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Kaye Scholer - Overzealous or Overblown?

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Kaye Scholer. The two words began as a metonymy for a prominent and respected law firm[1] and have become a metaphor—a symbol for overzealous advocacy by lawyers who knowingly assist their clients in defrauding the public and obstructing justice.

Illustrative is a recent conference of the Association of American Law Schools, where law professors who teach professional responsibility focused on the *Kaye Scholer* case. The unquestioned premise of the law professors' discussion was that the Kaye Scholer lawyers were guilty of seriously unethical conduct. The burden of the session, therefore, was what law professors can do to guide their students away from the overzealousness and outright fraud represented by Kaye Scholer.[2]

And why should one not assume the worst about Kaye Scholer? After all, the firm caved in without a struggle, paying the government $41,000,000 to settle the case.[3]

The subtitle of this paper is "Overzealous or Overblown." And, in my even-handed way, I will argue that the case represents both of these faults. On the one hand, the government lawyers advanced overblown charges. But, on the other hand, the government lawyers were overzealous in the way they pursued those charges and abused the powers of their office.

To begin with, the Office of Thrift Supervision ("OTS") regulators did not say—as well they might—"*We* failed at *our* job." And they had indeed failed. As one commentator observed last year:

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* Howard Lichtenstein Distinguished Professor of Legal Ethics, Hofstra University. A.B., 1951, LL.B., 1954, LL.M., 1956, Harvard University. Author, UNDERSTANDING LAWYERS' ETHICS (Matthew Bender, 1990).

1. The full name of the firm is Kaye, Scholer, Fierman, Hays & Handler. The full name of the case is *United States of America before the Office of Thrift Supervision, Department of the Treasury In the Matter of Peter M. Fishbein, Karen E. Katzman, and Lynn Toby Fisher, Kaye, Scholer, Fierman, Hays & Handler, Former Outside Counsel of Lincoln Savings and Loan Association, Irvine, California, Respondents*, OTS AP-92-19 (Mar. 1, 1992).

2. Some of the professors seemed to be no less concerned with the evils of *zealous* advocacy, but that is a subject for another time.

3. Amy Stevens & Paulette Thomas, *Legal Crisis: How a Big Law Firm Was Brought to Knees by Zealous Regulators—At Kaye Scholer, Survival Prevailed Over Principle as Partnership Panicked—Redefining a Lawyer's Duty*, WALL ST. J., Mar. 13, 1992, at A1 [hereinafter Stevens & Thomas].

> To this day, the Office of Thrift Supervision is being run by the same people and on the same philosophy that fostered the destruction of the most efficient mortgage-producing system in the world.
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> . . . Chairman [M. Danny] Wall promised to stop the undue deference given the League of Savings Institutions. But, in fact, he allowed its lobbyists unprecedented access to him and placed a former league employee (who later returned there) in the key position of director of economic policy.[4]

Instead of confronting their own failures as guardians of the public interest, the regulators chose to ask the lawyers of Kaye Scholer, "Where were *you*?" This question has been given currency by Federal District Judge Stanley Sporkin's opinion in *Lincoln Savings and Loan Association v. Wall*.[5] Judge Sporkin asked (as it is frequently paraphrased): "Where were the lawyers?"[6] His point was not that the lawyers had been in complicity with their client's wrongdoing. Rather, Judge Sporkin complained that the private lawyers who represented the bankrupt thrift association had failed to do the government's job of investigating and exposing their client.[7]

Let us be clear on that. As Judge Sporkin himself said in the same opinion: "[T]here is nothing in the record that would in any way suggest counsel was acting in concert with [the client's] illicit activities."[8] The problem, as Judge Sporkin saw it, was that the lawyers had not exercised "due diligence" to assure that they had not been retained to "frustrate the public interest."[9] And, having ferreted out client conduct that is contrary to the public interest, the private lawyers would then be required to "cooperate with the public oversight regulators" in the prosecution of their own clients.[10]

This is not a new position for Stanley Sporkin.[11] Indeed, I have heard him boast, with justification, that the burgeoning attacks on members of the bar by government regulators originated with his own tenure in the Enforce-

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4. *See* Benjamin F. Dixon IV, *Who's Really to Blame for the Thrift Crisis?*, LEGAL TIMES, Mar. 22, 1993, at 29, 31.

5. 743 F. Supp. 901 (D.D.C. 1990).

6. *Id.* at 919–20. The actual language was: "Where were these professionals . . . ?" "Why didn't any of them speak up . . . ?" "Where also were the outside . . . attorneys when these transactions were effectuated?" *Id.* at 920.

7. *Id.*

8. *Id.* at 921.

9. *Id.*

10. *Id.* at 920 & n.3.

11. But it is a selective position. When Judge Sporkin was General Counsel of the Central Intelligence Agency, and could have blown the whistle on the Iran-Contra scandal, he facilitated the cover-up and remained silent. Also, when Judge Sporkin's court was the subject of whistleblowing, he took vigorous measures against it. *See* Monroe Freedman, *So Where Was Judge Stanley Sporkin?*, LEGAL TIMES, Jan. 4, 1993, at 23, 27.

ment Division of the Securities and Exchange Commission ("SEC" or "Commission"), where he was Director from 1973 to 1981. At that time, the SEC found itself with a small staff, limited resources, and a heavy burden of securities enforcement. Accordingly, the Commission took the position that "the task of enforcing the securities laws rests in overwhelming measure on the bar's shoulders."[12]

For anyone who believes in the importance of limited government and an independent private bar, that is a radical and shocking proposition.[13] If the SEC, the OTS, or any other regulatory agency, lacks the resources to do its job adequately, the proper way to deal with the problem is to persuade the Congress to provide adequate funds. Instead, the SEC chose to dragoon the private bar into government service (and without benefit of civil service status).

As described by an SEC chairman, private lawyers were pressured to do the government's job by means of "overly crude" weapons.[14] That is, lawyers were intimidated by "suitable incentives"—a system of "rewards" and "punishments."[15] The punishments included threats to prosecute, disbar, or suspend lawyers who were zealous in representing their clients.[16]

As a result of these tactics, one commissioner publicly questioned whether the lawyer was becoming just "another cop on the beat."[17] And he added that "all the old verities and truisms about attorneys and their roles are in question and in jeopardy . . . ."[18]

That is, the traditional role—the constitutional role—of the lawyer is to stand between the client and the government. But to the regulatory agencies, this has become not a noble tradition, but a ground for harsh criticism and heavy sanctions. Thus, part of the government's Notice of Charges against Kaye Scholer is that the firm "interposed" itself between its client, Lincoln Savings and Loan, and the regulatory agency.[19]

As explained by Brendan Sullivan, representing Oliver North before a Senate committee, that is the lawyer's job. "I'm not a potted plant," Sulli-

12. *In re* Emanuel Fields, Securities Act Release No. 33-5404, 2 S.E.C. Docket 1, 1973 WL 18519, at *7 n.20 (June 18, 1973).

13. *See* Monroe H. Freedman, *A Civil Libertarian Looks at Securities Regulation*, 35 OHIO ST. L.J. 280 (1974). Judge Sporkin and I debated these issues in Monroe H. Freedman & Stanley Sporkin, *The Securities and Exchange Commission's Enforcement Program: A Debate on the Enforcement Process*, 38 WASH. & LEE L. REV. 781 (1981).

14. Ray Garrett, Jr., New Directions in Professional Responsibility, Address Before the American Bar Association, Washington, D.C. (Oct. 11, 1973) *in* BUS. LAW., Mar. 1974, at 7.

15. *Id.* at 12–13.

16. *Id.* at 11.

17. A.A. Sommer, Jr., The Emerging Responsibilities of the Securities Lawyer, [1973–1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,631, at 83,690 (Jan. 23, 1974).

18. *Id.* at 83,689.

19. *In re* Fishbein, OTS AP-92-19, ¶ 45 (Mar. 1, 1992).

van explained when told not to object to questions put to his client. "I'm here as the lawyer. That's my job."[20] The committee, of course, was acting in the highest public interest by trying to get at the truth of the Iran-Contra scandal. And Sullivan was also acting in the highest public interest by zealously representing the interests of his client, interposing himself between his client and the committee.

Justice Lewis Powell made the same point as Brendan Sullivan, less pungently perhaps, but in more measured terms:

> [T]he duty of the lawyer, subject to his role as an "officer of the court," is to further the interests of his clients by all lawful means, even when those interest are in conflict with the interests of the United States or of a State. But this representation involves no conflict of interest in the invidious sense. Rather, it casts the lawyer in his honored and traditional role as an authorized but independent agent acting to vindicate the legal rights of a client, whoever it may be.[21]

Eight years later, writing for a majority of eight, Justice Powell sharpened the point: "[A] defense lawyer best serves the public, not by acting on behalf of the State or in concert with it, but rather by advancing the 'undivided interests of his client.' "[22]

Just so. Kaye Scholer, hired as litigation counsel by a client who had been targeted by the government, did its job—not by acting in concert with the government, but by representing the undivided interests of its client. In a free society, that is one of the most important ways that lawyers serve the public interest.

Kaye Scholer's punishment for doing so was severe. Its assets were frozen for an indefinite period, and the firm was forbidden to transfer its

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20. Sullivan's words have been immortalized in FRED R. SHAPIRO, THE OXFORD DICTIONARY OF AMERICAN LEGAL QUOTATIONS 271 (1993).

21. *In re* Griffiths, 413 U.S. 717, 724 n.14 (1973). Justice Powell further asserts that:

> It has been stated many times that lawyers are 'officers of the court.' One of the most frequently repeated statements to this effect appears in Ex parte Garland, 4 Wall. 333, 378 [18 L. Ed. 366]. The Court pointed out there, however, that an attorney was not an 'officer' within the ordinary meaning of that term. Certainly nothing that was said in *Ex parte Garland* or in any other case decided by this Court places attorneys in the same category as marshals, bailiffs, court clerks or judges. Unlike these officials a lawyer is engaged in a private profession, important though it be to our system of justice. In general he makes his own decisions, follows his own best judgement, collects his own fees and runs his own business. The word 'officer' as it has always been applied to lawyers conveys quite a different meaning from the word "officer" as applied to people serving as officers within the conventional meaning of that term."

Id. at 728–29 (quoting Cammer v. United States, 350 U.S. 399, 405 (1956)); *cf. id.* at 731–32 (Burger, C.J., dissenting) (noting the importance to our legal system for lawyers to remain independent from the government on the one hand and client on the other).

22. Polk County v. Dodson, 454 U.S. 312, 318–19 (1981).

assets without the approval of the OTS.[23] One-fourth of the earnings of all partners were sequestered, as was an even higher proportion of the earnings of two partners. Three partners were forbidden to sell or to encumber their personal property in excess of $5,000. As a result of these heavy sanctions, banks closed down the firm's line of credit, and Kaye Scholer faced dissolution.[24]

These penalties were unprecedentedly harsh—a virtual death sentence for the firm. They were also imposed without notice, without hearing, and without any other due process. In addition, the government sought $275,000,000.[25] To the government's advantage, the case was to be litigated before an administrative law judge, not an Article III federal district judge.

Moreover, these severe sanctions were accompanied by charges of unlawful and unethical conduct[26]—charges that were never adjudicated but which were widely believed. As noted above, even a group of sophisticated law professors, specializing in lawyers' professional responsibilities, assumed without question that the Kaye Scholer lawyers were guilty in fact of the overzealousness, fraud, and obstruction of justice with which they had been charged.

Under these overwhelming pressures, Kaye Scholer quickly agreed to a negotiated settlement with the OTS.[27] But responsible people who looked more closely at the underlying facts came out on the side of Kaye Scholer.

The American Bar Association ("ABA") appointed a select Working Group on Lawyers' Representation of Regulated Clients. This group studied the Kaye Scholer matter and issued a report that was then unanimously approved by the ABA's House of Delegates. The report found that the OTS charges were based on standards of lawyer conduct that appeared to go beyond or to conflict with traditional principles of professional responsibility and the Model Rules of Professional Conduct. And it concluded (as argued here) that the OTS's novel positions on ethical standards were an inappropriate attempt to make lawyers representing regulated companies into agents of the government, contrary to their traditional ethical obligations of loyalty to the client.

In addition, the most serious charges against Kaye Scholer were investigated for a year, sua sponte, by Hal Lieberman, Chief Counsel of the New York State Departmental Disciplinary Committee that oversees the ethics of

23. Stevens & Thomas, *supra* note 3, at A1.
24. Stevens & Thomas, *supra* note 3, at A1.
25. Stevens & Thomas, *supra* note 3, at A1.
26. *In re* Fishbein, OTS AP-92-19, 4th Claim (Mar. 1, 1992).
27. Stevens & Thomas, *supra* note 3, at A1; *see also infra* text accompanying notes 31–32.

lawyers in New York City.[28] Lieberman's investigation included interviews with a large number of current and former Kaye Scholer lawyers, with officials of Arthur Andersen (which had resigned as accountants for the firm at a critical point), with the OTS and SEC officials, and with several Assistant United States Attorneys in Los Angeles. In addition, he reviewed thousands of pages of documents, including the OTS files and internal Kaye Scholer memoranda that had at one time been privileged and confidential.

Lieberman recognized that no lawyer is permitted to counsel a client to, or assist a client in, unlawfully withholding information or otherwise violating federal disclosure requirements.[29] But he found no substantial evidence that this had occurred, and no basis for taking any disciplinary action.[30]

The most impressive evidence of the overzealousness of OTS lawyers, however, was in the outcome of the case. The OTS had charged that Kaye Scholer had been responsible for a loss of $275,000,000, which the OTS sought to recover.[31] Then, with the law firm virtually broken by the asset freeze and at the mercy of the OTS, the agency settled for $41,000,000—a mere 15% of the harm for which it claimed Kaye Scholer had been responsible.[32]

Which leaves the question: If the OTS really had a case against Kaye Scholer for $275,000,000, and had the advantage of litigating the case before an administrative law judge, why did the OTS cave in and settle for a paltry 15% of that amount?

During the South Texas symposium, I posed that question publicly as a challenge to Harris Weinstein, who had been Chief Counsel for the OTS during the attack on Kaye Scholer. Mr. Weinstein chose not to answer it in his remarks at the symposium.

So here is my answer. The OTS caved in because its charges were unjustified and would not have stood up in administrative proceedings or in the judicial review that would have followed. Moreover, the asset freeze, without notice or hearing, was a violation of due process. And the words "Kaye Scholer" should not be a metaphor for overzealous lawyering by the

28. I know Mr. Lieberman to be an intelligent and conscientious disciplinary counsel of integrity.

29. Lieberman's conclusions were in the form of a letter to Kaye Scholer lawyer Peter M. Fishbein. Letter from Hal Lieberman, Chief Counsel of the New York State Departmental Disciplinary Committee, to Peter M. Fishbein (Aug. 9, 1994), *published as Re: Sua Sponte Investigation, Docket No. 0990/92*, NAT'L L.J., Jan. 3, 1994, at 10.

30. *Id.*

31. Stevens & Thomas, *supra* note 3, at A1.

32. Stevens & Thomas, *supra* note 3, at A1.

private bar. Rather, it should stand for the abuse of governmental powers by overzealous public lawyers intent upon shifting onto others the blame for their own agency's regulatory failures.