Financial Institution Attorneys As Gatekeepers

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I. Introduction

Section 307 of the Sarbanes-Oxley Act of 2002 directed the Securities and Exchange Commission ("SEC") to adopt new rules establishing minimum standards for attorneys appearing and practicing before the Commission. As discussed below, before 2002, many of the rules purportedly federalizing professional standards were actually already on the books for attorneys practicing before agencies other than the SEC. With the exception of the controversial permissive whistleblower provision found at Rule 205.3(d)(2), the banking regulators were ten years ahead of the SEC.

Thus, since the early 1990s, each of the five major financial institution supervisory agencies have incorporated two forms of disciplinary provisions into their respective Rules of Practice and Procedure. First, each agency has a code of conduct for conducting formal hearings akin to Rule 11 of the Federal Rules of Civil Procedures. Second, each agency has standards of general competence and integrity similar to those applicable to securities attorneys that were codified in Section 602 of the Sarbanes-Oxley Act and rules later adopted by the SEC under that Act.

This paper discusses the history of attorney regulation in this area and the current rules that apply to publicly traded financial institutions as well as non-public federally supervised banks, thrifts and credit unions.

II. The Roots of Whistleblower Obligations – Rule 2(e)

SEC Rule 2(e) was one of the first rules governing administrative practice. It was first adopted in 1935 and thus actually predated the passage of the Administrative Procedure Act of 1946.[1] Originally, admission was required before the Commission, a requirement that was eliminated in 1938.[2] The original version of the rule had two basic attorney character and fitness requirements:

> The Commission may disqualify, and deny, temporarily or permanently, the privilege of appearing or practicing before it in any way, to any person who is found by the Commission after hearing in the matter
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> (1) Not to possess the requisite qualifications to represent others; or
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> (2) To be lacking in character or integrity or to have engaged in unethical or improper professional conduct.[3]

The Rule was amended in 1970 to provide for automatic suspension of attorneys who were disbarred or suspended elsewhere or convicted of a felony or misdemeanor involving moral turpitude.[4] At that time, a third potential ground for discretionary suspension or disbarment was added for willful securities violations.[5] Thus admission to practice could be denied to an attorney found by the Commission,

> (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the federal securities law (15 U.S.C. 77a to 80b-20), or the rules and regulations thereunder.[6]

The final amendment reflected an enforcement philosophy that pre-dated Enron by thirty years. That policy was premised on three assumptions by the Commission

[1] 5 U.S.C. § 500 et seq.
[2] *In re Carter,* 47 S.E.C. 471 (1981) Westlaw 384414, p. 4, N. 13-14.
[3] *Id.* at N. 17.
[4] *Id.* at N. 18.
[5] *Id.*
[6] 17 C.F.R. 201.2(3)(1)(iii).

as to the extent its authority under the federal securities laws. Each would prove erroneous before the passage of Sarbanes-Oxley.

First, the SEC believed it had authority to police mere negligence by a professional in connection with the sale of securities. In cases as such *SEC v. Frank,*[7] the Commission brought enforcement actions on the theory that counsel failed to conduct adequate due diligence as to "infirmities in his client's story" as set forth in disclosure documents.[8] The concept that securities violations could be based on mere professional negligence in the offering process was subsequently rejected by the Supreme Court in *Ernst & Ernst v. Hochfelder.*[9]

Second, the Commission took the position, as evidenced in cases such as *SEC v. National Student Marketing,*[10] that attorneys had an ethical obligation to thwart fraudulent transactions by, among other things, reporting corporate misconduct to the shareholders.[11] In fact, while the aider doctrine was still a viable theory of liability, the appellate courts unanimously disagreed that a failure to "blow the whistle" on insider fraud was a viable theory of liability against professionals under the securities laws.[12]

Finally, the very notion that liability could attach for merely aiding versus committing securities violations was rejected by the Supreme Court in *Central Bank of Denver v. First Interstate Bank of Denver.*[13] It took an Act of Congress in 1995 to reinstate or at least clarify the authority of the SEC to prosecute aider claims in enforcement actions.[14]

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[7] 388 F.2d 486, 488 (2d Cir. 1968).
[8] 288 F.2d at 488.
[9] 425 U.S. 185, 213-14 (1976).
[10] 457 F.Supp. 682 (D. D.C. 1978).
[11] *Id.* at 714.
[12] *E.g., Barker v. Henderson, Frankin, Starnes & Holt*, 797 F.2d 490, 497 (7th Cir. 1986); *Schatz v. Rosenberg*, 943 F.3d 485, 490-92 (4th Cir. 1991).
[13] 511 U.S. 164 (1994).
[14] Private Securities Litigation Reform Act, 15 U.S.C. § 78t(f).

But the privilege of practicing before the SEC is not commensurate with an attorney's ability to successfully defend an enforcement action. Thus, the Commission had authority to enforce its disciplinary rules without establishing that a lawyer was independently liable for securities violations. Again, only the aiding provisions, added in 1970, required that the Commission establish a willful violation of the securities laws.

In practical fact, the SEC's enforcement of Rule 2(e) has been closely tied to its overall enforcement policies at various times. The first major contested Rule 2(e) proceeding, the *Carter Johnson* case,[15] pitted the Commission against a major Wall Street law firm. *Carter Johnson* involved a public company that was debt ridden and a president that insisted on issuing bullish press releases when, in fact, the company had severe liquidity problems. The lawyers, who had represented the issuer in preparing a registration statement for a debenture offering, continued to represent the issuer through the liquidity crisis but drafted only one press release and accompanying Form 8-K thereafter. That filing was the focal point for the Rule 2(e) proceeding.

Carter Johnson dealt with a classic disclosure struggle between a company and outside counsel. To stave off insolvency the company had to borrow heavily and at least have a plan to move from a growth to stabilizing business model. When a large workout loan was negotiated, the attorneys prepared draft disclosure letters to shareholders, both before and soon after the loan closed, outlining the full dimensions of the company's financial crisis. The company refused to send the letters and agreed only to a press release and Form 8-K that described the material terms of the loan.

Notwithstanding their efforts to counsel for full disclosure, the administrative law judge found the firm aided and abetted securities violations by preparing a press release and Form 8-K that failed, by omission, to describe the full circumstances the attorneys had privately asked the company to reveal.

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[15] *In re Carter*, 47 S.E.C. 470 (1981) 1981 Westlaw 384414.

The full Commission reversed the ALJ decision but ruled that its views as to an attorneys' ethical obligations should be considered advisory thereafter. The Commission provided three basic guiding principles, each of which are now cornerstones of lawyer guidelines promulgated under Section 307 of Sarbanes-Oxley.

(1) Duty to Maintain Client Relationship.

The Commission observed that it would not serve the objectives of the securities laws to resign over every disputed disclosure item.[16] Essentially, the Commission advised lawyers to stick with the client as long as there appeared to be a reasonable chance the issuer would be swayed by the power of persuasion.

(2) Duty to Be Proactive

The Commission stressed a point that was, at the time, relegated to ABA Ethical Canon 5-18 and the subject of little commentary before ABA Model Rule 1.13 was adopted in 1983. In particular, ABA Canon 5-18 provided:

> A lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, employee, or other person connected with the entity. In advising the entity, a lawyer should keep paramount its interests and his professional judgment should not be influenced by the personal desires of any person or organization.

Thus, the Commission strongly inferred that, when faced with an obstructionist executive officer, such as the president of the client in *Carter Johnson*, the lawyer owes the entity an obligation to seek out an honest and disinterested officer or director:

[16] *Id.* at 1981 Westlaw 384414 at 30.

> A direct approach to the board of directors or one or more individual directors or officers may be appropriate; or he may choose to enlist the aid of other members of the firm's management.[17]

(3) Duty to Withdraw

If all else failed, the attorney was required to withdraw:

> [T]here may occur situations where the lawyer must conclude that the misconduct is so extreme or irretrievable, or the involvement of his client's management and board of directors in the misconduct is so thorough and pervasive that any action short of resignation would be futile.[18]

But the additional possible step, of affirmatively rectifying any third party fraud, was never resolved in *Carter Johnson* because it, in practical fact it would involve a disciplinary violation.[19] Thus, ABA Disciplinary Rule 7-102(B) required an attorney to demand that a client reconcile any fraud the client might perpetrate on a tribunal or third person. However, the attorney was not entitled to disclose the fraud if it was revealed within the confidence of the attorney-client relationship.

[17] *Id.* at 31.
[18] *Id.* at 31.
[19] *Id.* at 31, N. 78 (External reporting requirements not involved.)

III. History of SEC Enforcement

The teachings of *Carter* Johnson fell on hostile ears. When the SEC proposed to promulgate more formal rulemaking, setting forth guidelines, the American Bar Association protested and no such rules were adopted.[20] The SEC never formally abandoned prosecution of Rule 2(e) proceedings. Proceedings against lawyers were rare after the 1970s. All of the major Rule 2(e) prosecutions were against auditors or in some cases stockbrokers.[21]

In fact, the SEC was candid that it had applied disparate standards to attorneys and accountants in *Checkosky v. SEC*,[22] on the ground that a lawyer's duty ran only to the client, whereas an auditor owed a duty to the investing public at large. As a practical matter, discipline usually took the form of a consent decree against the lawyer after a successful enforcement proceeding for aiding and abetting securities violations.[23]

Moreover, disbarment is not effective to deter attorneys who aid in the sale of unregistered securities. For that reason, injunctions against future violations have often been sought in lieu of Rule 2(e) proceedings.[24]

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[20] ABA Board of Governors Resolution Adopting Recommendations of Section on Corporation, Banking and Business Law (11/20/81).
[21] *E.g., Potts v. S.E.C.*, 151 F.3d 810 (8th Cir. 1998); *Sheldon v. S.E.C.,* 45 F.3d 1515 (11th Cir. J1995); *Touche Ross & Co. v. S.E.C.,* 609 F.2d 520 (2d Cir. 1979).
[22] 123 F.3d 452, 486 (D.C. Cir. 1994).
[23] *E.g., S.E.C. v. Bilzarian*, 43 SEC 1950, Release No. 12,144 (1989) Westlaw 991871; Attorney David Tallant Enjoined, SEC NEWS Digest 92-88, 1992 Westlaw 90355(SEC).
[24] *S.E.C. v. Universal Major Industries Corp*., 1975 U.S. Dist. LEXIS 11471 (SDNY 1975).

IV. Rules Affecting Attorney Disclosure Obligations Under Sarbanes-Oxley

As noted, the two provisions of the Sarbanes-Oxley Act that directly impact attorneys and other professionals are Sections 602[25] and Section 307.[26]

Section 602(a) essentially restates the text of Rule 2(e) to clarify that, to the extent the rule was previously merely derivative of the SEC's general enforcement authority, it now has the force of law. The statute subsequently withstood an attack by accountants asserting that it was unconstitutionally vague as to the meaning of "improper professional conduct," a potential flaw acknowledged in a later appeal of *Checkovsky*.[27] The court held that the meaning had been made sufficiently clear in the definitions portion of Section 602. The definition provides alternative standards of recklessness or negligence in the form one highly unreasonable departure from professional standards or multiple instances of unreasonable conduct.[28] But the definition only applies to accounting firms. This leaves open the question of whether a lawyer or other professional could urge that the statute fails to provide fair notice of the grounds for suspension.

The more controversial whistleblower provisions are set forth in Section 307. The statute directs the SEC to issue "minimum standards of professional conduct" not merely for attorneys appearing before the Commission but "in the representation of issuers."[29] Section 307 mandates that the rules include provisions

> (1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to

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[25] 15 U.S.C. § 78d-3.
[26] 15 U.S.C. § 7245.
[27] *Marrie v. S.E.C.*, 374 F. 3d 1196 (D.C. Cir. 2004); *See, Checkovsky v. S.E.C.*, 135 F.3d 221, 223 (D.C. Cir. 1998).
[28] *Id.* at 1203-04. The court held that it was unreasonable to apply Section 602 retroactively to an engagement that dated to 1994.
[29] 15 U.S.C. § 7245.

> the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and
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> (2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

The final rules became effective in August 2003, after several modifications.[30] The most significant provisions are as follows:

A. Organization as Client

The first substantive provision is drawn directly from ABA Model Rule 1.13:

> <u>Representing an issuer</u>. An attorney appearing and practicing before the Commission in the representation of an issuer owes his or her professional and ethical duties to the issuer as an organization. That the attorney may work with and advise the issuer's officers, directors, or employees in the course of representing the issuer does not make such individuals the attorney's clients.[31]

The clear message of this provision is that, as in *Carter Johnson*, where management is not part of the solution, it is part of the problem.

[30] 17 C.F.R. § 205.1 et seq.
[31] *Id.* at § 205.3(a).

B. Reporting Obligation

Next the rules expound upon the reporting obligations set forth in Section 307. As in the case of the statute, an attorney appearing before the Commission or otherwise representing an issuer must report a material violation or breach of fiduciary duty to a higher authority. The statute is supplemented by the following two definitions:

> Breach of fiduciary duty refers to any breach of fiduciary or similar duty to the issuer recognized under an applicable federal or state statute or at common law, including but not limited to misfeasance, nonfeasance, abdication of duty, abuse of trust, and approval of unlawful transactions.
>
> Material violation means a material violation of an applicable United States federal or state securities law, a material breach of fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law.

Both definitions are problematic. Some securities violations, such as basic registration violations and failures to disclose major transactions out of the course of business are easy to identify. But the touchstone of all securities disclosure obligations, materiality, can be a very elusive and debatable concept. Registration statements must be routinely updated under regulation S-K to reflect "material" changes on unlimited subjects covered in said SEC filings.[32] Not only is materiality a highly judgmental subject but at least a half dozen definitions have been formulated by the Courts and the SEC over the years.[33]

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[32] 17 C.F.R. § 229.10 et seq.

[33] From the early efforts to define the term "material," *In re Howard*, 1 S.E.C. 6, 8 (1934) ("[W]ould have deterred or tended to deter the average prudent investor . . . ,"), and *Kardon v. National Gypsum Co.*, 73 F. Supp. 798, 800 (E.D. Pa. 1947), *modified on other grounds*, 83 F. Supp. 613 ("would materially affect the judgment of the other party to the transaction"), to the Supreme Court's current rendition in *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. at 449 (1976), there have been a number of popular formulations. *See, e.g., Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-154 (1972) ("[A] reasonable investor might have considered them important . . . ."); *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir. 1965), *cert, denied sub nom., List v. Lerner*, 382 U.S. 811 (1965) ("a reasonable man would attach importance . . "); *Kohler v. Kohler & Co.*, 319 F.2d 634, 672 (7th Cir. 1963) (facts "which in reasonable and objective contemplation

The Commission's current definition is implicitly both subjective and speculative:

> Material. The term material, when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered.[34]

The danger of course is that an attorney, conflicted by his own desire to avoid compliance problems, will see potential violations where an otherwise objective lawyer would not.

Breach of fiduciary duty has similar ambiguity problems. Clear cases, such as the potential self-dealing involved in a Regulation O violation are easy to identify.[35] But breach of fiduciary duty also encompasses the doctrine of constructive fraud, that is, the failure of a fiduciary to disclose information material to the interests of a beneficiary of his trust.[36] Thus, the subject of materiality arises again.

The question then becomes whether the qualifiers "material" violation or "evidence of material violation" establish a sufficiently bright line. In adopting the definition of "Evidence of a material violation" the SEC believed it achieved such an objective standard.[37]

> *Evidence of a material violation* means credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to

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might affect the value of the corporation's stock or securities.") In *SEC v. Texas Gulf Sulphur Co.*,401 F.2d 833, 848-849 (2d Cir. 1968), *cert. denied sub nom.*, *Coates v. SEC*, 394 U.S. 976 (1969), the court advocated five different tests.

[34] 17 C.F.R. 230.405.

[35] *E.g., Hutensky v. FDIC*, 82 F.3d 1234 (2d Cir. 1996); *FDIC v. Mijalis*, 15 F.3d 1314 (5th Cir. 1994); *FDIC v. Schreiner*, 892 F. Supp. 869 (W.D. Tex 1995).

[36] *Kruse v. Bank of America*, 202 Cal. App.3d 38 (1988).

[37] *See,* 68 FR 6296 (2/6/03) Executive Summary, (8/5/03) p. 12-13 N. 41-50.

> conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur.[38]

The Commission believed the definition sets forth an objective standard but did not concede that the phrase "reasonably likely" was satisfied by a preponderance of the evidence standard:

> To be "reasonably likely" a material violation must be more than a mere possibility, but it need not be "more likely than not." If a material violation is reasonably likely, an attorney must report evidence of this violation. The term "reasonably likely" qualifies each of the three instances when a report must be made.[39]

It remains to be seen whether a reporting standard that is triggered at unknown points of probability between zero and fifty percent will pass constitutional muster as applied.

C. Reporting Chain of Command

The actual reporting protocol is complex on the surface. There is a lot of detail on the extent of individual attorney's reporting obligations on various rungs of the ladder from subordinates upward.[40] Complicating matters further, there are two alternative ways to satisfy the structural requirements of the law. The Rules can either be satisfied through normal reporting channels, beginning with management and ending with the board of directors or an audit committee.[41] Alternatively, the company can streamline the process by establishing a qualified legal compliance committee to which an attorney can report directly.[42]

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[38] 17 C.F.R. 205.2(e).
[39] Executive Summary p. 13.
[40] 17 C.F.R. § 205.3 - 205.5.
[41] 17 C.F.R. § 205.3(6).
[42] 17 C.F.R. § 205.3(c).

Notwithstanding these complexities, the basic theme is simple. As in *Carter Johnson* and under Model Rule 1.13, when no corrective action is taken, the attorney must take the problem to the next level and failing an appropriate response, must resign.[43] One superficially thoughtful provision is that which appears to allow the initial reporting attorney to escape liability if independent counsel is retained to review the violation.[44] But unfortunately provisions indicating such an engagement is an "appropriate response" are framed in terms of the reporting attorney receiving satisfactory information that there is a "colorable defense". The provision virtually cries out for the reporting attorney to conduct a redundant engagement to evaluate the investigating attorney's work for his own protection. Given the general tendency of attorneys to disagree, coupled with the fact that the investigating attorney that concludes a defense is available, by definition, will be disagreeing with the initial whistleblower's assessment, the lack of finality in referring the matter to a second lawyer is problematic. The rule fosters the predictable negative consequences of having too many cooks in the kitchen and the inevitable institutional log jam that can result when two attorneys are expected to agree on a close legal issue.

D. Permissive Disclosure

The most controversial provision, however, deals with reporting to the Commission. The Rule closely tracks the most recent amendments to the ABA Model Rules of Professional Conduct. Traditionally, a lawyer was required to maintain confidences except as necessary to prevent a crime.[45] But some states, such as California, drew the line around protecting confidences even more broadly. In California, a confidence may be divulged only to prevent a violent crime likely to cause death or serious bodily injury.[46] However, in the same period during which states like California were vigorously holding the line on protecting confidences, the ABA House of Delegates took a decidedly different approach.

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[43] 17 C.R.R. § 205.3.
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[45] ABA Model Code DR4-101.
[46] Cal. Bus. and Prof. Code § 6068(e).

The ABA established a Task Force on Corporate Responsibility in 2002 to examine the role of the bar in debacles like Enron. The Task Force believed that, if the entity as Client principle was properly applied, there was no good reason to allow the attorney client-privilege that to shield a company converted into an engine for third party fraud.[47] A company converted that practiced third-party fraud by insiders was, like Enron, usually the ultimate victim of its misdeeds.[48] Thus, Model Rule 1.6 was amended to allow permissive disclosure of a client's intended fraud on a third party as follows.

> (b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:
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> (2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;
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> (3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services.

[47] *ABA Task Force on Corporate Responsibility and the 2003 Changes to the Model Rules of Professional Conduct.* Georgetown J. of Legal Ethics (Fall 2003).
[48] *Report of the American Bar Association Task Force on Corporate Responsibility* (March 31, 2003) See, Task Force Report, pp. 19-25.

At the time Rule 205.3(d) was adopted the SEC pointed directly to Rule 1.6 which the Commission noted had been adopted in most states. Section 205.3(d)(2) provides:

> (2) An attorney appearing and practicing before the Commission in the representation of an issuer may reveal to the Commission, without the issuer's consent, confidential information related to the representation to the extent the attorney reasonably believes necessary:
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> (i) To prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;
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> (ii) To prevent the issuer, in a Commission investigation or administrative proceeding from committing perjury, . . . or committing any act proscribed in 18 U.S.C. 1001 that is likely to perpetrate a fraud upon the Commission, or
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> (iii) To rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used.

The Rules have a safe harbor provision set forth in Rule 205.6(c) that purports to immunize an attorney from discipline under state law for making such disclosures in good faith. Since the rule is only permissive, a California attorney, for example, is not presented with a Hobson's choice of blowing the whistle to check client fraud. But an interesting battle on federal preemption could ensue if a California attorney ever determined to avail himself of the safe harbor.

V. Federal Disciplinary Oversight of Bank Counsel

Section 916 of FIRREA[49] required each appropriate federal banking, thrift and credit union agency to promulgate uniform rules of practice and procedure. However, the rules ultimately promulgated were not limited to rules of practice for formal adjudicatory proceedings. FIRREA itself gave the agencies new and expanded enforcement powers, not merely to sanction bank officers but institution affiliated parties, including those who participate in the affairs of the institution.[50] Moreover, former insiders and bank representatives could be prosecuted for up to six years.[51]

Thus, when the OTS promulgated the first rules of practice under Section 916 they were not limited to rules governing formal hearings.[52] Disciplinary rules applicable to attorneys and others were established at three separate levels:

- Formal hearings;[53]
- Investigative proceedings;[54]
- Practice before the agency.[55]

The final regulations clearly manifest a response to the obstructionism and bad faith tactics described by Judge Stanley Sporkin in *Lincoln Savings and Loan v. Wall.*[56] Each separate set of rules contains provisions barring an attorney who engages in "dilatory, obstructionist, egregious, contemptuous or contumacious

[49] 103 Stat. 183 (1989).
[50] 12 U.S.C. § 1813(u).
[51] 12 U.S.C. § 1818(i)(3).
[52] 54 FR 49411 (11/30/89).
[53] 12 C.F.R. 509.1 et seq.
[54] *Id.* at 512.1 et seq.
[55] *Id.* at 513.1 et seq.
[56] 743 F. Supp. 901 (D. D.C. 1990).

conduct" from further participation in the proceedings.[57] By 1991, each of the remaining agencies had developed substantially similar attorney disciplinary rules.[58]

As precursors to Sarbanes-Oxley, the rules have many parallels. First, as in the case of rules promulgated under Sarbanes-Oxley, emphasizing the need to differentiate between the institutional client and management, each agency prohibits the representation of conflicting interests. OCC Rule 19.8 and FDIC Rule 308.8 have the most detailed provisions on conflicts and waivers.

> (a) *Conflict of interest in representation.* No person shall appear as counsel for another person in an adjudicatory proceeding if it reasonably appears that such representation may be materially limited by that counsel's responsibilities to a third person or by the counsel's own interests.[59]

Moreover, in all cases of multiple representation, whether conflicts exist or not, counsel must certify in writing to the administrative law judge that potential conflicts were disclosed and that each client determined that no actual conflict existed.[60]

In other areas the agency rules track the grounds for suspension or debarment set forth in Section 602 of Sarbanes-Oxley, except that discretionary discipline for aiding and abetting is typically tied to banking law violations.[61]

Moreover, each of the agencies has enacted broader and more detailed discipline provisions than those found in Section 602. Thus, the FDIC includes "contemptuous conduct before the FDIC" as grounds for suspension on disbarment.[62] The OTS

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[57] 12 C.F.R. § 509.5(c), 12 C.F.R. 512.5(b)(3), 512.6; *See*, 12 C.F.R. 513.4(a)(14).
[58] 56 F.R. 37968 (8/9/91) (FDIC); 56 F.R. 30824 (8/9/91) (OCC); 56 F.R. 38048 (8/9/91) (FRB) 56 F.R. 37762 (8/9/91) (NCUA).
[59] 12 C.F.R. § 19.8; 12 C.F.R. § 308.8.
[60] *Id.* at 19.8(b) (1)-(3), *See also*, UCUA Rule 747.8(b); FDIC Rule 308.8(b).
[61] *See, e.g.*, 12 C.F.R. § 513.4 (OTS); 12 C.F.R. § 308.109 (FDIC).
[62] 12 C.F.R. § 308.109(a)(iv).

includes "any dilatory, obstructionist, egregious, contemptuous, contumacious or other unethical or improper professional conduct before the office".[63]

The OCC, however, has the most expansive and detailed disciplinary rules. There are three basic grounds for censure, suspension or debarment. The two basic grounds – incompetence and disreputable conduct are similar in many respects to Section 602 and the rules of the other agencies. But misleading an actual or prospective client is expressly included as grounds.[64] In addition, disreputable conduct includes not only aiding banking law violations but securities law violations as well. A very detailed definition of incompetence is set forth which includes inadequate preparation or neglect of the file.[65] The most detailed description of obstructionist conduct is also set forth in the OCC Rules. Disreputable conduct includes:

> (b) Knowingly giving false or misleading information, or participating in any way in the giving of false information to the OCC or any officer or employee thereof, or to any tribunal authorized to pass upon matters administered by the OCC in connection with any matter pending or likely to be pending before it. The term "information" includes facts or other statements contained in testimony, financial statements, applications for enrollment, affidavits, declarations, or any other document or written or oral statement.
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> (c) Directly or indirectly attempting to influence, or offering or agreeing to attempt to influence, the official action of any officer or employee of the OCC by the use of threats, false accusations, duress or coercion, by the offer of any special inducement or promise of advantage or by the bestowing of any gift, favor, or thing of value.[66]

The scope of disbarment or suspension is similar to that set forth in SEC Rule 205.2(a). As in the case of the SEC rules, suspension from "practice" is by no means limited to appearing at a formal hearing nor limited to interface with agency officials

[63] 12 C.F.R. § 513.4(3).
[64] 12 C.F.R. § 19.193.
[65] 17 C.F.R. § 19.195.
[66] 17 C.F.R. § 19.196.

in the course of an examination or investigation.[67] Thus, OCC Rule 19.191 defines practice as virtually any form of representation that will ultimately touch and concern the institution's dealings with the agency:

> (a) *Practice before the OCC* includes any matters connected with presentations to the OCC or any of its officers or employees relating to a client's rights, privileges or liabilities under laws or regulations administered by the OCC. Such matters include, but are not limited to, representation of a client in an adjudicatory proceeding under this part; the preparation of any statement, opinion or other paper or document by any attorney, accountant, or other licensed professional which is filed with, or submitted to, the OCC, on behalf of another person in, or in connection with, any application, notification, report or document; the representation of a person at conferences, hearing and meetings; and the transaction of other business before the OCC on behalf of another person. The term "practice before the OCC" does not include work prepared for a bank solely at its request for use in the ordinary course of its business.[68]

Perhaps an attorney retained solely to handle customer or other third party disputes could continue representing banks in the face of such discipline. But it would be difficult to envision how a firm could maintain any corporate or transactional relationship with any financial institution after suspension. Thus, the O.C.C. rules also make suspension or disbarment by any other federal agency grounds for discretionary suspension or disbarment.[69]

But the reporting requirements promulgated under Section 307 of Sarbane-Oxley only formally apply to attorneys that represent public bank holding companies and their subsidiaries.[70] Nevertheless, professionals representing non-public entities will increasingly find themselves subject to the same regimen.

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[67] 17 C.F.R. 205.2(a), 205.6.
[68] 12 C.F.R. 19.191; *See also*, OTS Rule 513.2(e).
[69] 12 C.F.R. 19.196(g).
[70] 17 C.F.R. § 205.2(h) (Issuer includes subsidiaries).

Thus, in a joint policy statement issued in March 2003, the OTS, OCC and FRB noted that many of the audit provisions of Sarbanes-Oxley were largely redundant of those required under the Federal Deposit Insurance Act for institutions with assets of $500 million or more.[71] The Joint Statement and an earlier policy statement by the FDIC also stressed that the agencies had historically encouraged voluntary adoption corporate codes of ethics before 2002.[72] The FDIC noted codes analogous to those required of public companies under Section 406 of Sarbanes-Oxley were encouraged in its guidelines on preventing bribery and self-dealing.[73] Such policies become popular after a Delaware court ruled that their adoption could be used as a defense to fiduciary duty claims.[74] The 1991 Sentencing Guidelines also provide that sound corporate governance guidelines may be considered in sentencing computations.[75] The recent *McNulty Memorandum* reiterated that ethics programs would be considered favorably by the Justice Department, but only if they worked.[76] The ABA Task Force on Corporate Responsibility March 2003 Report[77] and the rules adopted by the SEC under Section 406 expressly encourage the establishment of a reporting protocol for violations of law as part of any code of ethics. In this climate, attorneys representing non-public financial institutions may find that up-the-ladder reporting is an institutional requirement of the engagement.

[71] *Joint Statement on Application of Recent Corporate Governance Initiatives to Non-Public Banking Organizations* (May 6, 2003).
[72] *Id.; FDIC Letter to Chief Executive Officer, Re Corporate Governance, Audits and Reporting Requirements*, FIL-17-2003 (March 5, 2003).
[73] FDIC Statements of Policy (12/31/87) *Guidelines for Compliance with the Federal Bank Bribery Law.*
[74] *In re Caremark*, 698 A.2d 959 (Del. Ch. 1996).
[75] U.S. Sentencing Commission Guidelines § 8B2.1.
[76] McNulty, *Memorandum Re Principles of Federal Prosecution of Business Organizations*, (Dept. of Justice 12/12/06).
[77] Report 3/31/2003 p. 65, Item 9.

VI. Enforcement History

Like the SEC, the agencies rarely prosecute disbarment and suspension claims against attorneys for mere malpractice.[78] Most litigated cases have involved breach of fiduciary duty claims against attorneys who faced not merely discipline but outright banking bans and other relief under FIRREA.[79] The infamous Kaye, Scholer account freeze proceeding under Rule 513.4 and a related proceeding against Kirkpatrick and Lockhart are notable exceptions.[80]

But in the case of the federal banking agencies, the failure to prosecute disciplinary claims has been a case of guilt with a reasonable explanation. In particular, the agencies had a path of much lesser resistance in the form of prosecuting simple malpractice cases.[81] Moreover, prosecuting those professional liability claims, which arose out of receiverships, required a major commitment of agency resources notwithstanding recoveries were substantial as well. In 1998 the FDIC published a recap of the bank and thrift failure crisis which contained extensive discussion of the Professional Liability Program.[82] Between 1990 and 1998 the RTC and FDIC had prosecuted close to one thousand professional liability claims and obtained recoveries of $2.5 billion.[83] It had also developed a huge bureaucracy with field offices around the country to manage the claims. *Id.* Failures plummeted to a low of four in 2001 and the bureaucracy was dismantled.[84] Whether the resources will be reapplied to front end enforcement, as has been witnessed by the SEC in

[78] *But see, OTS Seeks Prohibition, Restitution and Disbarment of Ohio Attorney*, OTS 96-12 (2/23/96; *Consent to Prohibition*, OTS-96-21 (3/25/96).
[79] *E.g., Lindquist & Vennum v. FDIC*, 103 F.3d 1409 (8th Cir. 1997) (unsuccessful cease and desist claim agains lawyers); *United States v.* Stoller, 78 F.3d 710 (1stCir. 1996) (FDIC debarment order followed banking ban); In *the Matter of Landry*, Docket No. FDIC-95-65e (1999).
[80] *In the Matter of Kaye, Scholer, Fierman, Hayes & Hanler*, AP No 92-19 (OTS 3/1/92); *In re Kirkpatrick & Lockhart*, AP No. 92-106 (OTS 10/5/92).
[81] *F.D.I.C. v. Malmo*, 939 F.2d 535 (8th Cir. 1991); *FDIC v. Mmahat*, 907 F.2d 546 (5th Cir. 1990); *FDIC v. Wise*, 758 F. Supp. 1414 (D.Col. 1991).
[82] *Managing the Crisis, The FDIC and RTC Experience*, (1998) Chap 11, Professional Liability Claims.
[83] *Id.* at p. 270-71, 287.
[84] FDIC 2002 Annual Report.

recent years,[85] remains to be seen. In practical fact, malpractice is much easier to detect after the fact, when the keys to the bank are in the hands of the receiver.

[85] *E.g.*, *Matter of Isselman*, SEC Lit. Release No. 18896 (9/24/04); *Matter of Silverstein*, Exchange Act Release No. 49676 (5/11/04); *Matter of Woghin*, Exchange Act Release No. 50653 (11/10/04).