Firrea Disrupts Traditional Notions of Attorney Duty by Exposing Lawyers, as Financial Institution-Affiliated Parties, to Personal Liability

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FIRREA DISRUPTS TRADITIONAL NOTIONS OF ATTORNEY DUTY BY EXPOSING LAWYERS, AS FINANCIAL INSTITITUION-AFFILIATED PARTIES, TO PERSONAL LIABILITY*

1. INTRODUCTION

According to former Secretary of the Treasury Nicholas F. Brady, more than 1000 savings and loans (hereinafter S&Ls), nearly forty percent of the industry, are unsound or insolvent and ultimately may be taken over by the federal government.¹ This alarming statistic naturally raises the question of who shall pay for the bailout, which could cost over $500 billion.² The most obvious answer is the federal government, since it has possibly the deepest of all pockets in this country.³ But because the federal government, specifically Congress, decided who shall be economically responsible for failed financial institutions, Congress obviously did not choose itself to bear the entire financial burden of the bailout.⁴

This search for alternative deep pockets is also motivated by Congress' fear of potential public anger. The federal government, as insurer of depository institutions, promises depositors that their money will be safe. However, the government does not possess the resources to fund the bailout entirely on its own⁵ and therefore eventually must renge on its promise to depositors. To pay for the bailout, then, the government must increase taxes to bolster the federal insurance fund. This tax hike essentially means that depositors will be insuring themselves, because their own tax money will be

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² Id. The Lincoln Savings and Loan scandal alone could cost more than $2.6 billion. Nancy Rutter, Dirty Hands, CAL. LAW., Jan. 1992, at 30.
⁴ Id. at 3.
⁵ Id. at 12.
used to refund their own lost deposits. As a professor of law at Duke University stated, "[T]he unprecedented exposure of taxpayers to the risk of depository institution failure is forcing the banking agencies to adopt a vigorous, formalistic, and unduly punitive approach to banking supervision."  

The federal government also may be taking this approach because of Congressional complicity in creating the need for and the size of the bail-out.  

Congress assisted the Administration in creating a set of regulatory and accounting rules that allowed troubled financial institutions to postpone failure long enough to massively increase the size of the ultimate loss.  

Because of this Congressional complicity, the government is very eager to share the blame and appear to be aggressive on the taxpayers' behalf by extending liability for the problem to other groups.  

Lawyers, because they have malpractice insurance coverage, are very convenient scapegoats, even though they will provide only a small percentage of the total cost of the bail-out.  

Due to the aforementioned factors, Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act (hereinafter FIRREA).  

According to FIRREA, attorneys who act as corporate counsel to financial institutions are considered "institution-


7. For example, Charles Keating's influence with Congress enabled him to fend off inspection by the federal regulators temporarily, thus allowing his illegal financial practices to continue. This procured delay increased the ultimate amount of loss to the depositors and shareholders. Rutter, supra note 2, at 32, 35.


10. Id.

11. The Lincoln Savings and Loan scandal demonstrates the validity of this assertion. The total cost of the bail-out for the failure of Lincoln Savings and Loan (hereinafter Lincoln) is $2.6 billion. Rutter, supra note 2, at 30. The law firm of Jones, Day, Reavis & Pogue (hereinafter Jones Day), which served as legal counsel to Lincoln, was being sued for $80 million. Id. at 31. The firm settled the case for $41 million. Stephanie B. Goldberg, Kaye Scholer: The Tremors Continue Part I: Welcome to the New Uncertainty, 78 A.B.A. J. 50, 50 (1992). Thus, the suit provided provided only 1.58% of the total cost of the Lincoln bail-out.


13. The term financial institution will be used in this comment to refer to banks, savings associations, depository institutions, member banks, nonmember banks, and savings banks as defined in 12 U.S.C.S. § 1813(a)-(g) (Law. Co-op. Supp. 1992), respectively. For purposes of
affiliated part[ies]" and now are exposed to personal liability should the financial institutions fail for reasons specified in the Act. As a result, FIRREA "raises all sorts of questions about what duties are owed by counsel providing legal services to an institution and to whom such duties are owed." Harris Weinstein, former Chief Counsel, Office of Thrift Supervision, Department of the Treasury, has suggested a somewhat radical answer to this question, as, according to one commentator, his views "are quite a departure from what most private counsel understand their duties to the government to be." Weinstein's model for liability does not rely on FIRREA and can exist independently, and vice versa. However, his proposal certainly complements the statute and draws strength from it to support his model. Weinstein states that the federal government is the ultimate insurer of a failed financial institution, and he asserts that:

[E]very fiduciary of a federally insured depository institution [i.e. counsel to the institution, as well as the directors of the institution] owes the federal insurer, at the very minimum, the very same high fiduciary duties that are owed depositors . . . [including] the duty not to risk . . . loss of funds deposited with the institution . . . [and] a strict fiduciary duty to act in the best interest of the institution, its shareholders and its depositors.

Weinstein's position is that, under certain circumstances, the duty of the attorney to the federal government as insurer, to the degree that the Federal Deposit Insurance Corporation (hereinafter FDIC), as insurer, stands in the shoes of the depositors, is greater than the duty owed to the client institution.

Attorneys are being blamed, at least in part, for the banking and savings and loan crisis. The impact of this public opinion is

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15. These reasons are discussed in detail later in this comment. See infra notes 67, 79, 83-84, & 104 and accompanying text.
18. "[W]e already have a code of ethics [for fiduciaries of depository institutions] and the existing rules are more than adequate to the task." Harris Weinstein, Remarks delivered at Southern Methodist University, Dallas, Tex. 1 (Sept. 13, 1990) (transcript available in Southern Methodist University Law School Library), in Speech by OTS Chief Counsel Weinstein on Duties of Depository Institution Fiduciaries, 55 BNA'S BANKING REP. 510 (1990) [hereinafter Weinstein].
19. Id. at 4.
20. ABA Task Force Studies Bank Counsel Liability, supra note 17, at 1.
reflected in FIRREA's inclusion of attorneys as parties who are potentially personally liable for thrift failure. The FDIC has gone one step further by filing approximately 140 lawsuits against individual attorneys and their firms "whose competence in representing financial institutions is beyond question." Some of these attorneys even served as counsel to the FDIC in prior actions. Therefore, in order to protect themselves against personal liability, counsel to financial institutions must devise a scheme to follow when advising these depositories. This comment attempts to clarify attorneys' duties under FIRREA and to construct a model of representation that has these goals in mind. Further, this comment suggests to the American Bar Association Task Force on the Liability of Counsel Representing Depository Institutions (hereinafter Task Force) various theories to investigate.

First, this comment examines prior treatment by the federal regulators of attorneys' fiduciary duties to their clients and the federal government. Then the need for FIRREA, the text of FIRREA, and its legislative history are discussed in order to trace the origins of this new standard of liability. Specific attention is given to the term "unsafe and unsound," a concept that pre-dates FIRREA. This term is not expressly defined in the text of FIRREA, and its meaning is critical to the determination of lawyer duty and liability. If the actions contemplated by the institution are definitely illegal or blatantly illegal, the attorney's duties are fairly clear under FIRREA and the Codes of Professional Responsibility. However,

22. Id.
23. The terms financial institutions, banks, thrifts, and depositories will be used interchangeably in this comment.
24. The Task Force, headed by Keith Fisher, was formed by the ABA for the following reasons:
[To] study the current trend toward increased liability of depository institution[s] counsel, evaluate the theories on which such liability is predicated, and report on the extent to which those theories are consistent, with or depart from, accepted standards of professional conduct. . . . It is hoped that the Task Force's final report will serve as a springboard for informed discussion and debate on the proper role of the legal profession in effecting these important [public policy] goals [of protecting the attorney client privilege and] . . . promoting public confidence in our nation's financial intermediaries.

Fisher, supra note 3, at 12.
25. See infra part II.A.
26. See infra part II.B.
28. See infra part II.C.
the acts of the institution in which attorneys are involved may not clearly be illegal, i.e., “unsafe and unsound.” If the act is not obviously illegal but is unsafe and unsound, it is deemed technically illegal according to FIRREA. The problem for attorneys, then, lies in how they are supposed to know whether the act is unsafe and unsound and what they should do if it is.

Next, this comment discusses at length Harris Weinstein’s position regarding the fiduciary duties attorneys owe to their client institutions and to the federal government as insurer. Support and criticism of the theory are also examined. Special attention is paid to Weinstein’s insurance argument and his discussion regarding attorney duty to the institution. Weinstein’s proposal is then used as the model standard of duty in a discussion of fact scenarios, and this discussion illustrates what lawyers’ duties are and to whom these duties are owed. During this examination, Weinstein’s position is tested and critiqued to determine how far it can be extended and if it could or should be modified to make it more practical and fair to attorneys. Once the standards of attorney duty are established, this comment suggests how lawyers should structure their representation so as to insulate themselves from personal liability when serving as counsel for depositories. This comment also suggests that if lawyers take the precautionary measures proposed by the author, FIRREA does not necessarily have to produce a chilling effect on attorney representation of financial depositories. The author proposes alternative ways for attorneys to protect themselves from personal liability other than refusing to represent financial depositories altogether.

II. Background

A. Pre-FIRREA/Common Law Fiduciary Duties of Attorneys

The passage of FIRREA changed, or at least modified, the existing law regarding attorneys’ fiduciary duties. Prior to the 1980s,
there were very few enforcement actions, because there were very few bank failures. In the mid-1980s, the number of bank failures increased dramatically, and consequently greater attention was paid to enforcement. These efforts, however, started with established law and the most clearly fraudulent cases, usually involving insiders.

While the argument that attorneys owe the highest fiduciary duty to the federal government existed before FIRREA was enacted, this theory was not often used in enforcement actions by the federal regulators. A 1990 Hastings Law Journal Note concluded that "[t]he scarcity of issued regulations or reported judicial decisions, however, suggests that the regulatory agencies chose to leave this potential enforcement power largely unexercised. The federal regulators followed this course of action, at least in part, because "the language of [regulatory statutes prior to FIRREA] was aimed primarily at the activities of financial institution directors, officers, and other insiders, and not at outside parties such as attorneys."

Prior to FIRREA, even if the federal enforcement agencies had been more aggressive, it was difficult for any individual related to a financial institution, be it as officer, director, or attorney, to be pinned with personal liability. This fact is true, in part, because the Seventh Circuit ruled that, notwithstanding broad statutory language, individuals could be held liable only when they had personal

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38. For example, between 1943 and 1974, only five out of every 14,000 banks failed. EDWARD L. SYMONS, JR. & JAMES J. WHITE, BANKING LAW 547 (3d ed. 1991).
39. Id. at 547-48. "In addition, the number of banks designated as problem banks by the FDIC exceeded 1,000 for the last several years of the 1980s." Id. at 547.
40. Id. at 548.
41. See Larimore v. Comptroller of the Currency, 789 F.2d 1244 (7th Cir. 1986); del Junco v. Conover, 682 F.2d 1338 (9th Cir. 1982).
42. Weinstein, supra note 18, at 2-3.
44. Id.
45. Id. at 254 (emphasis added).
46. The officers and directors of financial institutions did have common-law duties, however, and they "are, in effect, held to a higher standard of care than directors of other types of corporations." Danny Clearman, Comment, FDIC and FSLIC Pursuit of Claims Against Officers, Directors, and Others Involved with Failed Lenders, 58 Miss. L.J. 89, 102-03 (1988) (footnotes omitted). Corporate directors and officers have three primary duties: first, they are to act only within the power given to them by the corporation; second, the degree of care they are to display should be that of an ordinary prudent person; and third, they are not to use the corporation for their own personal gain. Id.
knowledge of the wrongdoing. In *Larimore v. Comptroller of the Currency*, the Comptroller of the Currency (hereinafter Comptroller) assessed personal liability against and sought compensation from individual directors of the First National Bank of Mt. Auburn, Illinois for losses resulting from their approval of loans that exceeded the legal lending limit as outlined in 12 U.S.C. § 84. One issue in *Larimore* was whether 12 U.S.C. § 93, which "imposes liability on directors [of financial institutions] for knowingly violating or knowingly permitting violations of banking laws," controlled construction and application of 12 U.S.C. § 1818 on the same facts. Under 12 U.S.C. § 1818(b)(1), the Comptroller is provided with the power to issue cease-and-desist orders on persons participating in the affairs of a bank if they "[engage] in statutory violations or unsafe banking practices." On this issue, the *Larimore* court reviewed the decision of *del Junco v. Conover*, in which the court expressly stated that it did not decide whether 12 U.S.C. § 1818(b) "import[ed] the scienter requirement of 12 U.S.C. § 93." The *Larimore* court ruled that § 93 does control § 1818(b), and therefore § 1818(b) included a "knowing or reckless" requirement. Under *Larimore*, then, for officers and directors to be personally liable, they must knowingly or recklessly commit the illegal acts.

The *Larimore* court added another requirement for officers and directors to be held personally liable for knowing or reckless illegal acts. The court stated, "To date, no court has analyzed, much less set forth, any rationale that would support [the Comptroller] imposing personal liability upon directors." Directors are first entitled to a trial in a proper court, and will not be held "personally liable [unless they have received] all the constitutional and legal protections accorded every citizen in a trial in a United States District Court." The salient question with regards to attorney duty is whether

- Larimore v. Comptroller of the Currency, 789 F.2d 1244, 1255 (7th Cir. 1986).
- Id.
- del Junco v. Conover, 682 F.2d 1338, 1341-42 (9th Cir. 1982).
- Larimore v. Comptroller of the Currency, 789 F.2d 1244, 1255 (7th Cir. 1986).
- Id. at 1251.
- del Junco v. Conover, 682 F.2d 1338 (9th Cir. 1982).
- Id. at 1342.
- Larimore, 789 F.2d at 1255.
- Id.
the regulations at issue in Larimore and del Junco could be extrapolated to lawyers at all. A key point here is that § 93 and § 1818 never expressly applied to lawyers. Assuming that the regulations could be applied, the result is that regulators could seek indemnity from non-directors, i.e., attorneys acting as counsel to institutions, only if the regulators were acting in place of the lender via receivership or assignment. The federal regulators, acting as insurers or subrogees, could not assess personal liability on attorneys under this model.

The Larimore-del Junco model suggests that the FDIC and FSLIC, as insurers or receivers, could not seek personal liability under § 93 or § 1818 but leaves open the possibility of liability under common-law fiduciary obligations. Therefore, there were two independent grounds for personal liability prior to FIRREA. First, regulatory actions did apply to attorneys, though not expressly, under § 1818(b). Second, breach of fiduciary duties exposed attorneys to regulatory action on a common-law basis. FIRREA combined these two grounds, making lawyers liable on a regulatory basis for common-law breaches of fiduciary duty. Under FIRREA, lawyers are subject to the "knowing and reckless" standard, but officers and directors are not.

The passage of FIRREA modifies this prior existing law. FIRREA gives federal regulators the ability to act against attorneys on a regulatory basis and not just on a reactive basis as insurers or receivers. FIRREA also eliminates the "knowing or reckless" standard to impose personal liability on officers and directors. Federal regulators now have preventive authority to step in and stem financial failure before it is too late.

B. Body and History of FIRREA

According to one commentator, "FIRREA was enacted to rectify existing problems in the thrift industry and to establish 'a new era for insured institutions and their regulators.'" Four of the

61. Clearman, supra note 46, at 115. "In some instances, the regulators are actually appointed receivers of the institutions." Id. at 91.

62. Regulators, as insurers, are entitled to "step into the shoes of the institution as subrogee and may pursue any claim the institution might have pursued." Id. at 92.


many purposes of FIRREA explicitly address this concern:

(5) To put the Federal deposit insurance funds on a sound financial footing.

(8) To provide funds from public and private sources to deal expeditiously with failed depository institutions.
(9) To strengthen the enforcement powers of Federal regulators of depository institutions.
(10) To strengthen the civil sanctions and criminal penalties for defrauding or otherwise damaging depository institutions and their depositors.\(^6\)

The regulators and the Attorney General felt that they needed stronger enforcement powers to better prevent the increasing problem of bank and thrift failure.\(^6\) For example, the former monetary penalties were inadequate as punishment and deterrent, because they were insubstantial compared to the large sums of money being transacted by financial institutions.\(^7\)

As a result of this perceived need, Congress broadened the scope

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(1) To promote, through regulatory reform, a safe and stable system of affordable housing finance.
(2) To improve the supervision of savings associations by strengthening capital, accounting, and other supervisory standards.
(3) To curtail investments and other activities of savings associations that pose unacceptable risks to the Federal Deposit Insurance funds.
(4) To promote the independence of the Federal Deposit Insurance Corporation from the institutions the deposits of which it insures, by providing an independent board of directors, adequate funding, and appropriate powers.
(6) To establish an Office of Thrift Supervision in the Department of the Treasury, under the general oversight of the Secretary of the Treasury.
(7) To establish a new corporation, to be known as the Resolution Trust Corporation, to contain, manage, and resolve failed savings associations.

Id. at 187.

66. Baxter, supra note 6, at 205.

67. Kawasaki, supra note 43, at 257. One excellent example of the need for increased enforcement provisions is the Ponzi scheme. A savings and loan institution makes a loan, for which it gets a fee. These fees are declared as profits by the S&L. When the S&L makes a big loan, the S&L pays itself the fee, which it then declares as a profit. In reality, however, there are not any profits until the loan has begun to be repaid, which never happens. Thus, the S&Ls have misleading balance sheets, which show that they are making money when they actually are losing it. This practice of “Ponzi finance,” or taking out a new set of liabilities to pay the interest on the old liabilities, has contributed greatly to the S&L problems in recent years. MARTIN MAYER, THE GREATEST-EVER BANK ROBBERY 7, 20 (1990); see also Hearing, supra note 8, at 304.
of who may be liable for a financial institution's failure by passing 12 U.S.C. § 1813(u). This section has caused a great deal of concern for attorneys who act as counsel for financial institutions. It provides:

(u) Institution-affiliated party. The term "institution-affiliated party" means—

. . . (4) any independent contractor (including any attorney, appraiser, or accountant) who knowingly or recklessly participates in—

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

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

By including attorneys as institution-affiliated parties, FIRREA exposes attorneys to personal liability when a depository fails. "[T]he concept of 'institution-affiliated party' [also] gives the regulators preventive authority before matters have reached the dire straits of the actual failure of the institution." With this power, the regulators may initiate cease-and-desist proceedings against the institution-affiliated parties, issue and enforce temporary cease-and-desist orders against them, exercise their removal and prohibition authority against the parties, suspend or remove institution-affiliated parties charged with a felony, or enforce a civil money penalty (hereinafter..."

69. Id. The "knowing or reckless" standard was eliminated from the list of requirements with respect to personal liability for officers and directors, which overruled the standard in Larimore v. Comptroller of the Currency, 789 F.2d 1244 (7th Cir. 1986), and del Junco v. Conover, 682 F.2d 1338 (9th Cir. 1982).
70. Malloy, supra note 63, at 1148.
71. If the institution-affiliated party has engaged or is about to engage in unsafe and unsound practices as part of the business of the financial institution, or if the agency has reasonable cause to believe the institution or party is about to break the law, the agency may issue a cease-and-desist order to prevent such action to the party or institution. 12 U.S.C.S. § 1818(b) (Law. Co-op. Supp. 1992). "A cease-and-desist order is the administrative equivalent of an injunction." Malloy, supra note 63, at 1120.
73. Whenever the banking agency decides the institution-affiliated party breaks or violates any provisions of this section, the agency may exercise its removal and prohibition authority "to remove such party from office or to prohibit any further participation by such party, in any manner, in the conduct of the affairs of any insured depository institution." 12 U.S.C.S. § 1818(e) (Law. Co-op. Supp. 1992).
The CMPs are of the greatest concern to attorneys, because such penalties could bankrupt them personally, as well as their firms. Therefore, attorneys must confine their conduct to a standard of practice that minimizes, if not eliminates, their exposure to CMPs.

There were several reasons for the passage of FIRREA. It was enacted primarily because federally insured financial institutions were failing in such large numbers that the FDIC and FSLIC could not cover all of the monetary loss. As the legislative history of FIRREA indicates, "[t]he thrift industry and FSLIC are now in perilous financial condition... unhealthy thrifts have bankrupted the FSLIC and jeopardized the future of the industry." A major contributor to this problem is "outright fraud and insider abuse [by institution management and counsel]."

Examination of the legislative purposes of FIRREA clearly reveals that Congress targeted private counsel as one of the sources for replenishing the federal insurance funds.

Public confidence in financial institutions has waned as a result of the increasing frequency of their failure. By holding attorneys personally liable, Congress also hopes FIRREA will restore consumer confidence, because the Act provides regulators with the power to punish any culpable institution-affiliated party, which in turn deters future illegal and punishable conduct.

Congress chose to specify attorneys as targets for personal lia-


76. The distinction between CMPs and damages for breach of fiduciary duty is significant. If the federal regulator determines that the attorney has committed a violation of any statute, it may assess CMPs on a daily basis and in varying degrees, depending on the severity of the violation. Penalties are assessed for each individual violation and continue to be levied until the violation is discontinued. 12 U.S.C.S. § 1818(i)(2)(A)-(D) (Law. Co-op. Supp. 1992). See also Fisher, supra note 3, at 7-8. Because certain actions taken by attorneys and the institutions they represent may involve several individual violations, and because the penalties are ongoing until corrected, the total amount attorneys may be forced to pay can become substantial. These penalties are much more worrisome to attorneys than are compensatory damages resulting from breaches of fiduciary duty, because such damages are limited to the amount of money that was lost. CMPs, on the other hand, are potentially limitless.


79. Id. at 90.

80. See supra note 12 and accompanying text.


82. Id. at 262.
bility, because they have been involved in the insider abuse "[by] participat[ing] in some of the serious misconduct in banks and thrift institutions." However, Congress provided for personal liability of counsel to financial institutions only if the attorneys in some way were involved in the conduct of the depository. In addition, the legislative history clearly indicates that attorneys are not to be held liable if they act in good faith. "However, an attorney who does provide legal advice and services and then knowingly participates in other activities which result in serious misconduct would be subject to enforcement actions." Thus, if the law is unsettled as to a particular type of transaction or banking practice, lawyers may counsel their financial institution clients on a course of action that possibly could be a violation of the law. Under FIRREA, however, the advice is considered to be given in good faith if there is a chance that the institution could successfully challenge the law in an administrative or judicial proceeding.

The problem with this kind of counselling, though, is that such advice could be deemed "unsafe and unsound" according to the standard set forth in FIRREA. If the instruction to act given by the attorney to the client is not clearly illegal, but only arguably so, it may still be unsafe and unsound and thus be prohibited as illegal by FIRREA. Thus, for attorneys to counsel financial institutions, while at the same time insulate themselves from personal liability, it must be determined what constitutes unsafe and unsound practices.

C. Pre-FIRREA Definitions and Uses of "Unsafe and Unsound"

The definition of "unsafe and unsound" is essential in determining attorney liability, and an understanding of its application is critical if lawyers are to avoid such personal liability. The meaning
of the term is especially crucial with respect to the question of whether it is unsafe and unsound for lawyers to provide their client institutions with financial, as well as legal, advice. "[The term] is nowhere defined in the federal banking statutes [as it applies to attorneys],"¹ but federal and state courts have defined the "concept within the context of supervisory actions."²

A classic definition of "unsafe and unsound" is found in the decision of First National Bank v. Department of the Treasury.³ The court declared that "these terms encompass what may be generally viewed as conduct deemed contrary to accepted standards of banking operations which might result in abnormal risk or loss to a banking institution or shareholder."⁴ This authoritative definition of

lessly" standard protects attorneys from liability under FIRREA for conduct that is merely negligent and that the minimum standard regulators should use is that of "gross negligence."⁵

A person acts knowingly with respect to a material element of an offense when:
(i) if the element involves the nature of his conduct or the attendant circumstances, he is aware that his conduct is of that nature or that such circumstances exist; and
(ii) if the element involves the nature of his conduct, he is aware that it is practically certain that his conduct will cause such a result.

. . . .

A person acts recklessly with respect to a material element of an offense when he consciously disregards a substantial and unjustifiable risk that the material element exists or will result from his conduct . . . [the disregard of the risk] involves a gross deviation from the standard of conduct that a law-abiding person would observe in the actor's situation.

Id. at 274 (quoting MODEL PENAL CODE § 2.02 (Official Draft 1985) (criminal law construction)).

Kawasaki also refers to tort law to clarify the meaning of reckless.

The usual meaning assigned to . . . "reckless" . . . is that the actor has intentionally done an act of an unreasonable character in disregard of a known or obvious risk that was so great as to make it highly probable that harm would follow, and which thus is usually accompanied by a conscious indifference to the consequences.

Id. (quoting W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 213 (5th ed. 1984) (footnotes omitted)).

Even though the definition of "knowingly and recklessly" is not yet settled, it will be useful for the overall understanding of this comment to consider the above suggestions.

９１. Fisher, supra note 3, at 7 n.15.


９４. Id. at 611 n.2; accord First Nat'l Bank v. Comptroller of the Currency, 697 F.2d 674, 685 (5th Cir. 1983); Gulf Fed. Sav. & Loan Ass'n v. Federal Home Loan Bank Bd., 651 F.2d 259, 264 (5th Cir., 1981). See also Fisher, supra note 3, at 7 n.15, and Malloy, supra
the term has since been adopted by both houses of Congress. In a memorandum, John Horne, the chairman of the Bank Board in 1966, explained that:

An ‘unsafe or unsound practice’ embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.

The FDIC Chairman agrees with this view and further states that the determination of what is unsafe and unsound depends on the individual context. "A particular activity not necessarily unsafe or unsound in every instance may be so when considered in light of all relevant facts . . . [T]he term ‘unsafe and unsound practices’ has a central meaning which can and must be applied to constantly changing factual circumstances."

Because of this ad-hoc, case-by-case determination of the term “unsafe and unsound,” the “courts have been relatively flexible in interpreting the scope of the ‘unsafe and unsound’ enforcement provisions.” This trend has worked in favor of bank regulators’ discretion. However, this flexibility is not without limits, as the court suggested in Gulf Federal Savings and Loan Association v. Federal Home Loan Bank Board. According to the Gulf court, “[t]he breadth of the ‘unsafe and unsound practice’ formula is restricted by its limitation to practices with a reasonably direct effect on an association’s financial soundness.”

A listing of several examples of “unsafe and unsound” practice helps illustrate the meaning of the term and provides a better understanding of how it is applied. Consider the following:

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96. 112 Cong. Rec. 24984 (1966) (quoting John Horne); see also Malloy, supra note 92, at 772.
97. Malloy, supra note 92, at 770-71 (quoting George LeMaistre, Chairman, FDIC, Testimony before the Senate Committee on the Subject of Overdrafts and Correspondent Banking Practices, CIS, S-241-25 (1977)).
98. Id.
99. Id. at 771.
100. Id.
101. Id. at 772.
103. Id.; see also Malloy, supra note 92, at 772; Fisher, supra note 3, at 7 n.15.
(i) a pattern of loans made with inadequate security;

(iv) excessive volume of overdue loans in relation to gross loans, due to hazardous lending and lax collection practices;

(vi) accumulation of an inordinate amount of unsafe assets, in relation to gross capital;
(vii) failure to implement adequate internal controls and auditing procedures;

(xiii) violations of lending limits . . . . \(^{104}\)

These examples list financial practices at odds with prudent management in the financial services industry. However, the question of liability for attorneys who advise financial institutions engaged in such practices is left open.

Even though the courts have defined unsafe and unsound practices, they never have done so with the idea of attorney liability in mind. Therefore, it is not clear whether this established application should apply to attorneys acting as counsel for financial institutions. This issue is discussed below in the analysis section\(^{105}\) to determine how much of a risk an attorney can take when giving "cutting edge" advice in unsettled areas of the law without engaging in an unsafe and unsound practice. Even more perplexing is the issue of whether it is unsafe and unsound for attorneys to provide their depository institution clients with financial advice and judgments. The latter problem also is discussed below,\(^{106}\) specifically regarding to whom the attorney owes a fiduciary duty when giving such financial advice.

D. *Harris Weinstein’s Proposal — Duty Is To Federal Insurer*

Weinstein attempts to answer the question of to whom attorneys owe fiduciary duties by calling for an expansion of these duties. When this heightened standard is coupled with FIRREA, which expanded the remedies for breach of that duty, the combined effect is that attorneys are much more vulnerable to personal liability if this fiduciary duty is violated.

Weinstein asserts that "'[s]afe and sound' policies must be instituted and maintained first to protect the public at large from the adverse consequences inherent in the failure of depository institu-

\(^{104}\) Malloy, *supra* note 92, at 773-74 (footnotes omitted).

\(^{105}\) *See infra* part IV.3:

\(^{106}\) *See infra* part IV.3.b.
tions, and second to limit the risks that ultimately are borne by depositors and their insurer, the federal government.\textsuperscript{107} These adverse consequences may be caused and/or avoided through action taken by counsel to the institution. Therefore, it is the “obligation of the institution’s fiduciaries [which includes attorneys acting as the institution’s counsel] to take every reasonable step to avoid loss of deposited funds.”\textsuperscript{108}

Weinstein goes on to make a drastic proposal which, if adopted by the courts, would revolutionize the thrift industry and attorney representation as counsel for financial institutions.\textsuperscript{109} He begins benignly, stating, “[i]t is a straight forward [h]ornbook principle that an insurer who covers a loss is subrogated to the rights of the insured.”\textsuperscript{110} Weinstein continues, asserting that fiduciaries of financial institutions, at the very least, owe the same duty to the federal insurer as they do to the depositors.\textsuperscript{111} Therefore, the federal government as insurer possesses the same rights as the insured depositors to obtain restitution from fiduciaries who are responsible for losing the depositors’ money.\textsuperscript{112} The drastic leap Weinstein suggests is that attorneys, as fiduciaries, owe a greater duty to depositors, and by extension to the federal government as insurer, than they do to their client institutions and the banks’ directors.\textsuperscript{113} “[T]he federal govern-

\begin{itemize}
\item \textsuperscript{107} Weinstein, \textit{supra} note 18, at 4 (emphasis added) (footnote omitted).
\item \textsuperscript{108} \textit{Id.} at 3.
\item \textsuperscript{109} \textit{ABA Task Force Studies Bank Counsel Liability, supra} note 17, at 6.
\item \textsuperscript{111} Weinstein, \textit{supra} note 18, at 4.
\item \textsuperscript{112} \textit{Id.} It is settled law that attorneys who represent organizations, i.e. financial depositories, owe a duty to the institution itself, as opposed to the individual officers and directors. “A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents [i.e. the officers and directors].” \textit{Model Rules of Professional Conduct} Rule 1.13 (Discussion Draft 1990). The FDIC, as receiver, can assert such claims against attorneys, because as receiver, it stands in the shoes of the institution and its shareholders and depositors. Thomas P. Vartanian & Michael D. Schley, \textit{Bank Officer and Director Liability-Regulatory Actions}, 39 \textit{Bus. Law.} 1021, 1028 (1984); see also Bank, \textit{Thrift Attorneys React to Duties Outlined by OTS Chief Counsel Weinstein}, 55 BNA’s \textit{Banking Rep.} 547 (1990).
\item \textsuperscript{113} \textit{ABA Task Force Studies Bank Counsel Liability, supra} note 17, at 1. Faith S. Hochberg, Senior Deputy Counsel, Office of Thrift Supervision, argues the same position as Weinstein. \textit{Id.} In a talk given at the October 4, 1990 Prentice-Hall Law & Business conference, she provided instruction regarding the conduct of depository counsel. “[I]n taking on representation of a thrift, be careful to heed that your duty is to the entity and all of its equity holders, depositors and creditors . . . [C]ounsel your clients about their fiduciary duty to the
ment, by virtue of its insurance of depositors' accounts, has the paramount interest in the safety and soundness of insured depository institutions.  

Weinstein cites the perspective of the federal government as equity investor to support his argument. "[C]orporate fiduciaries owe their duties to those who provide the equity with which an institution operates." The federal government has taken on a major equity position in every insured depository institution by providing deposit insurance. Therefore, the government demands the highest level of fiduciary duty from the institution and institution-affiliated parties, because it "has an unlimited negative equity risk while it has none of the potential for gain that common shareholders enjoy."

Weinstein also draws upon the notion of the debtor/creditor relationship to bolster his proposal. "[A] debtor who is insolvent or nearly so owes a fiduciary duty to creditors . . . to avoid losses to the creditors." The federal government is considered the primary creditor to depositories, since it insures loss. Because the government is exposed to a potentially infinite risk of loss, "fiduciaries of an insolvent or close to insolvent thrift institution [should] be primarily concerned with the interests of that institution's largest creditor, e.g., the U.S. government."

Weinstein relies on this formula to argue that fiduciaries of depositories are not allowed to take risks with their depositors' money. Therefore, counsel may not advise their clients to take such risks, even if it potentially could produce a large reward. The practices of counsel and their clients must at all times be safe and sound and never even potentially unsafe and unsound. "The only conscionable legal conclusion is that the directors owe a fiduciary duty to the holder of the potentially unlimited negative equity risk, e.g. the United States government, and that directors who fail to consider the potential effect of the transaction on the government breach their duty."

United States of America." Id. at 5.

114. Weinstein, supra note 18, at 5 (footnote omitted).
115. Id.
116. Id. at 5-6.
117. Id. at 6.
118. Id.
119. Id. at 6-7.
120. Id. at 7.
121. Id.
122. Id. at 11.
123. Id. at 12.
It is against Weinstein's extreme suggestion that the fact scenarios posed are tested to determine the attorney's duty and its outer limits under FIRREA. This approach aids in the assessment of the current trend under the law to hold attorneys personally liable for failing banks, and it serves as a model on which attorneys may structure their representation of financial institutions so as to avoid such liability.

III. STATEMENT OF THE PROBLEM

The remainder of this comment critiques Harris Weinstein's proposal to determine its validity and utility. This examination provides a better understanding of his model, so that it can be applied to the fact scenarios. The fact scenarios serve as examples of actions that are clearly legal and illegal under FIRREA. Using these two relatively clear-cut situations as building blocks, two additional fact scenarios are examined that involve actions that are neither clearly legal nor illegal, that is, unsafe and unsound under FIRREA. These "gray areas" cause attorneys the greatest amount of concern, because there is no definite standard on which lawyers can rely to determine if their actions are technically illegal under FIRREA, or if they are breaching their fiduciary duties.

Weinstein's proposal is applied to each fact scenario to further test the model's usefulness and potential problems. The extent to which lawyers can be personally liable under FIRREA also is examined in this context, with special attention paid to whether attorneys may give financial advice that qualifies as safe and sound, or whether they should give financial advice at all. Moreover, the issue of whether lawyers who discover that their client banks are know-
ingly or recklessly engaged in, or are about to undertake, illegal activities is explored. Under Weinstein's model, it is an open question whether attorneys may protect themselves from personal liability by resigning or if they must disclose the incriminating information to the board of directors and/or the federal regulators. This issue raises serious questions about the attorney-client relationship and the duty of confidentiality.

In addition, assuming that Weinstein's model is applied "as is," this comment suggests how attorneys should structure their representation in the three classes of factual situations discussed, so that they do not expose themselves to personal liability. Finally, the proposal section outlines ways in which Weinstein's model should be modified if it is to be applied by the FDIC and the courts.

IV. Analysis

A. Examination of Weinstein's Proposal

To fully understand Weinstein's position and to effectively apply it to the fact scenarios, support for and criticism of his theory must be examined.

1. Support for Weinstein's Proposal

As well as the reasoning Weinstein uses in his short speech, additional arguments exist that support his proposal. Since the time he gave that speech, Weinstein has stated that his theory is based on three basic principles attorneys serving as counsel to financial institutions must follow. First, Weinstein proposes that lawyers should not only think of themselves as merely advocates representing clients before neutral third parties, but also as counselors and advisors.125 Attorneys are not supposed to make business or financial decisions for their clients, "but [they are supposed] to assist management with an analysis on how to view the proposed action in the context of law."126

Second, Weinstein asserts that lawyers owe a legal duty to the institution itself, and not just to its employees, i.e., its officers and directors, a theory that draws support from the Code of Professional Responsibility.127 Third, Weinstein argues that attorneys should practice "whole law" and consider how their advice may affect

126. *Id.* at 767.
127. *Id.* at 766.
others outside the institution, i.e., the taxpayers.\textsuperscript{128}

These three criteria suggest that the attorney's duty is broader than a duty owed just to the individual officers as clients, because the institution is the client, not the individual officers.\textsuperscript{129} The institution, in turn, affects a great many people, because it is insured by the federal government. Therefore, if the bank fails, federal tax dollars are used for its bail-out. Before giving any advice, then, lawyers must consider what impact that advice will have on the taxpayers, as well as on their immediate clients.

Further support for Weinstein's position is related to the attorney-client relationship and the way in which the federal government becomes the lawyer's client. When the government takes over as receiver or as subrogee of a failed bank, it is then the client.\textsuperscript{130} Therefore, the government can waive the attorney-client privilege and require the attorney to disclose any and all information that was previously confidential and off-limits to the government.\textsuperscript{131} In such instances, attorneys need not worry about breaching the duty of confidentiality owed to the client.

However, Weinstein's model also suggests that attorneys, because of their duty owed to the insurer, should disclose information even before the bank fails and the government becomes the client. This argument is one of prevention. Attorneys "might have privileged access to information which the agency itself would not discover until long after the damage has been done."\textsuperscript{132} Attorneys, then, can prevent damage to those who ultimately must pay for the bank's failure, the taxpayers. Weinstein's model creates a climate where attorneys will be afraid to help their financial institution clients take calculated risks that potentially could make its depositors a great deal of money, and it possibly will induce lawyers to disclose confidential information obtained through the attorney-client relationship, so that they avoid exposure to personal liability.

FIRREA also lends support to Weinstein's argument. The statute expressly includes attorneys to financial institutions, along with its officers and directors, as parties potentially liable for knowingly

\textsuperscript{128} Id. at 766-67. Weinstein defines "whole law as a comprehensive view of technical regulatory standards, concepts of safety and soundness, concepts of fiduciary responsibility, and . . . 'the principle that imposes hostility to law-avoidance schemes.'" Advice on How to Exploit Loopholes, supra note 124, at 617.

\textsuperscript{129} Model Rules of Professional Conduct Rule 1.13 (Discussion Draft 1990).

\textsuperscript{130} Bank, Thrift Attorneys React, supra note 112, at 547.

\textsuperscript{131} Id.

\textsuperscript{132} Baxter, supra note 6, at S255.
FIRREA

or recklessly participating in unsafe and unsound banking practices. Therefore, it can be argued by extrapolation that attorneys now should be held to the higher standard of fiduciary duty to which officers and directors of financial institutions traditionally have been held. Bank officers must answer to the federal regulators, and so should attorneys for financial institutions.

2. Criticism of Weinstein’s Proposal

In a recent article, Keith Fisher stated, “[t]he notion that counsel to the [financial] institution are also representing the depositors [and the federal government as insurer] is hardly an accepted one.” Weinstein’s position has been highly criticized by other attorneys, because it creates an inherent conflict of interest between the duty owed to the client and to the federal government, and it “ignores the separate judicial existence of the [financial] institution.”

Two separate areas of Weinstein’s proposal must be addressed. The first issue is his opinion that attorneys owe a fiduciary duty to the depositors, and by extension, to the federal government as insurer. This notion includes the problems Weinstein’s model creates with respect to the attorney-client privilege. The second issue is related to the first: whether the extension of personal liability to attorneys is warranted and what effects this liability has on the quality of legal representation and the ability of banks to conduct business.

a. Do Attorneys Owe a Fiduciary Duty to the Federal Government?

Weinstein relies on hornbook principle and four cases to support his assertion that the insurer is subrogated to the rights of the insured. This point is not controversial. However, Weinstein then makes two “leaps” from this accepted and established law to support his proposal. The first leap is that because the FDIC insures the depositors and is subrogated their rights, attorneys for financial insti-

134. Clearman, supra note 46, at 103.
136. Id. at 10.
tutions owe the federal government some sort of fiduciary duty. This fact is true, at least to the extent that the FDIC becomes the client when it takes over the failed bank as receiver. Weinstein's second assertion, however, is very radical. He claims that attorneys owe the federal government as insurer the highest form of fiduciary duty, a duty potentially greater than that owed to the client institution. The cases on which Weinstein relies do not support these "leaps".

While these four cases do support Weinstein's assertion that the insurer is subrogated the rights of the insured, they may be distinguished on their facts from the context in which Weinstein uses them. Plaintiffs in each case are private insurance companies, and the claims at issue are either for personal injury, wrongful death, or damage to personal property. Of these cases, only two involve the loss of money, and these losses are results of accidents, not business transactions. Furthermore, the federal government is not involved in any of these cases, nor do these decisions have anything to do with financial institutions or attorneys.

At best, then, these four cases support the notion that fiduciaries owe some sort of duty to the insurer as subrogee, which probably makes Weinstein's first leap sound and rational. It is reasonable to charge attorneys with some degree of duty to depositors. Banks owe their depositors a duty of loyalty, and attorneys owe a fiduciary duty to their client banks. By extrapolation, then, attorneys owe a fiduciary duty to the depositors. The obligation to the institution includes the duty to avoid "unsafe and unsound" practices, both because such practices are financially risky for the client, and also be-

139. Bank, Thrift Attorneys React, supra note 112, at 547.
140. Id. "Every fiduciary of a federally insured depository institution owes the federal insurer, at the very minimum, the very same high fiduciary duties that are owed depositors... ." Weinstein, supra note 18, at 5 (emphasis added).
143. Dawson v. McWilliams, 146 F.2d 38 (5th Cir. 1944).
146. Vartanian & Schley, supra note 112, at 1029.
cause they could get the client into trouble with the federal regulators. These concerns are often synonymous with the interests of the depositors. When the bank loses money, its depositors lose money. Thus, if attorneys are required to observe this duty, a large part of Weinstein's objective, i.e., the prevention of risky banking practices, is achieved.

Assuming attorneys do owe a fiduciary duty to the federal government as insurer, two additional questions arise. The first issue is whether the duty owed to the depositors and government is higher than that owed to the client institution. While the obligation to depositors clearly exists, it is not necessarily a higher fiduciary obligation than the one owed to the client financial institution. This idea that attorneys owe their greatest fiduciary duty to the depositors, and by extension to the federal government as insurer, is wholly unsubstantiated by the cases on which Weinstein relies. These judicial decisions make no mention of attorney duty, they do not deal with the federal government as insurer, nor do they relate to the financial dealings of banks. This final great "leap" is the single biggest weakness in Weinstein's theory, and it is the source of most of the controversy surrounding his proposed approach.

The second question, assuming that there is some duty owed by lawyers to depositors, is whether there is an affirmative obligation on attorneys to disclose confidential information to the federal regulators if and when attorneys, through the course of representing client banks, discover that the thrifts are engaged in (potentially) illegal banking practices. This issue is inherently connected to the notion of attorney-client privilege. In fact, Weinstein's model wreaks havoc with traditional notions of the privilege and of client confidentiality. Because lawyers are supposed to act in the best interests of depositors above all else, Weinstein would assert that under these circumstances the duty to the federal government as insurer should prevail over attorney-client confidences if observance of the duty prevents financial loss.

However, the duty of attorneys to the depositors and the federal government as insurer is not greater than the duty lawyers owe to their client banks. Therefore, a duty is not imposed on attorneys to disclose information regarding (potentially) unsafe and unsound practices that was obtained through the confidentiality of the attorney-client relationship. In fact, such disclosure is not permitted, and said divulgence actually constitutes a breach of the lawyer's duty to

maintain attorney-client confidentiality. According to the lawyers for Jones, Day, Reavis & Pogue, "[California's] rule of client confidentiality puts client loyalty and the duty to keep client loyalty private above all else. It allows no exceptions. Further, the American Bar Association's Model Rules of Professional Conduct forbid revealing information to sources outside the company."149

The duty of an attorney to maintain client confidences is fundamental to the jurisprudential system. Many ethical codes require, almost at all costs, that lawyers not divulge any information given to them by their clients in confidence.150 According to the American Bar Association Model Rules of Professional Conduct (hereinafter Model Rules), "[a] fundamental principle in the client-lawyer relationship is that the lawyer maintain confidentiality of information relating to the representation. The client is thereby encouraged to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter."151 Weinstein's theory contradicts the very fiber of representation and advocacy represented in these codes. In addition, Weinstein draws on the old Model Code of Professional Responsibility for support of his ideas. However, he ignores the newer version, i.e., the Model Rules, which completely contradicts his position.

For example, Model Rule 1.6 states:

(a) A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except . . .
(b) A lawyer may reveal such information . . . (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.152

This duty of confidentiality continues even after the attorney-client relationship is severed.153 Weinstein's model and supporting arguments are completely at odds with these well-established rules. Unless there is some kind of homicidal plot or imminent threat of seri-

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149. Rutter, supra note 2, at 83. For a discussion of the FDIC's malpractice suit against Jones, Day, Reavis & Pogue, see infra note 186 and accompanying text.
152. Id. Rule 1.6 (emphasis added).
153. Id. Rule 1.6 cmts. 15, 21.
ous physical harm related to particular dealings of a financial institution, lawyers are expressly *not* allowed to disclose any information given to them by their clients, nor are attorneys permitted to divulge original ideas discussed between themselves and their clients, including all advice given to the clients by the attorneys.\(^{154}\)

Model Rule 1.13 supports the above argument and, in turn, also contradicts Weinstein’s theory.\(^{155}\)

\(\text{(b) If a lawyer for an organization knows that an officer \ldots is engaged in action \ldots that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, the lawyer shall proceed as is reasonably necessary in the best interest of the organization.}^{156}\)

In such cases, the only option available to attorneys involving proper disclosure of the information is to refer the matter to a higher authority in the organization.\(^{157}\) There is no mention of a requirement to inform the federal government in this or any other rule.

The California Evidence Code (hereinafter CEC) is a bit more lenient, but it too fails to support Weinstein’s proposal. According to CEC section 956, “There is no privilege under this article if the services of the lawyer were sought or obtained to enable or aid anyone to commit or plan to commit a crime or fraud.”\(^{158}\) This code section covers clearly illegal activities, but it still does not mandate that attorneys disclose potentially risky or “cutting edge” transactions made by the banks or the financial advice the lawyer provided to the institution.

Weinstein’s proposal that attorneys have a duty to disclose confidential information regarding their clients’ potentially illegal actions transforms the attorney from counselor and advocate of the institution to regulator and insurer of the client’s good faith.\(^{159}\) Under Weinstein’s model, clients must always think twice before discussing anything with their attorneys, because the possibility exists that their lawyers might divulge the information to the federal regulators. Such candor could come back to haunt the officers and directors as individuals in enforcement or penalty proceedings by the federal regulators. As a result, the attorney-client relationship becomes an adversary

\(^{154}\) *Id.* Rule 1.6.

\(^{155}\) *Id.* Rule 1.13.

\(^{156}\) *Id.*

\(^{157}\) *Id.*

\(^{158}\) [CAL. EVID. CODE § 956 (West 1991)]

\(^{159}\) Fisher, *supra* note 3, at 11.
process, and the working relationship, which is supposedly based on trust, is severely compromised. The result is a definite chilling effect on the relationship. According to one commentator:

Efforts by the government to impose responsibility upon lawyers to assure the quality of their clients' compliance with the law or to compel lawyers to give advice resolving all doubts in favor of regulatory restrictions would evoke serious and far-reaching disruption in the role of the lawyer as counselor, which would be detrimental to the public, clients and the legal profession.¹⁶¹

The only time that a duty to disclose confidential information to regulators ever exists, then, is at the time the federal government takes over as receiver of a failed institution. Once the FDIC has stepped into the shoes of the depositors as subrogee, it is then the client. The attorney-client privilege stays with the client, so the government can, in a sense, “waive” the privilege and require attorneys to disclose any and all of the information related to the institution.¹⁶² At this stage of the representation, the attorney may be required to disclose confidential information to the regulators, but such disclosure will not compromise the attorney-client privilege.

b. Expansion of Personal Liability for Attorneys and Its Effect on Legal Representation of Financial Institutions

Assuming attorneys do owe an obligation both to the client bank and to the insurer, it does not necessarily follow that lawyers should be personally liable if they protect their clients at the expense of the depositors and insurer; nor does it mean that they should be held personally liable if they fail to make disclosures to the federal regulators that would violate the attorney-client privilege. Weinstein's model attempts to create a new standard of attorney liability where one did not previously exist. As Max L. Gilliam, a defense attorney for Jones Day, stated:

[w]hat these lawsuits are seeking [by employing Weinstein's model] is to impose a liability on lawyers that does not exist under the Rules of Professional Conduct. That is, if you are advising a client in a regulated industry — and that’s most of

¹⁶⁰. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.6 cmt. 4 (Discussion Draft 1990).
¹⁶¹. Lehr, supra note 21, at 62 (quoting American Bar Ass'n, 1975 Statement of Policy, 31 Bus. Law. 543, 545 (1975)).
¹⁶². Bank, Thrift Attorneys React, supra note 112, at 547.
your corporate clients — you tell the regulators what you discover or be liable for it. That strikes at the heart of the way we practice law.  

Another problem with Weinstein’s theory is that because the duties placed on attorneys are not clearly defined, attorneys are likely “to err on the side of excessive caution, perhaps even to the ultimate detriment of the general prosperity of the industry.”

Attorneys may become too concerned with exposing themselves to personal liability by providing advice to the institution regarding any potentially illegal transaction, so they might inform the federal regulators about everything just to protect themselves. Such a practice might keep officers and directors from disclosing information to, or discussing important ideas with, their attorneys. Therefore, financial institutions might not obtain legal opinions before conducting a potentially illegal transaction, which they would not otherwise undertake if they had consulted their lawyer. Failing to obtain legal opinions regarding transactions could cause banks to become overly cautious and to abstain from engaging in innovative deals altogether. This result would stifle progress in the world of finance and, in addition, would produce a chilling effect on the attorney-client relationship.

B. Fact Scenarios

Even though Weinstein’s arguments are flawed, and the ABA Task Force believes that Weinstein’s “new emphasis on attorney liability is without substantive legal basis,” attorneys must prepare for the worst and assume that Weinstein’s proposal will become law. Because “[m]any legal malpractice and liability policies exclude criminal claims based on gross negligence . . . and some exclude coverage for suits brought by the FDIC,” it is critical for attorneys to understand what their duties are as counsel to financial institutions and to whom these duties are owed. In addition, attorneys must develop a way to effectively represent banks while at the same time protect themselves from exposure to personal liability. Consideration of specific fact situations outlining actions that are

163. Rutter, supra note 2, at 31.
164. Baxter, supra note 6, at S255.
165. ABA Task Force Studies Liability, supra note 124, at 756.
166. Id.
167. FDIC Seeks $300 Million in Suit, supra note 124, at 547.
clearly legal and illegal, as well as actions that are not as clear-cut, are examined and used as a backdrop for the development of such a scheme.

1. Attorneys' Actions Which Are Clearly Legal Under FIRREA and Their Relation to Weinstein's Model

A recent example of an attorney's actions that were clearly legal comes from the case of FDIC v. Shrader & York. The law firm of Shrader & York served as legal counsel to two S&Ls, City Savings and Loan Association (hereinafter City) and Lamar Savings Association (hereinafter Lamar). The FDIC, as receiver standing in the shoes of the institution, sued the firm for legal malpractice, alleging that the firm was negligent in failing to instruct the two S&Ls "to obtain regulatory approval for certain business transactions." The court disagreed with the FDIC, stating that even if it were malpractice for the firm not to instruct the institution to obtain regulatory approval for the transactions, plaintiff failed to show that the firm's omission "proximately caused the financial loss [of the shareholders] complained of by Plaintiff." The court also quoted Hud- dleston v. Herman & McLean stating, "[c]laving a party to enter a transaction that loses money does not make the procuring party liable for the transactional loss." Shrader & York were found not liable for their failure to give legal advice, even though it caused the S&Ls to enter into transactions that lost money.

Because Shrader & York is a recent case, FIRREA could have been employed to impose liability on the firm. Since Shrader & York were found not liable, however, it can be inferred that their actions did not constitute knowing or reckless participation in unsafe and unsound banking practices under FIRREA. Even if the actual investment were unsafe and unsound, that fact is irrelevant, because the attorneys were only providing the bank with advice on a legal issue, i.e., whether regulatory approval for the transaction was required. An attorney's interpretation of a law or statute, and the law-

170. Id. at 534.
171. Id. These transactions included "City's acquisition of Realty Development Company in 1983; Lamar's acquisition of Brazos Savings Association in 1983; Lamar's acquisition of stock in CTC Corporation in 1985; and the purchase of Stone Oak property in 1985." Id.
172. Id.
175. Id.
yer's subsequent instructions to the bank regarding that law, are clearly legal as long as they are based on good-faith advice.\textsuperscript{176} Even if the attorney knows such advice is illegal, i.e., unsafe and unsound, he or she can not be held personally liable under FIRREA if that illegality does not cause the loss.\textsuperscript{177} Because their acts were clearly legal, the firm did not have a duty to disclose this information to the federal government as insurer, as Weinstein would suggest. There was no reason for the firm to suspect that the transactions would be financially disastrous.

The application of Weinstein's model to attorneys' actions that are clearly legal, that is, safe and sound under FIRREA, has no effect on how attorneys should act in such circumstances. Because their actions are legal, there is no cause for alarm. As a result, there is no need to inform the federal regulators, because they are not needed to step in and prevent financial disaster. The attorney's duty, therefore, remains to the institution.

2. Attorneys' Actions Which Are Clearly Illegal Under FIRREA and Their Relation to Weinstein's Model

In contrast to the above example, Weinstein's model has a definite effect on clearly illegal actions by attorneys or the institutions they represent. Examination of two current cases demonstrates this point.

\textit{FDIC v. Eckert Seamans Cherin & Mellott} \textsuperscript{178}is a prime example of egregious action taken by an attorney, assuming that the alleged facts are true. The FDIC claimed that "Eckert [the attorney] facilitated and advanced Bernstein's [client director of the Guardian Bank, N.A.] personal goals by, inter alia, structuring transactions designed to provide Bernstein with access to millions of dollars in cash for his personal use, free from the scrutiny of bank examiners."\textsuperscript{179} Bernstein owned approximately 85% of the Guardian Bank, N.A. (hereinafter Guardian) stock, and wanted to use his control of Guardian to supply Guardian's mortgage-servicing subsidiary with money, "regardless of the harmful effects on the bank."\textsuperscript{180} These plans included Bernstein's personal use of the money to purchase

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\item \textsuperscript{176} H.R. REP. No. 101-54(I), \textit{supra} note 77, at 263.
\item \textsuperscript{177} For an attorney to be held personally liable, the "unsafe and unsound practice [must cause or be] likely to cause more than a minimum financial loss . . . ." 12 U.S.C.S. § 1813(u) (Law. Co-op. Supp. 1992).
\item \textsuperscript{178} FDIC v. Eckert Seamans Cherin & Mellott, 754 F.Supp 22 (E.D.N.Y. 1990).
\item \textsuperscript{179} \textit{Id.} at 23.
\item \textsuperscript{180} \textit{Id.}
Guardian’s subsidiaries and pay off some of his other private obligations.\textsuperscript{181}

It is also alleged that Eckert knew Bernstein planned to use these transactions for his own personal gain, and that Eckert still did not disclose these activities to the Office of the Comptroller of the Currency.\textsuperscript{182} This allegation is substantiated by a memo written by Eckert, “which later called for all directors to be ‘fully informed’ [of the transactions].”\textsuperscript{183}

Assuming the alleged facts are true, these acts by Eckert qualify as knowing and reckless, as well as unsafe and unsound. Eckert knew the real purpose of the transaction, which was to benefit Bernstein personally, yet he went ahead and drafted the deals anyway in disregard of their potential adverse effects on Guardian. In addition, Eckert transferred Guardian’s money to Bernstein as an individual, knowing that Bernstein would not use the money for the bank’s benefit and that Guardian would end up losing money; these acts constituted an unnecessary financial risk to the bank and its depositors.\textsuperscript{184} This risk, then, is an unsafe and unsound banking practice according to FIRREA.\textsuperscript{185}

An argument exists, however, that these acts were not clearly illegal. Since Bernstein owned 85% of Guardian’s stock, he could be considered the client, or at the very least his interests and the interests of the shareholders could be identical. It was arguably not a breach of fiduciary duty, then, for Eckert to structure the transactions to benefit Eckert personally. This argument suggests that Weinstein’s notion of fiduciary obligation to depositors would not affect the actions of attorneys in such cases, since the client institution and the shareholders are essentially the same entity. Therefore, the attorneys did not breach their fiduciary obligations to the client. However, shareholders and depositors are not the same entity, and their financial interests are not always the same. The Eckert case is a clear example of this proposition. Thus, if the attorneys also owe a duty to the depositors as Weinstein suggests, then Eckert’s actions are a clear breach of this duty. Accordingly, the application of Weinstein’s model makes a huge difference with respect to how attorneys are supposed to act in such cases, because the model raises questions about to whom attorneys owe fiduciary duties.

\textsuperscript{181} FDIC Seeks $300 Million in Suit, supra note 124, at 547.
\textsuperscript{182} Id.
\textsuperscript{183} Id.
\textsuperscript{184} Clearman, supra note 46, at 103.
To further understand the effect of Weinstein’s proposal on lawyers’ actions when the client is engaged in clearly illegal activity, another example must be considered. The law firm of Jones, Day, Reavis & Pogue has been sued by the Resolution Trust Corporation (hereinafter RTC) based on the following allegations:

Jones Day assisted . . . in concealing vital information from examiners and manufacturing documents for files, helping . . . create after-the-fact ratifications for [oral] transactions . . . [removing] incriminating . . . documents from at least one file . . . [and] allowing forgeries of minutes and resolutions to continue . . . Jones Day failed to notify the Lincoln board of directors or regulators of the fraudulent activity. . . Instead, Jones day acquiesced in, assisted, and cooperated in the deceptions. 186

If these alleged facts are true, they would certainly qualify as clearly illegal. The knowing and reckless standard is satisfied, since any competent attorney knows that it is illegal to forge and manufacture documents. It is also unsafe and unsound for Jones Day to conceal that information from the federal examiners. While doing so could potentially avoid immediate regulatory enforcement action and the assessment of civil money penalties against Lincoln Savings & Loan for violations of FIRREA or other banking regulations, the law firm exposes Lincoln Savings & Loan to potentially greater penalties in the long run. The longer a violation of FIRREA continues, for example, the larger the total civil money penalty becomes. 187

Weinstein’s model has no effect on the actions of attorneys and officers or directors in such circumstances for the very reason that these actions are clearly illegal. Weinstein argues that lawyers owe the highest fiduciary duty to the federal government as insurer. 188 However, if attorneys are engaged in illegal activity, they are by definition ignoring whatever fiduciary duty to the depositors that is supposedly placed upon them. The illegalities are committed for personal gain, and the best interests of the financial institution are most likely ignored as a result. The last thing lawyers in this position would do is inform the federal regulators of their acts, because they want to avoid enforcement proceedings by the federal regulators altogether.

Along similar lines, Weinstein’s approach would not aid in the

186. Rutter, supra note 2, at 31.
188. Weinstein, supra note 18, at 4.
enforcement of illegal action taken by financial institutions' officers and directors. Because they are engaged in illegal activity, the officers and directors would be wary about telling anyone, including the board of directors, for fear that the information would reach the federal regulators. Lawyers would be unlikely candidates to learn of this illegal activity, even in spite of the attorney-client privilege, because the officers and directors would not risk the exposure. Hence, the only way Weinstein's model would be of any use here is if the officers and directors asked the attorney to help them commit the illegal transactions and the lawyer refused.

Therefore, even if Weinstein's ideas were valid and practical, they would not be useful as a means of regulating attorneys in the context of actions that are clearly illegal. However, Weinstein's model does affect lawyers' actions when they learn of, but are not involved in, clearly illegal activities by their client banks. This issue is discussed below.

3. *Gray Areas — Attorneys' Actions That Are Neither Clearly Legal Nor Clearly Illegal Under FIRREA and Their Relation to Weinstein's Model*

The situations in which Weinstein's model has the most significant impact on an attorney's actions are those where the bank's undertakings are neither clearly legal nor clearly illegal. There are two interrelated reasons for this effect. First, attorneys become privy to a great deal of confidential information about the bank and its financial dealings during the course of the representation. Second, this confidential information may concern dealings that are potentially, but not clearly, unsafe and unsound. These two factors provide much of the support for Weinstein's model. Attorneys are in the best position to obtain this confidential information about potentially hazardous banking practices, so they should be the ones to inform the federal regulators. However, if attorneys are not certain whether the acts are illegal, i.e., unsafe and unsound, and they inform the federal regulators, the possibility exists that lawyers would be preventing banks from having the opportunity to engage in cutting-edge, perfectly legal transactions. This conflict raises questions regarding the duties charged to attorneys in this context and to whom these duties are owed.
The best way to deal with these issues is to examine several fact patterns where it is unsettled whether the actions taken by the attorney and/or the bank violate the unsafe and unsound provision of FIRREA. For example, it is technically legal for attorneys to advise their clients how to take advantage of loopholes in the law. However, the key to determining attorney liability under Weinstein's model, and also under FIRREA, is whether lawyers may provide such advice to their clients where attorneys are certain that the use of the loophole is legal in and of itself but may be financially risky, i.e., unsafe and unsound, and therefore illegal under FIRREA. In other words, can the lawyer render legal advice without reaching a conclusion as to whether the practice is financially unsafe and unsound. A related issue is whether attorneys must disclose confidential information to federal regulators if they learn that the banks are using this loophole, which may be unsafe and unsound financial practice, and the regulators are not aware of it.

To answer these questions, consider the following example concerning the accounting loophole used in the financial accounting procedure for acquisition, development, and construction (hereinafter ADC) loans, as explained by William K. Black, District Counsel for the San Francisco District, Office of Thrift Supervision. An ADC loan is usually given for the purpose of purchasing land and developing it with large commercial buildings. Often the borrower is loaned a large amount of cash for no money down and does not have to begin repayment of the principal and interest for two to five years. The accounting loophole for ADC loans may be employed when the lender chooses to carry the business risk of project failure; if the building is unprofitable, the bank’s loan is not repaid. When the lender carries the risk, “an ADC loan is treated as a direct investment by the regulators and is supposed to be treated that way by accountants.” The bank then ‘pays’ itself the interest due [on the

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189. Loopholes are defined as ambiguities or omissions in a statute. Lehr, supra note 21, at 57.

190. Hearing, supra note 8, at 286-89. This loophole was exploited by Lincoln Savings & Loan, which is a major reason behind the institution's financial failure. Id. at 286. FIRREA largely closes this loophole, but not necessarily for state-chartered banks.

191. Id. at 287.

192. Id. at 288.

193. Id. at 287.

194. Id. at 288.
loan] out of an ‘interest reserve,’” which translates as an immediate statement of profit for the thrift. This “paper profit” is “false,” however, since the bank has not received any money from an outside source. Consequently, the thrift’s overall net worth becomes falsely inflated.

In addition to the above factors, ADC loans of this type are clearly unsafe and unsound under FIRREA for three reasons. First, “[t]hey are generally of an extremely high loan to value ratio, meaning a downturn in the economy, or in some cases a lack of property value inflation, leaves the lender unprotected by the collateral securing the loan.” Second, the lender has no way to recover the amount of the loan from the borrower if the venture loses money, because the lender either has agreed to hold the borrower not liable, or the borrower has little, if any, net worth. Third, “real estate projects are frequently speculative, i.e., there is no one legally committed (and financially capable) of buying the project once it is built.” However, higher interest rates can be charged for riskier projects, which enables the bank to claim larger profits, further inflating the net worth of the thrift in a deceptive manner. When these three factors are combined with poor underwriting, i.e., no down payment required and little or no collateral secured for the loan, the likelihood of financial loss to the bank, and by extension, to the depositors and taxpayers, is substantial.

The use of this accounting practice is clearly not confidential, because it goes on the bank’s books. Therefore, when the federal regulators conduct a routine inspection, the information is disclosed. What may be confidential, however, is the attorney’s advice to the bank regarding the wisdom of exploiting such loopholes. It is not clear whether lawyers have an affirmative duty to disclose such advice to the federal government should their clients employ the loophole.

The legislative history to FIRREA suggests that attorneys should not be held personally liable for instructing their clients to take advantage of accounting loopholes.

195. Id. at 288, 294.
196. Id. at 289.
197. Id.
198. Id.
199. Id.
200. Id. at 297. An argument exists that if these ADC loan losses are unsafe and unsound by definition, it is never justified to advise an institution that it is proper to proceed with them.
By specifying "attorney" in this section [12 U.S.C. § 1813(u)], the Committee does not intend to subject attorneys to agency enforcement actions for those good faith activities falling within the traditional attorney-client relationship. Specifically, providing advice in good faith to a client financial institution, by itself, should not lead to an enforcement action . . . . However, an attorney who does provide legal advice and services and then knowingly participates in other activities which result in serious misconduct would be subject to enforcement actions. Moreover, repeated legal advice to violate a banking law provision . . . where the meaning of the provision is clearly established or settled by the courts, would not usually constitute good faith, and could possibly subject the attorney involved to enforcement action, if the grounds for such an action are present . . . . 201

This language suggests that FIRREA is designed to deal with outright fraud of attorneys rather than breach of fiduciary obligations. Use of loopholes is not outright fraud as long as attorneys believe in good faith that its use is legal. Lawyers, then, should not be held responsible for advising their banking clients to utilize those loopholes, assuming the loopholes are not being used to perpetuate fraud or delay or to hide its detection. Also, loopholes are often created for a specific purpose. As one commentator declared, "[s]eeming statutory omissions or ambiguities may indeed be the result of congressional compromise, and thus such 'openings' should be available as avenues of corporate [and banking] conduct until closed by appropriate legislative act."202

In addition, the meaning of the provision "unsafe and unsound" in the context of FIRREA has not yet been clearly established or settled by the courts. Therefore, if there is some doubt in lawyers' minds that the advice possibly could be unsafe and unsound, attorneys should be able to provide their clients with this advice without worrying about personal exposure to enforcement proceedings. Even if banking clients use their lawyers' advice to further a criminal scheme, lawyers do not become party to that course of action as long as the advice was provided in good faith with a solid legal basis.203

Weinstein's view is that "attorneys who discover [loopholes] must then ask whether the use of the loophole poses safety, soundness, or fiduciary considerations . . . . [A]ttorneys who advise clients

201. H.R. REP. No. 101-54(I), supra note 77, at 263.
202. Lehr, supra note 21, at 61.
203. Id.; see also MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2 (Discussion Draft 1990).
on how to exploit legislative or regulatory 'loopholes' may be guilty of unethical practice . . . "204 Therefore, if it is unsafe and unsound to use the loophole, it would also be unsafe and unsound for lawyers to counsel their clients to use it. Because the use of this accounting loophole for ADC loans is clearly unsafe and unsound financially, it is probably unsafe and unsound for attorneys to advise their clients to use it under Weinstein's model. Even though the thrift shows immediate paper profits, these are losses in reality. If the bank issues a large number of ADC loans and bears the risk of loss, it is likely that the bank will become insolvent after two years.205 Since Weinstein believes that attorneys owe the highest standard of fiduciary duty to the federal government, he would argue that lawyers have an affirmative duty to inform the regulators if advice to exploit such loopholes were given to their clients.

Even assuming that it is unsafe and unsound for attorneys to instruct their clients to use accounting loopholes, the attorney-client privilege, as outlined in Model Rules 1.6 and 1.13, as well as California Evidence Code section 954, precludes disclosure of this advice to the federal government. According to these two rules, the attorney's duty of confidentiality overrides all other concerns. As long as the accounting loophole poses no threat of substantial bodily harm,206 or the attorney was not asked to help the client use the loophole to perpetuate a crime or fraud,207 the advice may not be revealed to the federal government.

A related issue is what duties are imposed on lawyers if they discover that the financial institution is using the legal accounting loophole to disguise the true, fraudulent nature of the transaction from the depositors and federal regulators. Lawyers may choose from several possible courses of action in this case. They definitely must advise their clients against defrauding the government and the depositors in this or any other manner.208 If this advice is not followed, and often it is not,209 attorneys should at the very least inform the board of directors of the illegal action.210 If the board does not take steps to rectify the problem, lawyers also have the option to

204. Advice on How to Exploit Loopholes, supra note 124, at 616.
207. CAL. EVID. CODE § 956 (West 1991).
208. Rutter, supra note 2, at 33.
209. Id.
resign as counsel. Only under certain circumstances, however, may attorneys inform the federal regulators of their clients’ actions, even if the actions are illegal. Lawyers are bound by the attorney-client privilege to keep such information confidential, unless they are approached by their clients for the purpose of using the loophole to perpetuate a crime or fraud. Under all other circumstances, attorneys may not reveal their findings.

It is not clear, however, whether any of these options would insulate lawyers from personal liability under Weinstein’s model. Since Weinstein would require that this information be disclosed to the federal regulators before the bank fails and the federal government takes over as insurer, the only way attorneys could avoid personal liability under Weinstein’s theory is to disclose the information to the federal government.

In this hypothetical context, Weinstein’s model would have a tremendous effect on the attorney-client relationship, which could potentially result in even greater financial loss to banks. Assuming lawyers would be compelled to inform the government that their client thrifts are using the loophole, bank officers and directors would never even discuss the use of loopholes with the bank’s lawyers for fear that the lawyers would blow the whistle on the transaction. As a result, the officers and directors would attempt to use the loophole without asking their attorneys how to implement the tactic properly. Without expert advice, these laypeople might utilize the loophole incorrectly and unknowingly break the law. The banks could suffer monetary loss through the transaction; even worse, they could become subject to federal regulatory action for breaking the law. By not consulting with their attorneys, banks who wish to take advantage of loopholes stand to lose a great deal under Weinstein’s model, and the attorney-client relationship is compromised, as well.

b. Fact Scenario 2 — The Legality of Attorneys Providing Financial Advice to Their Clients

The most pervasive gray area of all involves attorneys giving financial advice to client banks. The problem is based on the fact that many officers and directors of financial institutions have financial training and are better qualified than lawyers to make such decisions. As one commentator noted, “Traditional legal advice encompasses a wide-array of activity ranging from oral consultations to

211. Id.
212. CAL. EVID. CODE § 956 (West 1991).
formal written opinions. It may or may not include elements of business or non-legal [i.e., financial] advice . . . .”

A recent example of this dilemma comes from the case of FDIC v. Wise. The FDIC’s complaint alleges that Silverado Banking, Savings and Loan Association (hereinafter Silverado) suffered damages in excess of $200 million as a result of former officers’ and directors’, as well as outside counsels’, misconduct. The complaint alleges, inter alia, that Michael Wise, counsel to Silverado, aided and abetted the officers and directors of Silverado in breaching their fiduciary duties. In addition, the FDIC claims that “[c]ounsel did not adequately advise on, inquire into, or investigate relevant [financial] matters on behalf of Silverado.”

While the Wise court did not provide a definitive opinion regarding whether attorneys must give their client depositories financial advice, the decision implies that attorneys may do so. The court stated that the defendant law firm “[may] have had a duty to advise Silverado on different aspects of these [financial] affairs.” This position is supported by Model Rule 2.1, which reads, “[i]n representing a client . . . a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client’s situation.” To make their representation competent, then, attorneys may be required to include financial advice along with their legal advice.

Keith Fisher, head of the ABA Task Force, disagrees: “Case law from several jurisdictions concludes that no such duty [providing clients with business advice] exists.” The reason for this statement is that many attorneys may not be entirely qualified to give financial advice. Giving such advice may be beyond their level of expertise. If lawyers are not well versed in financial matters, their advice would not be based on sound financial knowledge and principles.

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213. Lehr, supra note 21, at 60 n.8.
215. Id. at 1416.
216. Id.
217. Id. at 1418.
218. This opinion considers only a limited set of issues; namely, specific motions to dismiss claims and motions for summary judgment. Ultimate findings of fact and opinions based on the merits will not be given by the court until this case reaches trial. Id.
220. MODEL RULES OF PROFESSIONAL CONDUCT Rule 2.1 (Discussion Draft 1990) (emphasis added).
221. Fisher, supra note 3, at 11.
222. MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.1 cmt. 1 (Discussion Draft 1990).
There is, then, the potential for risk of loss to depositors if banks follow the business advice of attorneys. Therefore, it appears to be unsafe and unsound according to FIRREA for lawyers to give such uninformed advice to their client banks.

Model Rule 1.1 suggests that if attorneys do not possess the requisite knowledge and expertise required to render their clients competent legal advice, lawyers should do what they can to make sure that the advice is competent. Such measures include consulting with other lawyers "of established competence in the field in question," i.e., those who have experience in financial transactions, attorneys who have joint J.D./M.B.A. degrees, or lawyers who have educated themselves about the field. The ultimate solution to this problem would be for lawyers who serve as counsel to insured depositories to obtain training in the legal and financial fields, so that they could use their knowledge of both areas to provide their clients with truly informed advice.

Therefore, it seems clear that attorneys who possess the requisite training in financial matters may provide their clients with business advice and still satisfy the "safe and sound" requirement of FIRREA. On the other hand, if lawyers offer such counsel without the benefit of thoroughly educating themselves regarding financial matters, that act is considered an unsafe and unsound practice according to FIRREA, and they expose themselves to personal liability as a result.

Weinstein’s model, working in combination with FIRREA, has a definite effect on an attorney’s ability and desire to provide business advice to clients. Because attorneys owe their primary duty to the federal government as insurer, lawyers would refrain from giving business advice to their financial institution clients if there is even the slightest doubt in their minds that the advice is not one hundred percent correct. Assuming that attorneys can and will insulate themselves from liability by refusing to give financial advice, and that Weinstein’s suggestion that lawyers must reach financial conclusions as an integral part of their representation of thrifts is erroneous, banks will discontinue employment of attorneys for the purpose of obtaining financial advice, because much less advice would be forthcoming than in the past. As a result, attorneys stand to lose a substantial amount of income that existed pre-FIRREA and pre-Weinstein’s model. In addition, financially knowledgeable lawyers will not
be able to make cutting-edge financial suggestions to their clients that potentially could earn the bank and its depositors a great deal of money. Weinstein’s proposal would stifle innovation and advances in the world of banking while at the same time create personal liability problems for attorneys.

V. PROPOSAL

A. Ways in Which Attorneys Can Insulate Themselves from Personal Liability if Weinstein’s Model is Adopted

There are several means by which attorneys and their law firms can insulate themselves from liability under FIRREA if Weinstein’s model is applied by the courts. The following suggestions are made in the contexts of the three fact scenarios, i.e., when the actions of the financial institution and its counsel are clearly legal, clearly illegal, and neither clearly legal nor clearly illegal. Several commentators have made recommendations along these lines. This comment expands on these suggestions and adds more to the list, as well as proposes alterations to Weinstein’s model to make it more practical and considerate of the needs of attorneys, depositors, and federal regulators.

1. Clearly Legal Conduct by Well-Run Financial Institutions

The most obvious means by which attorneys can insulate themselves from personal liability is to stop representing insured depositories altogether. While this method is a sure-fire way to eliminate exposure to liability, it is not economically desirable for law firms. Serving as counsel to financial institutions can be extremely lucrative for attorneys, so this option should be used as a last resort. Alternatively, the idea could be narrowed a bit. Law firms could represent only those insured depositories that “have no prior history of misconduct.” As a result of the recent increase in bank failure due to fraud, however, there might not be many “clean” financial institutions left to represent. One commentator also called this option “a ‘cop-out’ with respect to professional responsibility.” What attorneys really need is a way to restructure their counsel, not eliminate it altogether.

225. Lehr, supra note 21, at 62.
226. Id.
227. Id.
One means of restructuring is for attorneys to “retain personal records, including not only opinions actually given, but [also] opinions they declined to give.”\textsuperscript{228} Such action would allow attorneys to represent banks while remaining confident that they could rebut allegations by the FDIC that they provided their clients with unsafe and unsound legal advice. Another way attorneys could use written documents to protect themselves is to “limit in writing the scope of [their] representation by the use of rather specific engagement letters.”\textsuperscript{229} For example, they could stipulate that they will not provide their clients with any financial advice. Attorneys could also use disclaimers in their representation contracts, stating that they do not warrant as one hundred percent reliable any financial or business advice given to the client, since the law, and not economics, is their field of expertise.

2. Clearly Illegal Activities by Financial Institutions — What Lawyers Should Do When They Discover the Illegal Practices

When attorneys find out that their thrift clients are engaging in clearly illegal activities, they are put in an awkward position. These lawyers must either maintain the attorney-client relationship and allow the financial institution to break the law and potentially become insolvent in the process, or these lawyers must breach the duty of confidentiality owed to their clients in order to save the bank from failure and the taxpayers from footing the bill for the bail-out.

Retaining documentation of the advice given and not given, as mentioned above, will insulate attorneys from personal liability only to a limited extent. While the records will show that lawyers did not advise their clients to commit illegal acts, attorneys would still be liable under Weinstein’s model if they do not act affirmatively to prevent the illegal acts by informing the federal regulators. This problem suggests that neither informing the board of directors nor resigning according to Model Rule 1.13, without making a disclosure to the federal regulators, would be sufficient to protect attorneys from personal liability. Trying first to work out the problem with the bank by advising its directors to discontinue the illegal activity would be equally ineffective if the illegal acts continued.

These two options are insufficient to insulate lawyers from personal liability for several reasons. Even if lawyers instruct the officers and directors to conform their transactions to the law, this ad-

\textsuperscript{228} FDIC Will Target Attorney Malpractice, supra note 124, at 547.
\textsuperscript{229} Lehr, supra note 21, at 62.
vice might not be followed. Along the same lines, if the attorney informs the board that the bank is engaging in illegal banking practices, the board might ignore the warning and allow the acts to continue. If either of these two scenarios occur, lawyers cannot protect themselves at this stage by mere withdrawal. Usually, they learn the details of the illegal practices gradually and first try to rectify the problems by directly dealing with the client, as discussed above. By the time the lawyers find out that the illegalities are continuing, they are already “tainted” by the improper activity. Even if the lawyer withdraws as soon as the illegalities are discovered, he or she would still have knowledge that, if brought to the attention of the federal regulators, possibly could help prevent the bank from failing financially.

The thrust of Weinstein’s argument in this context is that attorneys must do whatever they can to protect the financial institution, and by extension, the federal government as insurer. In this case, it is in the best interests of the depositors to inform the federal regulators of the improprieties. Therefore, no matter what lawyers do under these circumstances, anything short of informing the government will result in personal liability under Weinstein’s proposal. The best way attorneys can protect themselves from the federal government, then, is to disclose the confidential information to the federal regulators if their efforts to work out the problems with the client have failed. This option may expose lawyers to legal malpractice suits by their clients for breach of the attorney-client privilege.

If the attorney is sued, all he or she can do is hope that the jury, which is comprised of taxpayers, is sympathetic to the reasons the lawyer gives for violating the privilege. In California, however, if the attorney’s representation is sought by the bank to procure a crime or fraud, attorneys do not put themselves at risk of a malpractice action by their clients. Attorneys are entitled to disclose such information under these circumstances in California.

230. Rutter, supra note 2, at 35.
231. Id.
232. Weinstein, supra note 18, at 4.
233. Attorneys could try to stem the threat of such litigation by requiring their clients to sign a written statement at the beginning of their representation that they will disclose such information to the federal regulators. Such a written waiver may help solve the malpractice liability problem. However, it would only contribute to the problems of lost attorney income from a reduction in representation of banks and further inhibit client candor, as discussed above. See supra part IV.3.b. and text accompanying notes 160-64 & 225-29.
3. Questionable or Potentially Risky Financial Practices — The Balancing Act Between the Client, the Depositors, and the Federal Regulators

One way in which attorneys can protect themselves from liability when it is not clear whether the bank’s transactions are clearly legal or illegal is to disclaim responsibility for financial decisions and/or not provide them at all, as discussed above. There are additional ways for attorneys to protect themselves under these circumstances, but they could prove costly. One possibility is to have “a review partner [oversee] virtually every piece of advice or interaction with a client.” The problem with this option is that the review partner would end up duplicating much of the associate’s work. It would be inadequate for the review partner just to review summaries prepared by the associate, because the associate unwittingly could omit information necessary to the decision. To adequately insulate the firm from liability and ensure that the proper decisions are made, the review partner would have to conduct his or her own complete review of the facts and circumstances surrounding the transaction. This option is obviously very expensive for the client banks, because partners’ hourly rates are higher than associates’.

Another possibility is to “increase the competence of those who are handling the representation of regulated institutions.” Such upgrades in expertise could be accomplished by sending attorneys to business school. As one commentator stated, “There is a need to understand the business purpose and economic substance of a transaction and the total regulatory context that typically requires the attention of a more experienced attorney.” A more practical and cost-effective alternative to training attorneys who are already employed with the firm is to hire those who already have earned both J.D. and M.B.A. degrees. Hiring these lawyers for the specific purpose of counselling client banks would eliminate the increased cost to the firm, which would prevent the need for firms to raise their rates. If this practice were adopted, attorneys’ and the public’s interests would be sufficiently served. Lawyers would not have to worry about losing their financial institution clients, because they would not be lacking the ability to serve all of their clients’ needs regarding legal and business advice. Attorneys would also be more comfortable offer-

235. Lehr, supra note 21, at 62.
236. Id. at 62-63.
237. Id. at 63.
238. Id.
ing such advice, because their business training would presumably provide them with a better understanding of what constitutes unsafe and unsound banking practices. The taxpayers' interests would also be protected, because these specialized attorneys would be less likely to advise their clients to enter into unsafe and unsound banking practices. Therefore, fewer financial depositories would fail, and the taxpayers would not be forced to pay the higher taxes needed to bail out the federal insurers.

Informing the board of directors under these circumstances according to Model Rule 1.13, as opposed to the clearly illegal scenario, should be enough for attorneys to protect themselves. Because it is unclear whether the proposed transactions are unsafe and unsound, the standard for attorney liability should be more lenient. There is no need to "cry wolf" and inform the regulators, since the board may be able to resolve the problem on its own. If the attorney feels strongly that the transaction is unsafe and unsound and informs the board of this opinion, but the board does nothing to make the transaction legal, the attorney's best course of action is to withdraw according to Model Rule 1.13. The act of withdrawal might serve as a signal to the federal regulators that there is a potential problem, prompting the regulators to conduct a routine investigation of the thrift. If this system works, it would enable the regulators to prevent thrift failure and taxpayer exposure to the resulting bail-out, thus preserving Congress' public image. In addition, lawyers would be able to escape personal liability resulting from the federal regulators' findings, while at the same time protecting themselves from legal malpractice suits by their former clients for breach of the attorney-client privilege. If Weinstein's model were improved, however, this kind of "phantom disclosure" by lawyers would not be required to preserve the interests of all parties involved.

B. Improvements on Weinstein's Model

With a few alterations in form and application, Weinstein's model could serve a useful purpose in certain specific contexts. First, one way to make Weinstein's suggestion practical is to require attorneys to "make disclosures to the full board of directors when disclosure to the board is necessary [i.e., when the transaction is potentially unsafe and unsound]." This suggestion essentially restates Model Rule 1.13. By going to the board first, the attorney may be

239. FDIC Will Target Attorney Malpractice, supra note 124, at 547.
able to prevent the bank from engaging in the unsafe and unsound practice altogether, thus eliminating the need to involve the federal regulators. Also, members of the board could provide some insight and suggest ways to make the proposed transaction safe and sound. In addition, the confidentiality of the attorney-client relationship is preserved, because the institution, which is represented by the board of directors, is the client. The institution and its officers and directors still would feel comfortable discussing any and all potentially illegal activities with their attorneys, because they would not have to worry that the attorney would inform the federal regulators.

Second, Weinstein’s model could be applied only to cases where clients approach attorneys for assistance in helping them carry out clearly illegal, i.e., fraudulent, transactions. In other words, a version of California Evidence Code section 952 and Model Rule 1.6 should be adopted. “According to Stanford Law School Professor Deborah L. Rhode, who specializes in ethical issues, many jurisdictions are moving away from strict confidentiality, especially in instances where the lawyer has information suggesting fraud.” As long as the officers and directors of the bank ask attorneys to help them perpetuate a crime or fraud, the attorneys should be required to inform the federal regulators of this plan. The physical harm qualification of Model Rule 1.6, which is not included in CEC section 952, can be modified for purposes of this proposal to require instead the likelihood of “imminent financial harm” to the taxpayers through unsafe and unsound banking practices.

This model prevents outright fraud by insured financial institutions, while drawing support from the arguments on which Weinstein’s original proposal relied. In this updated version of Weinstein’s model, attorneys are still in the best position to obtain confidential information regarding the potential for failure of banks, so they are best able to prevent said failure. The taxpayers and the federal government as insurer are protected, but the attorney-client relationship is not compromised, because lawyers have always been under an affirmative duty to prevent crime or fraud. Moreover, banking innovation is not stifled, because if the proposed acts are not clearly illegal, there is no duty on attorneys to inform the federal regulators. Client banks are still able to feel comfortable about discussing proposed transactions that could, in good faith, test the boundaries of the law, without worrying that their attorneys will breach their confidence and disclose the confidential communications

240. Rutter, supra note 2, at 83.
to federal regulators. Most importantly for attorneys, this model allows lawyers to protect themselves from allegations by the FDIC that they were involved in the illegal acts of the bank.

VI. CONCLUSION

The passage of FIRREA and the inclusion of attorneys as potential targets for liability surely cause lawyers justifiable concern. Of even greater worry is the use of that liability in conjunction with Harris Weinstein's theory that attorneys for insured financial institutions owe their highest fiduciary duty to the federal government as insurer. If that duty is breached and FIRREA is violated concurrently, lawyers stand to lose a great deal in terms of potential clients, as well as their freedom to practice law, their ability to earn money, and their freedom as individuals. The problem with FIRREA and with Weinstein's theory is that they are vague, which makes it difficult for attorneys to conform their conduct to these standards.241

The combined use of FIRREA and Weinstein's model will produce an extreme chilling effect on the legal representation of insured financial institutions. Client banks will be afraid to disclose information critical to proposed transactions, because they do not want their attorneys to report them to the federal regulators. In addition, the acts might not even be unsafe and unsound. The uncertainty in the definition of "unsafe and unsound" will cause attorneys and banks to become overly cautious. If it is not clear whether the proposed transaction is unsafe and unsound, financial institutions will refrain from proceeding so as to avoid potential liability. This overly cautious approach, in turn, will discourage innovation in finance and could cause banks to lose, rather than save, money.

As they stand now, the term "unsafe and unsound," as well as Weinstein's theory, are unworkable and unfair. Banking regulators have the benefit of hindsight when making their evaluations of whether the acts were unsafe and unsound, and hence, whether or not attorneys breached their supposed fiduciary duty to the federal government.242 This Monday morning quarterbacking is inherently unjust, because the banks and lawyers can never be one hundred percent positive in advance that their transactions will turn out to be

241. Weinstein's model is not yet law, but it is assumed for the sake of this comment that it will become law after the recent attorney malpractice cases brought by the FDIC are decided. Because the FDIC and the courts in which these cases are being tried are both federal creatures, it is expected that the federal courts will provide a great deal of deference to the FDIC's position.

safe and sound.243

Instead of rebuilding confidence in the banking industry, FIRREA and Weinstein's model destroy public confidence in attorneys. The suggestions in this comment regarding how attorneys to financial institutions can restructure their representation hopefully will help them avoid future personal liability, as well as restore public confidence in the morality and ability of attorneys.

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