Duties of Attorneys Advising Financial Institutions in the Wake of the S&L Crisis

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DUTIES OF ATTORNEYS ADVISING FINANCIAL INSTITUTIONS IN THE WAKE OF THE S&L CRISIS

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I. INTRODUCTION

"RTC Sues Jones Day."1 "RTC Sues Troutman Sanders."2 "Kaye Scholer Agrees to Settle With RTC for Up to $22 Million."3 "Ex-Partners Targeted in S&L Cleanup: RTC Extends Its Search for Culpable Attorneys."4 "FDIC Seeks $300 Million in Suit Against Law Firm."5 "Where Were The Lincoln Lawyers?"6 These and other similar headlines have become almost routine fare of legal newspapers, journals and periodicals over the past two years.

Banking attorneys, like all other participants in the S&L crisis including the bankers, accountants, appraisers, regulators, Congress, and even the depositors, have been criticized for contributing to the crisis and the massive losses to be borne by the taxpayers. Some of those attorneys are now being asked to pay for their share of the losses.

The Federal Deposit Insurance Corporation ("FDIC") and the Resolution Trust Corporation ("RTC"), the receivers of failed federally-insured financial institutions, have filed numerous, multi-million dollar malpractice suits against the attorneys of now-failed institutions.7 In addition, the Office of Thrift Supervision ("OTS"), regulator of federal S&Ls, has taken administrative actions seeking restitution from the attorneys of several failed thrifts.8 These legal actions targeting bank attor-

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7. See, e.g., Charles F. Byrd & Isabella W. Sammons, FDIC Legal Action Against Attorneys and Other Professionals, 108 BANKING L.J. 420 (1991); see also supra notes 1-6 and accompanying text.
8. See, e.g., OTS Settles With Silverado Law Firm, Reaches Separate Agreement on C&D Order, 56 BANKING REP. (BNA) 1204 (June 24, 1991); OTS Freezes Kaye, Scholer's Assets, Asks for
neys are unprecedented in three ways. First, the federal receivers
traditionally have not pursued the attorneys of failed institutions. In the
past, the FDIC and the Federal Savings and Loan Insurance Corpora-
tion (predecessor to the RTC) had primarily targeted the directors and
officers of failed institutions. Now the FDIC and RTC have over forty
attorney malpractice suits in process. Second, the receivers and regula-
tors have named some of the largest and most prestigious firms in the
country in these actions. Third, and most significantly, the suits allege
that the attorneys' actions had caused substantial losses which contrib-
uted to the failure of those institutions. The suits do not address iso-
lated instances of negligent representation. Rather, they allege ongoing
breaches of the attorneys' fiduciary duties to their clients, specifically
those duties which impact on the safe and sound operation of the bank.
Those breaches, according to the liquidators, have resulted in some of the
most costly bank and savings and loan failures in the nation's history.

$275 Million in Restitution, 58 BANKING REP. (BNA) 419 (March 9, 1992)[hereinafter OTS Freezes Kaye, Scholer Assets]. The OTS initiated these administrative enforcement actions pursuant to 12 U.S.C.A. § 1818(b) (1991).

Bank attorneys may be subject to cease and desist orders, as well as other civil enforcement actions, by the federal banking regulators if they are determined to be institution-affiliated parties, as defined in 12 U.S.C.A. § 1813(u) (1991). See Raymund G. Kawaski, Comment, Liability of Attor-

The OTS has no standing to sue for attorney malpractice. Generally, an attorney is liable only to her client. See Savings Bank v. Ward, 100 U.S. 195 (1879). The concept of privity has long
protected attorneys from malpractice claims by nonclients. Pelham v. Griesheimer, 440 N.E.2d 96, 99 (Ill. 1982). However, some courts have held that attorneys may be liable for damages caused by
their negligence to a third party, where that third party was intended to be benefitted by the attor-
ney's performance. See, e.g., id., at 100; Roberts v. Ball, Hunt, Hart, Brown & Baerwitz, 128 Cal.
Rptr. 901, 905 (1976). Even under an expanded view of attorney liability to third parties, it appears
unlikely that the OTS could have standing to sue bank attorneys for malpractice because it would
not be the party incurring any damages.


10. Suits Against Bank Lawyers Now Number 44 at the FDIC, BANKING A'TY, Sept. 6, 1991, at 1. The FDIC and RTC staff expect this number to increase significantly. Byrd & Sammons, supra
note 7, at 422.

The increase in corporate attorney malpractice suits has not been limited to banking. More and
more, attorneys are being sued by people injured in dubious financial deals. Lawyer Deep Pockets, A.B.A. J., Jan. 1990, at 34.

11. See, e.g., Jensen, supra note 1; Cox, supra note 2; Adams, supra note 3.

12. See complaint at 4, FDIC v. Eckert Seams Cherin & Mellott, (E.D.N.Y. 1990) (No. 90-
0488); First amended complaint at 59, FDIC v. Wise, (D. Colo. 1990) (No. 90-1688); Third
amended complaint at 17, RTC v. Keating, (D. Ariz. 1991) (No. 89-1509 PHX-RMB); Complaint

13. The cost of the Lincoln S&L failure is estimated to be $2.5 billion. Rita H. Jensen, Rever-
berations From a Failure, NAT'L L. J., Nov. 13, 1989, at 1. The Silverado Banking, Savings and
Loan Association failure will cost the taxpayers approximately $1 billion. Neil Bush, Other Silverado
Board Members, and S&L's Law Firm Agree to Settle With FDIC, 56 BANKING REP. (BNA) 1058
(June 3, 1991).
The bank attorney's duties to her client in this context is an unsettled area of law. Few suits of this nature have ever been filed. Most, if not all, have been settled before final adjudication. The number, nature and amount of the receivers' and regulators' suits raise serious questions for the banking bar. What are the duties of bank counsel, specifically when the client is planning or has committed some act which may adversely affect the safe and sound operations of the institution? Are the FDIC, RTC and OTS attempting to hold bank counsel to higher standards of duty in this regard? Do bank attorneys have a duty to ensure the safe and sound operation of their clients? Or, assuming the receivers' case-specific allegations are true, have the bank counsel-defendants allegedly breached duties which they knew or should have known existed?

14. See Adams, supra note 3; Sherman & Howard and co-defendants agreed to a $26.5 million settlement in FDIC v. Wise, 758 F. Supp. 1414 (D. Colo. 1991) (C.A. No. 90-F-1688, settlement agreement dated June 5, 1991). Similarly, the FDIC's negligence suits against directors and officers are almost always resolved through settlement. According to an agency spokeswoman, 90% to 95% of FDIC suits alleging director and officer liability are settled before they get to the courtroom. Christi Harlan & Milo Geyelin, FDIC Wins Rare Negligence Trial Against Bank Officers, WALL ST. J., Dec. 16, 1991, at B5. But see FDIC v. Mmahat, 907 F.2d 546, 552 (5th Cir. 1990) (upholding trial court's determination that bank attorney/director was liable for malpractice for advising the board to approve loans in excess of the lending limit).


Critics of the FDIC, RTC and OTS claim that they, through their recent legal actions, are attempting to impose higher standards of professional conduct for bank attorneys. More specifically, the critics charge that the receivers and regulators, without justification, are imposing upon the attorney the duty to "police" the client, to ensure it complies with laws and prudent banking standards, to ensure the client's directors and managers fulfill their fiduciary duties, and to report non-compliance and improprieties to the regulator. The critics argue that such duties are not supported by case law or professional ethical standards, noting also that the latter alleged duty is inconsistent with the Codes of Professional Responsibility Conduct and the Rules of Professional Conduct. Some fear that the malpractice insurers will increase rates to the point where the costs become prohibitive. As a result, many firms may decide to pass the high rates onto the banks or even withdraw from bank representation altogether.

Similar concerns were raised by securities lawyers in the early 1970's in response to the Securities and Exchange Commission's ("SEC") legal actions against attorneys. Critics had claimed that the SEC was imposing upon securities lawyers a duty to the securities market. Some interpreted this duty to the market to include a duty to reveal to the public misleading or fraudulent information contained in their clients' disclosure documents. See Frederick D. Lipman, The SEC's Reluctant Police Force: A New Role for Lawyers, 49 N.Y.U. L. REV. 437 (1974). The most noted case was SEC v. Nat'l Student Marketing Corp., 457 F. Supp. 682 (D.D.C. 1978). In that case, the SEC charged two prestigious firms, Lord, Bissell & Brook and White & Case, with violations of several sections of the Securities Act. The court ultimately determined that the attorneys did not have a duty to disclose the misleading information to the SEC or to the public. However, the attorneys were held liable for aiding and abetting securities law violations by not preventing the misleading disclosure. Id. at 713.
The bank attorney's duties are significantly influenced by the nature of the banking industry and the broad duties of the bank director. This note will outline the critical duties of counsel engaged to provide advice on banking transactions or practices which may affect the condition of the financial institution. The duties set forth below would also apply to attorneys representing banks with regard to regulatory issues and relations with bank regulators. The note will distinguish the duties of bank counsel from those of a non-bank corporate attorney.

This note will first review the unique aspects of the highly-regulated, federally-insured financial institution in relation to other corporate entities. Likewise, the note will contrast the duties of the bank director with those of other corporate directors. With this background, a suggested framework for the duties of bank counsel will be developed. This section will draw upon analogies to agency and tort case law. Professional codes of conduct also provide guidance in defining the bank counsel's duties.

Finally, several of the FDIC's, RTC's and OTS's charges against bank counsel will be evaluated in light of the bank counsel duties as set forth in this note.

I conclude that bank counsel are not subject to a higher standard of duty than other corporate counsel. However, they may have a broader scope of duty than their non-banking counterparts. This broader duty is a function of the public's interest in a safe banking industry and the higher standards of duty to which bank directors are held. The FDIC, RTC and OTS complaints reviewed in this note are consistent, for the most part, with the suggested framework for bank counsel duties.

II. FACTORS INFLUENCING THE SCOPE OF BANK ATTORNEYS' DUTIES

The contours of the bank attorney's duty is formed in part by the nature of the banking system. Each banking client is a part of an integrated system upon which the nation's economy is heavily dependent. There exists a strong public interest in maintaining the stability of that system. Thus, public policy exerts a strong influence on the operation of banks, as well as the myriad of legal relationships that exist within the entire banking system. This influence is manifested by the comprehensive regulations governing banking and the higher standards of conduct required of bank directors. Bank counsel must consider these public interest factors when providing advice to their bank clients.
A. Public Policy In Support of a Strong Banking System

The nation's banking system, which includes commercial banks, savings and loans associations and credit unions, serves many vital functions in our nation's economy. The banking system is an intermediary of funds between savers and borrowers. Banks meet the credit needs of their communities by providing mortgage and consumer credit and business loans. They provide a safe haven for the savings of many people since deposits under $100,000 are guaranteed by the FDIC. In addition, banks form the basis of the nation's payments system. The efficient processing of checks and electronic funds transfers facilitates the flow of money and credit throughout the world. Finally, the Federal Reserve System controls the nation's money supply through the banking system.

Bank failures can severely impact the workings of this highly integrated system. Each of the above functions is disrupted to some degree by a bank failure. Of course, the system can absorb some relatively minor, inevitable bank failures. However, as the number of failures across the nation increases, so does the adverse impact on the economy. Likewise, failures of larger institutions have a broader effect on the economy. The massive number of bank and S&L failures experienced in the 1980s and 1990s have indeed negatively affected the economy.

16. Unless noted otherwise, commercial banks, savings and loan associations and credit unions will be referred to in this comment as "banks."
18. Id.
19. Id.
20. Id.
21. Some failures are good for the system, particularly if they represent the institution's inability to compete in the marketplace. Neither the banking system nor local economies are benefitted by poorly managed institutions which are focused on survival rather than growth and prosperity.

In addition to significantly increasing the nation's already huge deficit, bank failures cause other harm to the economy. Financial institution failures have also resulted in depressed real estate values in several parts of the country. The RTC, as liquidator of failed savings and loan associations, is the owner of approximately $17 billion of real estate. RTC Defends Itself, Rejects 'Mind-Boggling' Sales Alternative, AM. BANKER, Feb. 6, 1992, at 4 (letter to editor by Stephen J. Katsanos, Director, corporate communications, RTC). The RTC is charged with selling these properties. In over-built areas, where much of this real estate is located, the market will be unable to absorb these properties.
It is not surprising then that the banking system is subject to a complex and comprehensive scheme of governmental regulation. All aspects of banking are governed to some degree by federal or state regulation. One purpose of this regulatory scheme is to minimize bank failures and their impact on the economy. Although Congress and many state legislatures began to deregulate banking to some extent in the early 1980s, that trend has been dramatically reversed since 1989. Primarily in response to the savings and loan crisis and the insolvency of the FDIC insurance fund, Congress passed two broad banking bills, the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") and the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"). The banking system has never before been subject to such comprehensive federal regulation as it is now.

Banking laws and regulations are numerous. Many of the laws and regulations are designed to protect the consumer. Others are intended to ensure efficiency within the banking system. But the most significant body of banking laws and regulations are designed to ensure the safety, soundness and stability of banks. Examples of these types of laws include limitations on loans to one borrower, limitations on loans to insiders, limitations on transactions between affiliates, and minimum capital requirements. However, compliance with these laws and regulations does not preclude the possibility of a bank’s failure, although non-

for a number of years. Applying the basic economic law of supply and demand, the massive volume of properties on the market will likely have a depressing effect on real estate values for a number of years. Large numbers of bank failures also contribute to fears over the stability of the entire economy. Furthermore, weaknesses in the American banking system impair its competitiveness in worldwide markets.

24. Id. at 7-8.
28. Id. at 99-142.
29. Id. at 49-96.
30. 12 U.S.C.A. § 84 (1991). Generally, loans by a national bank to one borrower are limited to 15% of bank capital. 12 C.F.R. § 32 provides regulations setting forth exceptions to the statute and criteria for combining loans to separate borrowers for purposes of the statute.
32. 12 U.S.C.A. § 371e-1 (1991). Loans to each affiliate of a national bank limited to 10% of the bank’s capital. Aggregate loans to all affiliates limited to 20% of capital. All loans are required to be collateralized within certain loan-to-value ratios, depending upon the nature of the collateral.
33. 12 C.F.R. § 3 (1991). The best rated national banks must maintain a minimum leverage ratio 3% of total assets. Lower rated institutions must have leverage ratios at least 100 basis points
Banks must exercise safe and sound banking practices in order to ensure profitable, ongoing operations. Failure to adhere to safe and sound banking practices may result in losses and even insolvency. By engaging in unsafe and unsound banking practices, bank directors and officers breach their fiduciary duty of care to the institution, its shareholders and its depositors.

What precisely are unsafe and unsound banking practices has not been specifically enumerated. However, bank regulators provide guidance in this regard through publications, periodic banking bulletins and circulars, and banking advisories. Regulators also communicate directly with directors and officers about unsafe and unsound practices during examinations and other supervisory contacts. Examples of practices which may be unsafe and unsound include advancing loans without adequate analysis of repayment capacity, placing too much reliance on collateral values in granting loans, and having an excessive concentration of loans to one industry.

Clearly, banks fail for many reasons. The Office of the Comptroller of the Currency ("OCC") has determined that adverse economic factors play only a small role in the failure of financial institutions. Fraud is also not a major factor in the failures. Rather, poor management, inadequate supervision by directors, and non-fraudulent insider abuse are the primary causes of bank failures. In particular, failed bank managers

higher. In addition, all national banks must maintain a minimum tier 1 capital to risk-weighted assets ratio of 4% and a total capital to risk-weighted assets ratio of 8%.

34. See generally, Office of the Comptroller of the Currency, Bank Failure, An Evaluation of the Factors Contributing to the Failure of National Banks (1988) [hereinafter Failed Bank Study]. This is a study of national bank failures during the period 1979 through 1987. The study was based on an analysis of 171 failed banks, 51 rehabilitated banks which had experienced significant difficulties from which they recovered, and 38 healthy banks which served as a control group.

35. An unsafe and unsound practice is:
   one in which (1) there has been some conduct, whether act or omission, (2) which is contrary to accepted standards of prudent banking operation, and (3) which might result in exposure of the bank or its shareholders to abnormal risk of loss.


36. See e.g., Office of the Comptroller of the Currency, Income Diversion Through Management and Other Fees, Banking Circular 115 (Aug. 30, 1978) (stating that the payment of fees to insiders which bear no relationship to the type, level, quality or value of the goods or services provided represents an unsafe and unsound banking practice.)


38. Failed Bank Study, supra note 34, at 10.

39. Id. at 9.

40. Id. at 1.
were more likely to have violated laws and regulations, engaged in unsafe and unsound practices and breached their fiduciary duty than the managers of healthy banks. Leading contributing factors to bank failures include nonexistent or poorly followed loan policies (this characteristic was noted in 81% of failed banks), missing financial information on borrowers or poor collateral documentation (81%), inadequate systems to ensure compliance with policies and banking laws (69%), inadequate controls or supervision of key bank officers (63%), collateral-based lending and insufficient cash flow analysis (55%), unwarranted concentrations of loans to one industry (37%), and self-dealing by insiders (35%).

The OCC concluded from its analysis of failed banks that the best way for banks to weather economic storms is to minimize internal shortcomings. Not surprisingly, the difference between the failed banks and the healthy banks in the study was the quality of management. The study also emphasized the importance of an active and informed board of directors to the safety and success of banks. Those management teams which avoided unsafe and unsound banking practices and fulfilled their fiduciary duties to the bank, its shareholders and depositors survived economic downturns and remained viable financial institutions. Those that failed in this regard were more likely to see their institution fail as well.

Congress has recently enacted laws which recognize the importance of the avoidance of unsafe and unsound banking practices and breaches of fiduciary duties. FIRREA expanded the scope of federal bank regulators' civil enforcement authority to cover breaches of fiduciary duty and unsafe and unsound practices engaged in by institution-affiliated parties. FDICIA goes even further by requiring that the bank regulators implement regulations for certain bank operations such as loan underwriting, compensation, and funds management. Such regulation will in effect be a codification of certain safe and sound banking practices.

Notwithstanding the new regulations to be promulgated under FDICIA, mere compliance with banking laws and regulations will not insure against losses or insolvency. Generally, safety and soundness laws and regulations define only minimally or maximally acceptable behavior. At the edge of legal bank activity often lies a grey area of possible unsafe

41. Id. at 6.
42. Id. at 6-9.
43. Id. at 15-16.
44. Id. at 15.
46. FDICIA, supra, note 26 (Section 112).
and unsound practice. For example, it may be legal for a bank with a legal lending limit of $1,000,000 to loan $999,999 to one borrower. However, it may be an unsafe and unsound practice if the bank granted the loan without first analyzing the borrower's repayment capacity. In that case, the directors would have breached their fiduciary duty of care to the bank by approving such a loan.

Bank directors and officers rely heavily on the attorney to guide them through the maze of legal issues impacting day-to-day banking business. As a result, bank attorneys often play decisive roles in the health and stability of the institutions that they advise.\textsuperscript{47} The bankers must be concerned with more than mere compliance with laws and regulations. Legal issues include duties owed by directors and officers to the bank, the shareholders and the depositors. And those duties necessarily include adherence to safe and sound banking practices. Thus, the attorney's advice will impact broadly upon the operations of the institution.

\textbf{B. Special Duties of Bank Directors}

Bank attorneys must be keenly aware of the higher standards of care to which the bank directors are held. The attorney's advice to the bank must take into consideration the directors' duties to the institution. The institution itself may be held liable by the regulators for unsafe and unsound practices or breaches of fiduciary duties by the directors and officers.\textsuperscript{48} The bank may be assessed civil money penalties or be subjected to an administrative order to cease and desist.\textsuperscript{49} Thus, the bank attorney must be mindful of legal, but imprudent activity of the directors.

The advice of corporate attorneys to their client is highly dependent upon the facts and circumstances surrounding the subject matter of the advice. Corporate attorneys are called upon to advise corporate directors and officers as to alternative courses of action. Often, the requested advice relates to the legality of a transaction or course of action, or whether the client or its agents could incur liability as a result of such action. The attorney must address more than whether a transaction is merely allowable under applicable law.

In order to provide adequate advice in such a situation, the attorney must fully understand the legal relationships and duties between the client, its directors, officers, shareholders, customers, and others. For ex-

\textsuperscript{47} Thrift Lawyers Can Be Regulated By OTS, Senior Agency Official Says, 56 BANKING REP. (BNA) 1202 (June 24, 1991) (comments of OTS Chief Counsel Harris Weinstein).


\textsuperscript{49} 12 U.S.C.A. §§ 1818(b) and 1818(i) (1991).
ample, a corporate attorney might advise a closely-held corporation differently than a publicly-held corporation on the same matter. The advice might vary because of the differences in the legal relationships among the officers, directors and shareholders in closely-held corporations and those in publicly-held corporations.\textsuperscript{50} Similarly, the special duties of the bank director will significantly influence the advice of the bank attorney.

Corporate directors owe fiduciary duties of care and loyalty to the organization and its shareholders.\textsuperscript{51} These common law duties have since been codified in many state corporation statutes.\textsuperscript{52} A typical statute establishing a director's duties states that he must perform those duties "in good faith and with that degree of care which an ordinarily prudent person in a like position would use under similar circumstances."\textsuperscript{53}

The courts have applied this same standard of duty to bank directors. Nevertheless, bank directors have been held to a stricter standard of care than other corporate directors.\textsuperscript{54} Liability for the breach of the duty of care has been imposed upon bank directors more often than on directors of other types of corporations.\textsuperscript{55} The bank director is not in a \textit{like situation} with that of most other corporate directors. As noted above, a bank is part of an integrated system that is critical to the nation's economy. Courts have held bank directors to a higher standard of care because banks are depositories for public money.\textsuperscript{56} Bank directors are charged with a responsibility to see that depositors' funds are safely and providently invested.\textsuperscript{57} Courts have also placed a higher duty on

\textsuperscript{50} In general, shareholders do not owe a fiduciary duty to the corporation. However, some courts have held that shareholders in a closely-held corporation owe fiduciary duties to the corporation and other shareholders. See Hagshenas v. Gaylord, 557 N.E.2d 316, 322 (Ill. App. Ct. 1990). The attorney must consider this significant difference in legal relationships when advising a closely-held corporation.


\textsuperscript{52} Hugh F. Sharber, Note, \textit{A Realistic Duty of Care for Outside Bank Directors}, 51 TENN. L. REV. 569, 574 (1984).

\textsuperscript{53} N.Y. BUSINESS CORP. LAW § 717(a) (McKinney 1991).

\textsuperscript{54} Sharber, \textit{supra} note 52, at 576-81. See also Gadd v. Pearson, 351 F. Supp. 895, 903 (D.C.M.D. Fla. 1972) (stating that officers and directors of banking corporations generally owe a greater duty than other corporate officers and directors); Lane v. Chowning, 610 F.2d 1385, 1388-89 (8th Cir. 1979) (noting that it is well settled that bank officers and directors owe fiduciary duties to shareholders and depositors); Atherton v. Anderson, 99 F.2d 883, 888 (6th Cir. 1938) (stating that a bank is a quasi-governmental agency, not a private corporation in which shareholders alone are interested); Hoehn v. Crews, 144 F.2d 665, 672 (10th Cir. 1944) (stating that bank directors owe a "high degree of duty to the general public and stockholders").

\textsuperscript{55} Sharber, \textit{supra} note 52.

\textsuperscript{56} See e.g. Broderick v. Marcus, 272 N.Y.S. 455, 461 (1934).

\textsuperscript{57} Id.
bank directors because of the "quasi-public role that financial interests serve."\(^5\) One in the position of a bank director must necessarily exercise greater care than a non-bank director.

Generally, the duties of the bank director include an obligation to provide for competent management, to monitor operations to ensure adequate internal controls and compliance with laws and regulations and to oversee business performance.\(^5\) The following represent some of the practices the FDIC has identified as forming the basis for negligence suits against bank directors:

1. self-dealing;
2. imprudent or excessive lending practices;
3. failure to adhere to applicable laws and regulations;
4. failure to correct conditions or practices criticized by the regulators;
5. failure to properly supervise the institution;
6. failure to require prudent internal procedures and controls;
7. permitting the institution to operate without adequate liquidity or capital; and
8. failure to require prudent diversity in the institution's loans and investments.\(^6\)

For the most part, the above represent breaches of the director's duty of care. Furthermore, each of the above may be considered an unsafe and unsound banking practice.

Directors are entitled to reasonably rely upon the advice of attorneys in carrying out their fiduciary duties.\(^6\) In the highly regulated industry of banking, directors and officers often solicit the lawyer's advice. Often that advice may have a material impact on the bank's overall operations and condition. This reliance, however, places a duty on the attorney to the board consistent with her duty to the bank. Indeed, a bank director may claim reasonable reliance on an attorney's advice as a defense to a charge of negligence.

### III. Specific Duties of Bank Counsel

Thus far we have seen that there exists a strong public interest in ensuring the stability of the banking system, that that system can be destabilized by bank failures, and that most bank failures are caused by poor management and inadequate board supervision. These supervisory weaknesses often result in, or are manifested by, violations of banking

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58. Sharber, supra note 52, at 576. See also Atherton v. Anderson, 99 F.2d at 888.
59. The Director's Book, supra note 17 at 19-46.
laws and regulations, unsafe and unsound banking practices and breaches by directors of their fiduciary duties to the bank, its shareholders and its depositors. As a result of the public's special interest in a sound banking system, bank directors are held to a higher standard of care. As a result of these circumstances, it becomes clear that the bank attorney assumes duties which differ from those of a non-bank corporate lawyer.

This section of the note will focus on some of those duties which influence the attorney's advice with respect to questionable banking activity, i.e. activity which may be unsafe or unsound, a breach of a fiduciary's duty, or a violation of law or regulation. These are the duties which, if breached, could lead to significant losses and insolvency. While I conclude that the bank attorney is not subject to higher standards than other corporate attorneys, the bank attorney's duties are different. That difference lies primarily in the bank attorney's duties with respect to potential unsafe and unsound practices and breaches of directors' fiduciary duties.

Bank attorneys, as do corporate lawyers, owe fiduciary duties of care and loyalty to their clients. The nature of these basic duties is shaped by several sources, including agency, corporate and contract law, as well as codes of professional conduct. Four of the most critical duties of the bank attorney, in the context of questionable banking activity, are (1) the duty to loyally represent the client, as opposed to the directors, shareholders and officers; (2) the duty to advise on the entirety of the transaction or course of conduct, which necessarily includes being aware of possible unsafe and unsound practices and breaches of fiduciary duty; (3) the duty to warn corporate agents of existing or planned violations of law and regulation, unsafe and unsound practices, and breaches of fiduciary duty; and (4) the duty to refrain from knowingly assisting in breaches of others' fiduciary duties to the bank.

A. Duty to the Client

The bank attorney owes a duty to represent the interests of her client—the bank. When an attorney is retained by a bank, her responsibilities and loyalties are to the bank and not to the individual employees, officers, or directors of the bank. This is a fundamental duty, yet one

62. See 7 AM. JUR. 2d Attorneys at Law § 119 (1980). See also Fund of Funds, Ltd. v. Arthur Andersen & Co., 567 F.2d 225, 233 (2d Cir. 1977) (attorney's duty was tantamount to that of a fiduciary or trustee); Ball v. Posey, 222 Cal. Rptr. 746, 749 (1986) (attorney-client relationship is fiduciary relationship that should be of the highest character).

that may be difficult to distinguish in the corporate context. The attorney must deal with the corporation through its agents—the directors and officers. Yet the interests of those corporate agents may be different from, indeed adverse to, those of the corporation. This conflict is exacerbated when the organization is closely held. The corporate attorney must be mindful of such potential conflicts and ensure that her representation of the organization is not compromised. The bank attorney is often faced with this challenge, since a large number of the nation’s financial institutions are either closely held or controlled by a single major shareholder.

B. Duty to Advise on Entirety of Transaction

The bank attorney has a duty to provide the bank with competent advice based upon her informed judgment on the totality of a transaction or proposed activity. In other words, the bank attorney must not limit her advice to whether a particular transaction is legal and enforceable. Nor should an attorney structure a transaction so as to meet minimum legal requirements without considering non-legal factors. Rather, bank counsel must advise her client as to the possibility of whether the transaction may be a breach of another’s fiduciary duty or an unsafe and unsound banking practice. In order to be able to provide such advice, the attorney may have to inquire or investigate as to the context of the transaction.

This is not to say that the bank attorney is responsible for ensuring the safety and soundness of the institution. Banks are in the business of taking risk. It is the board’s responsibility to ensure that risk is prudent and properly managed. The board’s acceptance of too much risk or the failure to measure, monitor, mitigate and control risk is unsafe and unsound and a breach of their fiduciary duty. The directors have a duty to establish policies, procedures and systems designed to manage risk.

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64. Consider a bank owned 100% by one individual. The interests of the bank and the individual would be different, even though there are no other shareholders. The bank’s reliance on depositors’ funds creates differing interests for the bank and its officers and directors. Thus, a sole shareholder of a bank would not be able to borrow from the bank at preferential rates. However, the sole shareholder of a hardware store may be entitled to borrow excess funds from the business at lower than market rates. The banker has to answer to the depositors; the hardware store owner need only answer to himself.


67. Id.
The attorney's duty is not to assess the risk. But the bank attorney should advise the bank of the need for risk management systems. In addition, the attorney must advise of weaknesses in, or non-adherence to such systems, if reasonably aware of such activity. Indeed, by virtue of the wide range of banking matters requiring legal advice, the attorney is often in a unique position to know how the bank actually operates in relation to how policy states it ought to operate.

Many courts have taken a broad view of the attorney's duty to the client. These courts have held that the attorney is more than a mere scrivener. He has a duty to look beyond the client's instructions, to investigate matters under certain circumstances. He must not remain silent in the face of a client's legally unacceptable decisions. Furthermore, he must ensure that the client is seeking a legitimate goal and using legal means to get it.

One of the broadest views of the attorney's duty was set forth in Bryan v. Bartlett when the court held that an attorney representing a failed consumer finance company served in the same fiduciary capacity as the directors. Under such a holding, the bank attorney might owe a special duty of care to the institution and to the depositors. The attorney would be expected to look beyond the instant transaction and be alert to irregularities.

In FDIC v. Wise, a legal malpractice suit against the attorneys of a failed S&L, the attorney-defendants argued in a motion to dismiss that

69. Id.
70. See, e.g., In re Blatt, 65 N.J. 539 (1974); Avianca, Inc. v. Corriea, 705 F. Supp. 666 (D.D.C. 1989); In re Consupak, Inc., 87 B.R. 529 (Bankr. N.D. Ill. 1988). See also, Cherokee Restaurant, Inc. v. Pierson, 428 So. 2d 995, 997-98 (La. Ct. App. 1983) (noting that the attorney's duty of care is imposed by law and is something over and above any contractual duty). But see Johnson v. Jones, 652 P.2d 650 (Idaho 1982). In Johnson, the court held that an attorney, retained to draw up a contract for the purchase of a business, owed no duty to advise the client as to the need for an inventory of corporate assets or as to their rights to receive certain assets withheld by the seller. Id. at 652. The court stated that the scope of an attorney's contractual duty to a client is defined by the purposes for which the attorney is retained. Id.
71. 705 F. Supp. at 678-80. The court held that the attorney owes a continuing fiduciary duty to the client, even though he was not expressly retained in connection with a particular transaction.
72. 87 B.R. at 549-51. The court interpreted Canon 7 of the Code and Rule 2.1 of the Rules to require an attorney to offer legal advice, on their own initiative, when either the client is unaware of the potential adverse legal consequences of its planned action or when it is in the client's best interest.
73. Id. at 551.
74. 65 N.J. at 545. The New Jersey Supreme Court, in its review of an attorney disciplinary action, held that an attorney may not follow the client's directions without first ensuring that the client is seeking a legitimate goal and is using legal means to attain it.
76. Id. at 37.
they had no duty to advise, investigate or inquire into the client's improper activities.\textsuperscript{77} The court denied the defendants' motion to dismiss\textsuperscript{78} and it concluded that the facts might support the claim that the attorneys owed a duty to advise and investigate certain matters.\textsuperscript{79}

These cases strongly suggest that bank counsel have a duty to advise on the legality and propriety of transactions in their totality. They support the concept of "whole law" promoted by OTS Chief Counsel Harris Weinstein.\textsuperscript{80} The principle of "whole law," according to Weinstein, means determining whether transactions, which are legal when viewed in isolation, may pose safety, soundness, or fiduciary considerations.\textsuperscript{81} The "whole law" principle is a comprehensive view of technical regulatory standards, concepts of safety and soundness, concepts of fiduciary duty, and hostility toward law-avoidance schemes.\textsuperscript{82}

The "whole law" concept applies particularly well to fiduciary relationships. In \textit{Garner v. Pearson}, the court stated that the entire course of dealing between a fiduciary and beneficiary is governed by the standards of good faith and fairness.\textsuperscript{83} In holding that a certain transaction caused by fiduciaries of a bank was a sham and therefore void, the court looked not at the separate related transactions but to the entire course of dealing between the fiduciaries and the bank.\textsuperscript{84}

Rule 2.1 of the Model Rules of Professional Conduct states that when rendering advice, "a lawyer may refer not only to the law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation."\textsuperscript{85} The comments to this rule address the possible inadequacies of purely technical legal advice. According to the comments, overly narrow and technical advice may be inadequate or of little value to the client.\textsuperscript{86} Even when a client inexperienced in legal matters asks for purely technical advice, the comment suggests that the attorney might have a responsibility to indicate that more may be involved than strictly legal considerations.\textsuperscript{87}

\textsuperscript{78} Id. at 1419.
\textsuperscript{79} Id.
\textsuperscript{80} Advice on How to Exploit Loopholes May Be Unethical, OTS' Weinstein Says, 56 Banking Rep. (BNA) 616 (April 1, 1991).
\textsuperscript{81} Id. at 617.
\textsuperscript{82} Id.
\textsuperscript{83} 545 F. Supp. 549, 558 (M.D. Fla. 1982).
\textsuperscript{84} Id. at 561.
\textsuperscript{86} Model Rules of Professional Conduct Rule 2.1 cmt. 2 (1988).
\textsuperscript{87} Id. at cmt. 3 (1988).
lawyer is asked for advice that goes well beyond legal matters and requires the expertise of other professionals, the lawyer should recommend that the client consult with the appropriate professional.\footnote{Id. at cmt. 4 (1988).}

In a bank's situation, it is critical that the attorney's advice be as broad as possible. As noted above, mere legal compliance does not protect the interests of the bank.\footnote{See discussion infra part II.A.} When asked for advice, the attorney should address more than the narrow aspects of a particular transaction. The advice should encompass potential safety and soundness issues or possible breaches of fiduciary duties.

This is not to say that the attorney must identify and advise on every possible unsafe and unsound banking practice or potential breach of duty. Rather, the attorney must identify any such improprieties or imprudent practices to which she has reasonably been put on notice.\footnote{See Owen v. Neely, 471 S.W.2d 705, 708 (Ky. 1971) (if lawyer accidentally or otherwise receives information that should reasonably put him on notice of a defect, it is his duty to investigate or report it to his client).} Furthermore, where the attorney is not on notice of any particular problem, she should nevertheless advise the bank that safety and soundness factors must be evaluated in deciding whether to take a proposed action.

An important distinction must be made regarding the bank attorney's duty as an advisor to provide advice to the client and the attorney's duty as an advocate to zealously represent the interests of the client. The advocate generally deals with past conduct.\footnote{Dean Marsan, Tax Shelter Opinions: Ethical Responsibilities of the Tax Attorney, 9 Ohio N.U. L. Rev. 237, 239 (1982).} She must take the facts as she finds them.\footnote{Id. at 239-40.} As an advocate, the attorney should resolve doubts as to questions of law in the client's favor.\footnote{Id at 239-40.} The advocate may urge any

\begin{enumerate}
\item \footnote{Id. at cmt. 4 (1988).}
\item \footnote{See discussion infra part II.A.}
\item \footnote{See Owen v. Neely, 471 S.W.2d 705, 708 (Ky. 1971) (if lawyer accidentally or otherwise receives information that should reasonably put him on notice of a defect, it is his duty to investigate or report it to his client).}
\item \footnote{Dean Marsan, Tax Shelter Opinions: Ethical Responsibilities of the Tax Attorney, 9 Ohio N.U. L. Rev. 237, 239 (1982).}
\item \footnote{Id. at 239-40.}
\end{enumerate}
permissible construction of the law favorable to her client whether or not
the attorney believes the construction will prevail.94

The role of the advisor is much different. The advisor assists the
client in determining future courses of action and relationships.95 The
advising lawyer must inform the client of all relevant considerations if
the client is to decide how to proceed.96 Thus, the advisor carries a heav-
ier burden and must be more objective than the advocate.97

Working in a regulated environment, the bank attorney is sometime
sometimes an advisor and sometimes an advocate. On occasion, the attorney
may be requested on behalf of the bank to contest the regulator’s citation
of a violation of law. Under those circumstances, the attorney assumes
the role of advocate. Her duty is to zealously put forth a position which
casts the best light on the alleged violation. At other times the attorney
may be asked for advice on future activity, such as documenting a loan
transaction, structuring a new operating subsidiary, or drafting a conflict
of interest policy. In those instances the attorney serves as advisor to the
bank. Her duty will be to advise the bank as to the legal aspects of the
proposed activity, as well as any safety and soundness and fiduciary duty
issues of which the attorney is reasonably aware.

The distinction between the two roles is not necessarily the subject
matter. Rather, the question of which role the attorney must fill—advoc-
ate or advisor—often turns on whether the events underlying the repre-
sentation have already occurred. While this seems to be a clear
distinction, the line becomes blurred when considering the attorney’s in-
volve in the bank’s reporting of certain past transactions to the reg-
ulator or responding to the regulator’s requests for information about
past events.

The American Bar Association Committee on Professional Ethics,
in Opinion 314, addressed this question as it relates to a tax attorney
advising her client in preparing his tax return.98 The Opinion states that
the preparation of a tax return is an adversary situation and that the tax
attorney is in an advocate role.99 By analogy, this Opinion suggests that
a bank attorney advising his client on regulatory reporting require-
ments100 might also be deemed to be in an advocate role.

94. Id. at 240.
95. Id.
96. Id.
97. Id.
99. Id.
100. For purposes of this discussion, regulatory reporting requirements include routine financial
    reporting, such as the reports of income and condition submitted quarterly to the FDIC, as well as
The "reporting requirements" owed to the IRS, however, are clearly distinguishable from the regulatory reporting requirements of banks. The tax return is used by the IRS for the purpose of determining the amount of tax owed. The IRS has no interest in the filer's behavior which produced the reported revenues and expenses. It is only concerned that those revenues and expenses are reported correctly—so that the amount of the tax is correct. By aggressively taking a position most favorable to the client, the advocate/tax attorney is benefitting the client by minimizing the tax liability. The advocacy role of the tax advisor seems appropriate in this context, even though the attorney is advising as to a future event—the filing of a tax return.

But regulators use the information they request of banks in the supervision of those institutions. Moreover, some of that information is used by the public in evaluating the condition of the bank. Both uses serve as corporate monitoring devices. Unlike the IRS agent, the regulator, depositors, investors and others are specifically interested in the bank's behavior. Certain required reports assist the regulator and others in understanding that behavior. Regulator-required reports are often designed to enable the reader to identify financial weaknesses, unsafe and unsound activity, violations of law, and other matters critical to the supervision of the institutions.

In this regard, the preparation of regulatory reports or responses to regulatory requests are more akin to the reporting requirements of the Securities and Exchange Acts of 1933 and 1934 than the IRS tax returns. These laws prescribe standards of liability for material misstatements or omissions in required reports to shareholders. Under certain circumstances, attorneys involved in the preparation of required reports can be held liable for violations of the acts or for aiding and abet-

101. See MERTENS LAW OF FED. TAX § 47.03 (1992).
102. In particular, the quarterly reports of income and condition are often relied upon by depositors, shareholders, stock analysts, regulators, and other interested parties to provide an insight into the financial condition of financial institutions. OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S HANDBOOK FOR NAT'L BANK EXAMINERS, § 408.1. These reports include a balance sheet and income statement, as well as other schedules and listings. Examples of available information include past due and non-accrual loan statistics, number of insider loans granted during the period, and various breakdowns of deposits. Id.
103. The primary objectives of the securities laws are to promote disclosure, which would enable investors to make informed investment decisions, deter fraud, and bolster confidence in the market. Steven M. Abramowitz, Note, Disclosure Under the Securities Laws: Implications for the Attorney-Client Privilege, 90 COLUM. L. REV. 456, 464-65 (1990).
Attorneys that assist in the preparation of these reports serve in an advisory role. The securities attorney is not considered to be in an adversarial role with the shareholders. Rather, the shareholders, and thus the corporation, are the beneficiaries of the protections afforded by securities laws.

Similarly, the bank attorney that assists in the preparation of regulatory reports or responses to regulatory requests for information is performing an advisory function. She should not approach the representation from an advocate's point of view. As such, the attorney in this position should provide objective advice which addresses all aspects of the reporting, including the need to state material facts which might result in a less than favorable regulatory response. It should be left to the client to choose a course of action based upon that objective advice.

If the attorney advising on the preparation of regulatory reports were to take an advocate's role, he might seek to minimize the impact of past improprieties in those reports. As a result, regulators or others who may use such reports might be unable to recognize weaknesses in the institution. Improprieties might continue uncontrolled and ultimately the bank could be harmed. Therefore, the interests of the bank and the public would be at risk if the bank attorney did not assume an advisory role when assisting in the preparation of regulatory reports.

C. Duty to Warn and Advise the Bank

Once the bank attorney has learned of potential violations of law or regulation, breaches of fiduciary duty, or unsafe and unsound banking practices, she has a duty to warn the corporate agents of such activity. The attorney’s fiduciary duty embraces the obligation of full and fair disclosure to the bank of facts which materially affect its rights and interests. Indeed, the attorney has a duty to disclose anything known to her which might affect the client’s decision on whether or how to act. This duty is the corollary to the directors’ right to rely upon the advice and expertise of the attorney. To allow the directors to rely upon the attorney, without requiring the attorney to provide them with all rele-

105. Id. at 76-77.
107. Ball v. Posey, 222 Cal. Rptr. 746, 749 (1986). See also Zidell V. Bird, 692 S.W.2d 550, 553 (Tex. Ct. App. 1985) (stating that negligence may consist of an attorney's failure to inform the client); Collins v. Fitzwater, 560 P.2d 1074, 1077 (Or. 1977) (upholding trial court's finding that attorney was negligent in failing to advise the board that they could incur liability if unregistered securities were sold).
vant data upon which they can make an informed judgement, would make such reliance unwarranted and unwise.

Rule 1.13 of the Model Rules of Professional Conduct establishes guidelines for the corporate attorney when he becomes aware of improprieties. However, Rule 1.13 is "riddled with qualifying language" which limits the attorney's duties when aware of improper activity. One of the major qualifications of Rule 1.13 is that the improper activity must be a matter related to the attorney's representation. It has been suggested that this limitation was designed to discourage attorneys from officiously interfering in corporate affairs, even if the activity was serious and client-threatening, as long as the impropriety was outside of the matter on which the attorney was providing advice.

In addition, the ultimate course of action recommended by Rule 1.13, reporting the activity to the board of directors, effectively makes the board, rather than the corporation, the ultimate client. Under certain circumstances, such as when the board of directors has breached its fiduciary duties, this course of action may undermine the intent of the rule. It is in these situations that the entity is most in need of the protection of the attorney since advice to the perpetrators of improper activity might fall on deaf ears. Another recommended course of action is to resign from the representation.

Notwithstanding some of the shortcomings of Rule 1.13, it does provide guidance for the attorney on possible courses of action. When aware of improper activity, the attorney should advise the board of directors and refuse to lend assistance in furtherance of the activity. Resigning from the representation may be necessary if the board is a party to the improprieties or the client insists on legal assistance to further the activity in spite of the attorney's advice against it. While these courses of action may be unproductive in many corporate scenarios, the banking situation is much different. Unlike most corporations, banks are subject to frequent examinations by their regulators. The resignation of an attorney or the presence of an attorney's memo regarding noted improprieties might never be noticed by anyone outside a non-bank corporation. However, examiners are more likely to learn of such actions during examina-

111. Villa & Murphy, supra note 15, at 296.
112. Id. at 297 (quoting Charles W. Wolfram, Modern Legal Ethics 744 (1986)).
115. Id.
116. Id.
tions. Indeed, hints of this nature are red flags for bank examiners that would likely prompt some regulatory follow-up.

It is important to note that the bank attorney generally has no duty to disclose possible improper activity to the bank regulators. Some critics of the FDIC, RTC and OTS have claimed that the receivers and regulators are holding the attorneys to a duty to make such disclosures.\textsuperscript{117} Indeed, there has been a great deal written in the press about the bank attorney’s duty to “blow the whistle” on their clients.\textsuperscript{118} To the contrary, such disclosure would be a breach of the attorney’s duty to protect the client’s confidences.

The nature of the attorney-client relationship is based upon the principles of agency law.\textsuperscript{119} As such, agency law establishes the attorney’s duty to protect the client’s confidences. Client confidences are also protected by the attorney-client privilege, which is based upon rules of evidence.\textsuperscript{120} State standards of professional conduct provide additional guidance on the issue of client confidentiality.\textsuperscript{121}

The attorney, as an agent, is under a duty not to use or communicate information confidentially given her by the principal or acquired during the course of the agency, unless there is an agreement to the contrary.\textsuperscript{122} However, an agent is privileged to reveal confidential information in the protection of a superior interest in herself or a third person.\textsuperscript{123} Thus, under the law of agency, an agent would be free to reveal that the principal is committing or is about to commit a crime. However, the agent is not required to make such a revelation.

The attorney-client privilege also restricts the attorney’s ability to disclose certain client information.\textsuperscript{124} However, the privilege only protects information communicated to the attorney for the purpose of obtaining legal advice. For example, the privilege does not extend to

\begin{itemize}
  \item \textsuperscript{117} See supra note 15 and accompanying text.
  \item \textsuperscript{119} Note, \textit{The Attorney’s Duty to Reveal a Client’s Intended Future Criminal Conduct}, 1984 \textit{Duke L.J.} 582, 590 [hereinafter \textit{Duty to Reveal}].
  \item \textsuperscript{120} Id. at 589.
  \item \textsuperscript{122} \textit{Restatement (Second) of Agency} § 395 (1957).
  \item \textsuperscript{123} Id. at cmt f.
  \item \textsuperscript{124} The attorney-client privilege is defined by Wigmore as follows:
    \begin{enumerate}
      \item Where legal advice of any kind is sought, (2) from a professional legal advisor in his capacity as such,
      \item the communications relating to that purpose, (4) made in confidence by the client,
      \item are at his instance permanently protected from disclosure by himself or by the legal advisor,
      \item except the privilege be waived.
    \end{enumerate}
\end{itemize}

\textbf{John H. Wigmore, A Student’s Textbook of the Law of Evidence 392-93 (1935).}
business advice given by an attorney to a client. This exclusion may be relevant in situations where an attorney gives advice on safety and soundness matters. The attorney-client privilege also has a crime-fraud exception. Communications made to the attorney for the purpose of furthering a crime or a fraud are not protected.

Finally, state standards of professional responsibility establish limitations on the attorney's ability to disclose client confidences.

In summary, the doctrines of agency and attorney-client privilege, and the standards of professional conduct adopted by the states, would not support claims of a bank attorney's duty to disclose the client's improper activity to its regulator or other third parties. Rather, these guidelines clearly establish a strong bias against attorney disclosure of confidential client information. Exceptions to this bias are limited to situations in which the information relates to a client's planned criminal or fraudulent acts. In many states, even those types of planned acts may not be disclosed unless they might result in serious bodily injury. In some instances, the fraud exception to the prohibition may allow disclosure in the context of a bank attorney-bank client relationship. But, in

126. See Duty to Reveal, supra note 119, at 590.
127. See Kramer, supra note 121, at 994. Each state's rules of professional conduct set the ethical standards for all members of the state's bar. The rules are adopted by the high courts of each state and are generally based upon one or more of the several models of professional standards established by the ABA. Thus, there is no one set of standards addressing the issue of disclosure of client confidences. With respect to disclosure of client confidences, most states have adopted either the ABA Model Code of Professional Responsibility (Model Code), the ABA Model Rules of Professional Conduct (Model Rules), or the Revised Final Draft of the Model Rules of Professional Conduct (Draft Rules). Steven Shavell, Legal Advice About Contemplated Acts: The Decision to Obtain Advice, Its Social Desirability, and Protection of Confidentiality, 17 J. Legal Stud. 123, 140 n.38 (1988).

The following is a summary of the ethical standards among the states regarding disclosure of planned acts:

(i) Attorneys are generally not obligated to disclose planned acts of clients communicated to them in confidence.
(ii) Attorneys in all states have the discretion to disclose clients' planned acts if the acts are crimes threatening serious bodily injury; in most states, attorneys have the discretion to disclose any type of crime or fraud.
(iii) Attorneys generally cannot disclose information about other planned acts, such as an intention to commit a breach of contract or much behavior that could give rise to a tort. Furthermore, in some states, attorneys cannot disclose information about any planned act unless it is a crime threatening serious bodily injury.
(iv) However, an attorney's obligation not to disclose a planned act might not apply if he gains his information inadvertently (for example, if he overhears his client talking to another person), if a third party who would not be expected to maintain confidentiality is present when the client speaks to the attorney, if the attorney has been drawn into assisting an illegal act, or if the client waives the privilege of confidentiality. In such cases, attorneys may have the discretion to disclose planned acts.

Id. at 140-141.
128. Shavell, supra note 127, at 140-41.
most states, a duty to disclose does not exist under these rules of law.  

D. Duty to Refrain From Assisting Directors in Breaches of Their Fiduciary Duty

We have seen that the bank attorney has a duty only to the client bank, a duty to advise on the entirety of a transaction, and a duty to warn the client of possible improper or imprudent activity. Rule 1.13 suggests, but does not dictate, some courses of action the attorney might take when learning of certain illegal activity. One of those courses of action is to advise the board of directors or other corporate agent of such possible improprieties. The attorney cannot fulfill his duty to the client by superficially advising the corporate agents of the activity, and then assisting those agents in carrying out that same activity. The bank attorney must not knowingly assist in activity which represents a breach of a fiduciary’s duty to the bank.

A fiduciary who breaches any of the responsibilities imposed upon him is personally liable for any damages arising from such breach. Also, a third party who assists a fiduciary in a breach of duty is liable for the harm caused. The common law elements for a cause of action for inducing or participating in a breach of fiduciary duty are (1) a breach by a fiduciary of obligations to others, (2) knowing inducement or participation in such breach, and (3) that the breach was induced or participated in by the third party.

129. Notwithstanding the current state of the law regarding disclosure of client confidences, the OTS has suggested that it may require S&L attorneys to disclose to the OTS certain information relating to the client’s violations, unsafe and unsound practices and breaches of fiduciary duty. OTS Considering Policy on Requesting Information From Outside S&L Counsel, 57 BANKING REP. (BNA) 305 (Aug. 19, 1991). OTS Chief Counsel Weinstein has commented on the possibility of requiring S&L attorneys to periodically submit a letter to the bank examiners which would include, among other things:

1. A statement, “modeled on the securities disclosure advise paragraph standard to the auditor’s letter,” that the lawyer has provided legal advice required to inform the client that a transaction could constitute a violation of law, rule, or regulation, an unsafe or unsound practice, or a breach of fiduciary duty, if those concerns are implicated; and
2. A statement that the lawyer sought review by the highest corporate authority where management proposed to go forward with such a transaction and that the lawyer declined to assist in any such transaction that nevertheless occurred.

Id. Such a policy would contradict longstanding policy against such disclosure. The purpose of maintaining client confidences is that it encourages clients to seek out legal advice. Protection of confidentiality should lead to socially desirable changes in behavior when parties seek legal advice and the advice they obtain promotes such behavior. See Shavell, supra note 127.

However, under the proposed disclosure guidelines, S&L officers and directors might be discouraged from seeking legal advice about potential unsafe and unsound practices. They may feel safer proceeding without advice, placing the bank at risk in the process. Thus, the proposed disclosure rules may encourage more risky behavior by bankers than might occur without the disclosures. See Schatz v. Rosenberg, 943 F. 2d 485 (4th Cir. 1991), cert. denied, 112 S. Ct. 1475 (1992).

130. See discussion supra part III.C.

131. RESTATEMENT (SECOND) OF AGENCY § 401 (1957).

132. 3 AM. JUR. 2d AGENCY § 299 (1992); RESTATEMENT (SECOND) OF AGENCY § 312 (1957); RESTATEMENT (SECOND) OF TORTS § 874, cmt c (1979).
tion by the defendant, (3) and damages resulting from the breach.133

The federal pension laws of ERISA give rise to much of the federal case law regarding attorneys aiding and abetting breaches of fiduciary duties. Federally-regulated pension plans serve as a good analogy to the federally-insured banking system. Both are subject to federal regulations intended to protect the saver. Directors of banks and trustees of pensions each manage large sums of money for the benefit of depositors/beneficiaries. They must exercise similar care in protecting those funds. Loans and investments must be creditworthy, based on proper analysis, and properly documented. Similarly, bank directors and pension trustees must refrain from any self-dealing activity. And both the bank director and pension trustee must rely heavily upon the advice of the attorney in carrying out their fiduciary duties.

ERISA has effectively federalized the common law of trusts and incorporated the basic trust principle imposing liability on third-party non-fiduciaries.134 Unfortunately, the federal courts have not been consistent in defining the required elements of that liability. Some courts have held that, under ERISA, a fiduciary can be found liable for aiding and abetting a breach of fiduciary duty if it can be shown that he gave knowing aid to the breach.135 Other courts have required a standard of knowing and substantial aid.136 Another has stated that the non-fiduciary defendants must have conspired with the fiduciary.137 Yet another has opined that the degree of participation required for a finding of liability need not reach the level "of purposeful conduct necessary for a claim of assisting in the perpetration of a fraud."138

The courts have let stand allegations against attorneys of aiding and abetting breaches of fiduciary duty under ERISA for such actions as making "deceptively incomplete representation(s)" to an insurance regulator which had the effect of delaying the revelation of the fiduciary's diversion of premiums.139 The drafting of documents effectuating a deceptive transfer of funds also justified a claim of an attorney's conspiracy to breach another's fiduciary duty.140 On the other hand, the courts have

137. Thornton v. Evans, 692 F.2d 1064, 1078 n.34 (7th Cir. 1982).
139. Thornton, 692 F.2d at 1070.
140. Id. at 1082.
held that merely providing incorrect advice about the termination of a pension plan would not meet the standard of conduct necessary for an aiding and abetting claim.\textsuperscript{141}

IV. FDIC, RTC AND OTS CLAIMS

The bank attorney has a fiduciary duty to her client. That duty is broader than the duty of most corporate attorneys because of the stricter standards to which bank directors are held and the public's interest in a sound banking system. Four specific duties of the bank counsel have been discussed in this note. According to the following four complaints filed against the attorneys of several failed institutions, the defendant attorneys failed to fulfill one or more of those four duties. None of these cases were fully adjudicated. All have been recently resolved by settlement. Nevertheless, they illustrate the range of recent allegations being made against bank attorneys in the wake of the savings and loan crisis.

A. FDIC v. Wise

In Wise, the FDIC alleged that the law firm of Sherman & Howard aided and abetted the senior management of the Silverado S&L by, among other things, assisting in the consummation of loans which violated federal loan limits to one borrower.\textsuperscript{142} One example involves a $26 million loan to four partnerships controlled by two individuals. One week after the loan was advanced, Bill Walters became a 50% partner in each of the four partnerships.\textsuperscript{143} Mr. Walters was already a major borrower at the institution, owned a significant amount of preferred stock of the institution's holding company, and was a business partner of several of the institution's directors.\textsuperscript{144} Had Walters been a partner prior to the $26 million advance, the loan would have been a violation of the legal limit on loans to Walters.\textsuperscript{145} The FDIC alleged that Sherman & Howard (a) knew that Walters would become a 50% partner shortly after the loan was made, (b) that Walters' participation in the partnerships would cause a violation of the lending limit, and (c) that Walters' involvement in the partnerships was intentionally delayed in order to conceal the violation.\textsuperscript{146} The FDIC further alleged that Sherman & Howard participated in the structuring of the loan and had negotiated the terms of the

\textsuperscript{141} Pappas v. Buck Consultants, Inc., 923 F.2d 531, 542 (7th Cir. 1991).
\textsuperscript{142} First amended complaint at 59, FDIC v. Wise (No. 90-1688).
\textsuperscript{143} Id. at 21.
\textsuperscript{144} Id. at 14.
\textsuperscript{145} Id. at 22.
\textsuperscript{146} Id. at 52-53.
loan with Walters' counsel. The loans to Walters subsequently went into default and the institution incurred massive losses. This is just one example of many similar type transactions described in the complaint.

Assuming the allegations are true, the defendant-attorneys breached several of the four duties set forth above. First, they appeared to have placed the interests of the directors and a preferred stock shareholder over those of the bank. Mr. Walters benefitted while the growing concentration of loans to a financially-troubled borrower placed the bank at greater risk. Furthermore, the FDIC alleged that the attorneys failed to advise the board of directors about the potential lending limit violation, and the safety and soundness implications of the transaction. To the contrary, the attorneys actively and knowingly participated with some of the directors in the transaction, thus aiding and abetting a breach of those directors' fiduciary duties to the bank.

B. RTC v. Keating

In Keating, the RTC alleged that certain directors and officers had breached their fiduciary duties to Lincoln S&L by failing to comply with statutes and regulations governing safe and sound lending and investment practices for insured savings and loan associations. RTC further alleged that the law firm of Jones, Day, Reavis & Pogue aided and abetted the breaches of fiduciary duties by assisting and participating in the violations. Among other things, Jones Day allegedly assisted the holding company's attorneys in concealing vital and damaging information from federal regulators and helping the holding company attorneys create after the fact ratifications for transactions not appropriately authorized by the Lincoln board. The complaint also states that Jones Day knew of illegal, prohibited and abusive transactions which were harmful to Lincoln but designed to benefit the holding company and others. Jones Day not only failed to advise the Lincoln board of these transactions, according to the RTC, but they counseled the perpetrators on whether the regulators would discover the true nature of the deals. Thus, they had provided assistance to the perpetrators in the concealment of the numerous improper transactions. According to the complaint, Jones Day breached each of the four duties addressed above.

147. Id. at 52.
149. Id.
150. Id. at 155.
151. Id.
152. Id. at 157.
Also in *Keating*, the RTC alleged that the law firm of Troutman Sanders, Lockerman & Ashmore had aided and abetted breaches of fiduciary duties by their non-attorney codefendants.\(^{153}\) The complaint alleges that, among other things, the firm issued favorable opinion letters which enabled the holding company ESOP to borrow $15 million, secured by assets of Lincoln.\(^{154}\) Troutman Sanders issued its opinion based upon certain assumptions, certifications and opinion letters. According to the RTC, Troutman Sanders either knew, had reason to believe, or consciously avoided the knowledge that those assumptions and certifications were false, and that the transaction was designed to benefit certain of the codefendants at the expense of Lincoln.\(^{155}\)

These allegations suggest that the attorneys placed the interests of others before those of the client. The attorneys did not advise the board of the potential problems with the ESOP transaction. Moreover, their issuance of the opinion letters assisted some of the directors in a breach of their fiduciary duty to the bank.

**C. FDIC v. Eckert Seamans Cherin & Mellott**

The Eckert complaint focuses on the bank attorney’s involvement in a transaction between the principal shareholder and the bank.\(^{156}\) The transaction, labeled a “sham” by the FDIC,\(^{157}\) resulted in the bank’s sale of a mortgage subsidiary to a company controlled by the principal shareholder. As a result of that transaction, the bank incurred substantial losses which rendered it insolvent.\(^{158}\)

One portion of the Eckert complaint alleged that the attorneys and the principal shareholder went forward with a plan to divest of the bank’s mortgage subsidiary without notifying the OCC in advance, as required by an OCC order.\(^{159}\) Furthermore, the complaint alleged that the attorneys structured the transaction to appear to have complied with certain loan-to-affiliate restrictions, but was nevertheless unsafe and unsound and benefitted the principal shareholder at the expense of the bank.\(^{160}\)

In 1986, the bank stipulated and consented to an OCC order to

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153. *Id.* at 264.
154. *Id.* at 186.
155. *Id.* at 180-85.
157. *Id.* at 16.
158. *Id.* at 3-4.
159. *Id.* at 36.
160. *Id.* at 14-32.
The order required the bank to develop an alternative plan for the divestiture of its mortgage subsidiary. The bank was required to submit the plan to the OCC District Administrator for his review and approval. The order also specified that the plan must involve, at a minimum, a freezing of the level of credit exposure by the bank to the former mortgage subsidiary.

The bank submitted a plan to the OCC. However, that plan and all subsequent amendments to the plan were rejected by the OCC. Nevertheless, the bank subsequently sold the mortgage subsidiary to a shell company owned by the bank’s principal shareholder in a deal that “contained all the objectionable features of the Alternative Plan rejected by the OCC plus additional objectionable features.” Since the bank financed the sale, it retained all of the risk of the subsidiary, yet lost all control over its operations.

According to the FDIC, the bank’s attorney was intimately involved with the cease and desist order, development of the alternative plan and amendments, other related negotiations with the OCC, the sale of the subsidiary, and the sale of low quality assets to the bank. Furthermore, the law firm acknowledged in internal memoranda its duty to advise the directors of the “troublesome aspects of the proposed sale,” “that [the] OCC might consider any divestiture made without their approval to violate the spirit, if not the letter, of the C&D order,” that the transaction “constitutes an “insider” transaction that falls under the purview of various statutory and common-law restrictions on self-dealing,” that the loan to finance the transaction posed questions under “12 U.S.C. §§ 24, 371c, 375a, and 375b, dealing with lending limits, and again under the common-law duty of loyalty” and that “an independent appraisal of a major asset sale such as the proposed transaction is mandatory if the board was to be adequately protected.” Notwithstanding the existence

161. Id. at 11. Because Guardian Bank N.A. had a national bank charter, the OCC was its primary regulator.

162. Id.

163. Id.

164. Id. at 15-16.

165. Id. at 36-37. The “additional objectionable features” included the allegation that the principal shareholder obtained the funds he used to purchase the subsidiary and pay off personal debts by causing the bank to purchase worthless or substandard assets from the subsidiary well in excess of market value. Id. at 11-48.

166. Id. at 36.

167. Id. at 29.

168. Id. at 30.

169. Id. at 28.

170. Id. at 29.

171. Id. at 28-29.
of these statements in the attorney's memoranda, the directors were never advised of any of the above according to the FDIC. 172

The attorney's conduct in the divestiture of the mortgage subsidiary, as described in the complaint, represents a breach of all four of the duties discussed earlier. The primary problem seemed to be the attorneys' failure to place the interests of their client—the bank—over those of the principal shareholder. The attorneys appear to have been looking out only for the principal shareholder. Secondly, the attorneys were playing the role of advocate when it appears they should have been acting as advisor to the client. The attorneys' notes demonstrate their awareness of a duty to advise on the entirety of the proposed transaction. 173 Yet the board was never provided that advice. 174 The advice they did provide was allegedly incomplete and misleading. 175 Not only did the attorneys fail to advise the client as to the implications of the proposed divestiture, they also provided assistance to the principal shareholder in structuring and consummating the deal. 176 Furthermore, the attorneys were aware that the board was breaching its fiduciary duties to the bank by approving a transaction without full and complete information. 177

D. In re Fishbein

On March 2, 1992, the OTS startled the banking bar by freezing the assets of the law firm of Kaye, Scholer, Fierman, Hayes and Handler and seeking $275 million in restitution. 178 In an 83-page notice of charges, the OTS claimed that Kaye Scholer had participated in violations in the course of its representation of the now-defunct Lincoln S&L. 179 On March 10 the firm settled with the OTS for $41 million, reportedly well in excess of the firm's insurance coverage. 180

Among other things, the OTS alleged that Kaye Scholer was aware that Lincoln had backdated documents to escape investment limitations established by regulation, yet advised the bank that such backdating provided adequate legal support for avoiding the investment limitations. 181

172. Id. at 30-32, 49.
173. See supra notes 167-71 and accompanying text.
174. Id. at 30-32, 49.
175. Id.
176. Id. at 4.
177. Id. at 58.
178. OTS Freezes Kaye, Scholer Assets, supra note 8, at 419. The legality and propriety of the OTS's freeze of Kaye, Scholer's assets is not within the scope of this note.
179. Id.
181. OTS Freezes Kaye, Scholer Assets, supra note 8.
The attorneys allegedly failed to disclose to Lincoln’s board the deficiencies in the bank’s underwriting and appraisal activity, the reporting of illusory profits, and insider transactions. These allegations suggest that the firm may have failed in its duty of loyalty to the client, to the benefit of certain insiders. The firm may also have failed to advise as to the totality of transactions when it provided narrow advice on the investment limitations matter. Furthermore, the attorneys appear to have failed in their duty to fully inform the board of known unsafe and unsound practices within the institution.

One of the OTS’s more controversial claims was that the attorneys knowingly failed to disclose to the regulator the fact that the bank’s external auditor had resigned because of concerns over Lincoln’s operations. The OTS claimed that Kaye Scholer knew the auditor had concerns about the viability of the institution. Yet it provided the regulators only a copy of the auditor’s formal statement which indicated that the resignation was not the result of the bank’s financial health. According to the OTS, the attorney’s failure to mention the auditor’s earlier comments misled the regulator as to the true condition of the bank. The OTS claimed that the attorney had violated the provisions of 12 CFR 563.18(b)(1) and (b)(2) prohibiting false or misleading statements to the regulator or auditor of the institution by any of its agents.

Another disclosure issue involved the attorney’s statements to the regulator regarding the bank’s compliance with net worth requirements. According to the OTS, the attorney was aware of certain “linked transactions” involving a land swapping scheme financed by the bank. The existence of these transactions would raise some questions as to the value of the loans involved. If the value of those loans were in doubt, the bank’s net worth would be overstated. Nevertheless, when asked to respond to the regulator’s report questioning whether the bank was meeting its net worth requirements, the attorney failed to mention or even consider the “linked transactions.”

The controversy is centered around whether the OTS, in this particular claim, is attempting to impose a duty upon the attorney to disclose information to the regulator. As discussed earlier, the bank attorney

182. Id. at 420.
183. Stevens & Thomas, supra note 180, at A4.
184. Id.
185. OTS Freezes Kaye, Scholer Assets, supra note 8, at 420.
186. 12 C.F.R. § 563.18(b) (1988).
187. OTS Freezes Kaye, Scholer Assets, supra note 8 at 420.
188. Stevens & Thomas, supra note 180, at A4.
189. Id.
should not be under a general duty to disclose client information to the regulator. However, the attorney must avoid communicating false or misleading information to the regulator. Indeed, the attorney may incur liability by providing misleading information to third parties.\textsuperscript{190}

Notwithstanding the disclosure issue, it appears that Kaye Scholer breached several of the basic duties of the bank attorney. It is apparent that the attorneys assumed an adversarial role in their representation. Furthermore, it seems that the attorney may have lost sight of the client's best interests. The attorney's strategy was always to be literally truthful but never to help the regulator discover damaging information.\textsuperscript{191} However, avoiding more open disclosure to the regulator was not in the best interest of the institution. If the officers and directors were involved in improper activity, the client was the party being harmed. Indeed, the client failed as result of the improprieties of certain officers and directors. Had the regulators had a clearer understanding of the bank's condition earlier, some of the improper activity may have been avoided. While earlier intervention by the regulators would have been in the best interests of the bank, it certainly would not have been welcomed by the officers and directors perpetrating the crimes and fraud. Thus, the adversarial approach of the attorney tended to protect those officers and directors at the expense of the bank.

\textbf{V. CONCLUSION}

The receivers of failed banks and federal banking regulators have targeted the attorneys of failed institutions in their attempts to recover the losses. The resulting legal actions have raised many questions as to the scope and nature of the bank attorney's duties. Are the receivers and regulators holding the attorneys to higher standards of duty? Or have these targeted attorneys breached long-standing duties of care and loyalty to the client?

The bank attorney should not be held to higher standards of duty. Nevertheless, the bank attorney's duties are different than those of other corporate counsel. The bank attorney must consider the highly regulated nature of banking, public policy factors supporting a strong banking system and the stricter duties to which bank directors are held when advising or acting on behalf of a bank client. Most importantly, the bank attorney must keep the interests of the client ahead of those of the officers and directors. She must advise the client to look beyond mere compli-

\textsuperscript{190} See \textit{supra} note 139 and accompanying text.
\textsuperscript{191} Stevens & Thomas, \textit{supra} note 180, at A4.
ance with laws and regulations. Her advice must necessarily encompass safety and soundness considerations as well as the fiduciary duties of the directors. The bank attorney should keep the board informed as to potential safety and soundness matters, or instances where their actions might result in breaches of their duties.