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LAWYER LIABILITY IN THIRD PARTY SITUATIONS: THE MEANING OF THE KAYE SCHOLER CASE

by

GEOFFREY C. HAZARD, JR. *

The *Kaye Scholer*¹ case has excited much attention and alarm within the legal profession.² It is interpreted as greatly expanding the scope of lawyer liability to third parties and heralding much greater regulatory intervention into the relationship between lawyer and client. In some respects this interpretation is accurate. The *Kaye Scholer* proceeding is at least a "wake up call" to the legal profession, signalling that lawyers should be much more attentive to their legal and ethical obligations in transactional and regulatory matters. However, there is also much misunderstanding about *Kaye Scholer*, particularly the supposition that it created novel theories of lawyer liability to third parties. The purpose of this analysis is to explain what *Kaye Scholer* was about, what are the basic concepts of lawyer liability to third parties, and why the practicing bar should heed a "wake up call."

THE KAYE SCHOLER CASE³

The New York law firm of Kaye, Scholer, Fierman, Hays & Handler was hired in 1986 to represent Lincoln Savings & Loan Association ("Lincoln"), a California thrift, in dealing with the Federal Home Loan Bank Board ("the Bank Board") in connection with the Bank Board's examination of Lincoln's books and accounts.⁴ As is well known, Lincoln was controlled by Charles Keating, a financier originally from Ohio who in the 1980's had put together a major investment enterprise. Keating was bent on using Lincoln as a financing vehicle for some very ambitious real estate development, for aspects of which he has since been convicted in both state and federal courts.

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¹ The proper style of the "*Kaye Scholer* case" is; *In re* Fishbein, OTS AP-92-19, (Mar. 1, 1992).

² See, e.g., Ass'n Bar City of New York, Federal Legislative Committee Report, July 19, 1992; American Bar Ass'n Task Force Report, August, 1992.

³ It is hereby recorded that I was retained by the Kaye, Scholer firm as an expert witness in anticipation of claims against the firm, among which the proceeding in *In re* Fishbein eventuated. In that matter I provided a preliminary opinion to the firm which it used in making a public statement concerning the proceeding. On the issues presented by the *Kaye Scholer* proceeding, see generally ABA WORKING GROUP ON LAWYERS' REPRESENTATION OF REGULATED CLIENTS, LABORERS IN DIFFERENT VINEYARDS?: THE BANKING REGULATORS AND THE LEGAL PROFESSION, DISCUSSION DRAFT, January 1993.

⁴ The *Kaye Scholer* firm had previously represented Lincoln in other matters. Whether this prior representation was relevant in determining the firm's legal and ethical responsibilities was itself in controversy.

At the point at which Kaye Scholer undertook the engagement in question, Lincoln had already been subjected to an unusually intensive bank examination, caused by the Bank Board's suspicion that Lincoln, like many other S&Ls at the time, was vastly overextended. In the parlance of thrift regulation, the general concern to the Bank Board was whether Lincoln was engaged in "unsafe and unsound" banking practices. The Bank Board had specific concerns as well, including whether there had been improper loans to insiders or affiliates, improperly large loans to a single borrower, loans with inadequate appraisals or collateral, improper reciprocal loans with other expansion-minded S&L's, and inadequate or falsified loan documentation.

Kaye Scholer undertook to make the case for Lincoln that the company was generally in good financial shape and that the Bank Board's specific concerns either were misplaced or, taken as a whole, did not indicate that Lincoln was in unsafe and unsound condition. To this end, Kaye Scholer lawyers assumed direction of practically all of the communications between Lincoln and the Bank Board. Kaye Scholer strenuously resisted various inquiries and contentions by the Bank Board, and submitted extensive documentation to the effect that Lincoln was financially viable. In general, Kaye Scholer acted as a very aggressive advocate for its client. The engagement lasted for many months and was accompanied by much acrimony, reflecting Keating's hostility toward regulatory policy. Eventually, the Bank Board, acting in its regulatory capacity, closed Lincoln and, acting in its capacity as insurer of deposits, absorbed most of Lincoln's losses, totalling hundreds of millions of dollars.

The Bank Board's regulatory responsibilities subsequently devolved to the Office of Thrift Supervision ("OTS"), a newly created Federal Government entity given broad powers over the S&L industry. Moreover, in 1989, Congress enacted the Financial Institutions Reform Recovery and Enforcement Act ("FIRREA"),⁵ which extended and enlarged federal regulatory powers over S&Ls and other financial institutions. FIRREA imposed new legal duties on directors and officers of financial institutions covered by the Act, as well as on accountants, lawyers, and other advisers retained by such organizations. FIRREA gave the OTS extremely potent powers of administrative enforcement, including authority to initiate proceedings on the basis of "probable cause" as determined by the agency administrator; to sequester, by ex parte administrative order, assets of persons against whom such proceedings are initiated; and to prosecute the proceedings in administrative tribunals attached to the regulatory agency, without recourse to the United States District Courts or to jury trial. Review of determinations of the

⁵ Codified at 12 U.S.C. §§ 1811 et. seq. (1992).

administrative law judges in such proceedings is before the Courts of Appeals, on the record below, under a "clearly erroneous" standard as to findings of fact.⁶

In February, 1992 the OTS brought a proceeding against Kaye Scholer and certain individual lawyers in the firm. The substantive charges were essentially that the lawyers had given legal advice to Lincoln based on assumptions that were in reckless disregard of the facts; had made misstatements to the regulatory agency; and had failed to disclose facts to the agency that would have indicated that Lincoln's condition and operating procedures had been unsafe and unsound. By way of enforcement, the agency imposed an ex parte sequestration of the firm's accounts and receivables.

Three days after the proceeding was initiated, Kaye Scholer settled, agreeing to pay \$41 million as monetary redress. In addition, certain individual lawyers in the firm agreed to restrictions on their future practice in the banking field. Because the matter was resolved by settlement, the issues of whether the lawyers had in fact given recklessly improper legal advice, or had in fact made misstatements or improper omissions were never adjudicated. Also not decided was precisely what standards of law and professional ethics governed the lawyers' conduct. In this sense the matter was indeed Kafkaesque.

THE BAR'S REACTION TO *KAYE SCHOLER*

The proceeding attracted anxious attention in the bar on several counts. First, of course, there was the very large amount of the settlement. This suggested to some that the firm must have been guilty of something, and suggested to nearly everyone that the consequences of overstepping the bounds of zealous representation could now be made intimidatingly large. Second, there was the use of ex parte sequestration, which was wholly novel in such a context.⁷ It was thought that exercise of such power must be contrary to law or, worse, that if such power was indeed legally authorized, then the law had gone mad. Third, it appeared that the OTS was seeking to enforce in 1992 legal and ethical standards that had not been recognized in 1986 and 1987 when Kaye Scholer's alleged misconduct had occurred. Fourth, a lawyer's professional obligations, as OTS defined them, apparently included a requirement that a lawyer report to public authorities a client's illegal conduct, i.e., as the bar saw it, "squeal on a client." By

⁶ See generally Daniel B. Gail and Joseph J. Norton, *A Decade's Journey from "Deregulation" to "Supervisory Reregulation": The Financial Institutions Reform, Recovery and Enforcement Act of 1989*, 45 BUS. LAW. 1103 (1990).

⁷ Ex parte sequestration is of course not unknown to the law. In enforcement of criminal law it is authorized for seizure of contraband, such as illegal drugs and other instruments of crime. See *Calero-Toledo v. Pearson Yacht Leasing Co.*, 416 U.S. 663 (1974). In equity, a court may issue a temporary restraining order without notice when necessary to preserve a *res* such as a fund. See *Granny Goose Foods, Inc. v. Brotherhood of Teamsters*, 415 U.S. 423 (1974). However, the proceeding against Kaye Scholer was not an aid of enforcing criminal law, nor was it before a court of equity.

the same token, the government appeared to be imposing heavy sanctions on lawyers who had vigorously defended their client's interests.

The present discussion will address none of these issues. For one thing, my prior involvement in the matter⁸ requires that I forego further discussion of these specific issues as much as possible. More importantly, attention should be focused on an additional ground of concern about the *Kaye Scholer* case that has been widely expressed in the profession. This concern is that the *Kaye Scholer* case involves a broad extension of a lawyer's civil liability to third parties. Hence, the title of this presentation.

However, a short summary of what will be said is that the *Kaye Scholer* case as such does not involve extension of a lawyer's civil liability to third parties. The case involved a regulatory sanction exacted by the Government, in the nature of a civil penalty or administrative restitution. The sanction therefore is analogous to a disciplinary fine in lieu of suspension from practice. Indeed, the sanctions imposed on the individual *Kaye Scholer* lawyers were in effect disciplinary suspensions. Hence *Kaye Scholer* does not involve civil liability to third parties, let alone an extension of such liability.

Nonetheless, the *Kaye Scholer* event may well auger an extension of a lawyer's responsibilities along two lines. The first is legal responsibility to a regulatory agency having jurisdiction over the client for having failed to fulfill professional duties *to the client*. The second is enlargement of the scope of these duties. However, if such extensions ensue, they will evolve from law that pre-existed the *Kaye Scholer* case, or flow from statutory and regulatory impositions originating in Congress. Hence, the bar should be less concerned about the possibility of a rogue regulatory agency and more concerned about what courts and legislators consider to be a lawyer's proper legal and ethical duties. Understanding this point requires a revisiting of the legal and ethical duties imposed by existing law on a lawyer regarding clients and third parties.

A TRANSACTION LAWYER'S DUTIES TO THIRD PARTIES⁹

Rules of Ethics and Rules of Law

Many members of the bar seem to believe that a lawyer can only be held liable to a third party if the lawyer is guilty of aiding and abetting a client fraud.

⁸ See *supra* note 3.

⁹ The liability of an advocate to an opposing party is more narrowly circumscribed than that of a transaction lawyer. However, there can be liability for an opposing party's litigation costs, under rules such as Rule 11 of the Federal Rules of Civil Procedure, for asserting claims that lack a sufficient basis in fact or law. See, e.g., Carl Tobias, *Reconsidering Rule 11*, 46 U. MIAMI L. REV. 855 (1992). There also can be civil liability for persisting in assertion of a frivolous claim or defense. See *Chambers v. Nasco, Inc.*, 111 S. Ct. 2123 (1991).

This belief may stem from the supposition that the norms by which lawyers are governed are found only in the codes of professional ethics. The understanding derived from the codes is that a transaction lawyer is constrained against affirmatively advising a client in conduct that is a crime or fraud, but no further.

The relevant provision of the Model Rules of Professional Conduct, now in force in most states, is Rule 1.2(d), which provides:

A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent ...

The corresponding provision of the older Model Code of Professional Responsibility, DR 7-102(A)(7), was to the same effect.¹⁰ Under these rules, knowing furtherance of a client's crime or fraud is indeed a disciplinary violation.

However, the disciplinary rules are only part of the law by which a lawyer is governed. A lawyer can be held liable under criminal law for aiding or abetting a crime, including the crime of fraud. A lawyer also can be held civilly liable on essentially the same terms.¹¹ Strictly speaking, the basis of such liability is not violation of the rules of professional ethics, for those rules do not of themselves create criminal or civil liability.¹² Instead, a lawyer's liability for assisting a client in a crime or fraud arises under general principles of criminal, tort, and agency law. With few qualifications, those bodies of law govern lawyers like everyone else.

The important point is that questions as to a lawyer's liability to third parties are not determined by reference to the codes of ethics. Indeed, the same is true of a lawyer's liability to a client, where civil liability for malpractice and breach of fiduciary duty stands along side the rules of ethics.¹³ Hence, in determining a

¹⁰ DR 7-102 (A) (7) provides:

In his representation of a client, a lawyer shall not . . .

(7) Counsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent.

MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102 (A) (7) (1980).

¹¹ On criminal liability, *see, e.g.*, *United States v. Benjamin*, 328 F.2d 854 (2d Cir. 1964). On civil liability, *see e.g.*, *Newberger, Loeb & Co. v. Gross*, 563 F.2d 1057 (2d Cir. 1977). *See generally* Geoffrey C. Hazard, *How Far May a Lawyer Go in Assisting a Client in Legally Wrongful Conduct?*, 35 U. MIAMI L. REV. 669 (1981).

¹² The Preamble to the MODEL RULES OF PROFESSIONAL CONDUCT, par. [6], states:

Violation of a Rule should not give rise to a cause of action nor should it create any presumption that a legal duty has been breached.

The preamble to the MODEL CODE OF PROFESSIONAL RESPONSIBILITY has a disclaimer to the same effect.

¹³ *See, e.g.*, *American Motors Corp. v. Huffstutler*, 575 N.E.2d 116 (Ohio 1991); *Maritrans GP Inc. v. Pepper, Hamilton & Sheetz*, 602 A.2d 1277 (Pa. 1992) (breach of fiduciary duty concerning client secrets).

lawyer's civil liability to third parties it is necessary to go beyond the rules of ethics to the common law and related substantive statutes that govern lawyers.¹⁴

A Lawyer's Legal Duties to Third Parties

It is settled law that a lawyer can be civilly liable to third parties under various circumstances. This elementary proposition is often misunderstood, because lawyers assume that professional loyalty runs exclusively to the client. In a sense this is true, in that no duty of professional loyalty as such runs to anyone except a client. However, it is also true that the duty of loyalty to a client must be fulfilled "within the bounds of the law."¹⁵

These "bounds of the law" include three general bases of liability to third parties. First, liability may result where a lawyer assists a client in conduct that constitutes a legal wrong against a third party. Second, liability may result where the lawyer assumes a specific undertaking to the third party, typically by express or implied contract. Third, liability may result from failing to perform protective obligations in favor of third parties that are specially imposed by law. The last category is narrow but may expand in the future.

a. Assisting a Client's Violation of Duty to a Third Party

In assisting a client in a transaction, a lawyer is an agent. To call a lawyer an agent is both a description of function and a reference to the fact that a lawyer is governed by principles of agency law. Under the principles of agency law, an agent may not lend material assistance to a principal in the commission of an act that the agent knows is legally wrongful, or in reckless disregard of the act's legal wrongfulness.¹⁶ Thus, a lawyer may not assist a client in making material misrepresentations to the opposite party in a transaction, because that constitutes being an accomplice in the client's fraud.¹⁷

So also a lawyer may not assist a client who owes fiduciary duties to a third person to violate that trust. The most obvious case is providing assistance to a trustee who is known to be misappropriating the trust fund.¹⁸ A similar situation

¹⁴ See ALI RESTATEMENT OF THE LAW GOVERNING LAWYERS (Tentative Drafts 1-5 1988-1992).

¹⁵ MODEL CODE OF PROFESSIONAL RESPONSIBILITY CANON 7: A Lawyer Should Represent a Client Zealously Within the Bounds of the Law (1980). Compare MODEL RULES OF PROFESSIONAL CONDUCT Rule 8.4 (1983), defining various forms of professional conduct by reference to legal standards established in general law.

¹⁶ Restatement (Second) of Agency; Restatement of the Law Governing Lawyers § 42, Cmt. c; (§§ 343 et. seq.) (Tentative Draft No. 5, 1992). See also Hazard, *supra* note 11.

¹⁷ See 1 GEOFFREY C. HAZARD & W. WILLIAM HODES, THE LAW OF LAWYERING § 1.6:308 (2d ed. 1990). A few errant decisions have suggested that a lawyer who merely documents a transaction tainted by fraud is not an accessory even though he knows about the fraud. See *Schatz v. Rosenberg*, 943 F.2d 485 (4th Cir. 1992). Such decisions are clearly wrong.

¹⁸ See, e.g., *Fickett v. Superior Court*, 558 P.2d. 988 (1976). See generally Geoffrey C. Hazard, Jr., *Triangular Lawyer Relationship: An Exploratory Analysis*, 1 GEO J. LEGAL ETHICS 15 (1987).

is presented in representing a general partner who is engaged in conduct constituting a breach of fiduciary duty to limited partners.

A variation of this responsibility is the duty not to assist some other agent of a client in committing a wrong against the client. The most obvious example of such a situation is where a lawyer for a corporation enables a corporate officer or employee to commit a wrong against the corporate client.¹⁹ This is not a case of civil liability to a third party, but rather liability to the client for failing to interdict a third party's wrong against the client. However, since lawyers for corporations sometimes proceed as though the corporation's officers or board of directors are their client, it is wise to take account of this variation.

It may be observed that the charges against the Kaye Scholer firm involved none of the above. These concepts of lawyer liability to third persons antedated the *Kaye Scholer* case and rest on common law principles.

b. Contract Liability to a Third Party

In modern business transactions lawyers are often called upon to provide an opinion to third parties concerning the affairs of his client. Such an opinion is called a third party opinion and is the subject of an extensive professional discourse, notably the "Silverado" standards adopted by the Business Law Section of the American Bar Association.²⁰ The opinion can address various matters, such as the corporate standing of the subject client, the state of earlier secured transactions to which the client is a party, and the title to property of which the client is represented to be the owner.

The opinion is provided by the subject client's lawyer because that lawyer is familiar with the matters addressed or can readily make inquiries into them. The process of making necessary inquiries is commonly called "due diligence," meaning that the lawyer is required to use reasonable diligence in making the necessary inquiries. The opinion is required because the third party will not do the deal without it. Rendition of such an opinion therefore is a condition of the agreement between the client and the third party or is called for in a separate undertaking between the lawyer and the third party.

The lawyer's obligation in such an opinion is to address the matters specified in the undertaking with the third party, to make such inquiries and analysis concerning those matters as a reasonably competent lawyer would make in similar

¹⁹ See, e.g., *FDIC v. O'Melveny & Myers*, 969 F.2d 744 (9th Cir. 1992).

²⁰ See *THIRD PARTY LEGAL OPINION REPORT, INCLUDING THE LEGAL OPINION ACCORD, OF THE ABA, SECTION OF BUSINESS LAW*, 47 *BUS. LAW.* 167 (1991). This statement is known as the Silverado standards because it was at a California watering hole by that name at which the standards were completed. See generally, J. MACEY, *THIRD PARTY LEGAL OPINIONS: EVALUATION AND ANALYSIS* (3d ed. 1992).

circumstances, and to render an opinion in good faith and according to recognized standards of professional competence. The obligation runs to whomever the opinion is addressed. The addressee may be a single specific party, such as a lender or underwriter, or a designated group of parties, such as eventual purchasers of securities. If the addressee is wholly indefinite, ordinarily no legal obligation results because of the law's concern with imposing indefinite liability.²¹ However, where the negotiations on behalf of the third party are well-informed, a definite addressee for the lawyer's opinion will be specified. The result is legal obligation to a third party.

A leading case involving such an obligation is *Greycas, Inc. v. Proud*,²² a decision by Judge Posner of the Seventh Circuit. There, money was to be lent on the security of farm equipment owned by the borrower. The lender required the borrower to provide a lawyer's attestation as to the state of Article 9 filings against the equipment. That is, before making the loan, the lender wanted an opinion that the farm equipment was not previously encumbered by security interests in favor of others. The lawyer rendered an opinion that there were no such prior encumbrances. However, the lawyer actually was ignorant on this subject; he made no search himself, simply taking the client's word that the equipment was free and clear. When the client later defaulted on the loan, and the lender discovered that the farm equipment was previously encumbered, the lender sued the lawyer. The court held that the lawyer was liable for having made a negligent misrepresentation to a person to whom he had undertaken to provide a professional assessment.

There are dozens, perhaps hundreds of cases in which similar liability has been imposed, usually by settlement. Much of the "cleanup" of the S&L catastrophe, for example, has consisted of asserting liability against lawyers for third party opinions in S&L transactions that fell short of the standard of reasonable care.

It may be observed that this concept of liability also antedated the *Kaye Scholer* case and rests on established common law principles.

c. Special Obligations to Third Parties

Beyond the duty to refrain from committing fraud on third parties, and the duty to fulfill contract undertakings to third parties, the scope of a lawyer's liability to parties other than the client is relatively narrow. Perhaps the only safe generalization is that these situations involve some sort of fiduciary relationship between the lawyer and the third party.

²¹ See *Bily v. Arthur Young & Co.*, 3 Cal. 4th 1049 (1992).

²² *Greycas, Inc. v. Proud*, 826 F.2d 1560 (7th Cir. 1987).

What appears to be emerging is that when a lawyer's client has special obligations of care and truth-telling toward a third party, and the lawyer's role calls for direct dealing with that third party, then the lawyer has counterpart obligations of care and truth-telling that run directly to the third party.

The beginning place for this approach is the closely-held corporation or the business partnership. In these enterprises, the lawyer-client relationship as such typically runs to the corporate or partnership entity, rather than to the entrepreneurs as individuals. Nevertheless, in day-to-day and year-to-year activities, including conservation of assets and payout of revenues, the lawyer deals on a personal basis with the enterprise's managers and investors. The lawyer may also be corporate secretary and business counselor. Typically, the lay participants in fact look upon the lawyer as "their" lawyer even though technically he is retained by the corporation or partnership.

In various combinations, these circumstances may be held to result in a lawyer-client relationship with the individuals as well as with the entity. On that interpretation, of course, no "third party" obligation arises on the part of the lawyer, because what is being imposed is a first party obligation to a client. There is another permissible interpretation, however, of the lawyer's relationship with the minority shareholder or junior partner. It can be held that the lawyer has a fiduciary relationship with such a third party arising out of the "confidence and trust" that has been reposed in the lawyer.²³

The concept of a relationship of "trust and confidence" with a third party is sharply discordant with some versions of the lawyer's role. One version of the lawyer's role is that *no* duty is owed to anyone other than a client.²⁴ Moreover, the concept of "trust and confidence" is so amorphous that a lawyer might be unsure whether to show solicitude for a third party's interest or to deal at arm's length. On the other hand, under traditional legal doctrine a relationship of "trust and confidence" is defined by the conduct and expectations of the parties. The lawyer therefore is in a position to disabuse a third party who seems to be placing undue responsibility on the lawyer. After all, it is possible to say: "Look, I'm not representing you; if you want legal advice you need to get someone else to help you." The cases where fiduciary liability has been imposed involved lawyers who conveyed quite a different message.

²³ Compare *In re Brownstein*, 602 P.2d 655 (Or. 1979) with *Fassih v. Sommers*, 309 N.W.2d 645 (Mich. Ct. App. 1981).

²⁴ Lord Brougham's famous dictum to this effect is as follows:

"[A]n advocate in the discharge of his duty, knows but one person in all the world, and that is his client."

See 2 TRIAL OF QUEEN CAROLINE 8 (J. Nightingale ed. 1821).

It should be noted that Lord Brougham was referring to an advocate, not to a transaction lawyer.

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

Extension of a lawyer's legal responsibilities along this line clearly would go beyond established law. However, such an extension is not beyond the range of judicial imagination. An obligation of this kind was clearly contemplated by Judge Sporkin in his famous dictum in the Lincoln Savings case: "Where . . . were the outside accountants and attorneys when these transactions were effectuated."²⁵

d. Third Party Standing to Enforce Ethical Obligations to Client

Another extension of lawyer responsibility can be considered to be procedural rather than substantive. The essential idea is that the legal and ethical responsibility of a lawyer representing a corporate entity can be legally enforced by someone other than the present management of the entity. One of the charges in the proceeding by the OTS against Kaye Scholer can be interpreted in this way. That is, the lawyer's duty to give reasonably careful and competent advice to a corporate client could be enforced by a government agency having regulatory authority over the client.²⁶

Stated in this way the proposition seems novel and radical. However, it seems less radical if viewed in light of the larger legal context of corporate law. Present law recognizes that *successor* corporate management can impose legal liability on corporate counsel for having failed to give reasonably careful and competent advice to the corporation, even if the injurious transaction was at the behest of prior management.²⁷ It is also a fair implication from present law that corporate shareholders may maintain a derivative suit seeking to enforce the corporation's rights against the lawyer arising from the latter's legal and

²⁵ Lincoln Sav. & Loan Ass'n v. Wall, 743 F. Supp. 901, 920 (D.D.C. 1990).

²⁶ See text accompanying and following note 5.

²⁷ See FDIC v. O'Melveny & Myers, 962 F.2d 744 (9th Cir. 1992); cf. Financial General Bankshares, Inc. v. Metzger, 523 F. Supp. 744 (D.D.C. 1981), *rev'd*, 680 F.2d 768 (D.C. Cir. 1982).

professional obligations.²⁸ Some leap is involved in holding that a government agency having protective powers over the corporate client has similar standing. However, it is no greater a leap that the law has made before.

Indeed, such a step has been taken by Congress with respect to lawyers for financial institutions. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 defines a lawyer for banking institutions as an "affiliated party" and as accountable to the government for duties owed to the client. The statute provides:

The term "institution-affiliated party" means -- (1) any director, officer, employee or controlling shareholder ... of an insured depository institution; ... (4) any independent contractor (including any attorney, appraiser or accountant) who knowingly or recklessly participates in —

- (A) any violation of law or regulation;
- (B) any breach of fiduciary duty; or
- (C) any unsafe or unsound practice,

which caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution.²⁹

CONCLUSION

As evidenced by the terms of FIRREA, Congress evidently has in mind that lawyers for financial institutions have a public law obligation to their clients. The courts have had in mind that lawyers for a corporation have an obligation to the corporation that may be enforceable by the shareholders. The same concept could be applied to partnerships. The Securities and Exchange Commission has recently promulgated an interpretation of the Securities Exchange Act of 1934 to the effect that a lawyer for a regulated securities firm has a duty to take remedial action to prevent recurrence of violations of the Act by employees of the firm.³⁰ Also to be noted is a proposed Financial Fraud Detection and Disclosure Act that would require accounting firms in doing audits to scrutinize the client's books and procedures for possible fraud against the corporation.³¹ It is certainly not beyond imagination that a similarly enhanced legal obligation to clients could be imposed on lawyers.

These emerging special obligations are intended in part to protect third parties, including members of the investing public. For the most part, however,

²⁸ See *Yablonski v. United Mine Workers of America*, 448 F.2d 1175 (D.C. Cir. 1974); cf. *Garner v. Wolfenbarger*, 430 F.2d 1093 (5th Cir. 1970).

²⁹ 12 U.S.C. § 1813 (u) (1992).

³⁰ See *In re Gutfreund*, SEC Administrative Proceeding File No. 3-7930, 12/03/92, reported in 8 ABA/BNA LAWYERS' MANUAL ON PROFESSIONAL CONDUCT, 414 (Dec. 1992).

³¹ See H.R. 574, 103rd Cong., 1st Sess. (1993).

they simply underline the obligations that lawyers already owe to corporate clients. For a corporation lawyer, it is standing law that the corporation is the client.³² It follows that corporate management is a "third party" whose interests must be subordinated when they conflict with those of the corporation. The *Kaye Scholer* case may be heard as a call to the bar to wake up to that fact.³³

³² E.g., *Lane v. Chowning*, 610 F.2d 1385 (8th Cir. 1979); *Meehan v. Hopps*, 401 P.2d 10 (Cal. Ct. App. 1956). This proposition is of course the legal foundation of the provisions in Rule 1.13 (b) of the MODEL RULES OF PROFESSIONAL CONDUCT.

³³ The courts and agencies, as well as Senators and Congressmen in their "casework," should also be attentive to that fact. See Koniak, *When Courts Refuse to Frame the Law and Others Frame It to Their Will*, 66 S. CAL. L. REV. ____ (1993).