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Ethical Issues in Representing Thrifts

MICHELLE D. MONSE*

I. INTRODUCTION

Assume that a lawyer represents a savings and loan association owned by a holding company. The president of the holding company owns a controlling interest in the stock, and a handful of company directors owns the remainder. During the course of the representation, the lawyer documents and consummates a number of loans. Thrift officers or employees underwrite and approve each of the loans, but many of the loans violate federal savings and loan regulations.

Eventually, the thrift becomes insolvent because of unsafe lending practices. The federal regulators close the institution, pay insured depositors or sell the institution, and fire the law firm. Soon thereafter, the Federal Deposit Insurance Corporation (FDIC), as receiver, brings a malpractice action against the lawyer claiming, in part, that the lawyer had a conflict of interest by favoring the interests of the president and other controlling persons over the interests of the institution.

In this hypothetical situation, who was the attorney’s client? Should the lawyer have depended on the officers and directors of the institution to determine and articulate the best interests of the entity? Did the lawyer owe any duty to depositors or federal regulators? If the lawyer owed any duties to third parties, how did those duties affect the attorney’s other duties of confidentiality and loyalty to the nominal corporate cli-
ent? Should the lawyer have notified regulators if she suspected wrongdoing within the lending institution?

This dilemma of the lending lawyer is far from hypothetical, as a number of former counsel to lending institutions can attest. A number of pending suits based on similar facts allege that attorneys committed malpractice and other legal and ethical violations.¹ Observers expect many

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¹ The Federal Savings and Loan Insurance Corporation (FSLIC) was the plaintiff in suits against professionals prior to the passage of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (codified as amended in scattered sections of U.S.C.) [hereinafter FIRREA]. FIRREA reorganized thrift regulatory agencies and distributed responsibilities among them. The Act dissolved the FSLIC and the Federal Home Loan Bank Board (FHLBB); transferred responsibilities to the existing Federal Deposit Insurance Corporation (FDIC); and created two new agencies, the Resolution Trust Corporation (RTC), and the Office of Thrift Supervision (OTS).

The FDIC, formerly the insurer of commercial banks, now also insures thrift deposits, FIRREA § 211, 103 Stat. 218 (to be codified at 12 U.S.C. § 1821(a)); manages or sells failed thrift institutions as conservator or receiver, FIRREA § 212, 103 Stat. 222 (to be codified at 12 U.S.C. § 1821); and enforces thrift regulations, FIRREA § 902, 103 Stat. 450 (to be codified at 12 U.S.C. § 1818).

FIRREA also created the RTC, which the FDIC manages. The RTC is responsible for resolving thrift failures occurring between Jan. 1, 1989, and August 1, 1992, the third anniversary date of the Act. FIRREA § 501(b)(3), 103 Stat. 369 (to be codified at 12 U.S.C. § 1441a).

FIRREA formed the OTS as a branch of the Department of the Treasury. FIRREA § 301, 103 Stat. 278 (to be codified at 12 U.S.C. § 1462a). The OTS assumed many of the functions formerly performed by the FHLBB, such as regulatory examinations of thrifts. FIRREA § 310, 103 Stat. 282 (to be codified at 12 U.S.C. § 1464).

As a result of these organizational changes, both the FDIC and RTC act as plaintiffs in suits against former thrift counsel.


more suits by various regulatory agencies. Further, Congress recently amended the banking laws to give regulators greater enforcement tools against lawyers and other independent contractors for depository institutions.


This Article will focus on thrifts because of the apparently higher incidence of misconduct within those institutions. But regulators have also sued former bank lawyers. The cases pending against former bank counsel as of April 1, 1991, include: FDIC v. Eckert Seams Cherin & Mellott, No. CV-90-488 (E.D.N.Y. filed Feb. 8, 1990); FDIC v. Cassel, No. 88-854-CIV-ORL-19 (M.D. Fla. filed Sept. 26, 1988); and FDIC v. Rubinstein, No. 87-959-CIV-ORL-18 (M.D. Fla. filed Oct. 29, 1987).


Small firms have also been caught up in the malpractice maelstrom. For example, a threatened suit against a firm in Pine Bluff, Arkansas, reportedly settled for $12 million before suit was filed. Christi Harlan, Arkansas Firm Pays $12 Million Over S&L Claims, WALL ST. J., Sept. 6, 1989, at B7.

The only case that has been tried, to the knowledge of the Author, is FDIC v. Mmahat, 97 B.R. 293 (Bankr. E.D. La. 1988), aff'd in part, rev'd in part, 907 F.2d 546 (5th Cir. 1990), and cert. denied, 111 S. Ct. 1387 (1991), resulting in a judgment of $35 million against counsel and his law firm. The judgment is reportedly one of the largest legal malpractice awards ever. WALL ST. J., Feb. 14, 1988, at A20.

2. 55 Banking Rep. (BNA) 399 (Sept. 10, 1990) (report of press conference given on August 24, 1990, by officials of the OTS indicating the agency's intention to pursue professionals vigorously); Linda Himelstein, Malpractice Mayhem: RTC Officials Eye 140 Suits Against Lawyers, LEGAL TIMES, Nov. 19, 1990, at 1 (RTC expects to pursue additional 140 claims against attorneys).

Responding to the growing body of claims against former counsel, the American Bar Association formed a task force in 1990 to study the liability of counsel for depository institutions. 55 Banking Rep. (BNA) 755 (Nov. 5, 1990). The task force did not expect to complete the study until the autumn of 1991. Telephone interview with Keith Fisher, Chair of ABA Task Force (Mar. 26, 1991).

3. Thrift attorneys now have independent duties under new legislation enacted as a result of the thrift crisis. The savings and loan rescue bill, FIRREA, enacted in 1989, imposes substantial civil and criminal penalties upon attorneys who participate in wrongdoing. The enforcement provisions of the Act now apply to each "institution-affiliated party," a phrase that includes attorneys and other independent contractors.

An attorney is an institution-affiliated party if he or she knowingly or recklessly participated in 1) any violation of law or regulation, 2) breach of fiduciary duty, or 3) unsafe and unsound practice. In addition, the action must have had a significant adverse impact on the institution, or must have caused (or appeared likely to cause) more than a minimal financial loss to the institution. FIRREA § 204(4), 103 Stat. 193 (to be codified at 12 U.S.C. § 1813).

Violations are punishable by a range of civil and criminal penalties. Civil fines for individuals
Because of the immensity of the thrift debacle, public attention has turned to the role of attorneys and other professionals in facilitating misconduct. Although many attorneys would defend the conduct of lending attorneys under an orthodox view of the attorney-client relationship, dissent is beginning to emerge. In discussing the activities of attorneys and accountants who worked for Charles Keating, one of the most notorious thrift operators, one judge recently lamented:

Where were these professionals, a number of whom are now asserting their rights under the Fifth Amendment, when these clearly improper transactions were being consummated?

Why didn’t any of them speak up or disassociate themselves from the transactions?

Where also were the outside accountants and attorneys when these transactions were effectuated?

What is difficult to understand is that with all the professional talent involved (both accounting and legal), why at least one professional would not

range from $5,000 to $1,000,000 per day so long as the violation continues. Id. § 907 (a), 103 Stat. 462 (codified at 12 U.S.C. § 1813).

In a definition that may be even more frightening to attorneys, the statute also says the term “violation” includes “any action... for or toward causing, bringing about, participating in, counseling, or aiding and abetting a violation.” Id. § 204(f), 103 Stat. 193 (codified at 12 U.S.C. § 1813). Since counseling a violation is treated the same way as the underlying primary violation, attorneys might justifiably be concerned that rendering ordinary legal advice might later be penalized under the statute.

The House Banking, Finance, and Urban Affairs Committee said that it did not intend to make attorneys liable for “good faith activities falling within the traditional attorney-client relationship.” H.R. No. 54, 101st Cong., 1st Sess., pt. I, at 467 (1989). But the language of the House Report is sufficiently equivocal to suggest extra caution by attorneys advising thrifts and other depository institutions. For example, the House Report says that advice given when the law or regulations are unclear, even when that advice conflicts with positions taken by regulatory authorities, “would not usually or necessarily show bad faith.” Id. (emphasis supplied). By qualifying the sentence in this way, the Committee implicitly suggests that giving advice of this type could violate the statute in some circumstances.


have blown the whistle to stop the overreaching that took place in this case. 5

Vexing questions, all, and the current law answers them imperfectly. Issues of client identity lie at the heart of the problem. 6 Because of the legal fiction that a corporation is a juridical person separate from any of its constituent parts, the lawyer, it is said, represents that artificial being alone. 7 Yet artificial beings require actual beings to speak and act for them. Ordinarily, the interests of the constituents and the entity coincide — if the entity can be said to have genuine interests of its own. But many instances arise in which the entity's interests are difficult to ascertain, or those interests conflict with constituents' interests or with public policy. At that point, it becomes vital, yet markedly more difficult, for the lawyer to answer the central question, "who is the client?"

The thrift lawyer is not alone in struggling with these issues: lawyers for typical for-profit corporations, 8 close corporations, 9 labor un-

5. Lincoln Sav. and Loan Ass'n v. Wall, 743 F. Supp. 901, 920 (D.D.C. 1990) (Sporkin, J.). Coincidentally, Judge Sporkin worked as Director of Enforcement for the Securities Exchange Commission (SEC) in the 1970s, a period during which the SEC strongly advocated increased responsibilities from securities counsel to the investing public. Sontag, supra note 1, at 1, 31. See also infra text accompanying notes 146-64 for a discussion of some of the SEC's activities during that period.

As of June 1990, two law firms representing Lincoln Savings and Loan Association had settled private fraud claims brought by bondholders, although fraud or malpractice suits by federal authorities were still possible. The thrift's accountants had not yet settled. Rita Jensen, Kaye Scholer Settlement Is Reported, NAT'L L.J., June 11, 1990, at 3, 26.

6. "Financial institution counsel can no longer be sure of the identity of the client . . . or at least how the 'client' will be defined in possible actions against the firm." 55 Banking Rep. (BNA) 755 (Nov. 5, 1990) (discussing an ABA task force established to study the liability of counsel for depository institutions).

7. The Model Rules of Professional Conduct provide that "[a] lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents." MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(a) (1983) [hereinafter MODEL RULES]. "Constituents" includes the officers, directors, employees, and shareholders of corporate clients, or their equivalents in non-corporate clients. Id. Rule 1.13 cmt.

Similarly, the Model Code of Professional Responsibility provides that "[a] lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not a stockholder, director, officer, employee, representative, or other person connected with the entity." MODEL CODE OF PROFESSIONAL RESPONSIBILITY EC 5-18 (1980) [hereinafter MODEL CODE].


9. For a recent look at the subject of close corporations, see Lawrence E. Mitchell, Professional
ions,\textsuperscript{10} and other unincorporated associations\textsuperscript{11} all face similar issues. But the thrift lawyer, unlike lawyers for many other entities, deals with a highly-regulated industry that is strongly imbued with the public interest. When a lawyer is representing a client of this type, the shoe of the traditional entity fiction begins to pinch. Regulators depend on individual lawyers to ensure regulatory compliance. It is the thesis of this article that thrift lawyers had conflicts of interest within the thrift representations. Moreover, based on other case trends, those lawyers had duties of loyalty and disclosure to depositors and regulators, contrary to the traditional entity theory.

II. ORGANIZATION OF THRIFTS AND ALLEGATIONS AGAINST COUNSEL

A. Organization of Thrifts

The savings and loan associations of today barely resemble their forerunners, the building societies or building and loan associations of the nineteenth century. The early building associations financed home construction for working people within small communities. Contemporary thrifts, in contrast, finance commercial projects over broad geographical areas. Still, the tightly-knit nature of the early associations generated structural differences between thrifts and other types of depository institutions, and among thrifts themselves. Many of those differences still exist, and they may affect the ethical duties owed by thrift counsel.

During the nineteenth century, the increasing population and industrialization of this country created a large class of wage earners who had limited savings. These workers needed secure places to put their money, but the commercial banks were not interested in small deposits.\textsuperscript{12} Further, the workers needed a source of home financing, which commercial banks were similarly unwilling to provide.\textsuperscript{13} Relatively small groups of persons organized the building and loan associations to provide a safe

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\textsuperscript{13} Id. at 21.
\end{flushright}
place for members’ savings and a means of financing their residences. The members owned and managed the associations for their mutual benefit. Once all the members had received a loan, the association dissolved itself and distributed any remaining funds among the members.

The associations did not accept deposits from, or make loans to, non-members. Members could not withdraw their funds except by leaving the association entirely, after giving notice and paying a penalty. Members were known as shareholders because, like shareholders in a typical corporation, they owned an equity interest in the assets and were entitled to a share of the association’s earnings. Associations organized according to this model became known as mutual savings associations.

Over time, the building and loan associations changed to better suit the needs of small borrowers. Associations began accepting deposits from those who wished to join the association after its inception, but who did not wish to borrow funds. As the number of participants increased, so did the members’ general unwillingness to manage the institution. Eventually, the members delegated association management to elected directors and officers.

The organizational and ownership structure of the old building associations continues in mutual savings associations today. The mutual associations, as they have evolved, operate much like other forms of thrift associations: they take deposits, pay interest, and make loans. Despite these operational similarities, shareholders in a mutual savings asso-

14. The first American thrift, the Oxford Provident Building Association, had thirty-six charter members when it began in 1831 in Frankford, Pennsylvania. Most of its members were textile workers, and they formed the association “to enable contributors thereof to build or purchase dwelling houses.” ALAN TECK, MUTUAL SAVINGS BANKS AND SAVINGS AND LOAN ASSOCIATIONS 22-24 (1968) (quoting from constitution of Oxford Provident Building Association). The association dissolved ten years later after all members had taken loans.
15. Id. at 22.
16. Id. at 23.
17. R. DAN BRUMBAUGH, JR., THRIFTS UNDER SIEGE 3 (1988). A depositor, in contrast, is a person who delivers an asset to the institution and receives in return a debt obligation of the institution. Id.
18. TECK, supra note 14, at 31-32.
19. As was to recur in the halcyon days of the early 1980s, members of the real estate industry were eager participants in the expansion of building associations.
   Many lawyers and realtors found the management of building associations a useful source of financing for customers and fees for various services, and in the late 19th and early part of the 20th centuries a substantial fraction of the associations were organized as auxiliaries to law and real estate businesses.
19. TECK, supra note 14, at 32.
ciation still "legally own and theoretically control the association and are the residual claimants to its income."²⁰

The other principal form of thrift institution is a stock association. In a stock association, private shareholders own the institution. In contrast to their position in mutual savings association, depositors in a stock association do not own or manage the institution. Instead, depositors are treated as creditors of the institution.²¹

[A stock association] issues a special class of permanent or guarantee stock, which is not withdrawable, as are the ordinary shares of savings and loan associations, but which must be bought and sold at varying prices on the open market. . . .

This institutional form permits a small body of shareholders to assume full legal control of the association.²²

Mutual associations were the dominant form of savings association for many decades.²³ But beginning around 1980, the stock ownership form of association began to gain popularity. By 1988, more than forty percent of insured thrifts were stock associations.²⁴

Although different classes of persons own mutual and stock associations, some evidence suggests that, in most respects, the two types of associations operate similarly. Both mutual and stock associations tend to be dominated by a small group of persons, with power flowing outward from this small control group rather than inward from sharehold-

²⁰. Herman, supra note 18, at 782.

²¹. "In savings and loan associations with capital stock outstanding, as in commercial banks and almost all other types of capital stock organizations, stockholders have all of the membership and ownership rights and obligations. In these institutions, borrowers are debtors and savers are depositor-creditors. . . ." Teck, supra note 14, at 35-36. Cf. Lawrence v. Bank of America, 209 Cal. Rptr. 541 (Ct. App. 1985) (bank and depositor stand in debtor-creditor relationship).

²². Herman, supra note 18, at 782.

²³. The stock form of ownership began to attract interest in the 1880s and 1890s, and again in the 1950s. Id. at 784.

As of 1968, mutual associations represented 85% of the savings associations and 78% of the assets held by thrifts in this country. Id. at 782. Even by the end of 1980, mutual associations still represented 81% of American thrifts. U.S. LEAGUE OF SAVINGS ASSOCIATIONS, '81 SAVINGS AND LOAN SOURCEBOOK 38 (1981) (3,742 of 4,613 thrifts were mutual associations).

²⁴. Of the 2,949 insured thrifts existing as of December 31, 1988, 1,285 (44%) were stock associations. More than a third of the FSLIC-insured stock savings associations were located in just three states: California, Florida, and Texas. U. S. LEAGUE OF SAVINGS INSTITUTIONS, '89 SAVINGS INSTITUTIONS SOURCEBOOK 45-46 (1989).

Some of the reasons for mutual-to-stock conversions include: 1) directors and the public more readily understand the stock organizational form; 2) stock sales increase reserves; 3) the institution can sell debt more inexpensively; 4) the stock form facilitates mergers and acquisitions; and 5) the possibility of stock ownership may aid in the recruitment and retention of management. WALTER J. WOERHEIDE, THE SAVINGS AND LOAN INDUSTRY 178 (1984).
ers. Nonetheless, stock associations tend to grow more quickly, take more risks, and be more profitable than mutual associations. They may also pose greater risks of loss and problems of supervision to regulators.

B. Allegations Against Thrift Counsel

Federal authorities have filed many lawsuits nationally against professionals, such as attorneys, accountants, and appraisers, for their activities on behalf of various savings and loan associations. Although the suits emanate from thrifts of different sizes in different parts of the country, certain fact patterns are common to several of the suits filed against thrift counsel. Often a single, dominant individual controlled the stock of the institution or its holding company. Many of these individuals organized or purchased the thrifts in the early 1980s when various statutory and regulatory changes made thrift ownership a potentially lucrative business. Frequently, the attorneys represented the dominant individ-

25. Id. at 802-03.
27. Id. at 1204. Based on anecdotal evidence gleaned from the complaints filed against counsel, the most troubled thrifts were usually stock associations rather than mutual associations.
28. A list of pending professional liability suits obtained from the FDIC in June of 1990 listed twenty-six suits against attorneys, eighteen against accountants, and sixteen against appraisers. Some of the information on that list, however, was inaccurate. For example, the list did not mention some cases filed the preceding spring.
29. One former attorney for the Federal Home Loan Bank Board identified several recurrent factors in thrift failures: 1) change of control between 1982 and 1984; 2) dominance of the thrift by the owner; 3) use of brokered funds to facilitate growth; 4) cessation of traditional home mortgage financing; 5) concentration on acquisition, development, and construction loan financing. Investigation of Lincoln Savings & Loan Association Hearing Before the House Comm. on Banking, Finance and Urban Affairs, 101st Cong., 1st Sess., pt. II, 286-87 (1989) (prepared statement of William K. Black, former General Counsel for the Federal Home Loan Bank of San Francisco) [hereinafter Investigation of Lincoln Savings]. Several of these factors reappear in the complaints against former thrift counsel.

Among other changes, DIDMCA:
1) Allowed federally-chartered thrifts to make loans on commercial real estate, and investments in corporate debt securities and commercial paper. DIDMCA § 401, 94 Stat. 151-53 (codified at 12 U.S.C. § 1464(c) (1988)). Thrifts historically had been limited to making residential mortgage loans.
2) Began to eliminate interest ceilings payable on thrift deposits, which allowed thrifts to pursue deposits more aggressively. DIDMCA §§ 204-207, 94 Stat. 143-44 (codified at 12 U.S.C. §§ 3503-3506 (1988)).
3) Increased deposit insurance from $40,000 to $100,000, DIDMCA § 308(a)(1), 94 Stat. 147
ual in the initial incorporation or acquisition of the institution and then represented the institution as a whole. Generally, stock ownership was not widely distributed, and boards of directors were often captive to the interests of the controlling person.31

(codified at 12 U.S.C. § 1724 (1988)), which attracted larger depositors, such as money brokers, to thrifts.


A series of regulatory changes also occurred. For example, pursuant to its mandate under DIDMCA, the FHLBB lowered net worth requirements for thrifts, first from 5% to 4% in 1980, Net Worth Amendments, 45 Fed. Reg. 76,111 (Nov. 18, 1980), and then to 3% of liabilities in 1982, 47 Fed. Reg. 3543 (Jan. 26, 1982) (to be codified as 12 C.F.R. § 563.13). The FHLBB also promulgated a series of changes to accounting practices. These so-called “regulatory accounting principles” allowed the FHLBB “to maintain the fiction that many [savings and loan associations] were not . . . insolvent.” GEORGE J. BENSTON, AN ANALYSIS OF THE CAUSES OF SAVINGS AND LOAN ASSOCIATION FAILURES 14 (1985). For an illustration of the different results under regulatory accounting principles and generally accepted accounting principles, see PAUL ZANE PILZER, OTHER PEOPLE’S MONEY: THE INSIDE STORY OF THE S.& L. MESS 75-76 (1989).

In the words of one writer:

Greatly expanded thrift powers and the prospect of both an economic recovery and some fall in interest rates made savings and loan charters very attractive. Being able to form, with as little as $1 million in capital, a new association not burdened by old, low-interest-rate mortgages and having the right to offer depositors federal deposit insurance and a net-worth-to-asset ratio of as little as 3 percent seemed too good to be true. Whether choosing to start from scratch or to buy an existing association, real estate developers, syndicators, mortgage bankers, and many entrepreneurs with no particular specialty immediately sensed opportunity, especially in states where economic growth was rapid and regulations were extremely permissive.


In a 1985 memorandum to examiners, the Federal Home Loan Bank of Chicago identified a number of “abuse flags” warranting greater attention from examiners. The first item on the list was “[A] change in control followed by a dramatic change in operational philosophy,” FEDERAL HOME LOAN BANK OF CHICAGO, Memorandum to Examination Staff (December 24, 1985), reprinted in Adequacy of Federal Efforts to Combat Fraud, Abuse, and Misconduct in Federally Insured Financial Institutions: Hearings Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the House Comm. on Gov’t Operations, 100th Cong., 1st Sess. 740 (1987) [hereinafter Adequacy of Federal Efforts].

31. “[A] recurrent characteristic of institutions, particularly S&Ls, evidencing some type of misconduct is their ownership by one individual or a few individuals with a passive management and board of directors.” HOUSE COMM. ON GOV’T OPERATIONS, COMBATING FRAUD, ABUSE, AND MISCONDUCT IN THE NATION’S FINANCIAL INSTITUTIONS: CURRENT FEDERAL EFFORTS ARE INADEQUATE, H.R. REP. NO. 1088, 100th Cong., 2d Sess. 33-34 (1988) [hereinafter COMBATING FRAUD].
Following the changes of control, many of these lending institutions grew wildly. The lawyers and their firms generally served as the principal or sole counsel for the lending institution, closing a number of real estate loans and other transactions. Individual lawyers frequently were directors, some also became officers in the institutions. A few lawyers became such active managers of the institutions that they later were held criminally liable for their misconduct.

Counsel were involved in many transactions that allegedly violated various federal and state regulations, such as the federal limits on aggregated loans to a single borrower or its affiliates (known as the "loans-to-one-borrower" or "LTOB" rule) and loans to insiders. Some transac-

32. Empire Savings and Loan of Mesquite, Texas, for example, grew from $40 million in assets to $320 million between September 1982 and September 1983. John Ring Adams, The Big Fix 206 (1990). This growth level was typical for many thrifts in Texas: for the forty-one most troubled thrifts, assets grew by 190%, between 1982 and 1986, compared to 68% nationally. Governor's Task Force on the Savings and Loan Industry, Report to the Honorable William P. Clements, Jr. 11 (Jan. 25, 1988) (copy on file with Author).

Silverado Savings and Loan of Denver, Colorado, grew from $216 million in assets to $1.8 billion in assets between 1982 and 1986, a growth rate of more than 800%. Complaint at 8, FDIC v. Wise, No. 90-F-1688 (D. Colo., filed September 21, 1990).

Some of this dramatic growth may have stemmed from practices critics later found questionable, such as the heavy reliance on brokered deposits. Adams, supra, at 206. Brokered deposits, known colloquially as "hot money," were large accumulations of cash deposited in thrifts by money market funds or other deposit brokers, in search of the highest interest rates. "Unlike individual deposit accounts, brokered deposits could be — and were — moved daily in search of better returns.... For the most part, individual savers had neither the ability nor the inclination to shift their money around that often." Pilzer, supra note 30, at 72. Brokered deposits made the asset positions of thrifts appear robust, even though that appearance could change, literally, overnight. But see Benston, supra note 30, at 169. ("[I]t cannot be concluded that brokered deposits should be singled out from among other sources of funds as the cause of the failures [occurring between 1981 and 1985], though brokered deposits (among other sources) could have permitted risk-seeking [savings and loan associations] to have obtained funds for their adventures.").

33. See, e.g., Complaint at 8, FDIC v. Wise, No. 90-F-1688 (D. Colo. filed Sept. 21, 1990) (attorney served as director of thrift holding company).


35. See, e.g., United States v. Vineyard, 699 F. Supp. 103 (N.D. Tex. 1988), aff'd sub nom. United States v. Ryan, 874 F.2d 1052 (5th Cir. 1989). Laurence B. Vineyard, Jr., had served as attorney or director to a number of thrifts, including Key Savings and Loan Association of Englewood, Colorado; Brownfield Savings and Loan Association of Brownfield, Texas; and State Savings and Loan Association of Lubbock, Texas. Complaint at 4-5, FSLIC v. Vineyard, No. CA5-87-124 (N.D. Tex. filed June 17, 1987).

36. 12 C.F.R. § 563.93 (1991). Prior to FIRREA, the rule was codified at 12 C.F.R. § 563.3 (1989). One oft-used vehicle was the nominee loan, in which a straw person acted as the nominal borrower and the loan proceeds benefitted another person. Adequacy of Federal Efforts, supra note 30, at 605 (appendix to testimony of Oliver B. Revell, Executive Assistant Director, FBI, listing five most typical frauds used in financial institutions).
tions were merely temporary transfers of loans between various lending institutions in order to improve an institution's financial appearance before an imminent regulatory examination.\textsuperscript{38} Many institutions engaged in a number of other activities apparently designed to hide their true financial condition from regulators.\textsuperscript{39} Some other common transactions, such as "land flips," were not directly designed to evade federal regulations, but rather to benefit certain persons connected with the thrift.\textsuperscript{40} Extravagant spending on corporate offices, executive homes, company parties, executive salaries, and other perquisites also gained tremendous public attention.\textsuperscript{41}

Authorities differ on the role of fraud or misconduct by thrift insid-
ers and related outsiders. One House Report estimated that more than three-quarters of thrift insolvencies were at least partly attributable to misconduct. 42 Although at least one writer has disputed the exact role of abusive activities in thrift failures, 43 some of the most expensive thrift failures allegedly involved misconduct. 44

The FDIC’s allegations against lawyers are not uniform, but they fall into two large categories of negligence and breach of fiduciary duties. Within those two larger categories, several issues recur:

1) Participation in insider misconduct. Attorneys purportedly participated or assisted misconduct by structuring transactions that violated internal lending policies, federal regulations, federal supervisory agreements or cease and desist orders. 45 Common regulatory violations include loans-to-one-borrower limits and loans to affiliates. These allegations are sometimes phrased as aiding and abetting

42. Serious misconduct by senior insiders or outsiders (i) has caused, has contributed to, or was present in the insolventcies of most banks, savings and loans (S&Ls), and credit unions, and (ii) also has caused large losses in unhealthy and healthy institutions, during the period 1984 through the first-half of 1987. At least one-third (and probably more) of commercial bank failures and over three-quarters of all S&L insolventcies appear to be linked in varying degrees to such misconduct . . . .

COMBATING FRAUD, supra note 31, at 10.

The Committee included a wide range of activities within the definition of misconduct. Generally, the term encompassed any action designed to benefit the actor (or an associate of the actor) to the detriment of the institution. Examples include the payment of excessive compensation and fees, the extension of preferential treatment to friends or business associates, the acceptance of kickbacks from customers, the extension of loans to oneself, and the disregard of underwriting standards. Id. at 7-9.

43. “The bulk of the insolvent thrifts’ problems . . . did not stem from . . . fraudulent or criminal activities. These thrifts largely failed because of an amalgam of deliberately high-risk strategies, poor business judgments, foolish strategies, excessive optimism, and sloppy and careless underwriting, compounded by deteriorating real estate markets.” WHITE, supra note 40, at 117 (emphasis omitted). Even White, however, does not dispute that many violations occurred. Moreover, one observer has explained the differences of opinion as attributable, in part, to definitional differences of the terms “fraud” and “insider abuse.” Fraud in America’s Insured Depository Institutions: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs, 101st Cong., 2d Sess. 237 (1990) (statement of Prof. Benton E. Gup, Ph.D.) [hereinafter Fraud in Depository Institutions]

44. For example, the failure of Lincoln Savings and Loan Association, of Irvine, California, operated by Charles Keating, is estimated to cost $2.5 billion. Stephen Labaton, N.Y. TIMES, June 16, 1990, at A1, A31. The FDIC alleges that the failure of Vernon Savings and Loan Association of Dallas, Texas, will cost $1 billion. Complaint at 6, Bauman (No. CA-93-90-614-H).

breaches by insiders.\textsuperscript{46}

2) Conflicts of interest and failures to exercise independent professional judgment. Attorneys allegedly favored the interests of one group of insiders or favored borrowers at the expense of the institution, advanced their own interests, or failed to disclose conflicts to disinterested management.\textsuperscript{47}

3) Failures to monitor or supervise. Some complaints charge that law firms did not adequately monitor the behavior of attorneys within their ranks and did not establish sufficient internal procedures to protect against misconduct by those attorneys.\textsuperscript{48}

4) Failures to protect depositors after learning of misconduct or to disclose appropriate information to regulators. Although the number of complaints in this category is small, the FDIC has alleged that counsel had some duties — albeit not clearly defined in the complaints — to depositors or the regulators, or both.\textsuperscript{49}

The position of federal regulators can be discerned from additional sources. In a controversial speech, Harris Weinstein, the Chief Counsel of the Office of Thrift Supervision (OTS), opined that thrift fiduciaries (a group that presumably includes counsel) have a duty to federal regulators to avoid losses, and that this duty is heightened as the institution


\textsuperscript{49} For example, the FDIC has alleged that thrift counsel in one case failed to protect depositors after the lawyers knew of misconduct within the entity. Complaint at 21, FDIC v. Bauman, No. CA3-90-614-H (N.D. Tex. filed March 19, 1990). In another case, the FDIC has alleged that the firm aided and abetted breaches of fiduciary duty by actors within the thrift by "failing to disclose or misrepresenting to federal regulators facts concerning the [savings and loan] associations." Complaint at 52, FDIC v. Jones, Day, Reavis & Pogue, No. A-90-CA-925 (W.D. Tex. filed Oct. 30, 1990).
approaches insolvency.\textsuperscript{50} Although the FDIC has not embraced that theory fully, at least one representative of the agency believes that thrift counsel are obligated to disclose certain information to regulators.\textsuperscript{51}

The fact patterns in these suits bring the problems of entity representation into sharp relief. Unfortunately, as the next section indicates, the ethical codes provide little assistance in resolving those problems.

III. REPRESENTATION OF ENTITIES AND DISCLOSURE OF WRONGDOING UNDER THE ETHICAL CODES

In the typical conception of the attorney-client relationship, an individual retains an attorney to resolve a discrete problem, usually through litigation. The earliest codes of ethics reflected that paradigm, despite the myriad changes that had already occurred in legal services. Even the present ethical codification of choice, the Model Rules of Professional Conduct (Model Rules),\textsuperscript{52} preserves older notions of the professional relationship while recognizing some modern problems.

A. The Canons of Professional Conduct

The American Bar Association (ABA) first attempted to develop national ethical standards in 1908, by adopting the Canons of Professional Conduct (1908 Canons).\textsuperscript{53} The bar drew the 1908 Canons largely


\textsuperscript{51} [T]he legal division of the Federal Deposit Insurance Corporation has not embraced the view . . . thus far articulated by Harris Weinstein.

\ldots [But w]e think it appropriate to assert a duty owed to the regulators who need, in their examinations, to rely upon the quality of the institution's financial information. I don't think it's an unreasonable burden to expect those who have relevant data affecting the financial condition of an institution to disclose those data.


\textsuperscript{52} As of December 19, 1990, thirty-nine states had adopted the Model Rules in some form, and ten states still retained the Model Code. California has never adopted either the Model Code or Model Rules. 1 AMERICAN BAR ASSOCIATION, LAWYER'S MANUAL ON PROFESSIONAL CONDUCT (BNA) 1:3-4 (1990) [hereinafter ABA/BNA MANUAL].

\textsuperscript{53} AMERICAN BAR ASSOCIATION, CANONS OF PROFESSIONAL CONDUCT (1908) [hereinafter 1908 CANONS]. The original thirty-two canons were amended and supplemented beginning in 1928. See AMERICAN BAR ASSOCIATION, OPINIONS OF THE COMMITTEE ON PROFESSIONAL ETHICS AND GRIEVANCES at ix (1957). Ultimately, there were forty-seven canons before the adoption of the Model Code. For convenience, the original canons, additions, and amendments, will be collectively referred to as the 1908 CANONS.
from an ethics code Alabama adopted in 1887, the code based on the published lectures of a jurist in the mid-nineteenth century. The 1908 Canons exalted the view of law practice as a discreet matter between gentlemen. Whether that view was accurate is questionable. The Canons' genteel view probably resulted from the alchemy of memory, or from the desire of the ABA to glorify the profession, rather than from a dispassionate assessment of the bar at the time.

1. **Entity Representation Under the 1908 Canons.** The original 1908 Canons focused on trial practice, and emphasized the relationships between lawyers and clients, and among lawyers, rather than focusing on any broader sense of the responsibility of the bar. They scarcely mentioned representation of organizations; any references they did contain were merely cursory. None of the Canons were directed to the particular problems of organizational lawyers.

Canon 32 briefly mentioned that the lawyer should disregard the wishes of clients, individual and corporate, if those wishes conflicted with the lawyer's role as an officer of the court. The thrust of the canon was the lawyer's general duties to the system, not the special problems of entity representation. Canon 35 provided that organizations could hire

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55. G. Sharswood, An Essay on Professional Ethics (1854), reprinted in 32 ABA Rep. 1 (1907)). The Alabama Code of Ethics was also derived from resolutions written by a Maryland practitioner, David Hoffman, earlier in the nineteenth century. See David Hoffman, Hoffman’s Fifty Resolutions in Regard to Professional Deportment, reprinted in Drinker, supra note 54, at 338.

56. Charles W. Wolfram, Modern Legal Ethics § 2.6.2 (1986). Professor Wolfram contends that the ABA, which included a proportionally small number of lawyers, wished to enhance the stature of American lawyers by promulgating national ethical standards.

57. The canons of ethics put dominant emphasis on the lawyer-client and lawyer-lawyer relationships. Their next most striking emphasis was the overwhelming extent to which they focused on situations arising out of litigation. . . . Litigation held a decreasing relative, if not absolute, position in lawyers' business, compared with matters of office counseling and compared with lawyers' relations to legislative, executive, and administrative bodies. Despite this shift in the direction of law practice, the formal thinking of the profession about its ethical problems clung to the early nineteenth-century stereotype of the lawyer as advocate. It had little to say — and that in most uninformative generalities — about the main currents of law practice as these took direction after 1870.


58. The text of the canon read, in part:

No client, corporate or individual, however powerful, nor any cause, civil or political, however important, is entitled to receive nor should any lawyer render any service or advice involving disloyalty to the law whose ministers we are, or disrespect of the judicial office, which we are bound to uphold, or corruption of any person or persons exercising a public office or private trust, or deception or betrayal of the public. When
attorneys to act for them "in any matter in which the organization, as an entity, is interested, but this employment should not include the rendering of legal services to the members of such an organization in respect to their individual affairs."59 The main point of Canon 35 was to require that lawyers work directly with clients, not to address entity representations in particular.

The principal articulation of the entity notion during the reign of the 1908 Canons came from ethics opinions rather than the canons themselves.60 The ABA's ethics opinions regarding entity issues, few in number at the outset,61 have been nearly as feckless in guiding the entity lawyer as the ethical codes on which they were putatively based. One early ethics decision rendered under the 1908 Canons articulated the notion of the entity as client. An attorney sought an opinion whether the general counsel of a corporation could properly solicit proxies from stockholders on behalf of one group in a fight for management control. In responding negatively to the question, the committee said, "[t]he client of the general counsel of the corporation is the corporation itself... [The lawyer] is acting as the corporation's attorney only and not as the attorney of any of its stockholders, directors or officers as individuals, or any group or faction thereof."62 The authority for this proposition is unclear since the 1908 Canons did not explicitly provide it.

In another of its rare corporate-related opinions, the ethics committee recognized the role of corporate managers, but still did not answer important questions. In an informal opinion in 1968, the committee concluded that a corporate attorney could advise the corporate president how to defeat an attempt by minority shareholders to gain control of the rendering any such improper service or advice, the lawyer invites and merits stern and just condemnation.

1908 CANONS, supra note 53, No. 32.
59. 1908 CANONS, supra note 53, No. 35.
60. In 1922, the ABA authorized a pre-existing standing committee to interpret the ethical rules. ABA Comm. on Ethics and Professional Responsibility, Formal and Informal Ethics Opinions 1 (1985). The Committee was known for a time as the Committee on Professional Ethics and Grievances and the Committee on Professional Ethics, but has been known since 1971 as the Committee on Ethics and Professional Responsibility. Id. at 2. The task of the Committee is "to formulate opinions of general application, or to render advisory opinions where a lawyer is in doubt contemplated action would be ethical." ABA Comm. on Professional Ethics, Informal Op. 649 (1963).
board of directors. The committee said,

[A] corporation can function only through activities of those individuals who as directors shape and determine policies and make major decisions for the corporation and those individuals who as officers conduct its affairs and operations. . . . In acting as counsel for a corporation a lawyer not only may but should give legal advice to its officers in all matters relating to the corporation as long as they are in office, except in situations where to his knowledge the interests of the officers are adverse to the interests of the corporation and the giving of the advice would be contrary to the interests of the corporation.

The committee still begged the question. Although it stated that the attorney was entitled to rely on management unless he or she knew the rendition of advice would be contrary to the interests of the corporation, it offered no guidance to the attorney who has to decide when he or she has reached that juncture. Nor did it advise the attorney how to identify the corporation's interests.

The opinion also conflicted with the earlier Formal Opinion 86, rendered in 1932, in which the committee had found it improper for the corporate general counsel to solicit proxies in the midst of a proxy fight. One could argue that the facts in Formal Opinion 86 are distinguishable from the later Informal Opinion 1056. In Formal Opinion 86, corporate counsel was actively participating in proxy solicitation, rather than responding to a request for advice from the corporation, acting through its directors, as did the attorney in Informal Opinion 1056. But it is difficult to say with the same glib presumptuousness that characterizes Informal Opinion 1056 that the directors seeking advice in that case were acting purely from a desire to protect the corporation. The direc-

64. Id.
65. ABA Comm. on Professional Ethics and Grievances, Formal Op. 86 (1932). The committee said:

... [T]he client of the general counsel of a corporation is the corporation itself. As a corporation speaks and acts only through its officers and directors, its counsel is their legal advisor in respect to its affairs, but in performing that duty he is acting as the corporation's attorney only and not as the attorney of any of its stockholders, directors or officers as individuals, or any group or faction thereof.

In acting as the corporation's legal adviser he must refrain from taking part in any controversies or factional differences which may exist among stockholders as to its control. When his opinion is sought by those entitled to it, or when it becomes his duty to voice it, he must be in position to give it without bias or prejudice and to have it recognized as being so given. Unless he is in that position his usefulness to his client is impaired.

In the case of conflict between a formal opinion and a later informal opinion, the formal opinion controls. ABA Comm. on Professional Ethics and Grievances, Formal Op. 317 (1967).
tors obviously had a strong personal interest in the outcome of the fight with minority stockholders.

In effect, the ethics committee in Informal Opinion 1056 permitted the corporate counsel to offer advice to one of the constituent groups, while still pledging allegiance to the entity-as-client notion. The committee again tossed the underlying question — defining the corporation's best interests — squarely back in the attorney's lap.

2. Disclosure of Client Wrongs Under the 1908 Canons. The 1908 Canons protected client confidences in Canon 37: "[i]t is the duty of a lawyer to preserve his client's confidences. This duty outlasts the lawyer's employment, and extends as well to his employees . . . ."66 Canon 37 created exceptions to this duty for responding to the client's accusations and the client's announced intention to commit a crime.67

Canon 29 suggested that a lawyer should disclose perjury occurring during a trial to the prosecutor, although the canon did not distinguish between the perjury of clients and the perjury of other witnesses.68 Canon 41 also mandated disclosure of information if a lawyer discovered "some fraud or deception has been practiced, which has unjustly imposed upon the court or a party"69 and the client refused to rectify it. But the Committee on Professional Ethics and Grievances opined in 1953 that Canon 37, the general confidentiality rule, controlled Canon 41.70 Accordingly, a lawyer could not ethically reveal to a court the client's perjury occurring during the representation. The lawyer should attempt to convince the client to tell the truth, but could only withdraw if the client refused to do so.

66. 1908 CANONS, supra note 53, No. 37.
67. If a lawyer is accused by his client, he is not precluded from disclosing the truth in respect to the accusation. The announced intention of a client to commit a crime is not included within the confidences which he is bound to respect. He may properly make such disclosures as may be necessary to prevent the act or protect those against whom it is threatened.

1908 CANONS, supra note 53, No. 37.
68. Canon 29 said, in part, "[t]he counsel upon trial of a cause in which perjury has been committed owe it to the profession and to the public to bring the matter to the knowledge of the prosecuting authorities." 1908 CANONS, supra note 53, No. 29.
69. 1908 Canons, supra note 53, No. 41, which reads in full:
When a lawyer discovers that some fraud or deception has been practiced, which has unjustly imposed upon the court or a party, he should endeavor to rectify it; at first by advising his client, and if his client refuses to forego the advantage thus unjustly gained, he should promptly inform the injured person or his counsel, so they may take appropriate steps.

1908 CANONS, supra note 53, No. 41.
The committee dealt with the issue of misconduct by a corporate actor in Formal Opinion 202.\textsuperscript{71} In that case, a manager of a trust company embezzled funds belonging to trust beneficiaries. Recognizing its liability for the defalcations of its employee, the trust company proposed to purchase the outstanding beneficial interests of the trust beneficiaries in order to eliminate its liability. The company’s attorney approved this plan with the caveat that the company first disclose the embezzlement to the beneficiaries. The company disregarded his advice and completed the transaction without making the suggested disclosure.

The committee concluded that the trust company attorney could disclose the entire situation to the board of directors, but not to others because of the confidentiality rule of Canon 37. The committee looked only to Canon 37 for an exception to confidentiality, saying that disclosure might have been appropriate if the attorney had learned in advance of the trust company’s nondisclosure to the trust beneficiaries and that nondisclosure was also a crime. Oddly, the committee never mentioned Canon 41, which dealt directly with the imposition of a fraud by the client. Further, the committee did not say what the attorney should have done if the board of directors did not try to rectify the fraud, although Canon 16 suggested that a lawyer should withdraw if a client persisted in improper conduct.

B. \textit{The Model Code of Professional Responsibility}

1. \textit{Entity Representation Under the Model Code.} The 1908 Canons were amended several times,\textsuperscript{72} but the deficiencies of the rules were too widespread to be resolved by intermittent amendment.\textsuperscript{73} Eventually, the committee assigned to study the subject\textsuperscript{74} developed the Code of Professional Responsibility (Model Code), which the bar adopted in 1969.\textsuperscript{75} The Model Code improves upon the 1908 Canons in many respects, but

\begin{itemize}
  \item \textsuperscript{71} ABA Comm. on Professional Ethics and Grievances, Formal Op. 202 (1940).
  \item \textsuperscript{72} \textsc{American Bar Association}, \textit{Opinions of the Committee on Professional Ethics and Grievances} at ix (1957).
  \item \textsuperscript{73} ABA Special Comm. on Evaluation of Ethical Standards, \textit{Code of Professional Responsibility}, Preface at vi (Preliminary Draft, January 15, 1969).
  \item \textsuperscript{74} The House of Delegates to the ABA created the Special Committee on Evaluation of Ethical Standards in 1964 at the behest of Justice Lewis F. Powell, Jr., then president of the ABA. \textit{Id.} at v.
  \item \textsuperscript{75} By 1974, every state except California had either officially adopted or unofficially approved the Model Code. \textsc{Wolfram}, \textit{supra} note 56, § 2.6.3. The general deficiencies of the 1908 Canons and the structure of the Model Code are described in John F. Sutton, Jr., \textit{The American Bar Association Code of Professional Responsibility: An Introduction}, 48 Tex. L. Rev. 255 (1970). The word “Model” was added to the title of the document in 1978 following a settlement with the Justice Department over antitrust allegations. \textsc{Wolfram}, \textit{supra} note 56, § 2.6.3.
\end{itemize}
still pays insufficient attention to the problems of entity lawyers. The principal guidance to an entity lawyer under the Model Code resides in an Ethical Consideration, which states, "[a] lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity."77

In its preliminary forms, EC 5-18 was narrower in scope and was directed toward in-house counsel. For example, the earliest draft of the provision said, "[a] lawyer employed as such on a salaried basis by an entity, regardless of its type, is in a position distinct from that of other lawyers. His allegiance is owed to the entity. . . ."78 Eventually the drafters broadened the provision to include any attorney "employed or retained by an entity."79

The drafters rigidly adhered to the notion that the true client was the entity alone, even to the point of removing token recognition of the essential role of entity representatives. The preliminary and tentative drafts had contained the provision that "[i]n advising an entity through a stockholder, director, employee, or representative, [the attorney] should keep paramount its interests. . . ."80 But the drafters deleted most of the first clause, which had recognized, at least implicitly, that entities cannot act except through representatives. As a result, the provision has an artificial air. It perpetuates the image of the entity client as a sterile and inanimate monolith. The reality of entity representations is quite different.81

76. The Model Code is organized into nine canons. A canon is a general statement of obligation, such as, "[a] lawyer should exercise independent professional judgment on behalf of a client." MODEL CODE, supra note 7, at 5. Under each canon, the Model Code contains Ethical Considerations (ECs) and Disciplinary Rules (DRs). The ECs are "aspirational in character and represent the objectives toward which every member of the profession should strive. They constitute a body of principles upon which the lawyer can rely for guidance in many specific situations." MODEL CODE, supra note 7, Preliminary Statement. The DRs provide the minimal standards for attorney behavior. Although a lawyer can be disciplined only for violation of a DR, a few courts have viewed the ECs as binding. WOLFRAM, supra note 56, at § 2.6.3.

77. MODEL CODE, supra note 7, EC 5-18.

78. ABA SPECIAL COMM. ON EVALUATION OF PROFESSIONAL STANDARDS, CODE OF PROFESSIONAL RESPONSIBILITY EC VI-17 (Tentative Draft, October 1968) [hereinafter cited as MODEL CODE TENTATIVE DRAFT]. The Model Code Tentative Draft of this canon is excerpted and discussed in AMERICAN BAR FOUNDATION, ANNOTATED CODE OF PROFESSIONAL RESPONSIBILITY 224 (1979).

79. MODEL CODE, supra note 7, EC 5-18.

80. MODEL CODE TENTATIVE DRAFT, supra note 78, EC VI-17 (emphasis added).

81. In the words of Professor Charles Wolfram, "[t]he answers to the question of relationship given in the lawyer codes tend to be pat and satisfyingly high-minded but insufficient in dealing with the complex texture of real corporate life." WOLFRAM, supra note 56, § 13.7.2. Professor Geoffrey
2. Disclosure of Client Wrongs Under the Model Code. The Model Code permits far more disclosure of client confidences than its predecessor or successor. The Model Code obligates the lawyer not to disclose either "confidences" or "secrets." It defines the former as information protected under the attorney-client privilege, and the latter as other information that the client disclosed in confidence or that would be embarrassing or damaging to the client if revealed. The Model Code permits attorneys to reveal the client's intention to commit a crime, and confidential information if permitted by other ethical rules.

Another rule in the Model Code requires an attorney to reveal a client fraud to the defrauded person if the fraud occurred during the representation and the client cannot or will not rectify the fraud. This rule, DR 7-102(B)(1), does not require such disclosure if the information is "protected as a privileged communication." The ABA added the exception in 1974, but not all the states using the Model Code adopted the change. The exception, which refers to "privileged communication," could have been interpreted as forbidding disclosure of only "confidences," since the Model Code defines that term as information protected by the attorney-client privilege. But in a later ethics opinion, the ABA Committee on Ethics and Professional Responsibility held that the term "privileged communication" refers to both confidences and secrets. If that interpretation is correct, then the exception to DR 7-102(B)(1) vitiates the rule. But the general rule of confidentiality, DR 4-101(C), still permits an attorney to disclose a client's intention to commit a crime. Even under the enervated version of DR 7-102(B)(1), an attorney still may disclose fraudulent conduct so long as it would also constitute a future crime.

Hazard has also noted the evasiveness of EC 5-18, since it does not guide the attorney during the critical times of conflicts within an entity. See, e.g., Geoffrey C. Hazard, Jr., Ethics in the Practice of Law, 46 (1978) (Professor Hazard has also noted the evasiveness of EC 5-18, since it does not guide the attorney during the critical times of conflicts within an entity). For further criticism of the Model Code and its treatment of corporations, in particular, see Pierce, supra note 61.

82. MODEL CODE, supra note 7, DR 4-101(B).
83. Id. DR 4-101(A).
84. Id. DR 4-101(C).
85. Id. DR 7-102(B)(1).
86. As of 1974, forty-nine states had officially or unofficially adopted the Model Code. WOLFRAM, supra note 56, § 2.6.3. Of those states, thirty-eight did not adopt the 1974 amendment and therefore still required an attorney to rectify client fraud. See Robert A. Burt, 69 Geo. L.J. 1015, 1017 n.14 (1981).
C. The Model Rules of Professional Conduct

1. Entity Representation Under the Model Rules. After only a few years, the criticism of the Model Code was intense. In 1977, the ABA formed the Kutak Commission to examine the Model Code and suggest revision or reformulation. The Commission decided that a completely new set of rules was necessary, rather than a revision of the Model Code. The Commission proposed the Model Rules, which the House of Delegates approved in 1983.

The Kutak Commission submitted its first Discussion Draft of the Model Rules in 1980. In response to criticism that the Model Code ignored substantial practice areas outside litigation, the Commission drafted special rules for government and organization lawyers and emphasized the various roles of the attorney, such as advisor and intermediary. During the drafting and discussion process, some critics suggested that the Model Rules should adopt a "group theory" of organizational representation. That is, the lawyer for an organization should be "regarded as acting on behalf of a group of individuals who are associated with each other in an organization." Under this view, organizational representation would be a species of joint representation. But the


90. The elaborate structure of the Model Code was often criticized, so the Model Rules are arranged in a different fashion. Instead of the tripartite organization of Canons, ECs, and DRs, the Model Rules consist of mandatory rules and explanatory comments. "The Comment accompanying each Rule explains and illustrates the meaning and purpose of the Rule. . . . The Comments are intended as guides to interpretation, but the text of each Rule is authoritative." MODEL RULES, supra note 7, Preamble, Scope and Terminology.

91. MODEL RULES OF PROFESSIONAL CONDUCT (Discussion Draft 1980) [hereinafter MODEL RULES DISCUSSION DRAFT].

92. MODEL RULES, supra note 7, Rule 1.11 (government lawyer), and id., Rule 1.13 (organization as the client).

93. Id. Rule 2.1.

94. Id. Rule 2.2.


96. The Roscoe Pound-American Trial Lawyers Foundation (ATLF) proposed its own code in 1980. AMERICAN TRIAL LAWYERS FOUNDATION, THE AMERICAN LAWYER'S CODE OF CONDUCT (Public Discussion Draft, June 1980) [hereinafter ATLF CODE]. Rule 2.5 views the board of direc-
Kutak Commission remained faithful to the notion of the entity as the client. It changed slightly the section of the rule dealing with client identity. Ultimately, Model Rule 1.13 provided that an attorney representing an organization "represents the organization acting through its duly authorized constituents." 2

2. Disclosure of Client Wrongs Under the Model Rules. Perhaps the largest single source of controversy within Model Rule 1.13, as originally proposed, was a provision that would have permitted disclosure

97. MODEL RULES, supra note 7, Rule 1.13(a).

The full text of the rule is as follows:

Rule 1.13 Organization as Client
(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.
(b) If a lawyer for an organization knows that an officer, employee, or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, the lawyer shall proceed as is reasonably necessary in the best interest of the organization. In determining how to proceed, the lawyer shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the lawyer's representation, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters and any other relevant considerations. Any measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to person outside the organization. Such measures may include among others:
(1) asking reconsideration of the matter;
(2) advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization; and
(3) referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law.
(c) If, despite the lawyer's efforts in accordance with paragraph (b), the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, that is clearly a violation of law and is likely to result in substantial injury to the organization, the lawyer may resign in accordance with Rule 1.16.
(d) In dealing with an organization's directors, officers, employees, members, shareholders, or other constituents, a lawyer shall explain the identity of the client when it is apparent that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.
(e) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders, or other constituents, subject to the provisions of Rule 1.7 [the general conflicts of interest rule]. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.
outside the entity under some circumstances. If an attorney knew of a clear legal violation that was "likely to result in significant injury to the organization" and the highest governing authority of the organization refused to remedy the situation, the lawyer had the discretion to disclose the information outside the organization if disclosure was in the organization's best interests. The attorney could reveal the information to members, shareholders, or public authorities. Critical reaction was swift and indignant. Eventually, the bar changed the rule to permit withdrawal from the representation, rather than disclosure, as the lawyer's last resort.

Other provisions of the Model Rules also discuss the issue of an attorney's discretionary or mandatory duties to disclose client wrongs. Model Rule 1.6, which defines the general ethical duty of confidentiality, prohibits disclosure of information relating to the representation.

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98. MODEL RULES DISCUSSION DRAFT, supra note 91, Rule 1.13(c).
99. Id. at Rule 1.13. The Commission's concern with disclosure of wrongdoing was the outgrowth of several highly publicized cases in the 1970s. In cases such as SEC v. National Student Marketing Corp., 457 F. Supp. 682 (D.D.C. 1978), the SEC alleged that securities lawyers had a duty to disclose to regulators securities violations committed by their clients. The SEC filed the case in 1972. The complaint is reprinted in [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,360.
100. In the foreword to the public discussion draft of the ATLF Code, the authors sniffed, "[t]he proponents of an alternative to this Code have apparently forgotten that [our system of justice is an adversary one]. Their most recent draft would erode basic constitutional protections by making the lawyer the agent of the state, not the champion of the client, in many important respects." ATLF CODE, supra note 98, at iii. See also Monroe H. Freedman, Lawyer-Client Confidences: The Model Rules' Radical Assault on Tradition, 68 A.B.A. J. 428 (1982) (the traditional strict protection of lawyer-client confidences is necessary to maintain the traditional relationship between lawyer and client).
101. See supra note 97 for the full text of the rule as adopted.
102. MODEL RULES, supra note 7, Rule 1.6, which provides:
   Rule 1.6 Confidentiality of Information
   (a) A lawyer shall not reveal information relating to the representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraph (b).
   (b) A lawyer may reveal such information to the extent the lawyer reasonably believes necessary:
      (1) to prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm; or
      (2) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client.
103. See also MODEL CODE, supra note 7, DR 4-101(B) (prohibiting disclosure of "confidences" or "secrets"). The Model Code defined confidences as information protected by the attorney-client
except in limited circumstances. The Model Rules' exceptions to confidentiality are narrower than the Model Code's exceptions. The Model Code permits disclosure of a client's intention to commit any crime, not just those involving serious bodily harm.\textsuperscript{104} And the Model Code, before the 1974 amendment, seemingly mandated disclosure of client crime or fraud occurring during the representation if the client could not or would not rectify his or her conduct.\textsuperscript{105}

The Model Rules, in contrast, do not contain any parallel provision for disclosure of client fraud. Professor Geoffrey Hazard, however, argues strongly that the second express exception to confidentiality — "to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved"\textsuperscript{106} — permits an attorney to disclose client wrongdoing if the attorney fears being charged with complicity.\textsuperscript{107}

Curiously, Model Rule 1.6 does not contain exceptions for disclosures needed to comply with other rules, or other law, although earlier forms of the rule did so.\textsuperscript{108} For example, the rule itself does not contain an exception for an attorney who has been ordered to testify over claims of attorney-client privilege. The comment to the rule suggests that disclosure under these circumstances is permitted.\textsuperscript{109} But the comments to the rules are not authoritative.\textsuperscript{110} That the ABA House of Delegates would have relegated such an important exception to a non-binding com-

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\textsuperscript{104} \textit{Model Code}, supra note 7, DR 4-101(A).

\textsuperscript{105} Id. DR 7-102(B)(1), which provides:

(B) A lawyer who receives information clearly establishing that:

(1) His client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal, except when the information is protected as a privileged communication.

\textsuperscript{106} \textit{Model Rules}, supra note 7, Rule 1.6(b)(2).

\textsuperscript{107} 1 Hazard & Hodes, supra note 95, at 143-45, 174-75. \textit{But see} Monroe H. Freedman, Understanding Lawyers' Ethics 105 (1990) (stating that Model Rule 1.6(b)(2) requires that charges be pending against the attorney).

\textsuperscript{108} \textit{Model Rules Discussion Draft}, supra note 91, Rule 1.7(c) (permitting disclosure to serve the client's interests, to prevent or rectify the client's wrongful acts, to establish claims or defenses of the lawyer in disputes with the client, or to comply with law or other rules of professional conduct).

\textsuperscript{109} "The lawyer must comply with the final orders of a court or other tribunal of competent jurisdiction requiring the lawyer to give information about the client." \textit{Model Rules}, supra note 7, Rule 1.6 cmt.

\textsuperscript{110} Id. Preamble, Scope and Terminology.
\end{flushleft}
ment is quite curious, unless the delegates understood and desired that the comments would be viewed as binding. 111

Model Rule 4.1 is also relevant because it mandates that a lawyer disclose material facts to a third person when disclosure is necessary to avoid assisting in a client crime or fraud. 112 But this mandatory duty is limited by the general rule of confidentiality. That limitation nullifies the rule, unless one reads into Rule 1.6 an implied exception for disclosure of client fraud as Professor Hazard suggests, or at least views the text of Rule 1.6 as only a partial list of exceptions. 113

IV. ENTITY REPRESENTATION IN THE COURTS

Although the current ethical codes steadfastly adhere to the entity theory of organizational representation, a review of court decisions concerning conflicts of interest reveals limited adherence to the theory. Cases involving close corporations are particularly salient. Further, trends in other areas of the law suggest some changes in the traditional view of the organizational client. When an attorney challenged for a conflict of interest has represented a close corporation, several courts have followed the traditional rule that the attorney represents the entity alone. 114 But a few other courts have been quite willing to look beyond

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111. The comment to Rule 1.6 also refers to Rules 2.2 (lawyer acting as intermediary between clients), 2.3 (lawyer preparing evaluation, such an opinion letter, for use by a third party), 3.3 (lawyer behaving candidly toward court), and 4.1 (lawyer acting truthfully toward others).

112. Model Rules, supra note 7, Rule 4.1 which provides:
   Rule 4.1 Truthfulness in Statements to Others
   In the course of representing a client a lawyer shall not knowingly:
   (a) make a false statement of material fact or law to a third person; or
   (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

   The quoted language is similar to the rule establishing the scope of legal representation, which prohibits a lawyer from knowingly assisting a client's crime or fraud. Id. Rule 1.2(d). Moreover, attorney-client communications made in furtherance of a crime or fraud are not protected by the evidentiary privilege of confidentiality. Wolfram, supra note 56, § 6.4.10.

113. 2 Hazard & Hodes, supra note 95, at 720-23.

114. See, e.g., Orchard v. Covelli, 590 F. Supp. 1548 (W.D. Pa. 1984) (attorney for closely-held corporation not liable to minority shareholder for participating in breach of fiduciary duty by majority shareholder since attorney acted in response to requests of the corporation); Bobbitt v. Victorian House, Inc., 545 F. Supp. 1124 (N.D. Ill. 1982) (attorney for closely-held corporation did not represent individual director-shareholder); Mullaney, Wells & Co. v. Savage, 402 N.E.2d 574 (Ill. 1980) (prior representation of corporation owned by defendants did not preclude later representation of plaintiff in suit against defendants); Felty v. Hartweg, 523 N.E.2d 555, 556 (Ill. App. Ct. 1988) (“A shareholder in an ordinary corporation does not thereby become a beneficiary of an attorney-client relationship between a lawyer and the corporation in which he owns shares.”); Terre du Lac Prop-
the corporate fiction that supports the entity theory. One of the earliest cases to ignore the corporate entity was *Seifert v. Dumatic Industries, Inc.*,\(^\text{115}\) in which Seifert, a fifty percent stockholder in Dumatic Industries, sued the corporation and the remaining stockholder derivatively. Seifert charged the other stockholder, Globe Ticket Company, with breach of the Dumatic incorporation agreement. Seifert's counsel also represented the corporation. Globe moved to disqualify the corporate counsel from representing Seifert in the derivative suit. The court cited the general rule against conflicts of interest,\(^\text{116}\) but concluded that no interest of the corporation conflicted with Seifert's position in the derivative suit. The court ignored the corporate form and viewed the suit merely as an action for breach of contract between Seifert and Globe.\(^\text{117}\)

Similarly, in another case,\(^\text{118}\) the court looked at the stock ownership and management of two corporate defendants when the plaintiff sought to disqualify their counsel. The corporations were the third- and fourth-party defendants in a construction dispute. One of the corporations had impleaded the other, and the same attorney represented both companies. Three members of the same family owned the capital stock of both companies, and the companies shared the same officers, substantially the same directors and shareholders, and the same office space and employees. Due to the "substantial identity of interests"\(^\text{119}\) between the corporations, the court held that no conflict of interest existed. Of more recent cases involving close corporations, the Oregon Supreme Court, has moved the farthest away from the entity theory. In a disciplinary proceeding against two lawyers, Banks and Thompson, the Oregon State Bar charged the attorneys with a conflict of interest in their representation of a closely-held business.\(^\text{120}\) Banks, Thompson, and their firm rep-

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\(^\text{115}\) 197 A.2d 454 (Pa. 1964).
\(^\text{116}\) At the time, the 1908 Canons were in effect. The court cited Canon 6, which reads in part: "It is unprofessional to represent conflicting interests, except by express consent of all concerned given after a full disclosure of the facts. Within the meaning of this canon, a lawyer represents conflicting interests when, in behalf of one client, it is his duty to contend for that which duty to another client requires him to oppose." 197 A.2d at 455 (quoting 1908 CANONS, *supra* note 53, Canon No. 6).
\(^\text{118}\) Brown & Williamson Tobacco Corp. v. Daniel Int'l Corp., 563 F.2d 671 (5th Cir. 1977).
\(^\text{119}\) *Id.* at 673.
\(^\text{120}\) *In re* Banks, 584 P.2d 284 (Or. 1978).
represented United Medical Laboratories (UML), which was owned and controlled by R. S. Michel, his wife, and their two daughters. The Michel family owned all the stock and the four family members comprised the board of directors. Thompson also drafted Michel's will and his employment contract with UML.

After a period of great growth, the company began experiencing financial problems, and a serious family dispute erupted. Mrs. Michel and her daughters placed their stock in a voting trust and elected a new board of directors. The new board briefly ousted Michel from control of the company, and Michel refused to cooperate with the board in resolving a dispute with one of the company's lenders. Banks opined to the board that Michel's actions were a breach of his employment agreement, which Thompson had drafted. Eventually, the family sold the company. The new owners rehired Michel and he promptly fired Banks, Thompson, and many employees. Some of those employees founded a new company to compete with UML, and Banks and Thompson then began representing the new competitor.

The Oregon Supreme Court formally reprimanded the attorneys for conflicts of interest. Although the court claimed allegiance to the entity theory, it decided that the corporate entity should be disregarded for conflict purposes when the corporation is closely held. And, significantly, the court focused on the actors within the entity.

In weighing the interest of the corporation and the desirability of avoiding conflicts of interest, it seems to us that the balance should be struck the other way in closely held family corporations where the operator of the corporation either owns or controls the stock in such a manner that it is reasonable to assume that there is no real reason for him to differentiate in his mind between his own and corporate interests. In such a situation all the reasons are in existence which give rise to the rule against conflicts of interest because there is no basis for the individual to believe that the attorney has or ever will have other than his individual interests at heart. It is our conclusion that the only ethical position for an attorney to adopt when substantially identical interests which he has represented become divergent is to represent neither the individual nor the corporation.\footnote{584 P.2d at 292 (footnote omitted)}

The court concluded that the firm represented both Michel and the corporation when it drafted Michel's employment contract and therefore could not represent either party in a later dispute over the contract without the consent of both. Further because of Michel's prior identity of interest with the corporation, it was also improper for the attorneys to
advise the corporation during Michel’s temporary ouster, even though the board of directors had specifically sought the representation.\textsuperscript{122}

The attorneys in \textit{Banks} viewed themselves as representing the corporation rather than Michel during the bulk of their engagement, a view consistent with the entity theory of both the Model Code and the Model Rules. Although they later were somewhat uncertain about the true client in their more personal work for Michel — the will and employment contract\textsuperscript{123} — at the time they may well have seen those activities as incidental to their representation of the corporation, small conveniences that lawyers typically provide to the officers of organizational clients.\textsuperscript{124} And when the highest authority of the corporation, the board of directors, requested the attorneys to continue serving the corporation, the attorneys complied.

In another disciplinary proceeding, \textit{In re Brownstein},\textsuperscript{125} the attorney again was charged with a conflict of interest in a corporate representation. Brownstein had incorporated a drapery business founded by Woods, who was a major shareholder along with his father and a friend. Brownstein later served as corporate counsel. When the company faced financial trouble, the attorney introduced Woods to Whitcomb, another of Brownstein’s clients who invested in small businesses. Whitcomb invested in the drapery business, in exchange for a corporate note guaranteed by Woods.

Eventually the corporation defaulted on the note and fired Brownstein as corporate counsel. Whitcomb, represented by Brownstein, pursued Woods on his personal guaranty. When the bar challenged Brownstein for his conflict of interest, he contended that he had represented the corporation, not Woods, when Whitcomb was brought in to the company as an investor. Because he had represented only the corpo-

\textsuperscript{122} The court also found that Thompson should not have represented the competitor while still involved in some of UML’s activities. But the court found the defendants innocent of the specific disciplinary charge brought by the Oregon State Bar regarding the representation of the competitor.

\textsuperscript{123} When Thompson was deposed, he considered drafting the wills to be a personal activity for the Michels. Regarding the employment contract, Thompson testified at various points, “I guess I was representing both sides, maybe. I don’t know,” and “I was [employment contract was] drawn when we were representing the company, and at that time I certainly felt that I was drawing it on behalf of the company, and, oh, I suppose it’s like a lot of employment contracts. You draw — you know, when you’ve got a friendly client, he doesn’t hire outside counsel. He knows how much money he wants and that’s it, you know.” 584 P.2d at 291.

\textsuperscript{124} Based on the Author’s own experience as an attorney, it is a rare attorney who has not reviewed a lease, discussed a traffic violation, or done some other small favor for the officers or employees of an organizational client. Those favors are typically done without considering the true “client” in the representation.

\textsuperscript{125} 602 P.2d 655 (Or. 1979) (per curiam).
RATION, Brownstein contended that he had no conflict in representing Whitcomb. The court disagreed. The rights of the controlling shareholder in a closely-held corporation are "virtually identical and inseparable" with and from the corporation so that the attorney in fact had represented Woods as well as the corporation. That prior representation precluded Brownstein's later representation of Whitcomb in the collection action. In the court's words,

[w]here a small, closely held corporation is involved, and in the absence of a clear understanding with the corporate movers that the attorney represents solely the corporation and not their individual interests, it is improper for the attorney thereafter to represent a third party whose interests are adverse to those of the stockholders and which arise out of a transaction which the attorney handled for the corporation. In actuality, the attorney in such a situation represents the corporate owners in their individual capacities as well as the corporation unless other arrangements are clearly made.

... [W]hen such a transaction is handled, it should be with extreme caution and with a clear and explicit understanding concerning whom the lawyer represents.127

126. 602 P.2d at 656.
127. 602 P.2d at 657 (citations omitted).

In a later disciplinary case, the Oregon Supreme Court returned to the subject of conflicts in close corporations. In In re Kinsey, 660 P.2d 660 (Or. 1983), Kinsey was retained to organize a corporation, Berlinair, that would operate an air taxi service. After the three principal shareholders of the corporation had a falling-out, the holders of two-thirds of the corporation's stock requested that Kinsey organize a separate corporation without ownership participation by the minority shareholder, and Kinsey did so. The new corporation would compete with Berlinair by taking advantage of a corporate opportunity that otherwise could have been exploited by Berlinair.

In a subsequent disciplinary proceeding, Kinsey apparently argued, among other things, that his true clients were the majority shareholders so there was no conflict in his continuing to represent them in organizing the new corporation. The Oregon Supreme Court explained a portion of the quoted section by saying:

The language in Brownstein [that the attorney for a close corporation in actuality represents the corporate owners] should not be misinterpreted. It refers to the special relationship in Banks where the controlling stockholder was the corporation. The appropriate rule for a corporation with minority stockholders with substantial interests such as [the 33 percent share at issue in Kinsey] is:

"As a corporation speaks and acts only through its officers and directors, its counsel is their legal advisor in respect to its affairs, but in performing that duty he is acting as the corporation's attorney only and not as the attorney of any of its stockholders, directors, or officers as individuals, or any group or faction thereof." ABA Opinion 86 (1932)....

660 P.2d at 670 n.10.

The court's attempt to limit Banks by defining duties based on the extent of stock ownership is unconvincing. R. S. Michel, the principal of the close corporation involved in Banks, owned 29 percent of the stock, and his wife and daughters owned 29 percent, 21 percent, and 21 percent of the stock, respectively. Under the holding in Kinsey, the holding in Banks would have been quite differ-
The decisions in Banks and Brownstein are important on several counts. They indicate that the attorney must consider the expectations of the constituents within the organization when defining the "client."\textsuperscript{128} As the court said in Banks, there was no reason for Michel to differentiate between his own and the corporation's interests. And, in the court's view, he rightfully believed that the attorneys would pursue only his individual interests. On that point, Banks and Brownstein are typical of a trend of cases that trace the commencement of an attorney-client relationship to the mind of the putative client and his or her reasonable beliefs.\textsuperscript{129} The decisions are refreshingly realistic about the quotidian operation of many corporate representations. Significantly, the court in

\textsuperscript{128} But cf. Felty v. Hartweg, 523 N.E.2d 555 (Ill. App. Ct. 1988), where the court stated in dicta:

The allegation that [the lawyer for the closely held corporation] should have known he was expected to protect the minority shareholders is an allegation which places upon him a duty not imposed by law. Even if, as alleged, he knew of those expectations, that would not necessarily have imposed a duty which he would owe to a client. In any event, as the charge is alleged in the disjunctive, it is an improper allegation, because the duty cannot be imposed on a theory [the attorney] should have known of the expectations.

\textsuperscript{129} In Westinghouse Elec. Corp. v. Kerr-McGee Corp., 580 F.2d 1311 (7th Cir.), cert. denied, 439 U.S. 955 (1978), Kirkland & Ellis represented an incorporated association, the American Petroleum Institute (API). On behalf of API, Kirkland solicited business information from API's members, including Kerr-McGee, about their holdings in non-traditional fuels such as uranium. Later, another office of Kirkland filed an antitrust suit on behalf of Westinghouse against Kerr-McGee and others alleging a conspiracy in the uranium industry.

In response to a motion to disqualify in the antitrust action, Kirkland contended that it had no attorney-client relationship with Kerr-McGee or the other API member responding to the questionnaire. The court held that a fiduciary or implied professional relationship existed between the firm and the respondents because the latter reasonably believed the firm to be acting in their best interests. Further, the court held that the law firm had the duty to apprise the respondents of conflicts of interest.


In Rosman v. Shapiro, 653 F. Supp. 1441 (S.D.N.Y. 1987) one of two fifty-percent shareholders in the corporation Filtomat, sued the corporation and the remaining shareholder, Shapiro, for an accounting and damages. The corporation had been created to distribute water filtration products from an Israeli manufacturer. At some point after the corporation had been created, Rosman and Shapiro consulted with the law firm of Yisraeli and Yerushalmi concerning their distribution agreement with the manufacturer. Rosman and Shapiro disagreed sharply over their rights under the distribution agreement, and Rosman sued. Shapiro countersued. The law firm represented Shapiro and Filtomat in both actions. Rosman moved to disqualify the firm in both actions.

Shapiro and the law firm contended that the firm had represented only the corporation, but the court rejected that claim:

[T]he Court may find that an attorney-client relationship existed between Rosman and
Brownstein assigns the burden of identifying conflicts and clarifying the scope of the representation to the lawyer.\textsuperscript{130} The lawyer is in a unique position to identify incipient conflicts of interest, and cannot deflect that burden onto the entity or constituents who claim some protection.\textsuperscript{131}

These cases still view the corporation as at least a nominal client, although it is difficult to conceive that the corporation as an entity has any genuine interest of its own when the corporation's stock is owned by one or a few persons. The courts promote the appearance of compliance with the traditional entity notion, a concept so entrenched in the law that the courts are not prepared to abandon it openly.

Paying homage to the entity theory while disregarding it is not unusual. Some courts have acknowledged the traditional rule, but then concluded that the rule does not apply absolutely to close corporations for any number of pragmatic reasons. For example, in \textit{In re Nulle},\textsuperscript{132} the court said that following the rule that a corporation is an entity distinct from its members or stockholders "would require blinding ourselves to its realities."\textsuperscript{133} And again, in \textit{In re Roberts},\textsuperscript{134} the court noted the harsh

\begin{quote}
[Yisraeli and Yerushalmi] if Rosman reasonably believed that [the corporation's lawyer] was acting as his counsel.

\ldots Although, in the ordinary corporate situation, corporate counsel does not necessarily become counsel for the corporation's shareholders and directors, \ldots where, as here, the corporation is a close corporation consisting of only two shareholders with equal interests in the corporation, it is indeed reasonable for each shareholder to believe that the corporate counsel is in effect his own individual attorney.

This is especially true in this case because both Rosman and Shapiro treated Filtomat as if it were a partnership rather than a corporation. In short, it would exalt form over substance to conclude that [Yisraeli and Yerushalmi] only represented Filtomat, solely because Rosman and Shapiro chose to deal with [the manufacturer] through a corporate entity.
\end{quote}

\textit{Id.} at 1445 (footnotes omitted).

\textsuperscript{130} This view is consistent with the Model Rules, which permit dual representation of a corporation and its shareholders if the clients give informed consent. Rule 1.13(e) provides that "[a] lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7." \textsc{Model Rules, supra} note 7, Rule 1.13(e). Model Rule 1.7, the general conflict of interest rule, also provides, "[w]hen representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved." \textit{Id.} Rule 1.7(b)(2). A lawyer acting as an intermediary between clients must make similar disclosures. \textit{Id.} Rule 2.2(a). If conflicts of interest arise, the attorney must withdraw. \textit{Id.} Rule 1.16(a)(1). \textit{Cf. In re Roberts,} 75 B.R. 402 (D. Utah 1987) (attorney seeking employment in bankruptcy proceeding has duty to inform court of any conflicts of interest).


\textsuperscript{132} 620 P.2d 214 (Ariz. 1980).

\textsuperscript{133} 620 P.2d at 217. \textit{In re Nulle} was a disciplinary proceeding in which an attorney, Nulle, was charged with unethical conduct arising from his representation of several corporations. For
economic consequences to the individual clients if the court adhered strictly to the entity rule and required them to retain separate counsel for their bankrupt corporation. The court noted in Rosman v. Shapiro that following the entity rule "would exalt form over substance."

Labor union cases also raise interesting questions for other entity representations. International Brotherhood of Teamsters v. Hoffa was a derivative action by a small group of dissident union members against union officers for wrongful expenditure of union funds. The union, a nominal plaintiff in the case, sought to be realigned as a defendant. The union's attorney also represented one of the defendant officers, and the plaintiffs moved to disqualify the attorney. The court prohibited the defense lawyer from representing the union. Allowing the dual representation would permit union funds to be used to defend officers charged with wrongdoing and might dictate the outcome of the charges against the officers.

several years, Nulle had represented Rare Earth Development Company, whose principals were Nocifera and Wirth, and later assisted them in the purchase of a new company, UID. Without the knowledge of Rare Earth, Nocifera, or Wirth, Nulle later acquired and exercised an option to purchase fifty percent of the stock of UID.

In defense of disciplinary charges arising from the incident, Nulle claimed that he represented only UID, not the individual shareholders, and that his actions in obtaining and exercising the stock option were in the best interest of his corporate client.

The court responded:

Respondent cites ... the proposition that a corporation is for most purposes an entity distinct from its individual members or stockholders. While this may be generally true, application of such a rule to the case at bar would require blinding ourselves to its realities.

The record before us discloses that for about four years before January of 1976 respondent had represented various corporations and business enterprises of Wirth and Nocifera and had represented each of those men in small personal matters. ... "In actuality, the attorney in such a situation represents the corporate owners in their individual capacities as well as the corporation ...."

We find that under the circumstances of this case, respondent represented James Wirth and Sam Nocifera as well as UID .... 620 P.2d at 217 (quoting In re Brownstein, 602 P.2d 655, 657 (Or. 1979); citations omitted).


135. The attorneys in the case represented the debtor corporation, Roberts, Inc., as well as Mr. and Mrs. Roberts individually. The Roberts were both debtors and creditors of the corporation. The court noted that the simultaneous representation of both the debtor and creditor in an ordinary bankruptcy proceeding would constitute a conflict of interest. But the court believed it necessary to examine the possibility of conflict more closely where a small, closely-held entity was involved. The court permitted the simultaneous representation because of the severe financial hardship of hiring separate counsel and the importance of honoring a party's right to choose its own counsel.


137. Id. at 1445.

[C]ounsel who are chosen by and represent officers charged with the misconduct, and who also represent the union, are not able to guide the litigation in the best interest of the union because of the conflict in counsel’s loyalties. In such a situation it would be incumbent upon counsel not to represent both the union and the officers.

Where, as here, union officials are charged with breach of fiduciary duty, the organization is entitled to an evaluation and representation of its institutional interests by independent counsel, unencumbered by potentially conflicting obligations to any defendant officer.139

In a later proceeding dealing with the selection of counsel, the court acknowledged the possibility that it might have to select counsel, but declined to do so.140

The same court voiced similar concerns a few years later in a series of cases involving the fight by Joseph Yablonski and others for control of the United Mine Workers union.141 The court set out its standards in the first case, Yablonski v. United Mine Workers.142 The plaintiffs, individual union members, charged defendant officers with misappropriation of union funds, and challenged the dual representation by the union’s retained outside counsel of both the union and the defendant officers. At the time, the union’s attorneys were also representing the union and one or more of its officers in a number of other suits pending between the Yablonski faction and the entrenched union leadership.

The court concluded that union retained counsel should be disqualified and should continue its representation of the officers alone. Following the analysis of Hoffa, the court concluded that the union needed an objective assessment of its institutional interests unhindered by allegiance to individuals within the union, and that the continued dual representation might determine the outcome in the underlying suit. Even if the conflict of interest was, as the defendants contended, still incipient, the court thought it appropriate to act before the actual conflict arose and to require separate counsel.143

139. 242 F. Supp. at 255-56 (quoting Milone v. English, 306 F.2d 814, 817 (D.C. Cir. 1962)).
141. Yablonski v. UMW, 448 F.2d 1175 (D.C. Cir. 1971) [hereinafter cited as Yablonski I], petition for further relief granted, 454 F.2d 1036 (D.C. Cir.), and cert. denied, 406 U.S. 906 (1972) [hereinafter cited as Yablonski II]; Weaver v. UMW, 492 F.2d 580 (D.C. Cir. 1973) [hereinafter cited as Yablonski III].
142. Yablonski I, 448 F.2d 1175 (D.C. Cir. 1971).
143. See also Tucker v. Shaw, 378 F.2d 304, 307 (2d Cir. 1967) (noting that in disqualifying union’s counsel, “it was clearly within the discretion of the district judge to nip any potential conflict of interest in the bud”).

In Yablonski II, the union’s in-house counsel attempted to represent the officers following the
The Hoffa and Yablonski cases, while concerned with labor unions, still raise interesting questions for all entity representations. The judges in those cases recognized that organizational counsel had a conflict of interest in litigation between the officers who chose her, the entity, and ultimately, the union members themselves. If that is so, one may ask why the courts implicitly assume these conflicts exist only during litigation. The courts may be assuming the conflict is never serious enough outside litigation to require outside counsel for the entity and the independent "evaluation and representation of its institutional interests."\(^{144}\)

One may also ask why courts like Hoffa find it so clearly "incumbent on the attorney" not to represent both the officers and the union in litigation, when the ethical codes generally permit an attorney to do so when the parties are not in court. Litigation gives dissidents — and they must generally be sophisticated dissidents at that — a procedural vehicle in which to raise the issue of counsel's loyalty, a vehicle denied them outside litigation. Counsel for an entity, whether that entity is a labor union or a thrift institution, must constantly watch for conflicts between the interests of officers and the interests of other constituent groups.

The attorney's duty to identify conflicts and to require retention of outside counsel for the independent evaluation of institutional interests is greater when there is no other vehicle through which outsiders can raise the issue. Cases and codes already require a lawyer to speak when the circumstances indicate a misapprehension about the lawyer's true role and loyalty.\(^{145}\) That requirement is fairly levied because the lawyer is in a unique position to realize and correct the conflict, and the putative client has no other means by which to raise the issue. Further, given the courts' reluctance, as demonstrated in Hoffa, to intervene in the selection withdrawal of outside counsel. But the court found that arrangement subject to the same infirmities identified in Yablonski I, and disqualified in-house counsel from representing the union. Yablonski II, 454 F.2d 1036 (D.C. Cir. 1971), cert. denied, 406 U.S. 906 (1972).

By the time of Yablonski III, the Yablonski faction had won control of the union and its general counsel's office. Because the conflict between the union's and defendant officers' interests no longer existed, the court declined to disqualify in-house counsel from representing the union and allowed the union to realign as a party plaintiff. Yablonski III, 492 F.2d 580 (D.C. Cir. 1973).


145. See MODEL RULES, supra note 7, Rule 4.3, which imposes the duty on a lawyer dealing with unrepresented persons to clarify any misapprehensions about whom the lawyer represents; and Togstad v. Vesely, Otto, Miller & Keeffe, 291 N.W.2d 686 (Minn. 1980) (lawyer who declined representation nonetheless liable for negligently given advice since lawyer should have known prospective client was relying on his opinion).
of counsel by an organization, the lawyer’s role in protecting the institution as a whole increases in importance.

The dissatisfaction with the entity rule is well-deserved. The rule assumes that representation of all types of organizations is the same and that the actors in all organizations follow the tidy behavioral model and organizational chart that underlay the entity rule. That a number of courts have diverged from the entity rule does not indicate that the courts flout or ignore the ethical rules. Instead, the growing body of contrary authority demonstrates that the ethical rules themselves do not conform to the actual behavior and expectations of actors within organizations and the lawyers who represent them. Under the Model Code and Model Rules, the courts would be justified in relying upon the entity theory’s comfortable fiction. But when they have to justify the behavior of attorneys whose actions, at least viscerally, seem inappropriate, they frequently find that fiction deeply unsatisfying.

V. CASE TRENDS EXPANDING THE SCOPE OF THE ATTORNEY’S DUTIES

The recent cases dealing with entity representation increasingly have abandoned the traditional conception of “the client.” Not surprisingly, cases dealing with other aspects of the attorney-client relationship reflect a similar willingness to broaden an attorney’s duties to parties other than the traditional client. Although the courts are reluctant to designate these third parties as “clients” in the complete, formal sense, the cases reflect a piecemeal extension to nonclients, thought to be deserving for one reason or another, of certain duties historically reserved only for clients.

A. The Duty of Care

The broadening of attorneys’ duties began in a series of securities cases more than twenty years ago. Before that time, securities lawyers had been held liable for active participation in securities fraud. But lawyers who acted solely as lawyers in transactions generally were not held liable. The SEC began to advocate a higher duty for securities

146. See, e.g., United States v. Crosby, 294 F.2d 928 (2d Cir. 1961), cert. denied, 368 U.S. 984 (1962) (affirming securities fraud conviction of attorney who had helped organize takeover scheme).

lawyers in the early 1970s, and thereafter the Commission pursued attorneys for securities violations even when the attorneys had not been actively involved in the securities violations.148

The defenders of the SEC's position believed that it was warranted by the unique role of attorneys in the securities registration process:

[T]he professional judgment of the attorney is often the 'passkey' to securities transactions.

. . . [T]he security bar's conception of its role too sharply contrasts with the reality of its role in the securities process to escape notice and attention—and in such situations the reality eventually prevails. Lawyers are not paid in the amounts they are to put the representations of their clients in good English.149

. . . .

The SEC further articulated this position in disciplinary proceedings against members of the securities bar.150 For example, in defending its right to disqualify an attorney from practicing before it, the Commission said:

[The notion that state ethical standards are the exclusive control over securities lawyers] overlooks the peculiarly strategic and especially central place of the private practicing lawyer in the investment process and in the enforcement of the body of federal law aimed at keeping that process fair. . . . [T]his Commission . . . is peculiarly dependent on the probity and the diligence of the professionals who practice before it. . . . This is a field where unscrupulous lawyers can inflict irreparable harm on those who rely on the disclosure documents they produce.151

One of the better known decisions during this era was Escott v. BarChris Construction Corp.152 BarChris prepared and filed a registration

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150. Under Rule 2(e) of the SEC's Rules of Practice, the Commission can discipline or suspend attorneys from practice before the Commission. 17 C.F.R. § 201.2(e) (1990). Persons may be suspended for lack of qualifications, commission of unethical conduct, or aiding and abetting a securities violation by another person.


Purchasers of debentures sued the signers of the registration statement, the underwriters, and the company's auditors, alleging that the defendants had included false statements in the registration statement and omitted material information. Grant, the corporation's attorney and one of its directors, was among the defendants. He had prepared and signed the registration statement. The court found that the registration statement contained a number of falsities and omissions relating to the financial condition of the company.

Grant claimed that he was not liable under the securities laws because he had investigated the statements in the registration statement and had reasonably believed them to be true. In evaluating his claim, the court considered "the unique position which he occupied" as an outside director and attorney for the corporation. The court concluded that "[m]ore was required of him in the way of reasonable investigation than could fairly be expected of a director who had no connection with this work."

Grant had the duty to investigate further those portions of the registration statement not prepared by experts by verifying state-
ments against source documents, reading corporate contracts and corporate minutes, and perhaps investigating certain matters with the company's outside auditors. By holding Grant to a different duty of investigation from other outside directors solely because he was also the corporation's attorney, the court essentially held that a corporate attorney has a duty to the investing public who purchases in reliance on the registration statement.

The securities case from this era most analogous to the thrift cases is \textit{Securities and Exchange Commission v. National Student Marketing Corp.}.\textsuperscript{158} The Securities and Exchange Commission (SEC) engendered tremendous debate in the bar and the academy when it filed a complaint against two prominent law firms and several individual lawyers within those firms.\textsuperscript{159} White & Case had represented National Student Marketing Corp. (NSMC), whom the SEC charged with securities law violations arising from a merger, among other transactions. Lord, Bissell & Brook had represented Interstate National Corporation (Interstate), the merger target.

The parties signed the merger agreement in August 1969, just before the end of NSMC's fiscal year, so NSMC provided financial information to Interstate from the 1967-1968 fiscal year and with interim information for the 1968-1969 fiscal year, in the form of unaudited financial statements for the first nine months of the year. Both companies solicited and received shareholder approval of the merger based upon those interim financial statements, which showed that NSMC had produced a \$700,000 profit for the interim period. The merger agreement required each company's accountants to provide a "comfort letter" at closing stating that the interim financial statements were accurate.

On the day of the closing, the accounting firm preparing the comfort letter for NSMC told the attorneys for NSMC that the interim statements should be adjusted to reflect certain deferred costs, uncollectible receivables, and other charges against income. Interstate and its attorneys were made aware of these suggested adjustments before the closing, but were not apprised of the effect the adjustments ultimately had upon the profitability of NSMC. In fact, NSMC assured Interstate that the

\footnotesize{more than three years at the time of the exchange offer and was actively involved in the negotiations between Leasco and Reliance.\\ 158. 457 F. Supp. 682 (D.D.C. 1978).\\ 159. The SEC sought injunctive relief against the law firms and a number of other parties for anti-fraud, reporting, and proxy violations. Most of the defendants settled before trial. \textit{Id.} at 687 n.2.}
adjustments would not affect the company's earnings significantly. Interstate considered postponing the closing, but elected to complete the merger as scheduled.

Neither law firm disclosed the accountants' suggested adjustments to shareholders or public investors. Both law firms issued opinion letters to consummate the merger. Neither opinion letter mentioned the discrepancies in the financial information.

NSMC's attorney also learned before closing that, if the company adjusted the financial statements as suggested, it would show a net loss for the interim period, rather than a $700,000 profit, and that the company would only break even for the fiscal year. Just after the closing, the accountants also recommended to NSMC's attorney that the company resolicit the approval of its shareholders with the correct information. NSMC's attorney did not disclose the consequences of the financial adjustments or the recommendation of the resolicitation to Interstate or its attorneys. Interstate did not learn of these matters until a few days after closing, when the accountants provided the final version of their comfort letter to directors for both companies.

The SEC contended that the attorneys should have refused to issue the opinion letters and should have demanded that shareholders be resolicited with the new financial information. If their respective clients refused to comply with this advice, the SEC contended that the attorneys should have withdrawn from the representation and informed the SEC of the misleading financial information.160

Ultimately, White & Case settled with the SEC,161 but Lord, Bissell & Brook proceeded to bench trial. The court concluded that the firm had aided and abetted a violation of the securities laws because of its


Several years later, the SEC also suggested ways securities lawyers could respond to client violations of securities laws, such as resignation or resort to the board of directors. In re Carter and Johnson, Release No. 34-17597, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847 (Feb. 28, 1981).

failure to interfere with the merger.\(162\) Upon learning of the misleading financial information, "the attorneys' responsibilities to their corporate client required them to take steps to ensure that the information would be disclosed to the shareholders."\(163\) The attorneys could not "rest on asserted 'business judgments' as justification for their failure to make a legal decision pursuant to their fiduciary responsibilities to client shareholders."\(164\)

National Student Marketing states that attorneys who represent a corporation have a fiduciary duty to the shareholders of the corporation, not simply to the corporation itself. Other securities decisions have reflected a similar willingness to broaden the scope of the attorney's duties to nonclients by liberalizing the standing requirements for securities suits. A common theme in these cases is some foreseeable reliance on the misleading information by the injured party.\(165\)

In addition to the securities cases, malpractice cases gradually have broadened the scope of an attorney's duty of care. One notable example is Fickett v. Superior Court.\(166\) Attorney Fickett had represented Schwager, the guardian for Styer. During the representation, Schwager used assets of the guardianship estate for his own benefit.\(167\) He loaned money to a business that his wife partly owned, paid himself and his family large management fees from a building he purchased for the estate, and commingled estate funds in his own account. Before a court finally removed Schwager as guardian, he had severely depleted the estate, leaving his previously wealthy ward in serious financial condition.

\(162\) The SEC, however, did not establish the likelihood of a further violation, so the court denied the injunction.


\(164\) Id. at 713-14. Similarly, in SEC v. Electronics Warehouse, Inc., 689 F. Supp. 53 (D. Conn. 1988), aff'd sub nom. SEC v. Calvo, 891 F.2d 457 (2d Cir. 1989), and cert. denied, 110 S. Ct. 3228 (1990), the attorney for the underwriter in a public offering was held liable as an aider and abettor for writing a letter that "substantially facilitated" the securities law violations. 689 F. Supp. at 65.

\(165\) See, e.g., Commins v. Johnson & Higgins, Inc., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,092 (N.D. Cal. 1988) (attorney may be liable to a "nonclient" if the attorney renders an opinion for his client and the attorney could have foreseen that the nonclient would see and rely on the opinion in its transaction with the client); Andreo v. Friedlander, Gaines, Cohen, Rosenthal & Rosenberg, 660 F. Supp. 1362, 1367 (D. Conn. 1987) ("[A]ttorneys can be held liable as aiders and abettors where it is reasonably foreseeable that potential investors will rely on documents they draft, if they omit material information from those documents or include erroneous information in reckless disregard for the truth."); and Haberman v. Washington Pub. Power Supply Sys., 744 P.2d 1032 (Wash. 1987) (en banc), appeal dismissed, 488 U.S. 805 (1988) (imposing liability on attorney for negligent misrepresentation resulting from bond issue).


The new guardian sued Fickett for negligence in failing to discover Schwager's defalcations. The guardian admitted that Fickett had not behaved collusively or fraudulently. Fickett contended, therefore, that he was not liable to Styer because she was not his client. The court concluded that privity of contract was not essential: an attorney may be held liable to a third person without privity of contract as a matter of public policy. In reaching this decision, the court considered factors, such as the foreseeability of harm, the blameworthiness of the attorney's conduct, and the policy of deterrence. The court concluded that public policy supported the conclusion that Fickett owed a duty to Styer:

We are of the opinion that when an attorney undertakes to represent the guardian of an incompetent, he assumes a relationship not only with the guardian but also with the ward. If, as is contended here, [Fickett] knew or should have known that the guardian was acting adversely to his ward's interest, the possibility of frustrating the whole purpose of the guardianship became foreseeable as did the possibility of injury to the ward. In fact, we conceive that the ward's interests overshadow those of the guardian.

_Fickett_ suggests that if an attorney represents a party who has fiduciary duties to a third party, the attorney has a duty of care to that third party also. The attorney should consider the possible harm to the third party, as well as the possible harm to the "whole purpose" of the relationship between the fiduciary and the third party.

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168. The common law supported Fickett's view. See Savings Bank v. Ward, 100 U.S. 195 (1879) (attorney not liable to non-client relying on title opinion absent fraud or collusion).

169. 558 P.2d at 990. Other factors include: 1) the actor's intent that the transaction affect the plaintiff, 2) the certainty of the plaintiff's injury, and 3) the causal connection between the actor's conduct and the injury. This so-called "balancing test" originated in a California case, Biakanja v. Irving, 320 P.2d 16 (Cal. 1958). Several other courts, in addition to the _Fickett_ court, have adopted it, including: Licata v. Spector, 225 A.2d 28 (Conn. C.P. 1966); McAbee v. Edwards, 340 So.2d 1167 (Fla. Dist. Ct. App. 1976); United Leasing Corp. v. Miller, 263 S.E.2d 313 (N.C. Ct. App.), appeal denied, 267 S.E.2d 409 (N.C. Ct. App. 1980); Auric v. Continental Casualty Co., 331 N.W.2d 325 (Wis. 1983).

170. 558 P.2d at 990.


172. As an alternative to the balancing approach followed in _Fickett_, other courts have held attorneys liable to nonclients under third-party beneficiary principles. Disappointed beneficiaries under negligently-prepared wills are frequent plaintiffs in these actions. See, e.g., Guy v. Liederbach, 459 A.2d 744 (Pa. 1983) (attorney requested devisee to attest the will; devisee later barred from taking devise because of her attestation). The nonclient can recover from the attorney for negligence when certain conditions are met: 1) the court must recognize a duty of care in the attorney's performance to effectuate the client's intentions, and 2) the client intended that the nonclient benefit from the promised performance. 459 A.2d at 751. Some courts have preferred the third-party beneficiary theory to the balancing test because of the specter of attorney liability to an ever-increasing
B. Right to Disclosure

In a parallel development to the extension of attorneys' duties of care, courts have imposed limited duties to disclose information to other classes of persons. An early example is \textit{Garner v. Wolfinbarger},\(^\text{173}\) in which shareholders brought securities claims and a derivative action relating to a stock issue. During discovery, the shareholders inquired about communications between the corporation's attorney and the corporation that occurred during the challenged stock offering. The corporation and its attorney asserted that the attorney-client privilege precluded disclosure to the shareholders. The court created an exception to the privilege:

[W]here the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show cause why it should not be invoked in the particular instance.\(^\text{174}\)

The Fifth Circuit justified the result on several grounds, two of which are relevant here. First, the court recognized that corporate management acts on behalf of the stockholders. "Conceptualistic phrases describing the corporation as an entity separate from its stockholders are not useful tools of analysis. They serve only to obscure the fact that management has duties which run to the benefit ultimately of the stockholders."\(^\text{175}\)

Second, the court believed that the joint client exception to the privilege militated toward disclosure. Under the exception, when an attorney acts for two or more parties, neither client can assert the privilege against the other in a later dispute between the two clients.\(^\text{176}\) By invoking the joint client exception, the court indicated it viewed shareholders as clients of the corporate attorney, at least for the limited purpose of disclosure.\(^\text{177}\)

\(^{174}\) 430 F.2d at 1103-04. The factors that may be considered in determining good cause include: the number of shareholders seeking disclosure and the number of shares they hold; the good faith of the claim; the necessity of having the information and its availability from other sources; the nature of the charges against the corporation; and the specificity of the request for information. In camera inspection and protective orders are appropriate to protect against wider disclosure of sensitive information. \textit{Id.} at 1104.
\(^{175}\) \textit{Id.} at 1101.
\(^{176}\) \textit{JOHN H. WIGMORE, 8 WIGMORE ON EVIDENCE} § 2312 (1961).
\(^{177}\) A few courts have limited the \textit{Garner} exception or rejected it as unsound. \textit{See, e.g.}, Weil v.
Other courts have applied the Garner rationale in different contexts, such as disputes between labor unions and their members, bankruptcy creditors and the creditors' committee, and other controversies between parties standing in some fiduciary relationship. Indeed, some later courts have viewed the existence of a fiduciary relationship between the party who consulted with the attorney and the party seeking disclosure as the true basis for the disclosure exception. These cases suggest very strongly that an attorney who represents a fiduciary owes disclosure to the beneficiary of the fiduciary's actions.

Allowing disclosure of otherwise-privileged information to shareholders or other persons in fiduciary relationships does not automatically transform those persons into clients to whom the full range of duties are owed. But one of the hallmarks of being a nonclient is that the attorney and the true client can withhold certain types of information from the


181. See, e.g., Washington-Baltimore Newspaper Guild, Local 35 v. Washington Star Co., 543 F. Supp. 906 (D.D.C. 1982) (refusing to require a showing of good cause for disclosure because that showing is not required under the common law of trust relationships); Donovan v. Fitzsimmons, 90 F.R.D. 583, 586 (N.D. Ill. 1981) ("[T]he Garner approach is not premised on concepts peculiar to corporate law, but rather has its underpinnings in the common law of trust relationships.")

182. See, e.g., Helt v. Metropolitan Dist. Comm'n, 113 F.R.D. 7, 9 (D. Conn. 1986) ("When a fiduciary communicates with its attorneys about a fund it administers for the benefit of others, courts have held that the attorney-client privilege does not operate to conceal from the beneficiaries information about the fund.").
nonclient. By allowing persons in fiduciary relationships — be they shareholders, union members, or pension plan beneficiaries — access to privileged information, Garner and its progeny have recognized an intermediate class of persons, located somewhere on the continuum between nonclients and clients. Persons in this intermediate group have been pulled from the multitudes of nonclients and vested with limited rights to information.

VI. ANALYSIS OF THE THRIFT REPRESENTATION EXAMPLE

Increasingly, critics have decried the role that thrift lawyers played in contributing to the crisis of the 1980s. Thrift lawyers have been charged with participating in improper transactions (sometimes rising to the level of aiding and abetting breaches of duty by others), disregarding conflicts of interest, failing to monitor attorneys, and failing to protect depositors and disclose wrongdoing. Former thrift counsel defend their conduct as fully consistent with their duties to their clients. Clearly both critics and defenders cannot be correct. Analysis of the ethical codes and cases reveals significant exposure for thrift attorneys on several points.

A. Conflicts of Interest

In response to charges of conflict of interest, some attorneys might believe that no conflict could exist because they represented the thrift alone, not depositors or regulators. But conflicts of interest originated among constituents within the thrift, more often than outside it. Even without considering possible duties flowing to outsiders such as depositors, the purported actions of many thrift attorneys were improper under current conflict of interest rules. The entity representation cases show an increased willingness to abandon the traditional formulation of the attorney-client relationship, in favor of one based on expectations and the

183. For example, the former general counsel of the Federal Home Loan Bank Board of San Francisco, after excoriating accountants and appraisers, said of attorneys: "[t]he final group of professionals to prostitute themselves for these thrifts were the attorneys who structured the sham deals and provided the legal opinions that regulations really were no barrier to whatever the fraudulent insiders needed done." Investigation of Lincoln Savings, supra note 29, at 299.

184. See supra text accompanying notes 45-49.

185. In responding to questions about the propriety of a thrift attorney's actions on behalf of Lincoln Savings Association, a defense attorney said that his client had done "exactly what a lawyer is supposed to do." Rita H. Jensen, Reverberations From a Failure, NAT'L L.J., Nov. 13, 1989, at 1, 29.

186. See supra text accompanying notes 114-44.
actual behavior of the parties. Under the analysis of these cases, many thrift counsel were representing both the entity — so long as the law wishes to sustain that fiction — and the controlling persons in the thrift, who considered the thrift’s interests to be identical with their own. Many of the thrifts had precisely the kind of ownership structure that makes the entity rule so farcical: a dominant person held all or virtually all of the stock of the thrift and its holding company.\textsuperscript{187} When one or a few persons owned a thrift, they did not differentiate between the entity’s interests and their own. They were clients on equal footing with the entity itself. An entity lawyer may represent both the entity and one or more of its constituents, but the attorney in doing so must comply with the conflict of interest rules.\textsuperscript{188} If the attorney’s responsibilities to the constituent conflict with his or her responsibilities to the entity, however, the attorney must withdraw from his representation of the entity.\textsuperscript{189}

Thrift attorneys should have withdrawn when the controlling persons were pursuing their own interests above those of the organization. This conclusion raises some of the same questions that plague the entity rule itself: What were the organization’s best interests? Who was the arbiter of those interests? In the end, the attorney must determine the institution’s interests as they relate to the attorney’s compliance with ethical rules.

This discussion does not suggest that attorneys for business entities should supplant duly authorized management of the entities and decide questions of business policy and daily operation. But attorneys are obligated, with whatever partial lights they possess, to assess continually the propriety of their own professional conduct. An attorney should not, for example, decide whether a particular loan should be made. But the attorney must decide whether his or her own participation in the transaction would violate the attorney’s professional duties. The attorney must be a limited arbiter of institutional interests because those interests are the touchstone for his or her own decisions of professional duty.

The allegations in the thrift cases, if true, offer numerous examples of misguided or unexercised professional judgment, as well as some

\textsuperscript{187} As one example, Jarrett E. Woods, Jr., purchased all the outstanding stock of Western Savings Association, the subject of one suit against former thrift counsel. He then transferred all the stock to a wholly-owned holding company. Complaint at 6-7, FDIC v. Vaughn, No. CA3-90-1282-D (N.D. Tex. filed June 4, 1990).

\textsuperscript{188} \textit{Model Rules}, supra note 7, Rule 1.13(e).

\textsuperscript{189} \textit{Id.} Rule 1.16(a), which provides in part, “[A] lawyer shall not represent a client or, where representation has commenced, shall withdraw from the representation of a client if . . . the representation will result in violation of the Rules of Professional Conduct or other law.”
guidelines for attorneys evaluating institutional interests. Those guidelines can be formulated as a series of questions.

1. **Does the transaction violate internal rules?**

   **Example:** The attorneys for Silverado Savings and Loan Association allegedly ignored internal lending limits that its board of directors established after federal regulators criticized the institution's lending practices.¹⁹⁰ Those lending limits included restrictions on the aggregate of loans to a single borrower, the size of loans on a single real estate project, and the number of major real estate loans.¹⁹¹ Federal regulators further allege that the attorneys reviewed the internal documentation for the questionable loans (such as the loan officers' files), discussed the transactions with management, documented the transactions, and supplied legal opinions.¹⁹²

   Depository institutions, like other businesses, set internal policies for the operation of the business.¹⁹³ One of the functions of the management of depository institutions is to set internal lending criteria to govern the extension of credit to borrowers. These policies are generally written, and therefore are easily verifiable by attorneys.¹⁹⁴ Internal lending criteria are an expression of institutional interests made independently of the personal and political factors that might exist in a particular transaction. Thrift attorneys should evaluate their own activities in light of lending policies and other internal standards. If the allegations in the example are true, the attorneys had ample opportunity to evaluate independently whether their instructions to close the transactions comported with institutional interests, as expressed by internal lending criteria.

2. **Does the transaction violate external rules?**

   **Example:** Thrifts are highly regulated. An oft-violated regulatory restriction is the loans-to-one-borrower (LTOB) rule.¹⁹⁵ The LTOB rule is designed to force a thrift to spread its lending risk over a broad number of borrowers. If an institution makes a significant percentage of its loans to a single borrower or related entities, the institution increases the possibility

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¹⁹¹ Id. at 10.
¹⁹² Id. at 54.
¹⁹³ MORTEN BODFISH & ADRIAN D. THEOBALD, SAVINGS AND LOAN PRINCIPLES 193 (1938).
¹⁹⁴ In some cases, attorneys might have to rely on thrift employees to provide necessary information. For example, if an internal lending policy restricts loan amounts to a certain percentage of the institution's net worth, the attorney probably will have to obtain net worth information from a thrift employee to ensure compliance with the policy. However, attorneys should not be permitted to assume compliance without the exercise of due diligence.
that the financial difficulties of that one borrower will be ruinous to the thrift.

The complaints against counsel are replete with claims that attorneys ignored the LTOB rule. One means by which counsel allegedly flouted the LTOB rule was structuring transactions to avoid its limits. Faced with a lending limit that would prohibit a desired loan, counsel in one case purportedly designed and documented the transaction as three separate loans to related or interposed entities, without disclosing the connected nature of the transactions. Documented in this way, the transaction appeared to comply with federal regulations.

An attorney can define an organization’s interests by looking to the legal environment in which the organization operates. With highly-regulated businesses like depository institutions, each entity has an interest in being operated in compliance with applicable regulations. Federal authorities promulgate regulations to protect the safety and soundness of each institution as a whole. Regulators designing rules are presumably free from the self-interest that may infect actors within the thrift. Thrift regulators have assessed independently which practices are beneficial for the thrift in the long term and which are not. Knowledge of regulations is the province of thrift attorneys, and those attorneys should consider a transaction that violates regulations to be an action contrary to the institution’s best interests. Attorneys should also consider a request to structure a transaction to avoid regulatory prohibitions contrary to the institution’s best interests.

Attorneys are capable of understanding the policies underlying regulations like the LTOB rule. While the historical mission of attorneys may have been to find “loopholes,” an attorney for an entity such as a thrift should not accept such a mission from a client unquestioningly. To comply with the attorney’s professional duties, the attorney must constantly assess the entity’s interests. An attorney can fairly assess those interests only by considering the applicable regulations and their underlying policies.

3. Is there a plausible business explanation for the transaction?

Example: Vernon Savings Association (Vernon) owned a subsidiary, Dondi

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196. Of the complaints reviewed, violation of the loans-to-one-borrower rule was the most frequently cited regulatory violation involving lawyers.
198. WHITE, supra note 40, at 32.
Residential Properties, Inc., which owned a great deal of real estate. Federal regulators allege that the subsidiary's properties were seriously overvalued on Vernon's books, and that Vernon knew it would have to recognize a loss on the properties at its fiscal year-end in 1985.\(^{199}\) Recognizing that a loss would reduce Vernon's net worth and income, Vernon purportedly began a campaign to sell its subsidiary's properties to existing thrift borrowers or friends of thrift insiders.\(^{200}\) The thrift financed the entire purchase price of each property, allegedly with the association's assurances that it would not require the borrower to make any principal or interest payments and that Vernon would find another borrower to assume the position of the first one.\(^{201}\) Federal regulators claim that Vernon's lawyers knew about these side agreements with the borrowers.\(^{202}\)

During a brief period, the law firm allegedly documented and closed some forty-seven loans in this series, totalling $98 million, many of them occurring during the month before the thrift's fiscal year-end. Regulators also claim that the lawyers realized the improper nature of the transactions, but did little to discourage them.\(^{203}\)

Assessing the plausibility of a transaction is more problematic for the attorney because it risks that the attorney will usurp the legitimate decisionmaking function of management. Yet competent and ethical representation of any client, regardless of the context of the work or type of client, requires an attorney to understand and question the client's business motives and goals. If the client wishes to sue another person, for example, the attorney should not bring suit if the action is frivolous.\(^{204}\) If the client wishes to consummate a business transaction, the attorney must understand the nature of the client's business and the client's objectives in the transaction, both to represent the client competently and to fulfill the attorney's own ethical obligations. The Model Rules prohibit attorneys from participating in activity that is criminal or fraudulent\(^{205}\) or that will conflict with the attorney's extant duties to others.\(^{206}\) Questioning the client about its objectives is competent and ethical lawyering, not unreasonable intermeddling. If the attorney is unsatisfied with the answers to his or her questions, the attorney may reasonably conclude that the transaction does not serve the best interests of

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200. Id. at 26.
201. Id.
202. Id. at 28.
203. Id. at 26-28.
204. MODEL RULES, supra note 7, Rule 3.1.
205. Id. Rule 1.2(c), provides, "[a] lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent . . . ."
206. Id. Rule 1.7.
the entity and that the attorney cannot ethically participate in the venture.

A related question for the attorney is whether a single transaction, although facially proper, is part of a larger series of improper transactions. Just as an attorney should understand the business purpose of an individual transaction, he or she should understand the purpose of a series of interrelated transactions. An attorney cannot be confident of the ethical propriety of his or her work unless the attorney takes this broader view. In a series of transactions, as chronicled above, an attorney might view each transaction, standing alone, as the routine extension of a loan by the thrift to a purchaser of an asset from the thrift's subsidiary. But as it becomes clear that a series of transactions are related, the attorney should question the ultimate purpose of the transactions as a group.

4. **Who are the apparent beneficiaries of the transaction?**

*Example:* A group of four men owned two different thrifts, Franklin Savings Association (Franklin) and Northwest Savings Association (Northwest). The group also owned a holding company, that, in turn, owned both Franklin Savings and Northwest Savings. Mann, who was one of the four owners, and a partner also jointly owned a third thrift, Equitable Savings Association. Northwest Savings was nearing insolvency, and its four owners wished to sell it. Mann proposed to the other owners that he purchase Northwest Savings individually and merge it with Equitable Savings. To do so, Mann would have to purchase his partner's interest in Equitable Savings as well. The other owners agreed, and Franklin Savings extended three loans to Mann of $10 million, $5.8 million, and $3.5 million, allowing him to purchase his partner's interest and Northwest Savings. Federal regulators claim that: 1) the terms of the $10 million note did not require Mann to pay anything on the debt, 2) the thrift and the lawyers improperly documented the $5.8 million loan, and 3) only the stock of the holding company that owned the already ailing Northwest Savings secured the $3.5 million loan. They also allege that Franklin Savings did not underwrite the loans to Mann, or review his financial position.\(^{207}\) They conclude that the four owners of the holding company "used the assets of Franklin, not for the benefit of Franklin, but for the benefit of [the four owners], who then divested themselves of the troubled Northwest."\(^{208}\)

The presence of large sums of money, the relative ease of appropriating funds, and the uncertainty of regulatory oversight combine to render thrifts and similar institutions tempting prey for self-interested insiders. By their nature, these institutions offer insiders "unparalleled opportuni-


\(^{208}\) Id. at 19.
ties to abuse their positions and to use insured deposits and other bank funds for their personal gain . . . . One way to do it is by making loans that will directly or indirectly benefit the dominant individual."209 Federal regulations attempt to address this problem, in part, through limits on loans to insiders and their related businesses.210 But insiders possibly used more sophisticated means than direct loans to achieve similar ends, as the above example shows.

So long as an attorney represents an entity, the attorney must evaluate constantly the entity's interests and possible conflicts with the wishes of entity insiders. In the same way that an attorney should evaluate the business reasons for a transaction, an attorney also should assess the transaction objectively to determine whether the transaction plausibly benefits the entity. If the allegations in the example are true, for instance, the attorney could have evaluated whether a promissory note that did not require the borrower-insider to make payments principally benefitted the thrift or the insider. If the attorney can find no rational explanation for the transaction, from the entity's standpoint, the attorney may conclude that the attorney cannot participate in it.

B. Duties to Third Parties

Under the traditional entity fiction, an entity lawyer is entitled to pursue the entity's interests as articulated by senior management regardless of the interests of other constituent groups.211 In the thrift context, depositors of the thrifts are among those constituents. Traditional doctrine has also considered depositors mere creditors of the institution, unless the thrift is a mutual association.212 But treating depositors of a thrift solely as creditors, part of the great unwashed throngs of non-clients, does not sufficiently protect them against the possible depredations of controlling persons within the thrift. Depositors stand in a fiduciary relationship with officers and directors of the thrift.213 Permitting attorneys to ignore breaches of duty to this group by officers and attorneys to abuse their positions and to use insured deposits and other bank funds for their personal gain . . . . One way to do it is by making loans that will directly or indirectly benefit the dominant individual."209 Federal regulations attempt to address this problem, in part, through limits on loans to insiders and their related businesses.210 But insiders possibly used more sophisticated means than direct loans to achieve similar ends, as the above example shows.

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directors increases the possibility that attorneys will facilitate the breach in some way. Further, under the law of agency, the attorney's relationship to depositors reflects the entity's relationship with those same parties. If the entity and its actors have a fiduciary relationship to depositors, so do the attorneys serving the entity and its actors.

When an attorney represents a client who has fiduciary responsibilities to a third party, Garner v. Wolfinbarger and Fickett v. Superior Court affirm the idea that the third party cannot be treated with the same distance that the attorney usually affords to nonclients. Further, other cases hold that an attorney-client relationship may arise without the formalities previously thought necessary. These cases, taken together, suggest at least two approaches to the question of duties to depositors. One view is that third parties who stand in a fiduciary relationship with the entity client (whom the Author shall call "protected persons") are the attorney's true clients, since all the activities of the entity's agents are performed for their ultimate benefit. Indeed, considering protected persons as the actual clients of an entity attorney may be beneficial. If they are so considered, they are joint clients, along with the entity itself. Treating protected persons as joint clients grants them the full measure of the attorney's devotion and the law's protection. But this joint client view is problematic. Conflicts of interest between the entity and the protected persons might be so frequent that an attorney could never represent an entity. To avoid these difficulties, extending only limited duties to protected persons might be preferable to designating them as full clients.

The attorney-client relationship brings with it many duties: the duty

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217. See supra text accompanying note 129.
of care, the duty of zeal, the duty of loyalty, the duty of communication. Courts have already granted protected persons rights to information in some circumstances.\textsuperscript{219} Extensions of other rights, such as the duty of loyalty, to protected persons is appropriate under existing law to ensure that their fiduciaries act in their best interests, without making entity representations totally unworkable. The duty of loyalty requires the attorney to identify conflicts of interest between the entity or its agents, and the protected persons. Attorneys already have the duty to identify conflicts in their own loyalty under present law,\textsuperscript{220} in part, because they are uniquely positioned and qualified to do so. The duty to identify conflicts also extends to lawyers representing an organization with its own fiduciary duties.

In the thrift context, attorneys should consider depositors as a special third class of persons, similar to shareholders in a pure corporate context, to whom the lawyer owes limited duties. Depositors fulfill a role similar to shareholders in some senses. (This comparison to shareholders is particularly appropriate if the lawyer is representing a mutual savings association, since depositors are the equity owners.)\textsuperscript{221} Depository institutions such as thrifts raise funds, in part, through the acceptance of deposits. A deposit is a debt owed by a depository institution to its customer, which the customer creates by bringing some asset, usually cash or negotiable instruments, to the institution.\textsuperscript{222} When it accepts the deposit, the institution acquires title to the asset. The institution can then use the depositor's former funds to create earning assets such as

\begin{itemize}
  \item \textsuperscript{219} See supra text accompanying notes 173-82.
  \item \textsuperscript{220} See In re Brownstein, 602 P.2d 655 (Or. 1979) (per curiam).
  \item \textsuperscript{221} For example, Rowen v. LeMars Mut. Ins. Co., 282 N.W.2d 639 (Iowa 1979), held an attorney liable to policyholders of a mutual insurance company for participating in a breach of fiduciary duty by corporate officers. Mutual insurance companies are owned by their policy holders, in the same way that mutual savings associations are owned by their depositors. The attorney, Dull, had participated in an illegal sale of the control of the company as part of the sale of the stock of a separate but related company. The sale of control was a breach of fiduciary duty by the corporate officers. The court held the attorney liable to the policyholders for participating in the breach of fiduciary duty by the company's president:

- We have already pointed out all who assist or cooperate in the breach of fiduciary duties — whether directors or not — are liable for the resulting damage. This is particularly true of one who acted as attorney. His duty is to the entire body of shareholders, or, in this case, policyholders. His obligation, indeed, is similar to, if not identical with, that of a director.

  \textit{Id.} at 654. See also Lane v. Chowning, 610 F.2d 1385 (8th Cir. 1979) (attorney serves in same fiduciary capacity as directors); and Bryan v. Bartlett, 435 F.2d 28 (8th Cir. 1970), \textit{cert. denied sub nom.} Edwards v. Bryan, 402 U.S. 915 (1971).

  \item \textsuperscript{222} DAVID R. KAMERSCHEN & EUGENE KLISE, \textit{MONEY \& BANKING} 145 (6th ed. 1976).
\end{itemize}
loans, to create reserves, or to pay expenses. Attracting deposits is absolutely essential to the continued operation of a depository institution. Thrifts and other depository institutions do not, technically speaking, "loan" their deposits, but deposits are a significant source of operating funds for these institutions. Treating depositors solely as creditors whom an attorney need not consider does not accommodate fairly the unique role that depositors play in thrift viability. Attorneys have the duty to identify conflicts of interest within the entity, and to seek counsel, perhaps through judicial appointment, for the depositors as protected persons.

C. Disclosure of Wrongdoing

The Model Code, as it stood before 1974, required attorneys to reveal client fraud to the defrauded person if the fraud occurred during the representation and the client was unwilling or unable to remedy the fraud. Later, the bar relieved lawyers from this requirement if they learned of the fraud through privileged communications. Even after the bar amended the Model Code with respect to client fraud, attorneys still had the discretion to disclose client conduct that was criminal.

The Model Code does not define what constitutes client fraud. Professor Wolfram suggests that the term should be defined the same way in

223. Id.

224. The history of the thrift industry during the 1970s and 1980s demonstrates the crucial nature of deposits. During that time, competition for the savings dollar increased tremendously as new types of investments became available to the consumer. Typically, these alternative investments offered higher rates of interest than traditional savings deposits, since thrift interest rates were limited until the early 1980s. For example, between 1970 and 1979, interest rate ceilings on thrift passbook accounts ranged between 5% and 5.25%. During that same period, the three-month United States Treasury Bill interest rate moved generally upward from 6.46% in 1970 to 12.07% in December 1979. White, supra note 40, at 63, 68. Interest rate ceilings on thrift accounts were lifted gradually beginning in 1980. DIDMCA §§ 204-07, 94 Stat. 143-44 (1980) (codified at 12 U.S.C. §§ 3503-06). As a result, money began to flow around the thrifts into the alternative investments, a process known as disintermediation. Thrifts that tried to attract deposits by paying market interest rates after deposit ceilings were lifted generated substantial losses. These institutions were "borrowing short and lending long," White, supra note 40, at 61, by acquiring short-term deposits at market interest rates and then extending long-term mortgage loans with the funds. Soon, losses in the thrift industry were enormous: nearly 85% of all thrifts were unprofitable by late 1981. Id. at 70. Commercial banks, however, were not as severely affected. At the time, banks had significantly greater regulatory flexibility and a different asset mix, which allowed them to preserve their earnings relatively well. Spellman, supra note 12, at 36-37.


226. Model Code, supra note 7, DR 7-102(B)(1).

227. Id. DR 4-101(C)(3).
all parts of the Model Code: "A client's knowingly false statements, acts, documents, or similar communications that intentionally induce another person to act or fail to act in reasonable reliance on the misrepresentation, and it usually involves an element of personal gain of a financial or similar kind or a litigational advantage."\(^{228}\)

If thrift insiders committed criminal acts, thrift attorneys were obligated to disclose any future crimes under the Model Code. For example,\(^{229}\) a land flip might violate federal criminal statutes on misapplying funds of depository institutions,\(^{230}\) and providing false reports or loan applications to depository institutions.\(^{231}\) More interesting, however, are the allegations of misconduct by thrift insiders. Many types of insider abuse should be considered fraud under the Model Code. Recall the allegations that insiders, with the assistance of counsel, structured transactions to avoid loans-to-one-borrower limitations.\(^{232}\) If insiders and attorneys in fact intentionally structured transactions to feign regulatory compliance, they misrepresented the facts of the loan to federal thrift regulators. Conceivably, an examiner surveying loan files might erroneously conclude that a loan complied with federal regulations, and then forebear from tighter regulatory scrutiny or sanctions. In these types of transactions, the early form of Model Code DR 7-102(B)(1) bound the attorneys to disclose the fraud. Even in states adopting the 1974 amendment to DR 7-102(B)(1), other ethical rules still prohibited thrift attorneys from participating in the transactions because of the fraud involved.\(^{233}\)

The Model Rules restrict disclosure of client information to a greater degree than the Model Code. Yet the Model Rules permit attorneys to disclose client wrongdoing under some circumstances: to prevent a crime likely to cause death or serious injury, to establish a lawyer's claim or defense in a dispute with the client, to defend criminal or civil complaints against the lawyer, or to defend other proceedings concerning the attorney's representation.\(^{234}\)

In contrast, Model Rule 1.13 permits withdrawal as the entity lawyer's last resort if a client persists in wrongdoing. The rule does not explain how it interacts with the exceptions to confidentiality of Model

\(^{228}\) Wolfram, supra note 56, § 13.3.6.

\(^{229}\) This example is taken from Fraud in Depository Institutions, supra note 43, at 62.


\(^{232}\) See supra text accompanying notes 190-92.

\(^{233}\) MODEL CODE, supra note 7, DR 7-102(A)(7).

\(^{234}\) MODEL RULES, supra note 7, Rule 1.6(b).
Rule 1.6. For example, what is the attorney’s appropriate response if a corporate client is engaging in conduct that will likely result in imminent bodily harm? \(^{235}\) If the attorney learns of the conduct and the corporation refuses to rectify it, may the attorney disclose the information under the exception in Model Rule 1.6(b)(1), \(^{236}\) or may the attorney withdraw only?

Given the drafting history of Model Rule 1.13, \(^{237}\) arguably Model Rule 1.13 should control for entity representations. But that conclusion leads to odd results. If Model Rule 1.13 supersedes Model Rule 1.6, the rules permit disclosure of conduct likely to physically injure another person if an individual plans to commit the act, but prohibit disclosure if an entity plans to do so. Disclosure is warranted by the nature of the harm to be inflicted, not by the nature of actor who inflicts it. The same can be said for any of the other exceptions to disclosure contained in Model Rule 1.6: permitting disclosure for individual clients while proscribing it for entity clients would be nonsensical. Further, the comment to the Model Rule 1.6 suggests that Model Rule 1.13 does not preempt Model Rule 1.6 for entity lawyers. \(^{238}\)

Under Model Rule 1.6(b)(2), an attorney may disclose information relating to the representation if necessary to defend the attorney against civil claims arising from actions involving the client. \(^{239}\) Formal proceedings need not have been filed before the lawyer may disclose otherwise protected information. \(^{240}\) Thrift attorneys would have been justified in disclosing client wrongdoing under this exception.

The Model Rules, moreover, support the view that attorneys may evaluate decisions of confidentiality differently in different contexts. The comment to Model Rule 1.13, speaking of government attorneys, says

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\(^{236}\) "A lawyer may reveal [information relating to the representation] to the extent the lawyer reasonably believes necessary . . . to prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm." MODEL RULES, supra note 7, Rule 1.6(b)(1).

\(^{237}\) See supra text accompanying notes 98-101.

\(^{238}\) "Where the client is an organization, the lawyer may be in doubt whether contemplated conduct will actually be carried out by the organization. Where necessary to guide conduct in connection with this Rule, the lawyer may make inquiry within the organization as indicated in Rule 1.13(b)." MODEL RULES, supra note 7, Rule 1.6 cmt.

\(^{239}\) The rule says: "A lawyer may reveal such information to the extent the lawyer reasonably believes necessary . . . to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved. . . ." Id. Rule 1.6(b)(2).

\(^{240}\) Id. Rule 1.6 cmt.
that “when the client is a governmental organization, a different balance
may be appropriate between maintaining confidentiality and assuring
that the wrongful official act is prevented or rectified, for public business
is involved.” The comment also suggests that government attorneys
may scrutinize the conduct of government officials, who are actors for
their client, more closely than would attorneys for private enterprises.
The “public business” of which the comment speaks is not the sole prov-
ince of government attorneys. Some industries, such as the thrift indus-
try, are so intimately tied to the nation’s welfare that they, too, involve
public business. The comprehensive regulation of the industry reflects
the public concern with these institutions; it is a “reflection of the Ameri-
can political system’s long-standing and deeply rooted belief that deposit-
ory institutions are ‘special’: that their crucial roles as providers of
credit . . . to businesses and households and as repositories for deposit
moneys by the rest of the economy make them special.”

Like their counterparts in the securities industry, thrift attorneys
serve as gatekeepers. Without them, their clients cannot create assets
(that is, extend loans), file necessary regulatory documents, or perform
many other tasks essential to the operation of the institution. Like their
counterparts in the Securities and Exchange Commission, thrift regula-
tors rely on the gatekeepers to promote compliance with the regulatory
scheme. The scope of the thrift crisis, and the litany of complaints
against counsel, testify to the consequences of misplaced reliance. The
comment to Model Rule 1.13 rightfully suggests that an attorney for a
client whose misconduct may cause widespread public harm, such as a
thrift attorney, should be permitted to evaluate confidentiality obliga-
tions differently. The modern rules of ethics have always recognized that
the degree of harm to others may warrant exceptions to traditional rules
of confidentiality. The rules have also provided exceptions to duties
when necessary to protect larger societal interests.

One might criticize the suggestion that an attorney should reveal
client wrongdoing because the lawyer then relinquishes his or her role as
an advocate for the client’s wishes. But that criticism does not deal ade-
quately with several points. First, the rules already obligate attorneys to
ignore their clients’ wishes under some circumstances and to protect
other societal interests. For example, attorneys must protect former cli-
ents, other clients, third persons, and themselves, by identifying conflicts

241. Id. Rule 1.13 cmt.
242. WHITE, supra note 40, at 25.
of interest. They must protect tribunals, whether adjudicative or non-adjudicative, by revealing client perjury and other fraud on the tribunals. They must protect the integrity of the profession by revealing wrongdoing by other lawyers, even if their own clients would prefer that wrongdoing be kept secret. And, most importantly, attorneys must not effectuate the client’s wishes if they are criminal or fraudulent. These obligations limit the attorney’s advocacy, but do not vitiate it.

Second, the view that an attorney must always function solely as an advocate for the client assumes that advocacy consistently fulfills a valuable purpose. That assumption may be valid in litigation where theoretically, one well-prepared advocate meets another, and each of them brings to an impartial tribunal the merits of his or her own cause, and the demerits of the adversary’s. Our adversary system assumes that the court will decide the case justly and protect other interests through appropriate remedies or procedural devices. In the environment in which business lawyers practice, however, the features of the adversary system that are supposed to promote the search for truth and justice simply do not exist. Even the Model Rules recognize that the lawyer’s role ought to be different if there is no adversary. Why else would the rules require an attorney in an ex parte proceeding to inform the court of unfavorable yet salient facts?

Again examining the thrift example, let us view a typical loan transaction. The two principal parties to the transaction are the thrift and the borrower. The thrift, if it is typically motivated, wishes to document the

243. Model Rules, supra note 7, Rule 1.7.
244. Id. Rule 3.3.
245. Id. Rule 3.9.
246. Id. Rule 8.3.
247. See In re Himmel, 533 N.E.2d 790 (Ill. 1989) (attorney disciplined for not reporting misconduct of client’s former attorney, even though client had requested attorney not to report).
248. Model Rules, supra note 7, Rule 1.2(d).
251. Model Rules, supra note 7, Rule 3.3(d), which provides: “[I]n an ex parte proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer which will enable the tribunal to make an informed decision, whether or not the facts are adverse.” The accompanying comment justifies the rule by noting the absence of a balancing presentation by the adversary and the judge’s overarching responsibility of rendering justice.
loan in a way that protects the safety and soundness of the institution. An ordinary thrift will be concerned with matters such as whether the loan documents permit the thrift to realize on its collateral effectively. The borrower, if it is typically motivated, wishes to lighten the personal and administrative burdens of the loan terms. An ordinary borrower will be concerned with matters such as whether the loan documents require personal liability for the debt or permit grace periods or notice before default. Other parties to a transaction may exist, such as the seller of property involved in the deal. But the interests of those parties do not drive the transaction in the same way that the interests of the thrift and borrower do. If a thrift is operating properly, then the ordinary self-interest of the thrift also will protect interested parties such as depositors. But if the thrift is operating unsoundly, nothing protects the depositors except for the possibility of regulatory review at some point in the future. If the thrift has concealed the true nature of the transaction from the regulators, that possibility becomes even more remote. Here the adversary system is meaningless.

VII. Changes in the Model Rules

Denying the significant involvement of lawyers in the thrift crisis is difficult. Many of the questionable transactions could not have been consummated without the participation of lawyers. The myriad transactions described in the complaints against counsel, many of them highly complex, could not have occurred without the assistance of sophisticated counsel: many transactions required complicated structures and lengthy documentation to accomplish the ends desired by thrift operators.

Model Rule 1.13 encourages unethical participation in transactions by entity lawyers because it provides attorneys with a tremendous incentive to remain ignorant about the client’s real motives. Model Rule 1.13 is not triggered until the attorney actually knows of wrongdoing within the entity. So long as the attorney can convince himself or herself that the attorney did not “know” of misconduct by the client, the attorney can avoid the difficult ethical choices that may lead to confrontation with the client and loss of the client’s business. If an attorney can rationalize his or her involvement as merely fulfilling the client’s wishes, the attorney can remain unconcerned with the larger implications of the work. The flaw of the entity theory, as articulated in Model Rule 1.13, is that it

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252. Under the Model Rules, knowledge means actual knowledge, although it may be established circumstantially. Id. Preamble.
permits attorneys to hide behind the putative wishes of the client, as articulated by controlling persons, without considering whether those instructions may damage others with whom the controlling persons stand in a special relationship. The current rules do not animate the lawyer to consider whether the attorney's services are being used to facilitate a crime or fraud, activities that are beyond the permissible scope of the representation under Model Rule 1.2.253 Nor do they give the lawyer sufficient reason to investigate whether individual transactions are part of a larger pattern of illegal or improper activity. That counsel in the thrift cases were completely and continuously unaware of the self-serving motives of the controlling persons within the thrifts strains credulity. Lawyers did not serve as mere scriveners in all of these transactions. They frequently participated actively in the structuring of transactions.254 But so long as the thrift attorneys avoided the abyss of "knowing," Model Rule 1.13 did not obligate them to act. The rule should be changed to require explicitly that an attorney exert reasonable efforts to ensure that the client is not committing a fraud on other persons or a breach of fiduciary duty. Without such a positive duty, an attorney cannot comply fully with his or her obligation not to assist wrongful conduct by the client. Prohibiting participation in crime or fraud without also imposing a duty to investigate is an empty exercise.

Model Rule 1.13 presently gives an attorney the discretion to withdraw from a representation when the lawyer knows of wrongdoing that the entity will not rectify. Because of their own self-interest in maintaining lucrative client relationships, or their interest in avoiding potentially hostile confrontations with clients, lawyers are not likely to exercise that discretion. As a result, client wrongs are likely to go unaddressed. To avoid this problem, Model Rule 1.13 should mandate the attorney's withdrawal if the client refuses to correct its misconduct. Attorneys might remain reluctant to investigate client conduct, for fear that they will learn dark secrets that will compel withdrawal. But the presence of a mandatory duty in the rules, rather than a discretionary one, might frighten attorneys a great deal more: the violation of a mandatory disciplinary rule might support a later civil malpractice action or disciplinary proceeding.255

253. Id. Rule 1.2(d), which provides that "[a] lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent . . . ."

254. See supra text accompanying notes 190-210.

As a companion measure, Model Rule 1.13 should obligate an attorney who withdraws from an entity representation because of client wrongdoing to disavow his or her work product. If attorneys do not do so, they could be aiding and abetting misconduct by the client. Under tort law, a person can be held liable for aiding and abetting an independent wrong if that person renders substantial assistance to the wrongful act by another and the aider and abettor was generally aware of his or her role. Silence can constitute assistance of a primary breach. Disavowal of work product could avoid aiding and abetting liability, since it is a form of communication about the client's conduct. In order to avoid aiding a breach of duty by a representative of an entity, attorneys should have a duty to speak symbolically through withdrawal from the representation and disavowal of work product.

VIII. CONCLUSION

This country will feel the effects of the collapse of the thrift industry for many years. Misconduct by thrift insiders undoubtedly contributed to the degringolade although the magnitude of their contribution is a matter of some debate. The extent to which attorneys may have facilitated misconduct raises disturbing questions about the appropriate limits of entity representation, questions that the ethical codes encourage attorneys to ignore.

256. See generally MODEL RULES, supra note 7, Rule 1.6 cmt., which says that the general rule on confidentiality does not prevent "the lawyer from giving notice of the fact of withdrawal, and the lawyer may also withdraw or disaffirm any opinion, document, affirmation, or the like." See also Ronald D. Rotunda, The Notice of Withdrawal and the New Model Rules of Professional Conduct: Blowing the Whistle and Waving the Red Flag, 63 OR. L. REV. 455 (1984).


258. SEC v. National Student Mktg. Corp., 457 F. Supp. 682, 713 (D.D.C. 1978) (finding aiding and abetting liability under securities laws for keeping silent in face of improper merger). But see Woodward v. Metro Bank, 522 F.2d 84, 97 (5th Cir. 1975) (holding that aiding and abetting liability may be inferred from atypical conduct, and that the aider and abettor "must knowingly render substantial assistance").

259. A related issue is the proper recipient of notice. If the proposed rule were applied to thrifts, mandating disclosure to depositors would be impracticable for several reasons. The number of depositors is potentially large, making notice costly and laborious. Further, many depositors are unlikely to be sufficiently sophisticated to understand the meaning of the notice. One solution would be disclosure to thrift regulators in the stead of depositors. If the institution becomes insolvent and the insurance fund pays depositors, the fund is subrogated to the rights of the depositors in any event. Further, allowing regulators to exercise rights on behalf of the protected class of depositors is practically sensible. See Donovan v. Fitzsimmons, 90 F.R.D. 583 (N.D. Ill. 1981) (allowing Secretary of Labor, as representative of pension plan beneficiaries, to discover confidential information between pension plan and its counsel).
From their inception, national ethical standards have reflected the typical model of the individual retaining an attorney to resolve a discrete problem. Yet many clients are not individuals, but entities. The codes, with their implicit paradigm of individual representation, view the entity alone as the true client. But this approach belies the protean complexities of entity representation. Reacting to the artificial simplicity of the ethical rules, many courts have taken a more realistic approach to defining the client in an entity representation, which focuses on the reasonable expectations of the entity's actors. Other aspects of traditional ethical doctrine reflect the same kind of artificiality as the entity rule. The orthodox view of the means of creating an attorney-client relationship holds that the attorney must explicitly agree to serve the putative client. Once that relationship exists, the attorney "knows but one person in the world, and that person is his client." But again, many courts have spurned this position. They have recognized less formal means of creating an attorney-client relationship and extended to third parties duties historically reserved for clients.

In light of these developments, the challenged conduct of many thrift attorneys is ethically questionable. Sadly, the ethical rules promote a false sanguinity among attorneys concerning the propriety of their conduct. The realistic approaches courts have taken to the issues of representation of entities, creation of relationships, and extension of duties indicate that attorneys have far greater duties to depositors and regulators than the ethical codes alone suggest.

The role of attorneys in the thrift fiasco highlights several deficiencies in the ethical rules concerning entities in general. The rules, as currently written, ostensibly prohibit attorneys from participating in misconduct by their clients, yet simultaneously discourage attorneys from investigating their clients' activities. Significant change is necessary if attorneys are to avoid participating in conflicts of interest or misconduct by their entity clients.

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260. 2 TRIAL OF QUEEN CAROLINE 8 (J. Nightingale ed. 1821).