Finally, the Bank Board was notoriously underfunded and understaffed relative to the magnitude of its duties. Keating’s purpose in deploying a battery of aggressive litigators was surely in part to signal that seizure would involve a costly battle, which in itself would be likely to give the regulators pause. n42

Second, the inefficacy of Kaye Scholer’s conduct has only limited bearing on both its blameworthiness and its liability. If you shoot at someone and miss, most people would regard you as just as culpable as if you had hit

him, and while your punishment may be less, it will still be severe. As the [*276] law of attempts in the criminal sphere expresses the idea that inefficacy is at best a limited excuse for antisocial conduct, civil penalties and punitive damages in the civil sphere connote that the blameworthiness and liability attached to certain kinds of conduct can be far greater than the loss the conduct caused. (And from the point of view of deterrence, optimal sanctions must usually be higher than the harm caused by the specific conduct sanctioned, especially with respect to offenses that are difficult to detect.) n43

It is notable that the willingness to excuse Kaye Scholer's conduct on the ground that it may have been harmless has not been matched by willingness to excuse OTS's "freeze" on this ground. It does not appear that the "freeze" was necessary to protect OTS's ability to enforce an award. Thus, it may well have been an abuse. That doesn't necessarily mean it did any harm, however. If the "freeze" was as inappropriate as the firm and its countless supporters have asserted, then one would have expected that the firm could have persuaded the courts to vacate it quite readily. Yet, the firm made no effort to do so. Perhaps this was because, even without the "freeze," the firm's credit would have been fatally disrupted simply by the pendency of the \$ 275 million claim (Beck and Orey 1992, 78-79). n44

Moreover, if OTS would have prevailed even if Kaye Scholer had been able to present its defense, the "freeze" did no harm to the firm. Kaye Scholer's public relations strategy has been to divert attention from the substance of the charges and to characterize them as a radical challenge to confidentiality norms. The "freeze" was a boon to this strategy. Thus, if "harmless error" is an available defense, it seems at least as helpful to OTS as to Kaye Scholer.

E. The "Government" Was Responsible

Macey and Miller and Daniel Fischel argue that Kaye Scholer (and in Fischel's case, most of the defendants in the other S&L suits) were "scape [*277] goats" for a government trying to divert attention from its own responsibility for the fiasco.

In their accounts, the government's irresponsibility dwarfs anything Kaye Scholer or even (in Fischel's account) Charles Keating might have done wrong. "In the early days of the crisis," Macey and Miller write, "many believed that fraud, incompetence and corruption within the banking system were to blame. But by 1991, it was clear to all that the regulatory system itself was at fault" (1993, 1137).

It was the government that decided in the early 1980s to run the huge risks of maintaining an obsolete and precarious industry dependent on federal

insurance. Trying to placate various interest groups and avoid recognizing short-term losses to the insurance fund, the government encouraged the banks to understate their financial weakness and make riskier investments. It tolerated and even promoted increased competition in the industry, ignoring that the new conditions created even greater pressures for the banks to take risks that were implicitly subsidized by the public. After these developments predictably attracted more aggressive and less principled financiers who used the deposits as personal slush funds and gambling stakes, the government continued to forbear for fear of aggravating its short-term fiscal problems or offending influential constituents.

Although the critique these authors make of public policies toward the industry is largely plausible, their arguments about responsibility seem unconvincing in several respects. Macey and Miller and especially Fischel decry the conclusory, moralistic denunciation of Kaye Scholer and others by the press and politicians as mindless demagoguery; yet their own discussions are full of conclusory moralistic denunciations of public officials. They provide no substantiation for their assertion that the "real reason" OTS prosecuted Kaye Scholer was that, in Macey's and Miller's words, "it needed a convenient scapegoat that it could confront in a dramatic gesture designed to help it regain prestige" (1993, 1138; for nearly identical language, see Fischel 1995, 232).

The logic of the charge is far from self-evident. In 1989 Congress came to share these critics' judgment of the Bank Board and responded by abolishing it. The OTS was a new agency with a strong interest, not in vindicating its predecessor, but in distancing itself from it. Neither of the men most responsible for the prosecution, OTS director Timothy Ryan and General Counsel Harris Weinstein (who are not identified in the Fischel and Macey-Miller accounts), were connected to the Bank Board. Both were scions of the establishment corporate bar who could have anticipated that they would take a good deal of grief for their effort, which of course they did.

Macey and Miller also repeat allegations that banking officials were corrupt without substantiation (1993, 1136). In one of many hyperbolic excesses, Fischel treats the S&L crisis as an epiphenomenon of what his title [*278] calls a "conspiracy to destroy Michael Milken," but the book provides not a word of evidence or analysis to substantiate anything that a lawyer should call a conspiracy.

The force of Fischel's moral indictment depends heavily on a literary trope that he shares with Macey and Miller. When he discusses the popularly designated private-sector villains of the S&L affair, Fischel identifies them by name, often gives personal information about them, often describes their

activities in detail, and analyzes the charges against them in a rather skeptical legalistic manner. In doing so, he creates a receptive setting for the rules-weren't-clear, everybody-was-doing-it, and harmless-error excuses, which he often invokes on their behalf.

On the other hand, when he discusses his own villain - the "government" - he usually paints it as a faceless monolith. He describes broad policies and nefarious motives, but the policies and motives are usually attributed to an abstraction rather than to particular people and conduct.

There are a few exceptions to this practice, and one is revealing - the treatment of the "Keating Five." These were five senators who were all beneficiaries of large political contributions from Keating and who, at critical points in the course of Lincoln's struggles, intervened with the Bank Board at Keating's request. After Lincoln's seizure, they were widely excoriated in the press and suffered rebuke (or in the case of Alan Cranston, the harsher sanction of "reprimand") by the Senate Ethics Committee. Fischel identifies them, tells their story at some length, and then brings out the rules-weren't-clear, everybody-was-doing-it, and harmless error excuses for their benefit. Responding to constituents' requests for fair treatment by the government is what legislators are supposed to do, Fischel concludes. In another over-the-top moment, he suggests that such intervention "comes closer to a model of how American democracy is supposed to work than proven wrongdoing" (Fischel, 245). n45

At this point, the reader who can resist the pull of Fischel's sympathetic narrative has to wonder, Aren't these guys part of the "government" that Fischel hitherto has painted as the villain? Where were they when Congress enacted the deregulatory initiatives that Fischel uses to explain much of the fiasco? Where were they while the inept and incompetent bureaucrats were allowing (nay, encouraging!) the likes of Charles Keating to run the industry into the ground with other people's money? Of course, the answer is that they were consistent, often zealous supporters of all the policies that Fischel deplors and of the appointments of some of the key regulators he disparages (Binstein and Bowden 1993, 224, 226-28, 260-61, 271, 275, 349-50; Kathleen Day 1993, 63-66, 117, 317-19). But apparently Fischel doesn't hold them responsible for this.

[*279] So the question arises, which individuals are responsible for the "government's" derelictions? The disturbing possibility suggests itself that the answer is - none. Even the career officials of whom Fischel speaks so disdainfully, once we identified them and looked at them carefully, would have their excuses. Surely their rules were as unclear as anyone else's. Surely they were no less conformist than the Kaye Scholer lawyers. And could we really say their ineptitude and peculation (if any) made a difference? Surely

no single official could have made a difference individually; and even collectively, they might well have felt powerless in the face of Congress's apparent support for forbearance (and the solicitude of individual legislators for various operators) on the one hand and the towering might of the operators and their professional assistants on the other.

Filled out in this manner, the full picture looks something like this: Kaye Scholer and the Keating crowd were not responsible because they were just responding to incentives created by congressional and regulatory policy. Legislators were not responsible because they didn't foresee the consequences of the policies they enacted, plausibly viewed their oversight role largely in terms of placating large contributors, and were not asked to intervene by any large contributors except those who happened to be crooked S&L operators. Regulatory officials were not responsible because Congress gave them no clear signals about the limits on forbearance and because the belligerence, financial might, and political influence of the operators made a more aggressive policy seem hopeless and dangerous to their careers. Tout comprendre, c'est tout pardonner.

If the "government" is the villain, then nobody is responsible. If this conclusion is unappealing, then consider the possibility that Fischel and Macey and Miller make two basic errors in their consideration of responsibility. First, the causal part of their analysis is too individualistic. Blameworthiness for them connotes not only that someone could have made a difference, but that she could have done so by herself. Since nobody could have had an impact alone, everybody gets off. But people might, in collaboration with others, have desirably affected events in infinite ways. At the very least, this suggests that people's causal efficacy should be judged not in isolation, but with reference to their possibilities of enlisting collaboration with others. n46

More important, it provides an additional reason why we should expect people to do the right thing without regard to their perceived causal efficacy. If the norms tell people they need only take personally costly, virtuous [*280] actions when they have reason to believe the actions will make a difference, virtue will be undersupplied because the ultimate impact of a virtuous act depends on the actions of other people about whom we have no knowledge. Moreover, even with perfect information, such norms will create collective action problems. Ex ante everyone will plausibly assume their own particular act is not necessary to the outcome, with the consequence that the outcome does not occur. n47

Second, the Macey-Miller-Fischel analysis of the norms applicable to the various role players is too static and formalistic. They treat the rules for each role (which they usually infer from customary practice) without regard to the

purposes of the relevant practices or the goals of the role and in isolation from the practices of the surrounding role players. In fact, the roles are interdependent, and the norms of each make sense only in relation to the norms and practices of the others. The lawyers' norms of zealous adversarial representation invoked by Kaye Scholer are premised on the adequate representation of other affected interests and the participation of honest, competent government officials. No one could insist more strongly than Macey, Miller, and Fischel have that these preconditions were not fulfilled in the S&L fiasco. But they ignore that this point means that Kaye Scholer's conduct was not consistent with the underlying purposes of the norms they attribute to it. On an ethically ambitious conception of the role, lawyers have a responsibility to apply norms in the light of their purposes, rather than to comply ritualistically with their texts. Kaye Scholer and many other lawyers resist such a conception. But the profligate exoneration to which their style of reasoning leads ought to be counted as a strong objection to it.

Ultimately, Macey and Miller and Fischel are caught in the libertarian paradox. On the one hand, they don't think private parties have the duty to assume public responsibilities. On the other, they don't think government officials have the capacity to do so. But some people have to assume public responsibilities for the system to work. If the government was behaving as badly as they believe, then the most plausible moral conclusion is that private parties had heightened responsibilities to compensate for their deficiencies.

F. Confidentiality

The most important thing to say about confidentiality in connection with the OTS charges was that none of them challenged the conventional professional understanding of lawyer duties in this regard. OTS was not asking that lawyers become "stool pigeons." OTS's main point was that if the only thing lawyers can do for a client is to assist its frauds, they should withdraw.

The Kaye Scholer defense team was inclined to mischaracterize the charges as challenges to confidentiality because confidentiality is a sacred cow in professional discourse. In fact, had the bar's mood been less defensive, Kaye Scholer might have been an occasion for rethinking confidentiality. Although the charges did not depend on any position on confidentiality, Kaye Scholer's representation of Keating did raise doubts about the leading rationale for the bar's most passionate commitment.

The rationale for confidentiality with respect to ongoing or anticipated wrongful behavior is that it induces people to seek legal advice. But a person who intends to abide by the law in any event does not need this inducement. The key question is thus why it is important to induce people who think

they might be inclined to violate the law to seek legal advice. Of course, such a person might learn something from the lawyer - say the size of the penalty - that would deter her from illegality. On the other hand, she might learn something that had the opposite effect. (Maybe the penalty will turn out to be lower than she expected.) So a key part of the bar's argument is that inducing people with a shaky commitment to law abidingness to seek legal advice is good because it gives their lawyers an opportunity to dissuade them from illegal conduct. The drafters of the Model Rules consider this practice so potent, they tell us, "Based upon experience, lawyers know that almost all clients follow the advice given, and the law is upheld (1983, Rule 1.6, comment, P 3)."

Presumably the drafters were given pause by the chorus of ridicule with which many greeted OTS's suggestion that Kaye Scholer had a duty to exhort Lincoln's officers and directors to mend their ways. No one suggests that Kaye Scholer tried to dissuade the Lincoln people; the defense has been [*282] that it would have been transparently pointless for them to do so. For example, Macey and Miller write,

If anything in the Lincoln case is clear, it is that these officers and directors were aware they were violating such regulations.... Indeed, if key directors and officers of Lincoln had not thought they were violating federal banking regulations, they never would have hired Kaye, Scholer in the first place. (1993, 1132)

Lincoln thus appears to be an example of a case in which a rule abrogating confidentiality would not have had any bad effects. Very likely Keating would have refrained from seeking legal assistance. If OTS is right in suggesting Kaye Scholer exacerbated Lincoln's frauds, then it would have been a good thing for society if Keating had never retained the firm; even if OTS is wrong, there might not have been any social costs to depriving Keating of representation.

Of course, this is only one example. It is, however, a very large example, and one suspects one could find others among the aggressive S&L failures. Moreover, since the bar has yet to give us any specific examples of circumstances in which the confidentiality rule for ongoing and future acts provided positive social benefits, I'd say these cases were sufficient to shift the burden of going forward.

IV. CONCLUSION

We do not know enough about the facts to pass confident judgment on Kaye Scholer's performance in the Lincoln case, but most of the OTS

charges seem facially well grounded. We are in a better position to assess the bar's response to Kaye Scholer's performance in the Lincoln case, and the only plausible judgment is condemnation. If only because of the magnitude of the stakes in the S&L crisis and Lincoln in particular, investigation and assessment of the OTS charges should have been a high priority. Even more important, the case was an occasion for clarifying substantive ambiguity about lawyers' duties of candor in banking and other contexts. Finally, the case strikingly raised issues about individual lawyer responsibility in situations of broad institutional breakdown. The bar failed to meet these challenges, and indeed spent considerable energy and ingenuity in evading them. Its performance has intensified the ambiguity about the relevant standards of professional responsibility and fueled doubts about its capacity for self-regulation.

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APPENDIX: KAYE SCHOLER'S RESPONSES TO THE OTS CHARGES

This appendix repeats the summaries of the OTS duty-of-candor charges from part I (omitting some footnotes), summarizes Kaye Scholer's responses to the charges, and then comments on the responses. Information about the responses comes from a press release Kaye Scholer circulated at the time of the Notice of Charges (Gillers and Simon 1992, 772-78), a letter to me from Peter Fishbein of Kaye Scholer (1996), and about 2,000 pages of materials Kaye Scholer provided me, consisting principally of excerpts from memoranda submitted to OTS in response to a draft Notice of Charges and supporting documents. Although I find Kaye Scholer's response to the charges unsatisfactory in some respects, I recognize that the record is fragmentary and sometimes obscure.

1. The "Grandfathered" Loans

Charge: Kaye Scholer made misleading representations regarding whether certain otherwise-prohibited Lincoln investments were allowed under a "grandfathering" exception. Whether the investments were grandfathered depended on whether Lincoln had made "definitive plans" for them by a cutoff date. Many documents Lincoln used to support its grandfathering claim had been prepared after the cutoff date in a manner designed to give the impression that they were contemporaneous records of a pre-cutoff decision. They were backdated and written in the present tense. Unauthorized signatures were appended to some documents, and some falsely recited that other documents had been presented to the Board prior to the cutoff date.

Beside its general participation in the examination, Kaye Scholer associated itself with Lincoln's fraud in two specific ways. First, it gave Lincoln an opinion, which it knew Lincoln intended to use to shore up its position with the Bank Board, that various investments met the "definite plans" requirement of the grandfathering exception. The opinion recited as grounds for its conclusion that the "Board of Directors had directed" that the investments be made prior to the relevant date. In fact, the documentation of board action provided to the examiners consisted of written consents that were prepared after the grandfathering date but backdated to before it. Second, it transmitted the misleading documents to the Bank Board and asserted repeatedly that they supported Lincoln's position, again without disclosing the circumstances of their preparation (OTS, PP 22-33, 140-53).

Response: First, Kaye Scholer argues that the records of Lincoln's board's authorizations were of "peripheral" importance in its argument that Lincoln had formed "definitive plans" to make the investments before the cutoff date. Director authorization was but one of a series of actions Kaye Scholer relied on to establish "definitive plans," and the other actions remain undisputed. For example, Lincoln had applied prior to the cutoff date to state regulatory authorities for approvals needed to make the investments (as contemplated by the disputed authorizations). Lincoln's board included full-time officers who were indisputably aware of the applications.

Second, the firm replies that the dating of the records of the board's actions was unimportant if the board did in fact make the decisions described there at meetings before the cutoff dates, as its lawyers were plausibly assured by Lincoln personnel.

Third, the lawyers plead ignorance of two aspects of the situation: (1) None of them had reason to believe that some of the signatures on the records were forged until late in the proceedings (at which point they ceased referring to the records), and (2) Fishbein was unaware that the records of board action purported to be written "consents" by directors to action without a meeting. His associate, Donna Goldstein, had misdescribed them to him as "minutes" of meetings, and since Lincoln officers had told him that the authorizations were made at meetings, he had no reason to question this description. (Arguably, the dating of consents is more important than that of minutes because action by written consent is not effective until the consents are executed, whereas decisions at [*284] meetings presumptively take effect when they are voted regardless of when they are memorialized.)

Comment: First, the fact that other steps, such as regulatory applications, had been taken would not make the authorizations immaterial. Director action was a legal prerequisite to the other actions Lincoln relied on as evidence of its "definite plans." If authorization was not effectively made, the

Bank Board might have argued that the “grandfathering” requirements were not met for that reason. Whether Lincoln could have argued successfully that even without timely, explicit director action, the directors effectively ratified the officers’ efforts prior to the cutoff is a question for which there is neither clear legal guidance nor sufficient evidence.

Second, if the lawyers were plausibly assured by Lincoln personnel that the meetings took place, they cannot be faulted for asserting this to the Bank Board. However, that would not excuse knowing transmittal of misleading documents or references to such documents as evidence of director action. There is no license to make use of fraudulent evidence even in support of a true contention. The Bank Board was entitled to make up its own mind on this question on the basis of a record free of deliberate distortion.

As long as any question remains as to whether the meetings took place, the date of preparation of minutes would be significant, since later-prepared minutes are weaker evidence than contemporaneous ones.

Third, if we excuse the associate on grounds of inexperience and accept Fishbein’s statement that he thought the documents were “minutes” instead of “consents,” two questions remain: (1) Should the lawyers have made clear to the examiners the circumstances of preparation of the documents even if they had been minutes? If Fishbein assumed the minutes had been misdated (as in fact the consents were), it seems reasonable that he should have insisted on disclosing that as a condition of continued misrepresentation. If he assumed the minutes were undated, the question is more difficult, but it is plausibly arguable that his obligation would be the same, at least if, as appears, the minutes were prepared after the dispute with the Bank Board arose and were left undated precisely to mislead the examiners about the date. Had the minutes been prepared undated prior to the dispute in accordance with a customary practice, the case for nondisclosure would be stronger. (2) Was Fishbein ethically negligent in relying on his associate’s characterization of the documents? If the circumstances indicated that the documents had been prepared by the client after the examination was underway for the purpose of influencing the examiners, the matter called for careful consideration.

2. The Arthur Andersen Resignation

Charge: Kaye Scholer transmitted a Lincoln SEC “8-K” filing requested by the Bank Board that reported the resignation of its accounting firm, Arthur Andersen, and that stated that the resignation “was not the result of any concern by AA [Arthur Andersen] with [ACC/Lincoln’s] operations ... or asset/liability management.” Although the Arthur Andersen firm approved this statement, members of the firm had expressed concerns about operations

and asset/liability management, and Kaye Scholer was aware of at least one of these statements. A few days before transmitting the form to the Bank Board, Fishbein wrote to Keating, enclosing a memorandum of a conversation with a senior Andersen partner named Joseph Kresse, which Fishbein characterized as containing “some insight into what may have motivated Andersen’s decision [to resign].” The memo reports various reservations about Lincoln’s operations, for example, “Lincoln looks like most of the other S&Ls that have failed.... Andersen views Lincoln as a high risk client.” Kaye Scholer did not disclose this statement in connection with its transmission of the SEC form (OTS, PP 37-42).

Response: First, the transmitted 8-K was not misleading because it referred to the reservations mentioned by Kresse, and in any event, the examiners were well aware of the problems.

[*285] Second, even if the 8-K statement was misleading, Fishbein should not be expected to have appreciated that it was since (1) It was explicitly approved by the senior Arthur Andersen partners responsible for the resignation decision; (2) it was prepared by an experienced securities lawyer after “due diligence” investigation; and (3) the allegedly conflicting statement was made two months before the resignation decision, by a partner other than the one in charge of the Lincoln audit, who was speaking of Lincoln’s problems in the spirit of a “devil’s advocate.”

Third, the SEC, which investigated various Lincoln-related matters, brought no charges against Kaye Scholer or Arthur Andersen.

Comment: First, the accountants’ statement gave as reasons for the resignation concerns about “litigiousness” and “regulators’ criticism over thrift institutions’ rate of growth and asset mix (although consistent with applicable statutes and regulations).” Concerns about litigation and regulatory policy are not the same things as concerns about soundness, which the 8-K denied. n50 If in fact the accountants had concerns about soundness that influenced the resignation, the statement was misleading. That the examiners already had their own concerns about soundness would hardly excuse deception on this point, since concerns of the accountants would have been material confirmation of the regulators’ concerns.

Second: (1) Andersen’s approval of the statement is not conclusive if Kaye Scholer had reason to doubt Andersen’s candor. In hindsight, it seems incredible that Andersen was not motivated by doubts about soundness. n51 What a reasonable person should have [*286] concluded at the time is harder to say, but the Kresse statement casts enough doubt on the 8-K statement by itself to require at least further inquiry. (2) We do not know whether the securities lawyer who prepared the 8-K was aware of the Kresse statement or what consideration he gave it. (3) Kresse was the “second

partner” on the Lincoln/ACC audits; he spoke at a time when Andersen was likely to have been considering whether to resign. The memo does suggest that Kresse was playing “devil’s advocate” in arguing that the Bank Board would intervene but still leaves the strong impression that Kresse regarded the soundness concerns as real and important.

By sending Kresse’s statement to Keating and characterizing it as giving “some insight into what may have motivated Andersen’s decision” three days before sending the 8-K to the Board, Fishbein indicated that he thought the statement material.

Third, the SEC’s failure to bring charges does not imply that it made a determination that the conduct was proper. We can’t be sure that it specifically considered the matter, or that if it did, its decision was based on the merits, rather than the exercise of prosecutorial discretion. Perhaps it was simply leaving matters to OTS.

3. The “Linked” Transactions

Charge: Keating inflated the book value of Lincoln’s assets by a series of “linked” transactions. He would sell property to an ally for a price higher than Lincoln had paid for it, recording the increase as a capital gain. In fact, Lincoln or ACC sometimes had loaned the ally the money to buy the property, promised to repurchase it, or simultaneously purchased an overvalued property from the ally. The records of the sale would be separated from the records of the loan, repurchase obligation, or concurrent purchase in the hope that the regulators would not notice the “link.” These practices were the major focus of the criminal charges that resulted in Keating’s federal conviction.

Kaye Scholer was aware of this activity and repeatedly expressed concern internally that the regulators would discover it, once for example referring to “Linked transactions” as “a powder keg which could explode if FHLBB analyzes them carefully.” The firm made general representations to the Bank Board about Lincoln’s financial circumstances that were misleading without disclosure of the links. For example, they argued that the earnings figures on Lincoln’s financial statements demonstrated “managerial skill” and “prudent underwriting,” knowing that these figures reflected the “linked transactions” (OTS, PP 58-71).

Response: Kaye Scholer responds that the firm did pursue its concerns about the “linked” transactions with Lincoln officials and was assured by Lincoln officials that accountants from the Arthur Young firm were aware of the facts and had concluded that they were properly reflected on Lincoln’s balance sheets. For example, Arthur Young “showed the Kaye Scholer lawyers papers containing over thirty pages of schedules detailing all of the

relationships among the transactions and the parties to them, as well as a contemporaneous memorandum analyzing these relationships, citing the pertinent accounting rules and concluding that Lincoln fully complied with generally accepted accounting principles” (Fishbein 1996).

Comment: Reliance on the accountants would be reasonable if Kaye Scholer ascertained that the accountants were aware of the facts that had prompted their own concerns about the “linked transactions” and if the lawyers had no reason to doubt the abilities and good faith of the accountants.

Kaye Scholer’s position seems consistent with the government’s case at Keating’s federal criminal trial, which focused on the “linked transactions.” According to Fischel’s account, the government sought to show that Keating deceived the accountants by withholding information about “links” based on oral agreements not reflected in the records. However, Fischel also notes that in other cases, the government charged Arthur Young [*287] with being a “willing participant in reporting the phony profits from the sham real estate transactions” (1995, 226-30). n52

Still, the Kaye Scholer memos quoted by OTS show that the lawyers found indications in the records of some “links” that they considered troubling. Even if they were plausibly reassured on the merits by the accountants, the inference remains from the lawyers’ memos that they knew that Lincoln had arranged its records unconventionally for the purpose of obscuring facts (the “links”) that the examiners would regard as material to critical disputed issues. n53 Even without misrepresentations, continued assistance to a client engaged in such deception would be questionable. The “linked transactions” issues were integral to the broader examination process in which Kaye Scholer was participating pervasively.

4. Underwriting Defects

Charge: Kaye Scholer’s study of Lincoln’s records revealed a pattern of loans made without formal loan applications, with little or no analysis of collateral, with unexplained negative-credit-verification material, and without appraisals or cash-flow histories. In an internal memo, a firm lawyer characterized one set of loan files as running “the spectrum from disaster to non-existent.” Yet in defending the firm’s underwriting to the Bank Board, the firm made statements such as the following: “In making real estate loans, Lincoln has always undertaken very careful and thorough procedures to analyze the collateral and the borrower. What is unusual about Lincoln’s underwriting is its particular emphasis on, and the thoroughness of, its underwriting of the collateral.”

Similarly, Kaye Scholer lawyers had privately concluded that Lincoln’s

junk bond underwriting was “very weak, and there is little or no evidence in the files of proper underwriting.” Yet they made representations to the Board to the effect that there was “no basis for the ... conclusion that Lincoln’s high yield bond underwriting is inadequate.” The lawyers used as examples two junk bond investments that they had selected privately “to show Lincoln’s underwriting in its best possible light” but represented to the Board that “a similar process is undertaken for all of Lincoln’s investments” (OTS, PP 76-103).

Response: First, Kaye Scholer suggests that the disparaging remarks about underwriting in its internal memos refer to Lincoln’s documentation practices, which it did think defective, while the laudatory claims about underwriting in its submission to the Board, refer to the substantive practices of credit analysis and investigation.

[*288] Second, as to substantive underwriting, the firm says Lincoln personnel assured it in detail that they did extensive and careful underwriting. It characterizes the portions of its internal memos noting substantive defects that OTS cited as atypical.

Third, the firm argues further that the Board could not have been misled by its statements, since the examiners had access to all the underwriting files and found many examples of what it considered substantive defects, including most or all of those referred to in Kaye Scholer’s internal memoranda.

Comment: First, Kaye Scholer’s claim that it reasonably believed Lincoln’s assurances that it generally had done substantial underwriting is not entirely convincing on the present record. The OTS charge cites several instances in which Kaye Scholer noted defects in the investigation and analysis of major loans. Kaye Scholer now disputes the importance of these defects and insists it did not doubt the overall sufficiency of substantive underwriting for most loans. With respect to Lincoln’s real estate underwriting, this claim is supported by a summary memorandum written to ACC’s general counsel at about the time of many of the allegedly misleading statements to the Board. The Kaye Scholer lawyers opine in the memo that “Lincoln’s position [on real estate underwriting] is good.” However, with respect to bond underwriting, the same memo concludes, “Lincoln’s underwriting has been very weak, and there is little or no evidence in the file of proper underwriting.” n54 This clearly implies both substantive and documentary deficiencies.

Second, Kaye Scholer seems on stronger grounds in arguing that given the Board’s knowledge of Lincoln’s dubious practices, the lawyers could not have expected their statements to mislead it. The key issue here is whether the lawyers expected the Board to understand their statements as

summarizing the lawyers’ own investigations independently of the examiners or as simply characterizing facts of which the examiners were fully aware. If the latter were the case, the statements should probably be deemed absurd but not fraudulent. For the OTS to have established a misrepresentation claim, it would have had to show that Kaye Scholer had a substantial amount of information contradicting its representations that was not known to the examiners, and the Notice of Charges does not indicate that it could have done so.

On the other hand, even taking Kaye Scholer’s view of the matter, its statements seem subject to condemnation as improper argument. The basic standard for argumentative, as opposed to factual, assertions is that they must have a nonfrivolous basis (ABA 1983, Rule 3.1). Even allowing room for rhetorical excess, it is questionable whether some of Kaye Scholer’s statements - “Lincoln has always undertaken very careful and thorough procedures”; “In virtually all cases, Lincoln has done a thorough underwriting”; “Lincoln has always analyzed the credit and the collateral of its borrowers with great care” - meet this standard. Frivolous argument, however, is a considerably less grave offense than misrepresentation.

5. The Doctored Loan Files

Charge: Kaye Scholer knew but failed to disclose that Lincoln had altered loan documentation files produced for the examiners. Information that reflected negatively on loans had been removed. Information supporting the loans had been added subsequent to the decisions to make them. Much of this information had not been obtained from borrowers or verified in accordance with customary underwriting practices, but had been pulled from the borrowers’ advertising and the public media. “Repayment analyses” coinciding with the payment obligations of the loan were invented without analysis and [*289] verification of the borrowers’ circumstances. Underwriting summaries prepared after the decisions were written in the present tense, as if they were contemporaneous with the loan decision, and placed, undated, in the files.

Kaye Scholer transmitted some of the misleading documents to the Board and made numerous representations defending Lincoln’s underwriting without disclosing these facts (though the Notice of Charges concedes that the principal written responses to the 1986 examination report did acknowledge briefly that some material had been added to some files subsequent to the loans) (OTS, PP 74-93).

Response: First, Kaye Scholer responded that as for “the removal of documents claim ... the OTS is attempting to generalize from a few snippets,” but the internal memos indicate awareness of only two loan files in which

documents were removed (Gillers and Simon 1992, 776).

Second, as for “the fact that underwriting summaries were prepared after the loans and investments were made, we learned that after the fact, but so did the regulators, because it was acknowledged to the regulators by Lincoln’s president and others before” the response to the 1986 examination report in which Kaye Scholer’s allegedly misleading representations were made (Gillers and Simon 1992, 776).

Comment: Kaye Scholer is persuasive that the representations quoted from its June and September 1987 submissions could not have misled the Board because (1) it acknowledged altering the files in the submissions and (2) the examiners were already aware of the alterations. Nevertheless, even if the lawyers knew of only two files from which negative information had been removed, they should have treated that as a serious matter. Arguably, as a condition of continued representation, they should have insisted on disclosure of the missing material and the circumstances of its omission.

Second, Kaye Scholer’s response that “we learned [of the file doctoring] after the fact, but so did the regulators” avoids confronting the implication of the Notice that Kaye Scholer learned before the regulators and made no effort to induce disclosure. Kaye Scholer points to an April 1987 deposition in which ACC’s president acknowledged the alterations to the Board. However, memos cited in the Notice of Charges indicate that Kaye Scholer knew of them by mid-1986.

Kaye Scholer says the Lincoln people told it they did not intend to deceive the examiners by the way they arranged the files, but it is questionable whether the lawyers could reasonably have believed such statements. n55 [*290]

6. Rancho Vistoso

Charge: Kaye Scholer made misleading representations about a large land development transaction that Lincoln had classified as a loan in an effort to comply with limits on equity investments. In fact, Kaye Scholer knew facts suggesting that the classification was improper, and many people within Lincoln had expressed doubts about it.

Arthur Andersen and its successor, Arthur Young, had signed off on the classification, but Kaye Scholer knew that they did so in ignorance of the facts, first, that Lincoln controlled the project, and second, that the putative borrower was dependent on further uncollateralized loans and “sham land ‘purchases’” by Lincoln in order to make the payments. Without noting either these facts or the accountants’ lack of awareness of them, Kaye Scholer repeatedly asserted that the opinions of the accountants, whom they described as having “carefully reviewed” and “closely scrutinized” the

transactions, established the validity of the classifications (OTS, PP 107-35).

Response: After investigating the matter in detail, Kaye Scholer was assured by Lincoln’s accountants - both Arthur Andersen and Arthur Young - that the classification of these transactions as loans was proper. “The accountants were intimately familiar with all aspects of the Rancho Vistoso matter, including subsequent transactions between Lincoln and the borrower” (Fishbein 1996, 10). Moreover, the accountants indicated that they regarded facts about control of the project as irrelevant to the classification issue.

Comment: The response seems strong. Kaye Scholer has pointed to several memos in which the accountants express support for the classification and a few in which they indicate that control is either completely or relatively unimportant. Kaye Scholer’s September 1987 internal memo to ACC summarizing its views assesses Lincoln’s position on the classification issue as “strong.” The claim that control was not relevant under the Board’s regulation, which incorporates accounting rather than legal principles concerning the debt/equity distinction, is facially plausible and supported by experts. n56

In theory, it would have been open to OTS to respond by showing that either (1) Kaye Scholer had strong reason to doubt the ability or good faith of the accountants, or (2) the lawyers misled the examiners with respect to facts it knew the examiners considered material, even if they plausibly believed the examiners’ premises were wrong. If Kaye Scholer should have expected the Board to interpret its statements about the accountants’ conclusions as implying that ACC did not control the project, their statements were misleading. However, OTS’s allegations do not suggest that it would have made a factual case in support of either theory.

7. The Hotel Pontchartrain

Charge: Kaye Scholer made misrepresentations about an \$ 20 million line of credit granted by a Lincoln subsidiary to a limited partnership formed by Keating and other ACC insiders to hold the Hotel Pontchartrain. The loan was an illegal “affiliated transaction.” It was made without collateral to an entity experiencing serious operating losses at a below-market interest rate. A Kaye Scholer internal memo reported these facts and noted that the “file lacks virtually all required materials” and the “loan has serious problems concerning (a) safety and soundness and (b) affiliate transactions.”

Kaye Scholer securities lawyers prepared SEC filings, which had to be filed with the Board as well, from which several specific facts reflecting on the quality and legality of the loan were misleadingly omitted. These facts included the liberal terms of the loan, which the internal memo had suggested might make it a “gift of assets,” and the severe operating losses and negative

net worth of the borrower.

[*291] When the California Department of Savings and Loan questioned Lincoln's disclosure, Kaye Scholer wrote a letter insisting that it was adequate and specifically referring to a letter from Lincoln that asserted that the borrower was running an operating profit, when in a nearly contemporaneous in-house memo one of its lawyers noted the following: "Although an 'operating profit' of \$ 60,037 was achieved, this failed to account for \$ 2,192,760 of expenses for interest, property taxes, depreciation, management fees and other expenses.... It seems disingenuous to fail to deduct [these expenses] when the relevant figures are so easily obtainable" (OTS, PP 153-69).

Response: First, the statements on which this charge focuses were not made to the Board but to the SEC and the California agency. Second, the adequacy of the SEC filings should be judged by securities law rather than banking law, and the SEC did not charge any wrongdoing in connection with the statements. Third, the Board had "access" to all the relevant records, and the SEC forms that identified it as an "affiliated party" transaction put the Board on notice that the transaction merited inquiry. The Board and the California agency should not have been misled by the assertion about the "operating profit," since that statement referred to an earlier letter in which the relevant figure was specifically identified as being profit before the deduction of interest and various expenses. Fourth, the SEC, which looked into the matter, brought no charges against Kaye Scholer.

Comment: The first point is unpersuasive if, as alleged, the SEC filings were submitted to the Board as well. The Notice of Charges calls the proceeding in which the statements were made to the California agency a "joint" proceeding with the Bank Board.

As to the second point, Kaye Scholer is correct in suggesting that the adequacy of disclosure in the SEC filings should be measured by securities law standards to the extent those standards differ from banking law ones. It is, however, unconvincing in suggesting that the omitted facts were not required under securities law standards. The OTS standards are arguably more demanding, but the securities standards still forbid misleadingly incomplete disclosure, and OTS's allegations make a good prima facie case that the Pontchartrain disclosures were misleadingly incomplete. n57 Moreover, since Kaye Scholer made its defense, the SEC has announced the filing and settlement of charges against ACC's General Counsel Robert Kielty for misleadingly incomplete disclosure in SEC filings about the Hotel Pontchartrain. Some of the instances cited in the Kielty order are identical to those cited by OTS, and others are closely analogous. n58

Third, if Lincoln and Kaye Scholer had a duty to disclose the omitted

facts, that duty would not be affected because OTS had other opportunities to get the information. Misrepresentation is not excused simply because it is not guaranteed to work, or fails. The implication that the examiners should have been more zealous seems disingenuous in view of Kaye Scholer's repeated claims during the examination that the examiners' demands for documents and information were excessive. Whether the representation regarding "operating profits" was misleading is difficult to assess without seeing the full correspondence.

Fourth, as with the Arthur Andersen matter, it's difficult to know whether the SEC's failure to charge represents a view on the merits or an exercise of prosecutorial discretion - for example, a decision to defer to OTS.

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FOOTNOTES:

n1. ABA 1969, EC 2-27 (“a lawyer should not decline representation because a client or cause is unpopular”).
n2. See 12 C.F.R. 563.17-1(c), 563.18(b)(1988).
n3. Indeed Congress and the Bank Board went so far as to encourage marginal banks to disguise their circumstances by accounting devices that, had they not been explicitly authorized, would have been fraudulent (Scott 1990, 6).
n4. In addition to helping Lincoln satisfy the capital and soundness requirements, the “linked” transactions inflated Lincoln’s profits and hence payments due to its parent, ACC, under a “tax sharing” arrangement that the courts found to be a form of looting. See Lincoln Sav. & Loan Ass’n v. Wall (1990, 908-10).
Judge Stanley Sporkin’s opinion in this case, rejecting Lincoln’s challenge to the Bank Board’s seizure, describes four of the “linked transactions” in detail. For example, in the “Wescon Transaction,” Lincoln purported to sell land for \$ 14 million that it had purchased for \$ 3 million, and hence recorded \$ 11 million in earnings on the sale. The \$ 14 million “purchase price” was paid in the form of \$ 3.5 million in cash and a note for the \$ 10.5 million balance. The nominal purchaser had neither the intention nor the ability to do anything with the property. The note it gave was nonrecourse, and no payments were ever made on it. The purchaser had borrowed the \$ 3.5 for the down payment from an investor who received a \$ 20 million loan from Lincoln on the same day the land sale closed (1990, 911-12).

n5. The full passage as quoted in the Notice of Charges (OTS, P 67) reads: “‘Linked transactions’ remain the greatest area of concern. These are the transactions such as the recent Crown-Zellerbach deal and the past Crowder ranch deal. We know that Charlie [Keating] will continue to do these transactions to support ACC’s real estate business, but these deals may

be a powder keg which could explode if the FHLBB analyzes them carefully. The number of such transactions appears to have increased dramatically since the completion of the last exam.”

Another excerpt, this from a memo from Kaye Scholer to ACC’s General Counsel, also suggests an attitude toward impropriety preoccupied with the possibility of discovery: “Although the file itself does not document how the \$ 10 million of the purchase price of the GOSLP stock was paid, it is possible that the linkage with the acquisition of the Garcia notes can be determined, and as discussed below, giving rise to questions of the soundness of each portion individually. A further concern is that the discovery of one linked transaction may cause the investigators to uncover other linked transactions” (OTS, P 68).

n6. OTS invoked two sets of banking norms. First, its regulations prescribe that “any person practicing before it” refrain from, inter alia, “unethical or improper professional conduct” or from aiding and abetting violations of the banking laws. 12 C.F.R.513.4(a)(3)(1986). OTS interpreted this regulation to incorporate the state professional responsibility codes. See ABA Working Group 1993, 144 (quoting OTS General Counsel Harris Weinstein). It remains ambiguous whether this means the requirements of a particular state (say, of the licensing state) or a “federal common law” consisting of norms that have been generally adopted or are considered relatively sound by the regulators. This issue, however, does not seem important in Kaye Scholer, since the relevant provisions are substantially the same in all the potentially relevant jurisdictions. In particular, they prohibit fraud, misrepresentation, and assisting illegal client conduct. ABA 1983 1.d(d) 3.3(a)(1), 4.1, 8.4(c) (Model Rules); ABA 1969 DR 7-102(A)(4)-(8) (Model Code). But see note 48 below on a possibly relevant difference between the Model Rules and Model Code.

Second, OTS invoked a series of disclosure, record keeping, and antifraud norms, including a conventional prohibition of statements “false or misleading with respect to a material fact,” 12 C.F.R.563.18(b)(1988) (now 563.180[b]). Two of these norms are arguably more demanding than conventional antifraud prohibitions: (i) a prohibition of any statement that “omits to state a material fact concerning any matter within the jurisdiction of the Board,” id.; (ii) a requirement that insured institutions “establish and maintain such accounting and other records as will provide an accurate and complete record of all business it transacts,” 12 C.F.R. 563.17-1(c) (1988) (now 562.1).

It is undisputed that the requirements of the first set of norms - those prohibiting “unethical or improper professional conduct” - applied to Kaye Scholer. However, the sanctions for violation of this section are limited to

censure, suspension, or disbarment from practice before the agency. The second set of norms are enforceable by civil penalties and injunctive relief but only against banks and “institution-affiliated parties.” Amendments effective since the events involved in *Kaye Scholer* specify that this term includes lawyers who participate in breaches of law or fiduciary duty. 12 U.S.C. 1813(u)(4). The law applicable at the time of the *Kaye Scholer* events did not mention lawyers, but it did include both an “agent” of an insured institution and a person “who participates in the conduct of [its] affairs.” 12 U.S.C. 1730(g)(1988). *Kaye Scholer* argued that it did not fit either of these definitions. With respect to the “participates in the conduct” language, it has found some support in cases interpreting similar language of the RICO statute not to apply to the work of an organization’s outside accountants (*Reeves v. Ernst & Young* [1993]; *Azreilli v. Cohen Law Offices* [1993]). OTS might have sought to distinguish these cases on the basis of either the unusual degree of *Kaye Scholer*’s involvement with Lincoln or the distinctive protective concerns of the banking laws, as opposed to RICO. Even if it lost this point, it would still have had the argument that the lawyers were “agents,” which seems strong.

Whatever the outcome of these arguments, *Kaye Scholer* was subject to the substantive professional responsibility norms of section 513. For general discussion of the banking law background, see *Lieberman, Smith, and Segall* (1995).

n7. 12 C.F.R. 563.18(b)(1988) [now 563.180(b)] prohibits insured banks, their agents, and affiliated parties from making any statement to the banking authorities that “omits to state a material fact concerning any matter within [their] jurisdiction.”

n8. The claim is supported by authority in both legal ethics (see ABA Standing Committee 1993, 3 [lawyer in total control of the examination process “may well have taken on the client’s own obligation”]), and banking law (see 12 C.F.R. 563.18[b][1988], now 563.180[b][extending bank’s disclosure duties to its “agent”]). The traditional common law rule, however, is different. See American Law Institute 1958, 354-57 (agent who undertakes and fails to perform duty owed by principal to third party is liable for physical but not pecuniary loss).

Note that OTS never argued that the categorical extension in the regulation of the bank’s disclosure duties to its “agents” made all bank lawyers responsible for compliance simply by virtue of their status as “agents.”

n9. For recent authority for this proposition in the securities area, see *Matter of Kern* (1991, P 997)(lawyer-director with “discretionary” responsibility for registrant’s disclosure compliance had higher duty than

independent legal advisor); *In Re Gutfreund*, (1992, P 85,067)(“Once a person in [Salomon Brothers General Counsel] Feuerstein’s position becomes involved in formulating management’s response to the problem, he or she is obligated to take affirmative steps to insure that appropriate action is taken to address the misconduct.”)

n10. Memorandum from *Kaye, Scholer, Fierman, Hays, & Handler* to ABA Working Group, 2 March 1993 (copy on file with author).

n11. Note that extreme as the maximal claim may appear, it does not completely abrogate traditional confidentiality notions. The demand, if the client refuses to comply, is for the lawyer to withdraw, not disclose.

n12. On agency norms, see notes 8 and 13; on discovery norms, see note 37.

n13. American Law Institute 1977, 527, 529, 539, 542 (defining as actionable specified indirect forms of misrepresentation); 876(b) (liability for “substantial assistance” to the tortious act of another); American Law Institute 1958, 348 (liability where defendant “knowingly assists” fraudulent conduct). But some tort authority suggests a view closer to the minimal standard. See, for example, *Matter of Estate of Lecic* (1981); *Garcia v. Rodey, Dickinson, Sloan, Akin, & Robb* (1988).

n14. 12 C.F.R. 563.18(b)(1988) [now 563.180(b)] (prohibiting “fraud” and “misrepresentation”); ABA 1983, 3.3(a)(1), 4.49(a), 8.4(c) (prohibiting “false statements,” “deceit,” “fraud,” and “misrepresentation”); and 1.2(d), 3.3(a)(2), 4.1(b) (prohibiting assistance to client fraud); ABA 1969 DR 1-102(A)(4) (prohibiting “fraud, deceit, or misrepresentation”); DR 7-102(A)(7) (prohibiting assistance to client fraud).

n15. E.g., *SEC v. Frank* (1968, 489)(“A lawyer has no privilege to circulate a statement with regard to securities which he knows to be false just because the client has forwarded it to him.”) (*Friendly, J.*); *Molecular Technology Corp. v. Valentine* (1991, 917-18)(lawyer who drafted misleading offering circular also “implicated himself in the alleged fraudulent scheme” by drafting other documents not independently wrongful); *SEC v. National Student Mktg. Corp.* (1978, 712-15)(lawyers wrongfully assisted violations by closing transaction without disclosing material new information); *In re Carter & Johnson* (1981, P 82,847) (“When a lawyer with significant responsibilities in the effectuation of a company’s compliance with the disclosure requirements of the federal securities law becomes aware that his client is engaged in a substantial and continuing failure to satisfy those disclosure requirements, his continued participation violates professional standards unless he takes prompt steps to end the client’s noncompliance.”)

On the other hand, there is authority suggesting more limited duties (e.g.,

Rubin v. Schottenstein [1997][lawyer who gave opinion not in itself misleading and made vaguely misleading statements knowing of client fraud not liable]). One securities case that rejects the intermediate standard (Schatz v. Rosenberg [1991][lawyer aware of client fraud who prepared nonmisleading documents and transmitted misleading client assertions not liable]) - has been called by Geoffrey Hazard “aberrant” and “absurd” (1993a, 707 n.26). See generally Painter and Duggan 1996.

To be sure, most securities act claims against lawyers have failed. However, the problem is most often insufficient proof of scienter, rather than of substantial assistance. See Jennings, Marsh, and Coffee 1992, 1178.

n16. See *In re American Continental/Lincoln S&L Sec. Litig.* (1992, 1450-52), which denied summary judgment to Kaye Scholer’s predecessor, Jones, Day, Reavis, & Pogue, in a private damage action that included claims for common law and securities act fraud based on allegations that the lawyers “provided hands-on assistance in hiding loan file deficiencies from the regulators, ... reviewed SEC registration statements and prospectuses [containing false statements], and lent its name to a misleading legal opinion.” (1992, 1452). See also Hazard, Koniak, and Cramton 1994, 793 n.91 (OTS’s allegations against Kaye Scholer “were at least as strong as those in the case involving Jones, Day and would probably have established a prima facie case against Kaye, Scholer of professional negligence, breach of fiduciary obligations to the entity client and aiding and abetting client illegalities.”)

n17. It is an interesting question why OTS put so little emphasis on common law misrepresentation rhetoric in asserting and explaining its claims. Perhaps it feared appearing to give up on its arguments for the maximal standard. Or perhaps it was worried that relief based on fraud would be harder to enforce because of the fraud exclusions commonly found in liability insurance policies.

n18. American Law Institute 1977, 527.

n19. The common law position of a “statement of opinion as to facts not disclosed” is more ambiguous. The Restatement asserts that such opinions may be taken as implied statements “that the facts known to the maker are not incompatible with his opinion” if “it is reasonable to do so.” That the maker has an “adverse interest” to the recipient weighs against reasonableness, but that he has “special knowledge” weighs in favor (1977, 539, 542).

It is probably not necessary to resolve this issue, since the Kaye Scholer opinions are not only as to “facts not disclosed” but make explicit reference to facts - for example, the accounting figures, the doctored files - in ways that are misleading.

n20. See the “litigation counsel” argument discussed in section 3B.

n21. Even if some of these statements were considered argument, they might well violate the ethical requirement that argumentative assertions “have a basis ... that is not frivolous” (ABA 1983, 3.1). However, frivolous argument is a considerably less serious charge than misrepresentation.

n22. In addition to the securities materials cited in note 15, see *Learld v. Brown* (1985) (lawyer violates consumer protection law by drafting contract with unconscionable term).

n23. An opinion from the ABA Standing Committee (1993) approves the lawyer continuing representation in a bank examination when management engages unilaterally in a single act of fraudulent concealment, but presumably there are limits.

n24. Three further OTS charges dealt with matters other than duties of candor toward the Bank Board. Although the conduct they allege seems less grave than that in the other charges, Kaye Scholer’s defenders have focused a lot of attention on them, perhaps because, unlike the disclosure/deception charges, they do seem either innovative (in one case) or insubstantial (in the other two).

First, OTS complained that Kaye Scholer failed to advise Lincoln’s directors about their own fiduciary duties and about breached duties by officers to depositors and the insurance fund (OTS, PP 33-35, 52-58).

While the authority for this charge is uncertain, it is far from off the wall. There is pertinent, though sparse, authority that directors may sometimes owe fiduciary duties to creditors, especially when they are bank directors and when the enterprise is in the vicinity of insolvency (Lin 1994, 1510-24; *Francis v. United Jersey Bank* [1981]). There is also recent, though disputed, support for the proposition that illegal conduct may be deemed a breach of duty to the corporation even when the shareholders participate in it or managers undertake it for the shareholders’ benefit. (Hence creditors succeeding to control of the corporation can sue in the name of the corporation for damage from the illegal conduct.) See, e.g., *FDIC v. O’Melveny & Myers* (1992, 749-51); *FDIC v. Clark* (1992, 1549-50); contra, *Cenco, Inc. v. Seidman & Seidman* (1982). Under either of these theories, it is arguable that a lawyer’s duty to a corporate client carries some obligation to protect creditors as well as shareholders from managerial misconduct. A modest interpretation of such an obligation would require lawyers to inform the Board of its duties and of any management misconduct with respect to creditors’ interests (see generally *Brown* 1994, 648-55, 680-85).

The fact that the directors may have been aware of the relevant activities and either complicit in or indifferent to them doesn’t mean that such advice would have been pointless. At the least, its function would have been to put

them on the spot by reducing their ability to claim later that they didn't understand their duties. Moreover, even if the directors knew their conduct was wrongful, they may not have been aware of the extent of the liability it potentially entailed.

Second, OTS charged that Kaye Scholer ignored conflicts of interest between ACC and Lincoln and did not get the informed consent of both clients to joint representation (OTS, P 56). Since ACC owned 100% of Lincoln, there was clearly no conflict at the shareholder level, and there was at least implicit consent by the two corporations' managements. ACC was siphoning cash out of Lincoln, but the victim was the insurance fund, not Lincoln. The charge makes sense only if we insist that Lincoln's interests be defined in terms of creditor, as well as shareholder, interests. So framed, it seems either redundant or implausible. It is redundant to the extent it merely rephrases the claim discussed above that the lawyers had some duties to protect creditor interests. It is implausible to the extent that it suggests that a corporate lawyer should treat creditor interests as client interests for the purposes of the conflict-of-interest rules.

Third, OTS charged that a loan Lincoln made to Kaye Scholer partner Lynn Toby Fisher violated banking regulations (OTS, PP 172-81). The Notice asserts noncompliance with procedural and documentation requirements, and it implies that the loan was made on terms so favorable that it amounted to a gift. However, the former assertions seem a minor matter, and the latter are too vaguely alleged to accept as a substantial claim.

n25. See, for example, ABA Standing Committee 1993, 10 ("We do not believe it helpful to make a lawyer's ethical obligation of disclosure depend on how she or someone else may abstractly characterize her role in representing a client.") See the discussion in section 3B.

n26. A book that Hazard co-authored opines that the OTS Notice of Charges did state a prima facie case of misrepresentation (Hazard, Koniak, and Cramton 1994, 91). See the language quoted in note 16.

n27. Richard Painter, a member of the committee, voted against the "freeze" resolution and report in part because "the report was drafted and approved far more quickly than other reports approved by the Committee (within days rather than months)," and the committee "had not heard an explanation from the OTS of its reasons for imposing the freeze" (Painter 1998).

n28. Another example of the typical journalistic approach to the charges is Margolick 1992. The standout exception is the American Lawyer feature by Susan Beck and David Orey (1992), which is notable not only for its pro-OTS conclusions but for its willingness to deal in detail with the charges. See also France 1992.

n29. ABA Working Group 1993, 197-212. The report rejects the idea of a duty to go to the Board on the ground that it is inconsistent with Model Rule 1.13 (ABA 1983), which makes going to the Board optional. It is, however, unable to give any plausible rationale for the rule's denial of a duty in circumstances where the interests of the client would be served by informing the Board. The discussion uses phrases like "interference ... that the client entity may not welcome" and "permit the entity to determine the scope of the attorney's work" (1983, 202), in ways that beg the question of who represents the entity when the officers are behaving unlawfully.

I agree with the report's conclusion on the conflict issue. See note 24 above.

n30. The text of the resolution appears in ALI-ABA 1994.

n31. The Working Group is quite candid about its self-protective motivations (ABA Working Group 1993, xv, 3, 15).

n32. The third was a charge reported in the American Lawyer that Kaye Scholer lawyers encouraged perjury in depositions (Beck and Orey 1992, 72). OTS was investigating the charge at the time it filed its case against Kaye Scholer.

n33. Letter from Hal R. Lieberman to Peter Fishbein, 9 August 1993 (copy on file with author).

n34. See Freedman 1994; Fox 1993; Robert Day 1993; Nussbaum 1992; Coombs 1994; Pogoda 1994; and Brown 1994. Freedman, Fox, Day, Nussbaum, and Coombs treat the OTS charges as radical or unsupported, without specifically discussing them. Pogoda and Brown each include insightful discussions that recognize the continuity of the OTS charges with established misrepresentation doctrine, but each discusses only one of the disclosure charges specifically.

In general, academics have been more sympathetic to the charges than practitioners. When he weighed in on behalf of Kaye Scholer, Monroe Freedman even portrayed himself as fighting the conventional wisdom (1994, 577). Nevertheless, as Freedman complained, approving references to the charges in academic discussions have been mostly passing and conclusory. To my knowledge the only law review article to discuss the charges in detail is Kostant 1993. A briefer discussion appears in an article by OTS General Counsel Harris Weinstein (1993). Both express sympathy for the charges.

n35. There is a long-standing debate about the propriety of the common law approach in regulatory administration (Breyer and Stewart 1992, 523-813). Whatever its difficulties in other areas, the approach seems naturally appropriate in this area because both the banking statutes and the bar's norms incorporate common law, equitable fraud, and fiduciary norms.

n36. See, e.g., ABA 1969, EC 3-5 (“The essence of the professional judgment of the lawyer is his educated ability to relate the general body and philosophy of law to a specific legal problem.”).

n37. *Pilling v. General Motors* (1968, 369); *Dollar v. Long Mfg.* (1977); *Miller v. Doctor’s Gen. Hosp.* (1977); see also the Advisory Committee notes to the 1993 amendments to Federal Rule of Civil Procedure 37, 146 F.R.D. at 690 (“Interrogatories should not be read or interpreted in an artificially restrictive or hypertechnical manner to avoid disclosure of information fairly covered by the discovery request.”). The Washington Supreme Court recently rebuffed an effort by the firm of Bodle and Gates, also with the assistance of Geoffrey Hazard, to justify withholding vital discovery information on a theory similar to Kaye Scholer’s. *Washington State Physicians Ins. Exch. & Ass’n v. Fisons Corp.* (1993).

n38. American Law Institute 1977, 527; see also 529 (“A representation ... misleading because of its failure to state additional or qualifying matter is a fraudulent misrepresentation”).

n39. Letter to the author from Peter M. Fishbein, 9 December 1996 (copy on file with author).

n40. On the examiners’ understandings, see the letter from B. J. Davis (1986), director of examinations, Federal Home Loan Bank Board, Eleventh District, protesting Kaye Scholer’s adversarial style at length and asserting that “examinations are informal and do not require the assistance or intervention of lawyers.”

The opinion of the ABA Standing Committee opinion on professional responsibilities in the context of a bank examination speaks in the spirit of the common law of misrepresentation, including the condemnation of misleadingly incomplete statements, and does not mention the “not frivolous” standard of Model Rule 3.1 (ABA Standing Committee 1993, 9-10).

n41. The T. J. Hooper (1932). See also American Law Institute 1977, 295A, comment: “No group of individuals and no industry or trade can be permitted ... to set its own uncontrolled standard at the expense of the entire society. If the only test is to do what has always been done, no one will ever have any great incentive to make progress in the direction of safety.”

n42. Although it is of only passing relevance to our subject, it is outrageously unfair to refer to bureaucratic “timidity” as a cause of Lincoln’s failure without noting that what “timidity” there was seems substantially attributable to the hostile interventions - and outright terrorism - of legislators and Reagan administration officials (especially Donald Regan), who threatened reprisals against Bank Board officials inclined to move against Lincoln. Moreover, some officials performed admirably. Michael Patriarca

and William Black, for example, correctly diagnosed the Lincoln situation in 1986, and they stood firm in the face of intimidation by Keating, Kaye Scholer, and the Keating Five (see Binstein and Bowden 1993, 172-408).

n43. OTS did style its monetary claim as “restitution” and calculated its demand on the basis of an estimate of harm Kaye Scholer caused (Beck and Orey 1992, 73). As a matter of policy, it is arguable that, if OTS’s view of the substantive merits were accepted, a large award would have been appropriate as a penalty (see Hazard 1993b, 398 [“The sanction ... is analogous to a disciplinary fine in lieu of suspension from practice.”]). However, it is doubtful that the banking laws would have warranted a penalty of the kind or size that OTS demanded, or got. See 12 U.S.C.1464(d)(8)(b)(1988) (authorizing penalties for conduct in violation of cease-and-desist orders of “not more than \$ 1,000 per day for each day during which such violation continues”). Amendments since Kaye Scholer’s Lincoln representation have strengthened the penalty provisions. See 12 U.S.C. 1818(i)(authorizing penalties of up to \$ 1 million per day for violations of banking laws).

n44. Beck and Orey argued that without the “freeze,” lawyers would have jeopardized collection of the judgment by leaving the firm. This seems implausible. Even if they left, they’d continue to be liable. And the firm had extensive insurance coverage.

n45. For criticism of this view, see Thompson 1990, 94-98, 108-15.

n46. Harris Weinstein disputes my concession that a single individual could not have made a difference. In addition to the admirable performances of William Black and Michael Patriarca (see note 42 above), he points to that of Julie Williams, a staff lawyer at the Bank Board who played a critical role in convincing the Bank Board to deny Lincoln permission to issue uninsured bonds to be sold through its branches (telephone conversation with author, 10 December 1997).

n47. For an excellent discussion of these issues with some references to Kaye Scholer, see Luban 1995.

n48. Actually, even if the OTS charges had contemplated whistleblowing, their impact on established confidentiality norms would not have been as radical as defenders suggested. Under the bar’s “choice of law” rules, the applicable confidentiality norm would probably have been New York’s. See Model Rule 8.5 (ABA 1983). New York has the Model Code’s confidentiality norm, 4-101 (ABA 1969), which permits lawyers to disclose information about ongoing and future criminal acts by the client (see Gillers and Simon 1992, 698). (In this, it differs from the Model Rules’, norm 1.6, which limits permission to disclose to situations where the acts are likely to cause death or bodily injury.) At least some of the information involved in

the OTS charges did involve ongoing criminal activity. As to this information, a “whistle-blowing” requirement would have merely changed the permission of the code to a duty. Since clients could not have expected confidentiality in these circumstances anyway, this does not seem radical.

n49. Judge Easterbrook objects that “even an honest firm may fear that one of its [many professionals] would misunderstand the situation and ring the tocsin needlessly, with great loss to the firm” *DeLeo v. Ernst & Young* (1990, 629). Fair point, but one that could be addressed in setting the threshold of conviction that triggers the disclosure duty and in balancing sanctions for wrongful disclosure and nondisclosure.

n50. The relevant portion of the 8-K reads:

AA confirmed to the registrant that AA’s resignation was not the result of any concern by AA with the Registrant’s operations, recordkeeping, books and records, management cooperation, or asset/liability management; AA expressed full confidence in the Registrant’s financial disclosure. AA advised the Registrant that the resignation was the result of AA’s concern over potential liability in representing certain savings and loan associations in view of the very litigious environment controlled to a large degree by regulators. In particular, AA cited the regulators’ criticism over thrift institutions’ rate of growth and asset mix (although consistent with applicable statutes and regulations), and AA’s concern over the considerable publicity generated by the FHLBB’s and its Chairman, Mr. Gray’s, disagreements with the policies of the Registrant. (American Continental Corporation, Form 8-K, dated 1 October [filed 9 October] 1986 [copy on file with author])

The Kresse memorandum that Fishbein sent to Keating on 6 October 1986 included the following:

Kresse was rather cynical about the S&L industry and Lincoln in particular. He took great pains to explain that Lincoln was always careful and checked its decisions with Arthur Andersen. However, in his view (which is probably a rather conservative one), Lincoln is a high-risk company open to attack by the Board. At first blush, Lincoln looks like most of the other S&Ls that have failed - it has high growth, unusual investments, very large loans, very high GS&A, negative spread; it takes about \$ 180,000,000 in real estate sales and other nonrecurring deals to make up the negative spread, etc., etc. Kresse said that if he were the FHLBB, he would try to find something to latch on to to bring Lincoln in tow. (Obviously, he was playing the devil’s advocate to point out some of Lincoln’s risks.)

Kresse reiterated that Andersen views Lincoln as a high-risk client (but he also said that he viewed all savings and loans as high risk in these times of turbulent interest rates)....

.... But, he further emphasized that the entire industry is a problem because it is so affected by factors out of its control - various markets, interest rates, etc. Thus, Andersen is not pursuing S&L business. But having said all that, Kresse reiterated that ACC is a particular risk because it has a \$ 180,000,000 nut instead of zero dollars, after its asset to liability mismatch is taken into account. (Memo to File from Karen Katzman, 27 August 1986 [reporting interview with Joseph Kresse, 6 August 1986] [copy on file with author]).

n51. See *Lincoln Sav. & Loan Ass’n v. Wall* (1990, 921) (expressing doubts about the technical and ethical quality of the Lincoln accountants’ performance).

n52. Ernst & Young paid \$ 400 million to settle a lawsuit by the government arising out of its predecessor firms’ work for S&Ls, including Arthur Young’s for Lincoln (Cushman 1992). Without charging bad faith, Judge Sporkin expressed astonishment that Arthur Young could have signed off on Lincoln’s characterizations of some of the “linked transactions” he reviewed in Lincoln’s challenge to the seizure, including the “Wescon transaction” summarized in note 4 above. *Lincoln Sav. & Loan Ass’n v. Wall* (1990, 912-13).

Kaye Scholer also argues that while the memos OTS points to in which Kaye Scholer lawyers express concern about “linked” transactions refer to 1987 transactions, one representation concerning soundness that OTS claims is misleading refers to 1986. This seems formalistic. Although the Kaye Scholer memos are concerned primarily with post-1986 transactions, the references to “linked” transactions are ambiguous as to time. In any event, the Notice of Charges does cite a 1989 Kaye Scholer statement regarding Lincoln’s “return on equity” that seems to include 1987 and allegedly presupposed the equity numbers affected by the “linked transactions.”

n53. The 11 September 1987 memo says, “Although the files themselves do not indicate linked transactions, it is known in some instances Lincoln or an ACC affiliate purchased a property with all or a substantial portion of the purchased price utilized by the other party for the downpayment in connection with an acquisition from an ACC affiliate. This situation is particularly problematic” (OTS, P 64). See also the quotations from the memos of 13 October 1987, and 4 February 1988, in note 5.

n54. Memo from Karen Katzman, et al., to Robert Kieilty (Lincoln official), 15 September 1987 (emphasis added). Copy on file with author. While other portions of the memo set out characterizations of the examiners’

complaints, this statement comes from a section setting out the lawyers own views of the situation. The submission to the Bank Board from which the laudatory language cited by OTS was taken was dated 26 June 1987.

n55. A sample of the April 1987 deposition testimony of ACC's president suggests why OTS may have doubted the reasonableness of Kaye Scholer's acceptance of the representations of the Lincoln/ACC people:

Q: Did you make a determination not to date these loan summaries or documents that we were referring to?

A: The question of the dating has become a major issue. There was no thought either way. The document was not prepared when the loan was made. That was clear. To put a current date on it made no sense because the intent was to show the information and document what had been available at the time we made a prudent decision to make the loan. To put a different date in between made no sense and they were an attempt to be a summary. They were not an attempt to be anything other than that. There was no signing of them, there was nothing other than the recording of historical facts to substantiate the thought process that went through when the loan was made.

Q: How do you reconcile that with the inclusion of information which would have been subsequent to the making of the loan?

A: Because I have one particular loan officer who - you showed me Continental Southern. That's a very extensive ongoing relationship. It's a very complicated loan. And for his ongoing work he wanted to make it something more than that. And I felt that if that served the purpose of an ongoing underwriting on that loan, that that was the way that one should be done.

(Deposition of Judith Elisabeth Wischer, Matter of Lincoln Sav. & Loan Ass'n, 1 April 1986, 30-31)

n56. The regulation appears at 12 C.F.R. 571.17(c). My Stanford colleague Kenneth Scott submitted a statement supporting Kaye Scholer's interpretation.

n57. See Loss and Seligman 1989, 657-62 ("The Commission ... has long recognized that in some circumstances involving matters such as managerial conflicts of interest or violations of law there should be disclosure even where the relevant transaction or occurrence would not be quantitatively material" [1989, 657]); Franchard Corp. (1964).

n58. Matter of Kielty (1994).