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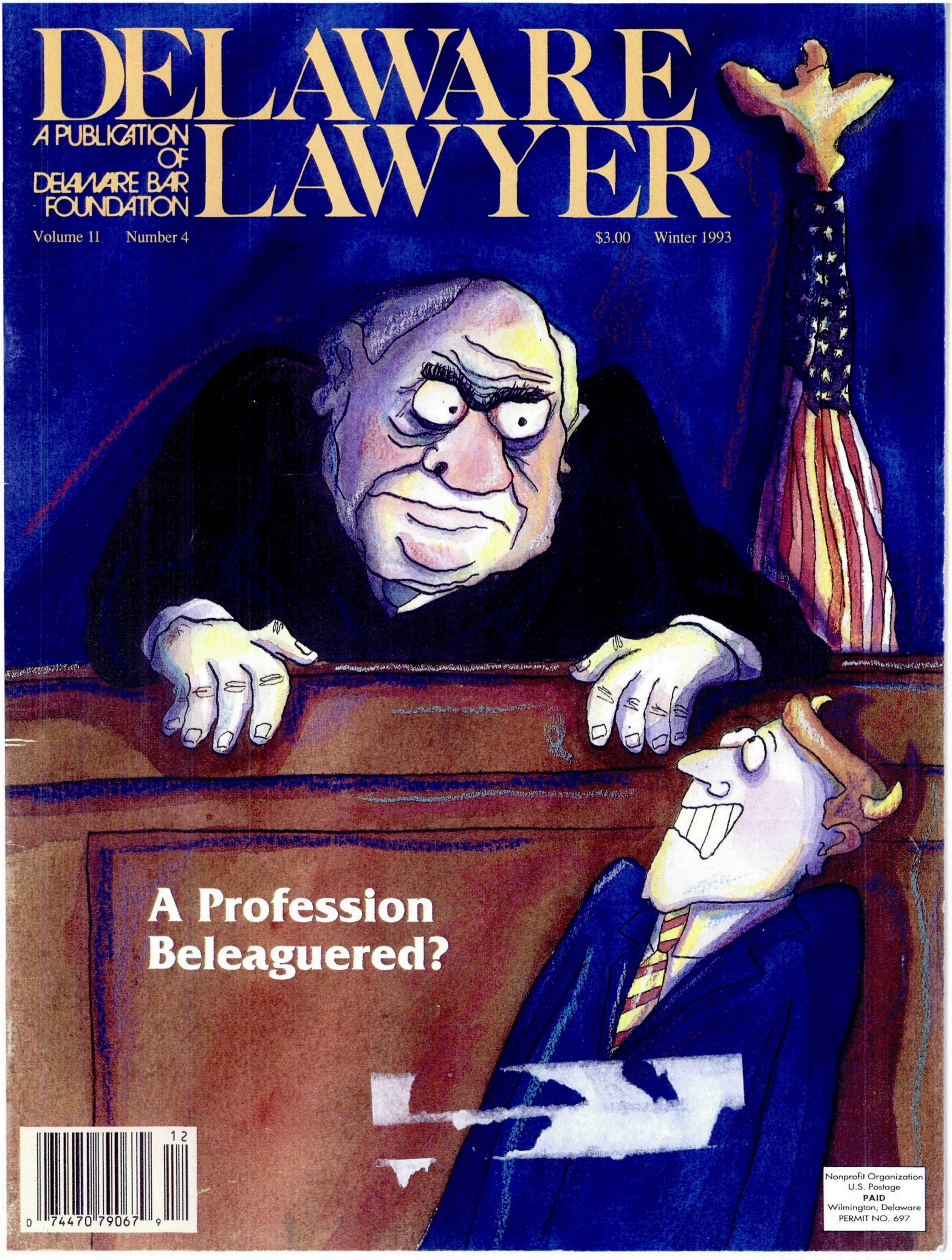

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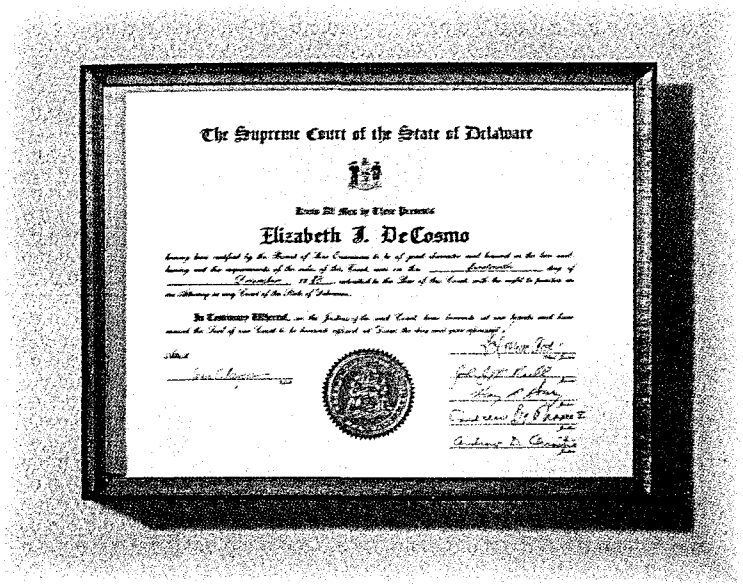

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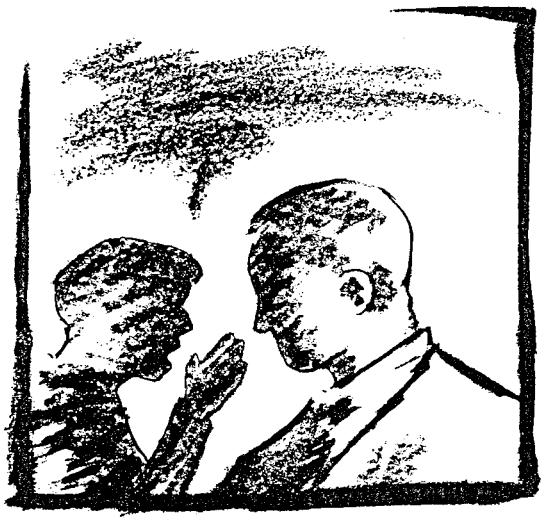

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EDITOR'S PAGE

WHITHER?

By the mid-'eighties it had become apparent that our legal profession was undergoing changes with profound implications for all of us, practitioners and judges alike. Indeed, the editors of this magazine devoted an entire issue to the subject in the Spring of 1986, entitled "Whither the Profession?"

The changes noted then continue to occur, and the concerns about where they will lead us persist. Hence the editors' decision to continue exploring in this issue both new and ongoing challenges to our professionalism in the 1990's.

Our Chief Justice, E. Norman Veasey, defines some bedrock issues of professionalism and suggests how we may preserve the values that give our profession meaning in an increasingly commercialistic environment. Leah Wortham, Associate Dean at the Catholic University School of Law, furnishes a needed discussion of the process by which the values of ethics and professionalism are brought home to students in law school.

The other authors address problems that may be viewed (collectively and lamentably) as particular manifestations of the larger concerns identified by the Chief Justice (e.g. Rule 11 and its noticeably increased appearance in Delaware courts), discuss new types of attorney-client conflicts of interest and cases suggesting an increased (and disturbing) risk that those conflicts may form new bases for attorney civil liability to clients and to non-client third parties. One author addresses a problem that has arisen in an entirely new context — the liability of lawyers and law firms that represent failed financial institutions. Although our profession's experience in that area is still limited, its implications are disturbing.

Although I am the author of this page, the real editor of the issue is Tom Ambro, a distinguished member of our Bar. Out sincere thanks to Tom, who, with Larry Drexler, assembled a panel of distinguished authors whose contributions are as enlightening as they are provocative.

Jack B. Jacobs

NEWS FROM THE FRONT

RULE 11: Another Look

Lawrence S. Drexler

In the Summer of 1987 this publication first examined the contours of Rule 11.[1] The Amendment to the Federal rule was then five years old and the amended Rule 11 in Superior Court was four years old. At that time Delaware lawyers had little or no experience with Rule 11. Unfortunately the same cannot be said today. This article will review the new Federal rule, which is scheduled to undergo a substantial makeover effective December 1, 1993, the comparatively modest changes to the Delaware rules in 1987, and significant case law from the U.S. Supreme Court and the Delaware Courts.

AND NOW TO OUR LEAD STORY

Pursuant to Order of the United States Supreme Court, Federal Rule of Civil Procedure 11 is substantially amended unless Congress provides otherwise before the effective date of Dec 1, 1993. 28 U.S.C. 2074. The revisions, assuming no changes by Congress,[2] respond to many of the criticisms and complaints leveled at Rule 11 over the last decade. The amended rule clarifies the obligations of the signatory to a pleading, creates a safe harbor opportunity to correct violations, creates procedures for sanction, and gives the Court options in selecting an appropriate sanction. The new rule reads as follows:

Signing of Pleadings, Motions, and Other Papers; Representations to Court; Sanctions

(a) Signature. Every pleading, written motion, and other paper shall be signed by at least one attorney of record in the attorney's individual name, or, if the party is not represented by an attorney, shall be signed by the party. Each paper shall state the signer's address and telephone number, if any. Except when otherwise specifically provided by rule or statute, pleadings need not be verified or accompanied by affidavit. An unsigned paper shall be stricken unless omission of the signature is corrected promptly after being called to the attention of the attorney or party.

(b) Representation to Court. By presenting to the court (whether by signing, filing, submitting, or later advocating) a pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,

(1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;

(2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;

(3) the allegations and other factual contentions have evidentiary support or, if specifically so identified , are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and

(4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

(c) Sanctions. If, after notice and a reasonable opportunity to respond, the court determines that subdivision (b) has been violated, the court may, subject to the conditions stated below, impose an appropriate sanction upon the attorneys, law firms, or parties that have violated subdivision (b) or are responsible for the violation.

(1) How Initiated.

(A) By Motion. A motion for sanctions under this rule shall be made separately from other motions or requests and shall describe the specific conduct alleged to violate subdivision (b). It shall be served as provided in Rule 5, but shall not be filed with or presented to the court unless, within 21 days after service of the motion (or such other period as the court may prescribe), the challenged paper, claim, defense, contention, allegation, or denial is not withdrawn or appropriately corrected. If warranted, the court may award to the party prevailing on the motion the reasonable expenses and attorney's fees incurred in presenting or opposing the motion. Absent exceptional circumstances, a law firm shall be held jointly responsible for violations committed by its partners, associates, and employees.

(B) On Court's Initiative. On its own initiative, the court may enter an order describing the specific conduct that appears to violate subdivision (b) and directing an attorney, law firm, or party to show cause why it has not violated subdivision (b) with respect thereto.

(2) Nature of Sanction; Limitations. A sanction imposed for violation of this rule shall be limited to what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated. Subject to the limitations in subparagraphs (A) and (B), the sanction may consist of, or include, directives of a nonmonetary nature, an order to pay a penalty into court, or, if imposed on motion and warranted for effective deterrence, an order directing payment to the movant of some or all of the reasonable attorneys' fees and other expenses incurred as a direct result of the violation.

(A) Monetary sanctions may not be awarded against a represented party for a violation of subdivision (b)(2).

(B) Monetary sanctions may not be awarded on the court's initiative unless the court issues its order to show cause

Illustration by Paulette Bogan

before a voluntary dismissal or settlement of the claims made by or against the party which is, or whose attorneys are, to be sanctioned.

(3) Order. When imposing sanctions, the court shall describe the conduct determined to constitute a violation of this rule and explain the basis for the sanction imposed.

(d) Inapplicability to Discovery. Subdivisions (a) through (c) of this rule do not apply to disclosures and discovery requests, responses, objections, and motions that are subject to the provisions of Rules 26 through 37.

STOP AND THINK

The signature of the attorney or party continues to require litigants to "stop and think" before making legal or factual contentions. The new rule clarifies that the signature is certification of four elements: (1) the absence of an improper purpose (harassment, cause delay or needless increase in costs); (2) legal contentions are warranted by existing law or a non-frivolous change of existing law or the establishment of new law; (3) the evidence supports the factual legal allegation or is likely to do so after further investigation or discovery; and (4) the denial of factual contentions is warranted or reasonably based on lack of knowledge.

Since the rule continues to require a writing, thus, a matter first raised during oral arguments is not subject to sanctions. This distinction is premised on the absence of an opportunity to "stop and reflect" before making assertions during argument. On the other hand, the "later advocating" of a position contained in a filing, which an attorney later learns lacks merit, is subject to the obligation of new 11(b)(2). Thus, even though a writing is consistent with Rule 11 at the time of filing, once an attorney learns that the position lacks merit, the position must not be advocated again. Similarly, in matters removed to the Federal Courts, presentation of papers filed in the State Court to the Federal District Court would constitute "later advocacy" and thereby fall within the rule's ambit.

The certification requirements contained in subsection (b)(3) and (4) recognize that, upon occasion, parties will make representations which they believe likely to be true but which will require discovery in order to confirm the evidentiary assertion. Such representations are not sanctionable; however, if discovery does not support the assertion, sanctions would be appropriate if the party continues to advocate the then unsupportable assertion. Discovery and responses thereto are specifically governed by rules 26 and 37. Accordingly matters arising under discovery rules are expressly exempted from new Rule 11.

The use of the term "evidentiary support" is somewhat troublesome when viewed in the context of summary judgment. While there can be no doubt that sufficient evidence to defeat a motion for summary judgment satisfies the purposes of Rule 11, the language of the rule leaves a substantial question where a summary judgment motion is granted because of a lack of evidentiary support. The commentary to the rule does not address this issue; however, it is reasonable to expect that, because the rule is not intended to be a fee shifting rule, Courts will not generally sanction parties. Further, under the newly established procedures, such a result is not likely.

The requirement of old Rule 11 that a pleading be supported by existing law or a good faith argument for extension, modification, or reversal of existing law has been changed in two respects: (1) extensions, modifications, and reverse of existing law must be nonfrivolous; and (2) nonfrivolous argument for creation of new law is not sanctionable. The commentary defines "nonfrivolous" as support for the legal theory in minority opinions, law review articles or consultation with other attorneys. The comments suggest that a specific identification of an argument requesting a change in law would be viewed with greater tolerance under the rule.

WIDER RANGE OF SANCTIONS

Under the new rule, the Court is vested with considerable discretion in crafting a sanction. Under section (c), the Court is permitted to "impose an appropriate sanction upon the attorneys, law firm or parties that have violated subdivision (b) or are responsible for the violation." The guiding principle in selecting a sanction is deterrence, not compensation.

The Court's options range from striking a pleading to referral to disciplinary authorities. The comments suggest consideration of a number of factors: Was the improper conduct (1) willful; (2) an isolated event; (3) applicable to the entire case or just one aspect of the case; (4) part of a pattern of conduct; (5) repetition of similar conduct in other litigation. In addition, the Court should consider (6) the intent of the conduct; (7) the effect on the litigation in terms of time and money; (8) the legal training of the responsible person; (9) the appropriate sum to deter similar activity by other litigants. In furtherance of the goal of deterrence, monetary sanctions should ordinarily be paid to the Court. The Court may, upon appropriate motion, and where warranted to deter improper conduct, order payment to the opposing counsel of some or all of the reasonable attorney's fees and other expense incurred as a result of the violation. Thus, as a general rule, Rule 11 is not a cost-shifting mechanism; it is rather a procedure by which Courts will control their dockets.

Under old Rule 11, sanctions are permitted only against the signer and are not permitted against the law firm to which the attorney belongs. *Pavelic & LeFlore v. Marvel Entertainment Group*, 110 S.Ct. 956 (1989). Under new Rule 11(c), the Court is directed in all but the most exceptional cases to impose appropriate sanctions upon the attorney and the law firm. On the other hand, Courts are not permitted to levy monetary sanctions upon represented parties for rule violations related to the legal validity of a claim. Thus, attorneys have a nondelegable duty of legal investigation.

SAFE HARBOR

New Rule 11 emphasizes deterrence and self-policing through a safe harbor provision, which permits sanctions only after a party is given an opportunity to take corrective action. Under section (c)(1)(A), a motion seeking Rule 11 damages must be served pursuant to Rule 5; however, it is not filed with the Court until twenty-one days after service. The party against whom sanctions are sought has twenty-one days after service to withdraw or correct the challenged pleading. If such correction or withdrawal is made within the twenty-one days, an action under Rule 11 cannot lie.

Motions under the new Rule 11 must be made separately from any other motion or request and must include a description of the specific conduct for which sanctions are sought. Thus, Rule 11 is effectively removed from ordinary motion practice.

New Rule 11 retains the Court's ability to raise Rule 11 upon its own initiative provided the offending party is given notice and an opportunity to respond. The Court must take such initiative during the pendency of the litigation and is prohibited from pursuing Rule 11 after voluntary dismissal or settlement of the claim. The Court will not interfere with a party who exercises self-restraint

through a voluntary dismissal or settlement. Nothing in the rule prohibits the Court from continuing to pursue an order to show cause where the dismissal or settlement occurs after the issuance of the Court's order.

IN THE LOCAL NEWS

In November, 1987, the Chancery Court version of Rule 11 was amended to mirror the standard in the Superior Court Rule 11, which required the signature of a pleading to implicitly certify after reasonable investigation that the paper was well grounded in fact and warranted by existing law or extension, modification, or reversal of existing law. There is one substantive difference between Chancery Court Rule 11 and Superior Court Rule 11.[3] In the Superior Court, the pleading must be signed by an attorney who is a member of the Bar of the Supreme Court of this State, currently entitled to practice in the Court, who maintains an office in Delaware for the practice of law and whose address shall be stated. In the Chancery Court Rule, the signing need only be by an attorney of record in his individual name whose address shall be stated. Thus, attorneys admitted *pro hac vice*, may sign a pleading or other paper.

The equivalent of Rule 11 in the Delaware Supreme Court rules is Rule 12. Rule 12 requires that, except for parties appearing pro se, all papers filed must be signed by an attorney who is a member of the Delaware Bar maintaining an office in Delaware. Parties appearing *pro se* are required to sign in lieu of an attorney. Under Rule 12, the signature constitutes "a certification by [the signor] that he has read the paper; that to the best of his knowledge, information and belief there is good grounds to support it; and that it is not interposed for delay".

AND NOW FROM WASHINGTON IF THE SUIT FITS...

Rule 11 litigation in the United States Supreme Court is of obvious import to Delaware practitioners. In *Cooter & Gell v. Hartmarx Corp.*, 110 S.Ct. 2447 (1990), the plaintiff's law firm represented a number of discount men's clothing stores which were being sued by a clothing manufacturer. During the pendency of that litigation, the law firm prepared and filed two anti-trust complaints against Hartmarx and its subsidiaries. The defendants moved to dismiss the complaint and sought sanctions under Rule 11. Six months later, the plaintiffs filed a Notice of Voluntary Dismissal. In June, 1984, before the dismissal became effective, the District Court heard argument on the Rule 11 motion and sanctioned the lawyers for failure to properly investigate the factual basis for the lawsuit.

The Supreme Court's ruling is significant in two respects. First, the Court determined that an abuse of discretion standard applied in reviewing "all aspects of a District Court's Rule 11 determination. A District Court would necessarily abuse its discretion if it based its ruling on an erroneous view of the law or on a clearly erroneous assessment of the evidence". Id. at 2461. Second, the Court held that Rule 11 does not authorize the District Court to award attorneys' fees incurred on appeal of a Rule 11 determination. Such a fee shifting would only occur pursuant to Federal Rule of Appellate Procedure 38, which requires that the appeal be frivolous. Thus, appeals of Rule 11 sanctions are not sanctionable so long as the appeal is well grounded.

THOU REAPEST ONLY WHAT THOU HAST SOWN

In *Business Guides, Inc. v. Chromatic Communications Enterprises*, 111 S.Ct. 922 (1991), the Court levied sanctions upon a party, even though the party was represented, for the party's failure to make a reasonable inquiry prior to signing an affidavit.

The plaintiff sought a Temporary Restraining Order for alleged copyright infringement of trade directories. The factual predicate for the claim was inclusion of information in directories published by the defendant which allegedly included ten instances of false information ("seeds") intentionally placed in the plaintiff's publication. The "seeds" were purportedly planted to detect infringement. The Court conducted its own investigation and determined, prior to hearing the parties and without the knowledge of the parties, that nine of the ten alleged "seeds" contained no incorrect information. The Court denied the T.R.O. and referred the matter to the Federal Magistrate for a recommendation regarding a violation, if any, of Rule 11.

The Magistrate held two evidentiary hearings, at which the plaintiff and its law firm presented a defense of "coincidence." The Magistrate doubted the good faith of the defense and recommended sanctions against the law firm and the client. Thereafter, the parties requested a third hearing at which an acceptable explanation was given. The Magistrate again recommended sanctions against both the law firm and the client for both of the Rule 11 evidentiary hearings and the client only for the initial complaint. The Magistrate found the law firm not liable for the initial complaint because of an urgent need to act and its reliance on the "sophisticated client." The Court, after allowing the defendant to be heard as to the form of sanction, found that the affiant,[4] who submitted an affidavit in support of the "coincidence" defense, failed to reasonably investigate the facts prior to signing the application for a T.R.O. and submitting the affidavit in support of the coincidence defense and, thus, sanctioned the party for violating Rule 11.

"I THOUGHT I SAW A RULE"

Most recently, the Supreme Court held that Rule 11 sanctions were appropriate even if it was later determined that the District Court lacked subject matter jurisdiction over the case. *Willy v. Coastal Corporation*, 112 S.Ct. 1076 (1992). Willy filed his claim in a state court. The defendants removed the case to the Federal District Court, prompting Willy to move to dismiss for lack of subject matter jurisdiction. The District Court denied Willy's motions and sanctioned him for creating a "blur of absolute confusion" by filing a "twelve-hundred page," unindexed, unnumbered pile of material that was "irresponsible at a minimum and, at worst, intentionally harassing". Further, Willy relied on a "nonexistent Federal Rule of Evidence". The District Court's finding of subject matter jurisdiction was eventually reversed. However, the Court of Appeals allowed the Rule 11 sanctions to stand.

The Supreme Court affirmed the Court of Appeal's conclusion that the lack of subject matter jurisdiction does not circumscribe the Court's power to police its docket. The Court's interest in compliance with of its rules of procedure does not disappear upon the determination that the Court was without subject matter jurisdiction. The Court found no constitutional infirmity for requiring those in practice to conduct themselves in compliance with its procedures.

MY CLIENT IS YOUR CLIENT?

The most striking incident in which sanctions were ordered in Delaware arose out of the dispute over ownership of and the right to control the Mother African Union First Colored Methodist Protestant Church ("The Mother

Church"). *North African Union First Colored Methodist Protestant Church v. The Conference of African First Colored Methodist Protestant Church*, Del.Ch., C.A. 12055, V.C. Jacobs (May 20, 1992) Interlocutory App. den. Del.Supr., No. 215, 1992 Order (June 25, 1992) Cert. den. No 92-260 (October 4, 1992) Aff'd, Del.Supr., No. 096, 1993 Order (October 14, 1993). The controversy over the Mother Church arrived in the Chancery Court in April, 1991, when the Court entered an Order restraining one faction of the church (the defendant) from interfering with use by another faction (the plaintiff) of the church facilities during the days and times specified in the order. Further, the defendant was ordered to "permit access for the conduct of funerals and weddings as requested by the plaintiffs."

When it became necessary to schedule a funeral, plaintiff's counsel approached defense counsel requesting that she notify Reverend Thomas E. Moon in order to make the necessary funeral arrangements. Defense counsel advised that she did not want to be involved and directed plaintiff's counsel to deal with Reverend Moon directly. Thus, plaintiff's counsel consulted with Reverend Moon to make arrangements for various services pursuant to the terms of the restraining order.

During the course of the trial on the merits, plaintiff's counsel, understanding that defense counsel did not represent Reverend Moon, informed the Reverend that he would not be called to testify. The next day, September 18, 1991, defense counsel wrote to the Court accusing plaintiff's counsel of ethically inappropriate conduct inasmuch as she, in fact, represented Reverend Moon. Thus, plaintiff's counsel decided that future communications with Reverend Moon would be through defense counsel.

When it next became necessary to schedule a funeral, defense counsel refused the request to make the appropriate arrangements with Reverend Moon, stating it was not her "role" to schedule funerals. Plaintiff's counsel wrote the Court requesting intervention to assure compliance with the Court's preliminary injunction. During the teleconference, the Court twice instructed defense counsel to get in touch with her client and twice she refused. The Court advised it would entertain a motion to hold defense counsel in contempt. The Court allowed plaintiff's counsel with certain constraints, to speak with Reverend Moon to make the appropriate arrangements.

Plaintiff then filed a motion for an order of contempt against defendant and its counsel. In response, defense counsel argued, in a motion styled Application to Withdraw, that, inter alia, Reverend Moon was an agent of her adversary and, therefore, she was precluded by the Rules of Professional Responsibility from speaking to the agent of a party opponent.

The Court determined that it would "be more productive" to address the inconsistent litigation positions concerning the legal representation of Reverend Moon under the rubric of Chancery Court Rule 11, as opposed to the contempt context. In so doing, the Court avoided the issue of whether the oral order made during the teleconference would support a contempt finding.

The Court concluded that defense counsel had taken inconsistent positions concerning the representation of Reverend Moon. The Court determined that the contentions in the "Application to Withdraw" that Reverend Moon was plaintiffs' agent were not "well grounded in fact" or "warranted by existing law" within the meaning of Rule 11. The Court then concluded that the Application was filed to harass and vex the opposition, an improper purpose under Rule 11. The Court required defense counsel to pay the reasonable attorneys' fees incurred by plaintiff and forwarded a copy of the opinion to disciplinary counsel of the Board on Professional Responsibility for such investigation or further proceedings as deemed warranted.

OTHER LOCAL NEWS

On several other occasions the trial Courts in Delaware have awarded sanctions. In *Hurst v. General Dynamics Corporation*, Del. Ch., 583 A.2d 1334 (1990), the Court granted the defendant's motion to stay the litigation for forum non conveniens in part on the status of litigation involving the parties in companion litigation in Canada. The gravamen of the Rule 11 sanction was the plaintiff's failure to disclose to the Court the status of the Ontario litigation. The Court held that Rule 11 imposed upon plaintiff's counsel a duty to conduct a reasonable inquiry as to the identity of defendants in the Ontario action. The Court found that the reasonable inquiry would have required little effort and expense from the plaintiff. The Court found the violation could have been rectified had the defendant brought the matter to the attention of counsel before proceeding under Rule 11. Thus, the Court balanced the omission versus the failure by defendants to "mitigate" and ordered plaintiff to pay the reasonable expenses in prosecuting the motion, not to exceed $1,000.00.

In *Kennedy v. Twer v. Berl*, Del. Super., C.A. No. 82C-NO-65 (September 12, 1989), the Court was confronted with a third-party complaint brought between former co-counsel to the plaintiff. The matter arose after disposition by summary judgment of Kennedy's personal injury claims as a result of an apparently unintended overly broad release. Kennedy sued Twer, the drafter of the release for malpractice. Twer then sued Berl alleging that Berl had committed malpractice. The Court dismissed the third-party complaint and sanctioned the third-party plaintiff, finding that the only basis for the third-party complaint was Twer's "belief" that he had discovered a more convincing argument than the one presented in opposition to the original summary judgment motion. The Court found that the cause of action was not warranted by existing law or a good faith argument and, thus, required the third-party plaintiff to pay the reasonable expenses incurred by the third-party defendant because of the filing of the third-party complaint.

Similarly, the Superior Court sanctioned attorneys for filing a motion to compel discovery in a "sham attempt to deflect its own deficiencies in responding to discovery in a timely way." *Ford Howard Cup Corp. v. Quality Kitchen Corp.*, Del. Super., C.A. No. 86C-DE-34, J. Steele (February 1, 1991). Thus, the Court required the plaintiff to pay attorney's fees and costs of $250.00 to offset defendant's expenses in responding to the frivolous motion.

A constant theme of cases adjudicating Rule 11 issues is that merely prevailing on a motion is not sufficient basis for Rule 11 sanctions. In *Ford v. Bank of Delaware, et al.*, Del. Super., C.A. No. 89C-FE-156, J. Toliver (December 8, 1992), counsel stipulated to an amended complaint. Thereafter, defendant's counsel urged by letter that plaintiff forego certain aspects of the claim. After motion practice, the Court dismissed some, but not all of the plaintiff's complaint. Defendant then argued that because it had prevailed on those claims on summary judgment, and had written the earlier letter, it was entitled to Rule 11 damages. The Court held that merely prevailing on all or part of an issue is not a basis for Rule 11 damages.

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Interestingly, the Court hinted at the existence of evidence that defendant offered to dismiss the Rule 11 motion in exchange for a dismissal of the complaint. The Court noted that once a Rule 11 motion is filed, it is to be resolved by the Court and not the parties. Id. at Footnote 3. The Court further noted that if such a horse trade were offered, "counsel's use of the Rule 11 motion was improper and itself a Rule 11 violation."

AN EDITORIAL COMMENT

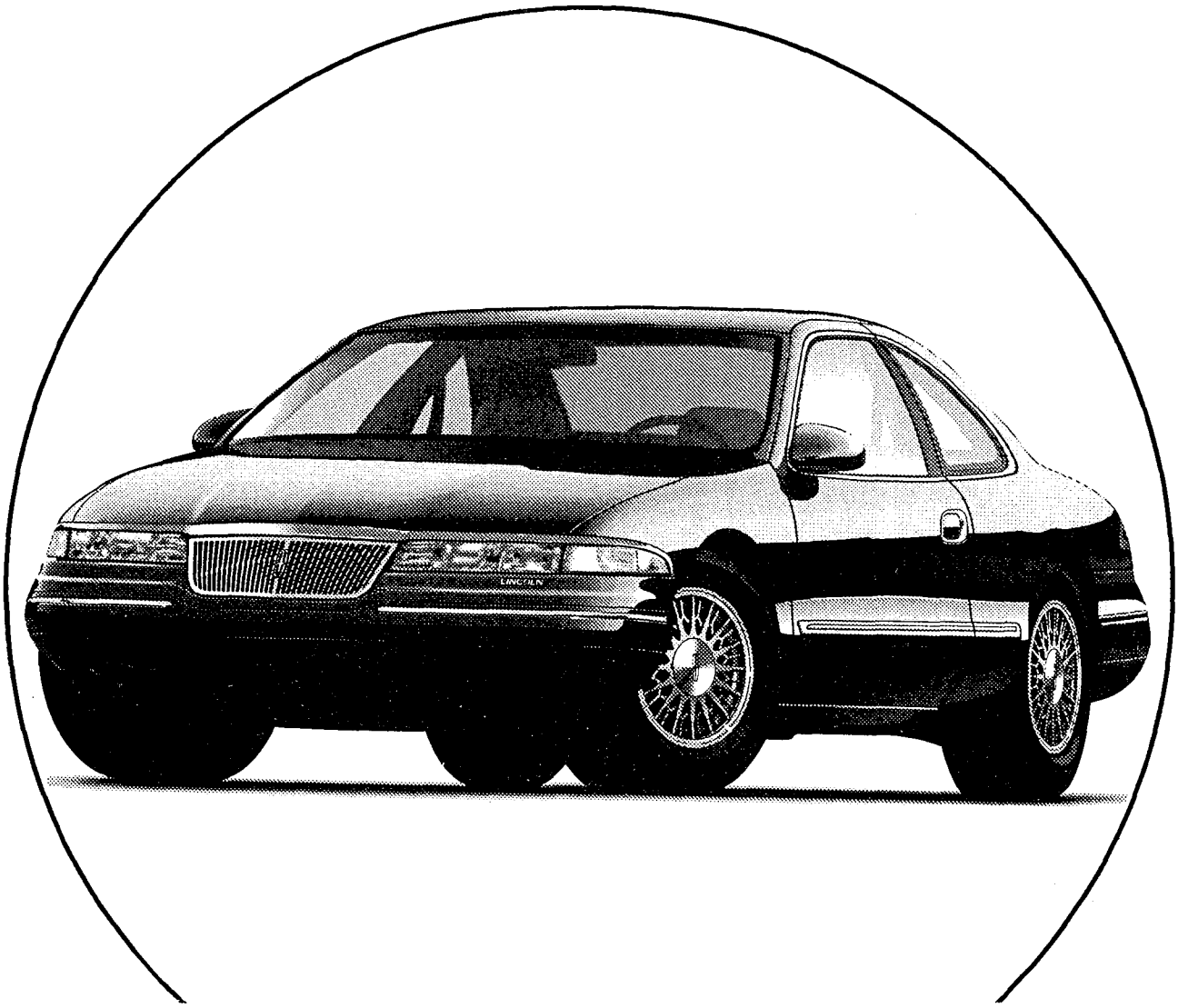
Unfortunately, Rule 11 has been the subject of numerous other motions in the various Delaware Courts. It is disturbing because, in many instances, Rule 11 has been invoked as the barb on the tail of a case dispositive motion. Parties seem to be using Rule 11 in an effort to shift fees as opposed to deterring improper conduct. In one instance, the Court suggested that the raising of Rule 11 was, in itself, "perilously close" to being a violation of Rule 11. *Wilkerson v. Harleysville Mutual Insurance Company*, Del.Ch., C.A. 12734, V.C. Hartnett (April 21, 1993).

The clear import of the case law is that the Delaware judiciary does not use Rule 11 to remedy the typical problems with pleading before the Court. Appropriately, the judiciary has exercised great restraint in finding violations of Rule 11. Rather, Rule 11 has been used for the most egregious problems.

The revisions to Federal Rule 11 shift the emphasis from one of compensation to one of deterrence. The rule expressly allows parties to act with candor and thereby avoid Rule 11 sanctions, rather than encourage Rule 11 litigation through fee shifting. These amendments are consistent with the ideals of the Delaware Bar and the case law. See *Hurst, supra.*

Rule 11 sanctions, like civil contempt, should be reserved for outrageous conduct. The Delaware Bar must be self-disciplining in terms of invocation of the Rule. We should be tolerant of the plight of the opposing party. We, as practitioners, should, when faced with a Rule 11 problem, be guided by the safe harbor provisions and give the opposing side the opportunity to correct the problem, as opposed to throwing it in the Court's lap. Informal resolution of Rule 11 problems is beneficial to both the Bar and the Courts. Further, it is the hallmark of the historical cooperation among members of the Delaware Bar.

It is clear that Rule 11 is an appropriate tool for the Court for circumstances such as the Mother Church case. The fact that



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occasionally a Court may be called upon to issue Rule 11 sanctions, is an inevitable part of the practice of law. Nevertheless, the occasion of sanctions is not a signpost of the demise of the profession.

On the other hand, the invocation of Rule 11 by attorneys in regular motion practice is a symptom and signal of the demise of the gentleman lawyer (a term I once again use in a non-sexist context to describe the historic relationship among lawyers in Delaware). The procedures set forth in the amendment to Rule 11 should be second nature to the Delaware practitioner. Rule 11, especially as amended, is a tool to maintain the integrity of our Courts and Bar and not a litigation weapon.

The regular invocation of Rule 11 will blur the distinction between the advocate, the lawyer, and the person, and strain the relationship between Bench and Bar. Old Rule 11 has unintentionally ratcheted up the stakes in litigation. We, as lawyers in Delaware, ought to urge the adoption of the amendments to Rule 11 and, thus, restore the balance between parties and relegate Rule 11 to the judge's quiver to be used only in circumstances where a lawyer, after a notice and an opportunity to make corrections, fails to act appropriately.

Lawrence Drexler, an editor of this magazine, pictured with sons Zachary and Philip, practices law in Wilmington with the firm of Elzufon, Austin & Drexler.

FOOTNOTES

1. The author gratefully acknowledges the research performed by Steven Rudolph, a third year student at Widener University School of Law.
2. To the extent Congress enacts and the President approves revisions to Rule 11, some or all of this article may be rendered moot.
3. As of January, 1991, the Superior Court rule was amended to be gender neutral.
4. Sanctions were not levied against the plaintiff's law firm because of its bankruptcy and dissolution of Finley, Kumble, Wagner, Heine, Unterberg, Manley, Myerson & Casey. ◆

THE HONORABLE E. NORMAN VEASEY

Professionalism and Pragmatism — The Future

A Message from the Chief Justice of Delaware

Our bench and bar rank among the best in the nation. Why do we have that kind of high recognition for quality? The competence, integrity, intellectual honesty, public service, and work ethic of our bench and bar are well-known. Good lawyers and judges have been attracted to Delaware over the years because of our national prominence. Yet, we have much work to do to improve our stature and our judicial system. For example, we have some systemic problems in our various court structures which need to be modernized. Those issues and others are being addressed by the Commission on Delaware Courts 2000 (the "Commission"), created by the 137th General Assembly in its recently concluded session.

The Commission is already at work, and its efforts should produce results in time for some legislative action in the second session of the 137th General Assembly in 1994. The Commission will be looking at the court structures, state of the art management techniques and the goal of making Delaware's court system a model for the nation. I also expect the Commission to have its collective eyes on what might be called—for lack of a better term— "futurology" (system of stating the probable form of future conditions by making assumptions based on known facts; *Webster's New World Dictionary* 568 (1986)). For example, to plan strategically for courts in the 21st Century we need to consider what will be the nature and economics of law practice, the dynamics of expectations of clients and the public, and the demographics of the bar and the bench in the years following the year 2000.

I believe that the practice of law is now at a crossroads in terms of economics and professionalism. We talk about professionalism, but have we focused on what we really mean? Some say it is a *platitude*. I say it is more a matter of *attitude*. We need to keep talking about the necessity for civility, but we must go beyond that aspect of professionalism. We should also focus on those aspects of professionalism which relate to competence, public service, intellectual honesty, candor, independence,[1] and the businesslike approach to the profession. It is a truism that the practice of law is the practice of a *profession*, not the conduct of a *business* in the rough and tumble of the marketplace. It is easy to say that, but many practicing lawyers scoff at any suggestion that the practice of law is not a business.

Professionalism includes, but is not limited to, compliance with the ethical rules embodied in the Code of Professional Responsibility. Professionalism goes beyond the minimum standards "*required* of all lawyers . . . professionalism is a higher standard *expected* of all lawyers."[2] Professionalism does not involve tasteless advertising, non-essential litigation, taking advantage of clients, misleading adversaries, disingenuousness, cutting corners, accepting engagements for which the lawyer is not qualified, indulging in conflicts of interest, disloyalty to clients, and greed.

More and more often the leaders of our profession are focusing on oaths, pledges, and aspirational goals by which we should be guided in practicing the profession. The Delaware Lawyer's Oath[3] requires "all good fidelity as well to the Court as to the client;" and that the lawyer "will use no falsehood nor delay any person's cause through lucre or malice." The Delaware State Bar Association Statement of Principles of Lawyer Conduct[4] stresses integrity, compassion, learning, civility, diligence, and public service. It expresses the expectation that "a lawyer should provide an example to the community in these qualities and should not be satisfied with bare compliance with the mandatory rules governing professional conduct." All over the nation, courts and the organized bar are moving forward forcefully to stress these qualities of professionalism. In 1986 the American Bar Association, through its Commission on Professionalism, expressed concern that, while lawyers observe the rules of ethics governing their conduct, professionalism is in decline.[5] The commission lamented the fact that lawyers tend to look at nothing but the rules; if conduct meets the minimum standard, lawyers tend to ignore exhortations to set their standards at a higher level."

In the state of Georgia, the Chief Justice's Commission on Professionalism expresses concern about the "unfortunate trends of commercialization and loss of professional community in the current practice of law . . . manifested in an undue emphasis on the financial rewards of practice, a lack of courtesy and civility among members of our profession, a lack of respect for the judiciary and for our systems of justice, and a lack of regard for others and for the common good." Lawyers, as professionals "should strive to make the internal rewards of service, craft, and character, and not the external reward of financial gain, the primary rewards of the practice of law." The Georgia Commission lists over 50 very specific aspirational ideals to which professionals should adhere when dealing with clients, opposing parties, courts, colleagues in the practice of law, the profession, the public, and the system of justice.[6]

These concerns seem to begin with the poor public image of lawyers.

Regrettably, that poor public image is pervasive. One hears it every day from members of the public, legislators and even fellow lawyers. Letters to the editor pop up frequently saying things like:

> If attorneys would police fellow attorneys and weed out the bad apples and unethical practices, instead of constantly defending them and trying to blame others for a poor public perception, [lawyer] jokes would vanish almost immediately.[7]

Many of us believe that these criticisms and "lawyer bashing" are not "fair" because they are generalizations based upon misconceptions and a few "bad apples." The public often does not recognize that the vast majority of lawyers are true professionals who are dedicated to public service.

Justice Sandra Day O'Connor has reminded us that membership in a profession "entails an ethical obligation to temper one's selfish pursuit of economic success by adhering to standards of conduct that could not be enforced either by legal fiat or through the discipline of the market."[8] Professionalism, profit, and pragmatism are not mutually exclusive. An aggressive, tough-minded, businesslike, and profitable law practice is certainly consistent with the highest levels of professionalism. But crass commercialism, disregard of the public interest, inherent conflicts with clients, and "Rambo" behavior are not.

The laments continue, and they center around what some believe to be a trend toward "commercialism." Chief Justice Carrico of the Virginia Supreme Court has stated his belief that

> The use of billable hours is the most serious manifestation of commercialism in the legal profession today. . . .
>
> The billable hours phenomenon inevitably produces other undesirable results [including outright dishonesty].
>
> Obsessed with making billable hour quotas, lawyers neglect their responsibility to participate in community affairs and to engage in such bar activities as pro bono programs designed to provide legal services to the poor.[9]

Judge Arlin Adams, nationally respected retired Judge of the Third Circuit Court of Appeals has expressed his regret that "[t]he commercialization of the profession . . . runs far deeper than timesheets or expense accounts. The decline in professionalism has deprived an entire generation of practitioners of suitable role models. . . . Equally distressing is the prospect of members of the profession *affirmatively accepting* this commercialized vision of themselves."[10] Judge Robert Merhige of the Eastern District of Virginia put it succinctly:

> I am immeasurably disgusted when I hear a lawyer say, "all we have to sell or give is time." Nonsense! Lawyers give integrity, loyalty, advocacy, knowledge, and those intangibles that make ours a profession. Lawyers who think that all they have to sell is time ought to become watchmakers.[11]

William R. Rakes, Esquire, President of the Virginia Bar, adds that the creeds and principles adopted by various state bars and courts "serve a useful purpose by raising the awareness level of [professionalism]. . . . But what is needed is a modification of the conduct of a significant portion of the bar in addition to aspirational standards. . . . We do a good job, but we are not always perceived as doing a good job." He asks:

> Would a Futures Commission on the Practice of Law . . . be able to step back and take a broad view of the profession and the public's needs, and recommend steps which would insure a strong profession made up of lawyers, who . . . would exhibit professionalism by elevating the client's interest above the lawyer's concern for financial reward and subordinating both to the good of the public as a whole?[12]

Speaking about <u>all</u> professions, Dr. James Laney, President of Emory University addressing the American College of Trial Lawyers this year, expressed concern that the image of the professional in general "has been sullied." He warned that "[o]ne of the things by which we identify a learned profession is its concern for more than making money. . . . We've got a big job ahead of us to stem the tide of materialism in our professions, to change the purpose, the culture, from the bottom line to the public trust. . . ."[13] The lawyer's zeal in representing the client and the lawyer's pursuit of self interest were addressed eloquently in Chancellor Allen's Law Day speech to the Delaware Bar in May of 1991. The Chancellor urged lawyers to accept the principle that the duty of zealous advocacy to the client "does not grant [the lawyer] license to act in ways that . . . you would personally regard as oppressive, unfair or morally wrong."[14] I would add that there are times when the true professional must "just say no" to the client who insists on unprofessional behavior. Judge Stanley Sporkin of the U.S. District Court for the District of Columbia (and a member of the Delaware Bar) urges lawyers who have taken a great deal out of the practice of law in a monetary way to "now put something back in by involving [themselves] in identifying and finding solutions to the critical problems of the day."[15]

Client expectations are changing the way lawyers practice their profession. The *New York Times* reported in July of this year that defendants in asbestos cases are dictating to lawyers how to handle their cases. Many clients are routinely requiring lawyers to put more paralegals on cases and have less involvement of expensive partners. It was observed in the article by some that this is "the wave of the future" and that "law firms are going along because they have no choice." Yet Harry Pearce, the General Counsel of General Motors was quoted as saying, "The very best lawyers are not going to put up with attempts to control their professional service. . . . We are not going to manage law firms, because we want them to be creative."[16]

Many clients have insisted on strict time billing, without regard to the various other factors in Rule 1.5 of the Rules of Professional Conduct. Thus, in many instances, the time method of billing has become ingrained in our culture even though a true professional relationship should be built on *value.* A half-hour of sound advice by a wise counselor exercising his or her judgment gained from experience is often of much greater value to the client than hours of needless research, paper shuffling, meetings, and memo writing which might generate an invoice of several thousand dollars. Yet clients sometime expect that it is only through such activities that lawyers can generate value. The irony then is that the lawyer may be tempted to generate make-work projects or to falsify time records.

I practiced law for 34 years, so I know something about the practicalities of law practice. I know that cost control, appropriate billing methods, staffing (and the prevention of overstaffing), attracting and retaining clients, and gaining recognition for a good reputation are among the keys to the running of a law practice in a professional, businesslike, and profitable manner. The practice of law is changing. Clients are becoming more demanding and less understanding. The public is disaffected. There are more and more lawyers (some projections are that there may be as many as a million lawyers in the United States in the year 2000). It is a struggle for practically every lawyer in private practice. The

answer is not, however, to cut corners, reduce quality, engage in crass commercialism, lose integrity, or ignore public service. We need to focus on the tension between a successful, businesslike law practice and the need for lawyers to be true professionals.

The best analysis I have seen so far, though it may not provide any specific answers, is that expressed by Seth Rosner, chair of the ABA Standing Committee on Professionalism. He starts with the observation of Dean Norman Redlich that lawyers who yearn for traditional professionalism may be "looking for their lost wigs." But, he notes, the clock is not going to be rolled back, as some would wish. His thesis is:

> [T]he defining tension in law practice today is between professionalism and money.
>
> But . . . it is foolish to say that we must be a profession and not a business, for the practice of law has always had a business side to it.
>
> *No, we do not have to choose between professionalism and money. Indeed, we do not even have that choice. What we do have to do is decide simply which one comes first. If our first priority is the highest level of service to clients of which we are capable, coupled with our obligations to the legal system and to our society, then everything else falls into place.* Virtually all, if not all, of the professionalism issues which we currently debate are resolved.
>
> If, on the other hand, money is our first priority, *if making as much money as we can is our goal and serving clients is seen simply as a means of making money, all kinds of results flow from that, and they are almost all bad.*
>
> [T]he intense focus on maximizing revenues by whatever means each firm felt appropriate . . . has led to billing practices which range from questionable to outright stealing.
>
> . . . .
>
> [T]otal reliance on hourly billing makes lawyer and client adversaries since the clients interest is in getting the best service at the lowest cost, while the lawyers interest is too often in maximizing the time and, therefore, the fee.[17]

Concern about hourly billing is only one of the professionalism issues, and it is a vexing and complex issue. It should not, however, dominate the debate. It should be used only as an example to illuminate the discussion. I do not know all (or even most) of the answers about

the future of the economics of the legal profession and the future of professionalism. I do believe that the legal profession is at a crossroads, and the tensions between pragmatism and professionalism are going to increase as we approach and go beyond the year 2000.

The solution does not lie solely in oaths, creeds, and specific aspirational goals (although those are very important); rather the answer lies in the attitude by which each lawyer approaches the practice of law. If, as Seth Rosner said, our first priority is the highest level of service to clients and obligations to the legal system in society, we are true professionals. Assuming businesslike practices in our daily lives, financial success can follow without the kind of crass commercialization which has fanned the flames of the poor public image of our profession. This change in the attitudinal approach could, I believe, help to mute some of the "lawyer bashing."

FOOTNOTES

1. Geoffrey C. Hazard, "Professionalism can be thought of as the 'right stuff' in lawyers," *National Law Journal* (1993).
2. The Honorable Harold G. Clarke, Chief Justice, Supreme Court of Georgia, *State Bar Journal of Georgia* (May 1989) (emphasis in original).
3. Delaware Lawyers' Oath. Supr. Ct. R. 54.
4. Delaware Lawyer's Statement of Principles, adopted by the Delaware State Bar Association November 15, 1991, and required to be subscribed to by lawyers admitted *Pro Hac Vice* in the Supreme Court. See Supr. Ct. R. 71 (b)(ii).
5. American Bar Association Commission on Professionalism, "In the Spirit of Public Service: A Blueprint for the Rekindling of Lawyers Professionalsim" p.7 (1986).
6. Chief Justices' Commission on Professionalism (Georgia) p. 12 (1990).
7. Lee Ellis, "Letter to the Editor," *USA Today,* July 9, 1993, at 10A.
8. *Shapero v. Kentucky Bar Ass'n,* 486 U.S. 466, 488-89 (1988) (O'Connor, J., dissenting).
9. The Honorable Harry L. Carrico, Chief Justice of The Supreme Court of Virginia, Address to the North Carolina Bar Association (1992).
10. The Honorable Arlin M. Adams, "The legal profession: a critical evaluation," *Judicature* 82 (Vol. 74 No. 2, Aug-Sept. 1990) (emphasis in original).
11. The Honorable Robert Merhige, U.S. District Court, E.D. Va., *Trial* (1992) (Quoted by William R. Rakes, Esquire, infra n.12).
12. William R. Rakes, Esquire, President of the Virginia Bar Association, "Public Confidence and Self-Regulation," *The Virginia Lawyer,* President's Page (May 1993).
13. Dr. James T. Laney, President of Emory University, Address at The American College of Trial Lawyers, entitled "The Law–A Moral Aristocracy" (Spring 1993).
14. The Honorable William T. Allen, Chancellor of Delaware, "Should Justice Matter," *Business Lawyer Update* (Vol. 12 No. 1, Sept/Oct. 1991) at 7.
15. The Honorable Stanley Sporkin, U.S. District Judge, Washington D.C., "It's Time to Stop Polishing the Pebbles," *Business Lawyer Update* (Vol. 12 No. 1 Sept/Oct. 1991) at 9.
16. Barnaby J. Feder, "Finding a Lifeboat in a Flood of Asbestos Litigation-Owens Corning cuts its costs by taking charge of its lawyers," *N.Y. Times,* July 4, 1993 (Sec. 3 p.5)
17. Seth Rosner, Esquire, Chair of the American Bar Association Standing Committee on Professionalism, "Professionalism and Money: A Matter of Priorities," *The Professional Lawyer* 9-11 (May 1993) (emphasis supplied). ◆

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LEAH WORTHAM

Teaching Professional Responsibility in Law School

I was pleased to be asked to write about teaching professional responsibility in law school. Ten years and sixteen classes of professional responsibility have allowed me to form many views. The following is organized in a variation of the journalist's standard five questions (who, what, when, where, and how). I consider WHAT to teach in professional responsibility courses, WHO should teach them, WHEN to teach the subject, HOW to teach it, and WHY it is hard to do. (PR in this article refers to Professional Responsibility.)

My assigned topic actually was teaching ethics in law school. First, a brief explanation for the shift in title. Most of us have heard lawyer joke punch lines on the subject. "Legal ethics is: 1) an oxymoron; 2) one of the world's shortest books." "Legal ethics is to ethics as military music is to music." Those cheap shots bear no relationship to my reasons.

There is a set of ethical principles generally accepted to underpin a lawyer's professional role. Ethics (not just the "legal ethics" described in the previous sentence) should be discussed in law school. I believe ethics (both the kind in the first sentence and the kind in the second sentence) are best considered in law school against the overall doctrinal body of law regulating lawyers. Calling a course Legal Ethics can have the counterproductive effect of encouraging students not to take it seriously — more on these views later.

WHAT should be taught about professional responsibility in law school?

My course begins with "Context," including: the legal structure for bar control; sources of authority; consideration of what, in addition to disciplinary codes, regulates lawyer conduct; antitrust limitations on lawyer regulation by state bars; and what exactly are the Model Code, Model Rules, and state codes. In the first class, I inventory student views on what it means to be "a professional."

A second section looks at bar admission and discipline, constitutional limitations on bar authority (including the years of dispute on interstate mobility) self-regulation, and the duty of bar members to supply information on applicants and report violations of the disciplinary standards.

After these background sections, we begin to consider the building blocks of conventional legal ethics: who is a client for the purpose of defining duty; loyalty; confidentiality; competence; communication; what decisions are the client's; clients with diminished capacity; crossing the line from permitted representation to participation in illegal conduct; handling client funds; advancing funds to clients; and withdrawal from representation. Conflicts of interest are complex enough to get their own unit and five or six hours of class time. A fifth section, entitled "Rules of the Game for the Advocate (Particularly the Litigator)" deals primarily with limitations on advocacy

A strong sense of personal ethics does not lead one to an easy resolution of ethical conflicts.

Illustration by Kevin Plottner

flowing from duties to the tribunal.

Criminal practice comes up in the previously described sections, but I devote three or four hours to some issues unique to criminal practice — duties regarding physical evidence that could be termed a fruit or instrumentality of the crime, legal ethics in plea bargaining, and prosecutorial conduct.

Next comes "the practice of law as a business" where we take up advertising and solicitation, fee agreements, fee collection, retainer agreements, professional association with non-lawyers, unauthorized practice, trade names, buying a practice, specialization, restrictive covenants, lawyer's responsibility for others in the firm, and entering and leaving firms. I do not teach law office management, but I want students to realize that when the business aspects — an adequate flow of paying clients, record keeping, and such matters — are out of control it is difficult to maintain high professional standards.

We end the course by considering making legal services available (the unpopular client, court appointments, pro bono work) and particular issues in representing special clients (groups and class actions, corporations, government entities). I briefly mention matters covered by the Code of Judicial Conduct and end the course as it began — with a discussion of what it means to be a professional, specifically a member of the legal profession.

In a few instances, I take the time to deal with matters not always covered in legal ethics courses. One cannot understand confidentiality without understanding the attorney-client privilege and its exceptions.

While teaching the body of law regulating lawyers, I tell students that a primary goal is for them to develop gut instincts about what to do in dangerous situations — the professional responsibility course as fire drill. I wear a red and white striped dress on the first day of class that I call the stop sign dress. (After ten years, I am on my second such dress.) I want to drill into their subconscious some points in practice where they should instinctively "stop" before a possibly irrevocable step is taken. In professional responsibility, "I'll look that up" comes too late once a lawyer has heard the confidence or taken custody of the physical evidence.

When people talk about the importance of teaching professional responsibility, they usually refer to client protection or enhancing respect for the profession. Both are worthy goals, but I think about how many sleepless nights I can save a student by focusing on how to prevent problems from arising. I worry not only about the PR problems of the selfish lawyer, but the hot water into which selfless lawyers can get when sympathy or zeal for clients clouds their judgment.

When I started teaching PR in 1983, something bothered me about the common rhetoric that seemed to assume that a goal of bar admission and discipline was to weed out people of bad character. Although there may well be some people of bad character for whom redemption is impossible, I doubt that anything I do in teaching a law school course will lessen the possibility they will lie, cheat, or steal.

I have watched discussions on "character" shift. I now see prominence given to the role substance dependency plays in malpractice and discipline cases and what an ABA article once called the "lethal combination of case overload, insufficient office support, financial pressure and emotional isolation" with which many lawyers, particularly in solo practice or small firms, must deal.

I turn one class over to a psychologist with a practice in individual counselling of unhappy lawyers and consulting for law firms on work place issues. She talks about seeking career satisfaction as a professional responsibility duty from the premise that it is difficult for people to do top notch work at a job that makes them miserable. She also talks about sources of lawyer stress and effective stress management techniques.

In addition to teaching a substantive body of doctrine on lawyer regulation, honing instincts for danger, and raising pressures that may affect one's ability to practice, I try to nurture students' often battered idealism. Many law students take lawyer jokes personally. When the Washingtonian magazine cover depicted a blindfolded lawyer being shot with a, "First, kill all the lawyers" caption, three distressed students brought it to class.

To this end, I mix the cautionary tales about lawyers who got into trouble with some hero stories about lawyers who do a good job and make a difference. I end the semester with a tape made by University of Detroit law professor, Larry Dubin, called Legal Heroes, which features Fred Gray, the African-American lawyer who represented Rosa Parks and others involved in the Montgomery bus boycott as well as other major desegregation cases in Alabama. He also interviews Amelia Lewis, who picked up Gerald Gault as a pro bono client whose case ultimately changed the U.S. system of juvenile justice, and Vincent McCarthy, a large firm real estate lawyer, who developed homeless shelters in Boston. The film shows Rosa Parks and Gerald Gault talking about what their lawyers and their cases meant to them. We also see Amelia Lewis going to her office in Sun City, Arizona at 85, a woman who loves her work too much to retire.

My law school has started recording oral histories of some of our older alumni. Our original intent was only to recapture the history of the law school, but in one early interview, Elizabeth Guhring, a leader of the family law bar in Washington, started to talk about her career. She looked up with unmasked joy and conviction and said, "I've been practicing law for almost forty years, and I've loved every day of it." I want clips like that to show my students, many of whom have become skeptical about whether they will ever take pride and satisfaction in their legal careers.

For a course to be effective, decisions on what to teach and the perspective from which to teach it must reflect the teacher's background and convictions. David Luban from the University of Maryland is a philosopher by training. I expect his course is as engaging and arresting as the talks I have heard him give on teaching it. Tom Shaffer, from Notre Dame, uses the Atticus Finch "hero story" from To Kill A Mockingbird as almost a semester-long metaphor for teaching the PR course.

I have neither Luban's philosophical nor Shaffer's literary bent. My course bears the stamp of the social scientist I might have been had I not gone to law school. Although I find my brief experience as a trial lawyer helpful in teaching the course, I am sure the PR course of my colleague Lou Barracato, a trial lawyer through and through, reflects that world view. There is much that any PR course should teach, but we all are most effective in teaching when an authentic individuality shows through.

WHEN to teach professional responsibility? Some parts of it should be taught in the first year of law school. First year case study is enriched and enhanced if students understand the basic aspects of the lawyer/client paradigm — subjects including confidentiality (including its limits), loyalty, fiduciary obligation for funds, basic notions of conflict, the self regulating nature of lawyer

ethical codes, including duty to report.

First year students also need a little time on unauthorized practice and the duty of competency to counterbalance their eagerness to try out what they know and the eagerness of their friends and relatives to say, "Now that you are in law school, could you just. . .."

As early as possible, law students need to be made aware that the admission system looks much more harshly at offenses committed while a law student than before and that "personal" matters like poor credit history, delinquent child support, and drunk driving are likely to generate an inquiry and perhaps a hearing.

The usual answer for adding things in the first year curriculum is the required research and writing class. These courses often are not taught by tenure track faculty, and instructors are more willing to be told what to cover than professors in the doctrinal courses. Also it would be difficult to integrate all necessary PR concepts into any one first year doctrinal course. Unfortunately, however, students sometimes think of the research and writing course as less important than their "real" courses taught by their "real" professors.

In my ideal curriculum, every professor in every law school course — first year and up — would teach at least one problem or hypothetical with a professional responsibility element. In my experience, when faculty do not do so, it often is because they feel insufficiently versed in the field. They know basics but are hesitant to teach a problem on which they do not know all the correct ethical rule sections and recent case law. A little collaboration with a professional responsibility teacher can produce a problem that will fit the teacher's syllabus and teaching style while providing the comfort of the correct reference citations and the right "answer."

I needed only to provide a tax teacher with Wolfman and Holden's, Ethical Problems in Federal Tax Practice, and some articles I had clipped from time to time. She worked out several problems. She came back to me and said, almost with a little shock in her voice, "The students really liked it. They were really interested."

A pervasive approach to professional responsibility serves two important purposes. First, the professors' substantive expertise allows them to teach PR problems in their particular fields with depth and sophistication. Any PR teacher must teach some criminal practice issues because they are so basic to the field, but I always feel uneasy about my lack of real world experience in the area. I skate cursorily over special professional responsibility contexts like tax or estates because I have neither the expertise nor the class time to deal with them seriously.

Clinical courses are a particularly effective place for teaching professional responsibility. The good clinical teacher finds "teachable moments" about PR almost daily, and this helps to emphasize that "it really does come up." Our clinical teachers frequently refer students to PR teachers on complicated matters, and we enjoy the opportunity to work with students in thinking out the issues.

Despite all the exposure students would have to professional responsibility in my ideal curriculum, I still would require a two or three credit PR course open to second and third year students. To teach the overall course that goes from sources of authority through ethical rules through related bodies of law, one needs the legal sophistication of the upper division students. To understand restrictions on bar regulation of advertising and license to practice, one needs some grounding in constitutional law. To understand liability for malpractice, one needs to know a little bit about torts and contracts. To consider ethical issues in representing a corporation or its employees, one needs to understand basic principles of corporate law.

WHO should teach professional responsibility? I find no particular background critical, but I think good teaching of PR requires time to master the body of law and new developments, plus the belief and energy to be a cheerleader for the subject. Whether they find the courses interesting or not, students are willing to grant that contracts, corporations, and civil procedure are important. In professional responsibility, the teacher must accept the need to keep offering real world examples and radiating enthusiasm about its importance.

I believe that many teachers who have had unhappy experiences teaching PR have lacked the time to do it right. Some law schools, like many law students, seem to find the ABA's PR requirement a burden to be discharged. They assign all sections to adjuncts or foist it onto teachers with no particular expertise or interest as a punishment or a function of who is left once the other necessary courses are assigned.

Ideal faculty members could be adjunct or full-time. Adjuncts offer the advantage of being "real lawyers" in student eyes. They can be effective teachers of the subject if they have the time to master the body of law but that can be difficult. Few practitioners specialize in the field. Many know the slice that relates to their doctrinal specialty but are unfamiliar with issues that arise commonly in other types of practice.

The explosion of good books and reference materials on professional responsibility makes good teaching of PR an easier task than when I began in 1983. Today there were many texts as well as useful hornbooks, a couple of specialized law reviews, and many articles on the subject. The American Association of Law Schools Professional Responsibility section publishes a newsletter and sponsors programs. The ABA Center on Professional Responsibility holds an excellent continuing education conference each year.

HOW to teach the professional responsibility course? The socratic method of case analysis can be defended fairly well for the "teaching to think like a lawyer" goals of first year, but it wears thin when overused in the upper division. A master of that method probably could use one of the professional responsibility "casebooks" and get a good result. I find, however, that the subject matter particularly lends itself to problems, and several of the texts are organized in that manner. Problems in PR offer students particular immediacy because the question is not just "What would you advise your client to do?" but "What would you do?"

The subject matter lends itself well to simulations that force the student to "act" in a tough situation. Students also can be pushed to see themselves as future bar leaders. In discussing what a state bar's role in encouraging pro bono work should be, my class last year became quite engaged when they divided into small "buzz groups" and formulated recommendations. The Center on Professionalism at the University of Pennsylvania Law School is one of several sources of excellent video tapes. Many tapes have teacher's manuals to quickly educate a new teacher on the issues.

Outside speakers can send the message that "real lawyers" in the "real world" have heard of this stuff and actually use it. They also can offer texture and richness in the specialized areas about which a teacher lacks experience.

At least in the law schools, it has been in vogue to discuss the power of narra-

tive. When the lawyer counselling committee representatives come to my class, I see students much less "grabbed" by the Director's discussion of ABA and state bar concerns about substance dependency than by the handsome, athletic Virginia and Harvard graduate who talks about how alcohol almost ruined his practice and his personal life. He looks like them, or their classmates, or their husband or brother, and brings students face to face with the notion that it could happen to them or a colleague. In addition to "Legal Heroes," Larry Dubin has produced tapes of disciplined lawyers and wronged clients telling their own stories.

WHY it is hard to do. Yes, I love teaching the course. No, it is not impossible, but it does present special challenges.

As the only course required of upper division students in most law schools, PR starts with a couple of strikes against it. I favor the requirement. The subject matter is critical enough to be worth ensuring that every law student in America is exposed.

I said earlier that PR requires more unrelenting enthusiasm than most courses and lots of effort to provide real world referents. Why?

Some of the reasons are the same as my basis for the resisting the course name, Legal Ethics. Some students respond, "I'm ethical. Why am I spending law school time and tuition money here when I could be taking a real course?"

I see three problems with "teaching ethics" as the highlighted focus. First, some of the law regulating lawyers, with which new attorneys should be familiar, has little to do with ethics. One can debate spiritedly whether rules on advertising, practicing with non-lawyers, restrictions on trade names and selling law practices are anticompetitive devices to hold market share or legitimate devices to protect the public. In either event, however, it devalues ethics to force them under that rubric.

Second, virtually all matters worth PR class time (as opposed to assigned reading of straightforward rules) are about ethical principles that conflict. Client perjury is about loyalty to client versus duties to the justice system. Conflict of interest law considers duties to former clients versus duties to new clients and client advantages in joint representations versus possible later contingencies that could arise.A strong sense of personal ethics does not lead one to an easy resolution of such ethical conflicts.

Third, students may find serious clashes between strongly felt personal ethics and "legal ethics." Most PR classes force students to realize that confidentiality rules could require keeping client communications secret even when that caused serious pain to others or an injustice.

The hardest ethical questions, e.g.drawing lines between client confidences and revelation for the good of others — do not have clear cut "right" answers. (Model Rule 1.6 on revelation of confidences has generated more ABA debate and more variation in state rules than any other.) There are moments when students realize that something discussed could Get Them Into Trouble, and they want answers. The hard issues worth class time are often those on which jurisdictions' ethical rules are in conflict and bar and judicial opinions are muddy.

Such unsettled questions heighten students' anxieties and tempt them to say, "Why bother? There are no answers in this course." I try to remind them that, although a problem may not have a single right answer, there usually are agreed upon parameters to the issues and some clearly wrong answers. I want the gut instincts for danger honed and enough knowledge to frame the issue when they seek expert guidance. I remind them that when there is no clear answer, it usually is because it is a hard question.

One must be philosophical and thick skinned enough to realize you never get them all — at least right away. Even in my semesters of best teaching reviews, I always have a couple of righteous, "This could have been covered in one day in a bar review course." I always hope that five or ten years later they will have changed their minds.

I attend many alumni functions. I am gratified, and a little amused, as I find some of my 1000 or so former students who come up and say, "You know that professional responsibility stuff really does come up." I also get lots of calls for consultation. I even had three alumni at the same function say that they remembered the stop sign dress. I guess I will have to buy my third one soon.

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GEORGE W. BERMANT

Securities Lawyers are Still Fair Game

The topic of suing lawyers comes up with increasing frequency these days at dinner parties, in media reports and even in late-night talk shows. Since the late 1960s, when the Federal District Court in New York decided *Escott v. Bar Chris Constr. Corp.*,[1] many members of the bar, not to mention executives of malpractice insurers, have regarded securities law as one of the riskiest practice areas. Of course there were always cases involving litigators missing the statute of limitations, trusts and estates lawyers failing to recognize the rule against perpetuities, and divorce lawyers overlooking the value of unvested retirement benefits. But the big cases were the civil and administrative cases against securities lawyers operating under one or more of the laws administered by the Securities and Exchange Commission (SEC).

A Sudden Change of Focus: The Woes of the Bank Lawyer

This emphasis on the liabilities of securities lawyers ended abruptly on March 2, 1992. Lawyers awoke on the next morning to headline stories of an administrative proceeding brought by the Office of Thrift Supervision (OTS) against the well-known and respected New York law firm of Kaye, Scholer, Fierman, Hays & Handler (Kaye, Scholer) and three of its partners in which OTS sought "restitution" from the firm of not less than $275,000,000. Lawyers recognized that OTS was playing at a different level of seriousness, and the emphasis on the dangers of being a bank lawyer began.

The bar's recognition of the plight of Kaye, Scholer became even greater when the details of the asset-freeze order[2] became known. Not only had OTS brought an administrative proceeding in which it sought a huge recovery, but OTS found its charges so compelling that it issued, without judicial involvement, a "temporary cease and desist order" impaling the assets of the firm and severely restricting their use pending disposition of the proceeding. Kaye, Scholer came quickly to its knees, consenting to a permanent cease and desist order under which it agreed to pay the government $42,000,000, and agreed to limitations on its thrift practice. The named partners agreed to sanctions against themselves individually, including in one case a ban against any future thrift practice.

This case received notoriety primarily because of the amount of money involved and the effect of the asset-freeze order on the ability of Kaye, Scholer to defend itself. For some time the nuances of *Kaye, Scholer* were the hot topics whenever lawyer liability was discussed. When they began to look at the dangers of representing banks[3], lawyers discovered that the OTS action against Kaye, Scholer was, in fact, different only in degree, albeit substantial degree, from what bank regulators had already done. But like early actions involving securities lawyers, most of the early culprits against whom OTS or its sisters regulating IDIs (FDIC and RTC, in particular) brought proceedings were not prominent, prestigious, big city law firms. And, if the cases got any publicity at all, the facts seemed pretty extreme and the lawyers hardly at the top of the profession.

The notion that being a lawyer for an IDI is a fast way to big-ticket liability simultaneously reached its apogee and demise in April 1993 when the Cleveland mega-firm, Jones, Day, Reavis & Pogue (Jones, Day), settled a civil action brought against it by the Federal Deposit Insurance Corporation (FDIC) by agreeing to pay $51,000,000 to the insurance fund. One of its partners, formerly a high staff employee of the Federal Home Loan Bank Board (predecessor of OTS), accepted a ban on any further thrift practice.[4]

Meanwhile, Securities Lawyers Still Have Big Problems

While the bar's attention has been focused on bank-lawyer liability, there have been a number of significant new cases involving the liability of securities lawyers. Some of these have arisen in the context of the representation of IDIs and their parent holding companies. Consequently the securities bar may not have been as alert as usual in reacting to these new developments.

Since 1991 there have been five significant court cases bearing on issues related to the liability of securities lawyers. The first two, involving the major firms also tarred by OTS, Kaye, Scholer and Jones, Day, were settled for important amounts prior to trial. Thus most of the information about these cases is anecdotal or comes from the press. Each of the cases involved the sale of its SEC-registered notes by American Continental Corporation (ACC), the parent of Lincoln Savings. When Lincoln Savings was seized by FDIC, ACC went under, with little or no assets available to pay the notes. Thus the plaintiff noteholders took the now customary course of suing the professionals—underwriters, accountants, and lawyers.

In both cases the plaintiff noteholders alleged wrongful acts by the professionals under § 11 of the Securities Act and under SEC Rule 10b-5. Of course it can never be known for sure which allegations caused the hefty settlements, but a

quick look at their scope is illuminating. The claims under the Securities Act, directed primarily against the underwriters and the accountants for ACC, were based on allegations that the prospectus was misleading in its description of the risks of the investment, including compliance with banking laws and regulations and the financial condition of Lincoln Savings and ACC, and of the character of the company and its officers. Section 11 does not list lawyers among those subject to liability for a false or misleading prospectus. That, of course, does not stop plaintiffs and their lawyers from seeking to expand the meaning of the words of the statute.

Had the case gone to trial it is likely that the court and jury would have faced many of the same issues that permeate the *O'Melveny* case discussed below. The question of lawyer liability for a false prospectus would have turned on what the lawyers actually knew and what they should have known. The latter, in turn, would depend on a determination of what duty a securities lawyer has to the investing public for failure to ferret out fraud. Despite 25 years of experience since *Bar Chris* the answer is far from clear.

However the more interesting aspect of the *Kaye, Scholer* and *Jones, Day* ACC-notes cases relates to claims not directly arising from the truth of the prospectus. Both defendants were accused of participating in ACC's use of Lincoln Savings' lobbies as, essentially, sales offices for peddling the ACC notes. Plaintiffs alleged that Lincoln tellers pushed the notes on unsuspecting widows who regularly deposited their life savings in Keating's thrift. Clearly one of the reasons why the case never came to verdict was the parade of the destitute through the court and before the jury. Plaintiffs argued that these hapless note purchasers were deliberately mislead into believing that the notes were just like insured deposits, with the US government standing behind both. No one who read the prospectus, or even skimmed its cover page, could have been so mislead since it bore the customary bold-face, all-cap legend (the SEC's ultimate weapon in disclosure) stating that the notes were not insured deposits.

The lawyers were accused of awareness of and participation in the bait-and-switch (insured deposit to junk bond). Again, leaving aside what the parties could prove at trial, the issue presented was the duty of a securities lawyer to monitor compliance by the client with advice, which, if followed, should immunize both the client and the lawyer from liability.

If lawyers who render advice are charged with making sure the client follows that advice, there will be significant expansion of what lawyers must do on a day-to-day basis. It is generally considered part of the lawyer-client relationship that the client determines the scope of the engagement. Imagine, if you will, the reaction of a client when advised that the lawyer, without being asked, and often contrary to direct instructions of her client, insists on monitoring the client's activities to make sure the client is doing the right thing. The lawyer, out of self protection, either sets the scope of the engagement or won't represent the client. Yet that is exactly the thrust of what plaintiffs in the ACC case would require of all of us, at peril of our fortunes, our partners' fortunes, and the fortunes of our insurance carriers.

Whatever the merits of the cases against these two law firms, one sobering fact remains: the two firms and their malpractice carriers came up with a total of $44,000,000 to settle with the note purchasers. When that sum is added to the $93,000,000 paid to the government through settlements by the same two law firms with the OTS, their representations of Charlie Keating have proved costly beyond anyone's wildest imagination.

A New Twist: Securities Lawyer Liable to the Client for the Client's Fraud

To securities lawyers no recent case has proved more vexing than the 1992 decision of the Ninth Circuit in *F.D.I.C. v. O'Melveny & Meyers.*[5] While the case has been widely reported and discussed, it seems to have missed the close scrutiny that other cases involving securities lawyers have received. This may have resulted from its surface appearance as just another savings and loan case. And indeed there are significant thrift issues involved in the case that are likely to have great significance in securities and corporate cases not arising in a failed-thrift context.

O'Melveny arose when American Diversified Savings Bank (ADSB) failed and was seized by the predecessor of FDIC in early 1986. During 1985 ADSB had hired the firm (O&M) to represent it and its subsidiaries in connection with two tax shelter syndications. What O&M didn't know and didn't find out was that the two owners and other officers of ADSB were engaged in a massive fraud designed to make the financial statements of ADSB look much better than they were. They were, as the Court described it, "cooking the books". The case came to the Ninth Circuit after a grant of summary judgment in favor of O&M by the District Court.

The three principal issues were (i) whether the admitted fraud of ADSB's principals should be attributed to ADSB; (ii) even if it should be attributed to ADSB, whether FDIC, as receiver, took the claim free of such attribution and (iii) if FDIC was not tarred with the fraud of the ADSB principals, were there triable issues of fact as to whether O&M had committed malpractice in its role as lawyer to ADSB.

To issue (i) the Court held that the fraud of the principals of ADSB was not attributable to the bank because the "wrongdoers were acting adversely to ADSB and not on its behalf". However, there is nothing in the opinion to indicate that the principals personally profited or committed any fraud other than on behalf of the bank. To issue (ii) the Court determined that even if ADSB could not have successfully maintained an action against O&M because of the attribution to it of the fraud of its principals, FDIC took free of those claims. The Court found "incredible" the idea that "the agency created by Congress to rescue the economy and the victims of failing thrifts can claim no stronger ethical position than did the wrongdoers within the corporate entity."[6] It is on the issue of attribution of the fraud of the officers of the failed bank to the receivers that the case has garnered its notoriety in the world of failed-bank litigation. However, for securities lawyers, the holding that ADSB itself was not bound by the fraud of its owners and officers is likely to have the longest term adverse consequences.

One key element that distinguishes *O'Melveny* from other securities-law cases is that it is not about the duty of a securities lawyer to the purchaser of securities. Rather it deals with the liability of a securities lawyer to her own client, the principals of which are actively trying to mislead their own lawyers as well as the purchasers of the securities.

From the opinion it appears that while O&M did conduct an investigation of ADSB designed to allay its concerns that there be a "proper portrayal of

ADSB" in the private placement memoranda (PPM), the Court was extremely dissatisfied with O&M's failure to speak with any of the three national auditing firms ADSB had used during the year in which O&M was retained or to speak with Rogers & Wells (R&W), which also did work for ADSB that year. The Court states that the auditors who certified ADSB's financial statements included in the O&M-prepared PPMs were unaware of such inclusion. The Court also criticizes O&M's failure to interview several of the principals of ADSB, even though the Court seemed willing to acknowledge that some if not all of such principals were actively perpetrating the fraud.

The Court indicates that the duty of a lawyer, particularly one who "specializes" in securities law, is the protection of the client, ADSB as an entity, "from the liability which may flow from promulgating a false or misleading offering to investors." It also states that O&M "had a duty to guide [ADSB] as to its obligations and to protect it against liability. In its high specialty field, [O&M] owed a duty of due care not only to the investors, but also to its client, ADSB." It is the combination of these two principles that has created such a firestorm of protest from those who have followed the developments of the case. A decision holding that a lawyer has an obligation to the corporate client in the issuance of securities to ensure that the client is not lying is novel. The Court cites no supporting authority. Coupling this startling, newly found duty to the client with the unavailability of a defense based on the ongoing fraud of everyone at the client with whom the lawyer could interact is indeed frightening.

In simple terms *O'Melveny* stands for the proposition that a lawyer in a securities matter who does not know of a client's fraud and fails to find out about it through independent effort is probably liable to that client. This is a truly startling proposition. The Court in its defense indicates that if the ultimate trier of fact concludes that O&M was negligent, it would not be because of its "declination to 'ferret out fraud', but rather because it failed to make a reasonable, independent investigation." In the hot-house atmosphere of trials involving failed financial institutions, the trier of fact will have a difficult time differentiating between what procedures O&M followed and what it failed to find out as the result of those procedures. But whatever the conclusion, in the Ninth Circuit at least, a duty never before known has been created: if the client lies, cheats and defrauds his lawyer, he could well be liable to that client for not detecting its evil ways and preventing its fraudulent actions.

But They Aren't Liable to Defrauded Purchasers

Compare the *O'Melveny* description of the duties of securities lawyers to those found applicable in two Fourth Circuit cases decided within the past two years.

The first of those cases is the much criticized *Schatz v. Rosenberg*.[7] *Schatz** came to the Fourth Circuit after the District Court had granted a motion to dismiss. Thus the facts outlined below, which seem quite extreme, are those in the complaint, as construed against the defendant lawyers.

In *Schatz* the buyer of a business delivered to the seller a promissory note (a security) representing most of the purchase price. As part of the negotiation process the buyer of the business (seller of the security) delivered a copy of its financial statements to seller. These financial statements showing buyer to be in healthy financial condition were false. Buyer's lawyer knew of their falsity and knew that buyer was in fact insolvent. Nevertheless the lawyers participated in the closing, preparing closing documents, including a certificate from the buyer asserting the truth of the financial statements and averring that no adverse change had taken place since their date. The lawyers knew the statements in the closing certificates were false.

On the basis of these assumed-to-be true facts, seller sued buyer's lawyers. Before commencing the suit seller had obtained on a no-name basis a ruling from the Maryland State Bar Committee to the effect that buyer's lawyers had violated the applicable Rules of Professional Conduct. The Bar Committee opined that the lawyers had an ethical duty either to withdraw or to disclose the falsity.

Seller argued three bases for liability, each of which justified a finding that a duty existed and was breached: federal securities laws, the Maryland Rules of Professional Conduct, and public policy. The Fourth Circuit panel rejected all three and affirmed the dismissal.

On the securities law claim the Court reasoned that to have a duty to disclose, the lawyer must stand in some fiduciary or confidential relationship with plaintiff. Since none existed, no duty to disclose existed. The Court specifically rejected the idea of imposing on lawyers liability for misrepresentation under SEC Rule 10b-5 if the lawyers disseminate information (in *Schatz* by delivering or participating in the client's delivery of known false information) "'with an intent, knowledge or awareness that the information will be communicated or disseminated to persons . . . in connection with the purchase or sale of a security.'" The Court distinguished those cases that held a lawyer liable to third parties when the lawyer had drafted "*knowingly false disclosure documents.*" [Emphasis added.] The Court noted that the lawyers "did not solicit any purchase of securities or prepare any solicitation documents." The nature of this comment suggests that the result would have been different if a PPM or other offering materials had been used.

The Court also rejected the Ethics-Rule argument and held that ethics rules form the basis for disciplinary action, but do not create a civil claim for damages.

Finally the Court found no merit in the public-policy argument. While sympathizing with plaintiff's plight, the Court determined that the public-policy grounds justifying the preservation of client confidences were at least as convincing as those which would require a lawyer to prevent financial harm to a non-client.

A Look at Why Rosenberg Won and O'Melveny Lost

The results in *O'Melveny* and *Schatz* are anomalous. To prevail O&M, which did not know of its client's fraud on it and the buyers of its securities, will have to establish that it couldn't have found out about the fraud by exercising "due diligence". If the trier of fact determines that O&M didn't do an acceptable job of diligence, O&M will be liable for damages. The party receiving the money will not be the investors for they have already got their money back. Rather it will be the fraudulent client, in this case represented by its successor. On the other hand the lawyers in *Schatz* knew their client was committing a fraud in connection with the sale of a security, and participated to the extent of preparing documents and participating in the closing. They were found not liable to the defrauded buyer. The *O'Melveny* Court stated that O&M had conceded the lawyer's duty to the buyers of securities; it was only their liability to the fraudulent client that concerned the Court.

* * *

*See also the Freeman and Freivogel discussions elsewhere in this issue. *Schatz* has occasioned unprecedented expressions of disbelief and disgust. Ed.

The other case from the Fourth Circuit, *Fortson v. Winstead, McGuire, Sechrest & Minick*,[8] gives further solace to securities lawyers. Like O&M in the ADSB matter, Winstead, McGuire, was retained to represent the syndicators of a real estate limited partnership in connection with the private offering of partnership interests. The firm was identified in the PPM as "counsel for the partnership", but its role was, in fact, limited to tax matters and the rendering of a tax opinion reproduced in the PPM.[9]

Like the panel in *Schatz*, the Court in *Fortson* found that Winstead, McGuire, as counsel to the syndicator, had no duty to the purchasers of the securities. While the Court seemed disinclined to believe that Winstead, McGuire was aware of the false financial statement complained of by plaintiffs, it determined that even if the firm did know, there could have been no justifiable reliance by the investors on expectations that the firm was charged with securing disclosure of the falsity.

By way of comparison: in *O'Melveny* FDIC did not argue that O&M knew of the fraud, yet was able to convince the Ninth Circuit that "should have known", a negligence standard, is enough to make the law firm liable to its fraudulent client. *Schatz* and *Fortson* were decided on records stipulating that the lawyers knew of their client's fraud, yet the lawyers escape liability. In *O'Melveny* the Court states that O&M conceded a duty to investors. The two Fourth Circuit panels found the lawyers to have no duty to investors, even though the lawyers knew of the fraud of their clients. *Fortson* involved an offering document, *Schatz* did not. These cases present major and irreconcilable inconsistencies between the views of the two Circuits.

Summing Up and A Look at Damages

It is interesting to speculate whether the Ninth Circuit would have been less solicitous of the fraudulent client had the case not arisen in the context of the "savings and loan disaster". However, as the law now stands, a lawyer in the Ninth Circuit owes its organization client a duty to discover and prevent the client's fraud on third persons. Failing this it will have to pay damages to its client in the amount suffered by the client as the result of the client's fraud.

The Ninth Circuit gives guidance in calculating the damages O&M will pay if FDIC prevails at trial. In addition to forfeiting any fees due and giving back all fees received, the firm will be liable for real estate settlement costs, brokerage fees, and most importantly, losses on the real estate purchased with the proceeds of the fraudulent offering. This could be a high price to pay to a client because it is a cheat.

The law firms affected by the rash of liability claims from OTS and its sister regulators for failing the grade as S&L lawyers have had their names dragged through the mud, with such headlines as "They Got What They Deserved". Their malpractice carriers have paid numerous multi-million dollar judgments and settlements. Even with these massive insurance payments almost all major settlements have involved the partners in the firms having to reach into their own pockets to fill the pot. Together this will inevitably cause significant increases in E&O insurance premiums or the insolvency of casualty insurance companies and Lloyd's syndicates, as well as severe instability in law partnerships as the innocent, as well as the guilty, experience the financial pain of a thrift practice.

In the securities field the E&O insurance market for securities lawyers went through a major upheaval in the 1970s and early '80s. Insurance premiums went up in many hundreds of percent. Bar-related insurance carriers, typically insuring lawyers not practicing in larger firms, either excluded coverage for securities work, or sold a rider for a hefty premium. It is not yet possible to predict what will happen to availability of coverage for bank and thrift work or the added cost of writing around an exclusion.

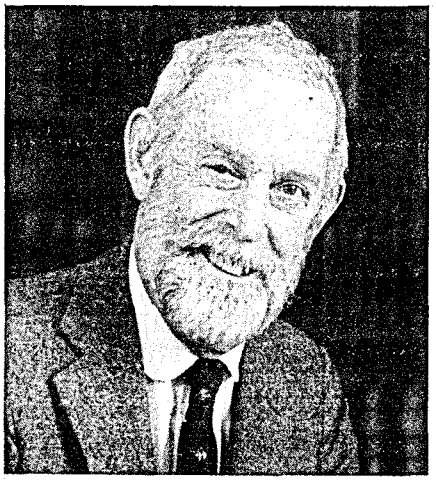
Some insurance carriers have already put limitations on their insured's representation of IDIs if a lawyer in the firm sits on the board or owns any substantial amount of its stock. Many large law firms have made their criteria for undertaking a new representation of an IDI much more difficult to satisfy and have been reviewing the risk/reward ratio of continuing in that business at all. These firms are trying to judge whether they can provide the service the client wants and needs at a price the client can afford, given the self-preservation needs of the firms to shield themselves from OTS/FDIC-type claims.

The ultimate answer to the rhetorical question posed by Judge Stanley Sporkin and usually paraphrased (incompletely and inaccurately, but nevertheless pervasively) "Where were the lawyers?" will be "No one represents banks any more; it's just too risky." IDIs may well be left to find their lawyers among the unsophisticated or uninsured. While legislative calls to the financial institution regulators to be diligent in extracting as much as possible from the lawyers and accountants involved with banks in the 1980s may produce many millions of dollars in judgments and settlements, the long term cost to society of driving capable professionals out of the practice area will ultimately be measured in the billions. The same is, to a lesser extent, true in the securities field. The revenues from a securities practice must be commensurate with the risks of being found liable for not detecting that your client is a crook. If even *the crook* can sue you for malpractice, the risks have been greatly multiplied. And, of course, the costs go up, maybe dramatically, as you plan your diligence efforts with a view to protecting yourself from ultimate liability.

From an ethical viewpoint, the regulators' and plaintiffs' bar, not your client, are dictating the scope of your engagement. In your own self defense you may well insist that the client authorize you to do more than the client may want. If the client won't go for the increase, or in the more typical case won't pay for it, your choices are (i) not to represent the client, (ii) take the risks inherent in a job done less fully than you believe necessary for self-protection, or (iii) cut or eliminate the profits from the work. Each choice produces undesirable results for you, for the client and for society.

* * *

Constraints of space make it impossible to include the author's extensive footnotes, but the numbers to these footnotes appear. The full footnotes will be available upon request to the offices of this magazine.



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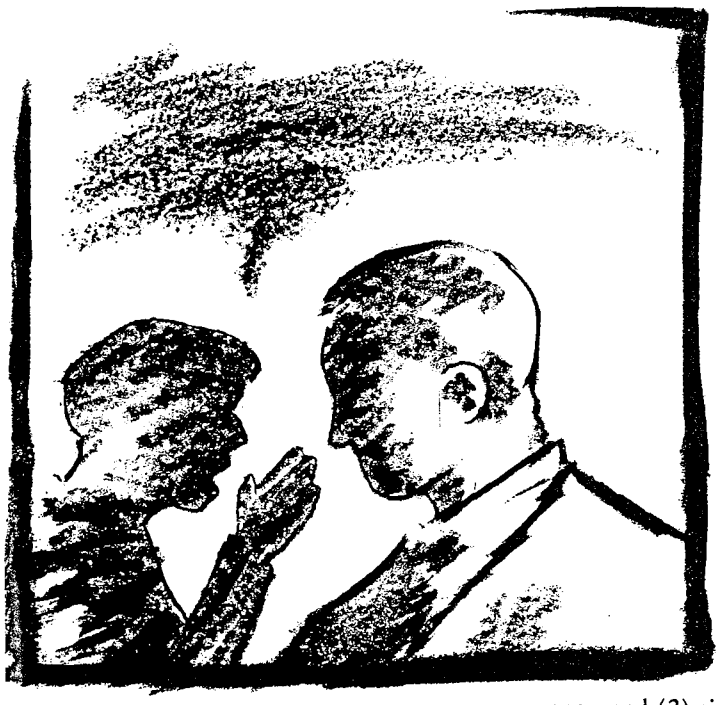
JOHN P. FREEMAN

Current Developments in Lawyer Liability: Coping with the Fraudulent Client

Legal ethics and malpractice have combined into a distinct specialty area. Developments marking the field's evolutionary growth come in increased volume, complexity and magnitude. Major recent mileposts include the unpleasantness encountered by Jones Day, Kaye Scholer and numerous other fine law firms adversely affected by the S&L implosion; bankruptcies at some large firms; government forfeiture attacks on legal fees; myriad sanctions decisions; and an impressive drumbeat of civil cases.



We examine here the issue from three overlapping perspectives: (1) the lawyer's ethical obligations; (2) requirements flowing from the common law of agency; and (3) aider and abettor under the securities laws.

THE ETHICAL DUTY TO REPORT CLIENT MISCONDUCT

THE NATIONAL STUDENT MARKETING PRECEDENT

The SEC gave us the first dramatic, nationally significant lawyer liability case raising profound ethics issues when it sued two prominent firms, White and Case and Lord, Bissell & Brook, in 1972. See the landmark *National Student Marketing* complaint in [1971-72 Transfer Binder] Fed. Sec. L. Rep. (CCH) 93,360 at 91,913. For the first time prominent lawyers and law firms were accused of participating in and aiding and abetting their clients' multi-million dollar frauds.

More stunning yet was the SEC's seemingly bizarre allegation that certain defendant lawyers owed a whistle-blowing obligation transcending their duties of loyalty, zeal, and confidentiality to their clients. The SEC alleged that "[a]s part of the fraudulent scheme," White & Case, Lord Bissell & Brook, and certain individual lawyer defendants had wrongfully failed to halt a merger premised on bogus financial statements, or, that alternatively, the lawyers had a duty to withdraw and notify the Commission concerning the misleading financial statements.

THE CODE OF PROFESSIONAL RESPONSIBILITY

The SEC's suggestion of an obligation to squeal on clients to a federal agency struck most lawyers as absurd. Precedent for the SEC's position existed, however, and in the most embarrassing possible place: the ABA's Model Code of Professional Responsibility. As originally adopted, DR 7-102(B)(1) demanded that a lawyer seek to have his or her client rectify client frauds perpetrated in the course of representation, with, as a last resort, the lawyer having a duty to "reveal the fraud to the affected person or tribunal."

The belated appreciation of DR 7-102(B)(1)'s broad reach led the organized bar to issue what amounted to a product design defect recall, in the form of a 1974 amendment to the rule, aimed at limiting instances when whistle-blowing was required. The amendment was adopted by a minority of states and later buttressed by a restrictive interpretive opinion, ABA Formal Opinion 341 (1975).

Illustration by Steve Ansul

THE RULES OF PROFESSIONAL CONDUCT

The subsequently-adopted Rules of Professional Conduct continued with a pro-client bent, incorporating a very strong confidentiality bias in Rule 1.6. The Rules were written seemingly to bar lawyers' disclosures about their clients' financial frauds, no matter how vicious or cunning. The new Rules' text seemed to confine the lawyer's whistle-blowing duty to instances of client fraud on tribunals. The seemingly absolute ethical duty of confidentiality carried a possible side benefit in the form of malpractice protection. After all, how could a lawyer be civilly liable for not having taken action that was ethically forbidden? Indeed, a number of cases have cited confidentiality as a basis for protection against civil claims by third parties. *E.g., Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 497 (7th Cir. 1986).

ABA FORMAL OPINION 92-366

The overwhelming pro-client, pro-confidentiality bias found in the Rules of Professional Conduct has undergone some erosion. The American Bar Association's Ethics Committee Formal Ethics Opinion 92-366 suggests whistleblowing in the face of client fraud is permissible in some cases. It deals with a corporate lawyer's duty to reveal client fraud in the context of a tainted $5 million loan. The client ostensibly had a net worth of $15 million. The lawyer gave the lending bank an opinion:

> in the customary form to the effect that (i) the client had been duly organized and was in good standing ... (ii) the loan transaction had been duly authorized ... ; (iii) all obligations cited in the loan documents were enforceable against the client in accordance with their terms ... ; and (iv) all installation contracts were enforceable obligations ... against the client's customers.

At closing, the lender relied on the legal opinion, the client's audited financials depicting robust economic health, and client's treasurer's opinion attesting that the financial statements fairly reflected the company's financial position. Unbeknownst to the bank, the lawyer, and the client's CPAs, the client's net worth had been severely inflated by the company's CEO and treasurer who had fabricated millions of dollars of false installation contracts; the client's true net worth was less than the $5 million borrowed from the bank. The loan foreseeably would not be repaid when due, and part (iv) of the lawyer's opinion letter was false.

After obtaining the loan, the CEO and treasurer confessed to the opinion lawyer, while announcing their intention to conceal the fraud from everyone else, including the company's CPAs.

In light of the disclosures made, the lawyer knew that the client intended further use of her opinion to defraud the bank and other third parties. After consultation pursuant to Rule of Professional Conduct 1.13, the company's third board member basically elected to ignore the problem.

On the foregoing facts, the ABA Committee held:

> A lawyer who knows or with reason believes that her services or work product are being used or are intended to be used by a client to perpetrate a fraud must withdraw from further representation of the client, and may disaffirm documents prepared in the course of the representation that are being, or will be, used in furtherance of the fraud, even though such a "noisy" withdrawal may have the collateral effect of inferentially revealing client confidences.

The Committee premised its ruling on the interaction of Rule 1.16, Rule 1.2(d) and with Withdrawal comment under Rule 1.6 that allows withdrawing lawyers to "withdraw or disclaim any opinion, document, affirmation or the like." Rule 1.16(a)(1) requires that a lawyer shall withdraw if the "representation will result in a violation of the rules of professional conduct or other law." The Committee read the term "representation" to include permitting the client's continued use of the lawyer's pre-existing work product in furtherance of a fraudulent scheme. It interpreted Rule 1.16(a)(1) to mandate that lawyer's withdrawal from representation in any matters involving the legal opinion, the fraudulent contracts, or the erroneous financial statements, on the theory that continued representation would constitute assisting the client in a course of conduct known to be fraudulent in violation of Rule 1.2(d). The Committee specifically approved issuance of the "noisy notice of withdrawal" option available under the Withdrawal comment to Rule 1.6 in mandatory withdrawal cases. It held that the

> Comment correctly reflects the need to interpret Rule 1.6's requirement of confidentiality in light of what Rule 1.2(d) and 1.16(a)(1) require of a lawyer in a situation where continued representation of the client will entail the lawyer's assisting in the client's continuing or future fraud and withdrawal is therefore mandatory.

The lawyer's repudiation envisioned by the Committee was strictly bare bones: "The lawyer may and indeed must decline to discuss or otherwise reveal anything about the disaffirmed work product beyond the simple fact that she no longer stands behind it." Likewise conservative was the Committee majority's closing evaluation of its handiwork:

> Our present opinion reads the Rules as permitting limited disclosure only where the client is determined to continue the fraudulent conduct which the lawyer has unwittingly facilitated, or to make use of the lawyer's services or work product in a future fraud, *and there is no other way for the lawyer to avoid giving assistance to such continuing or future fraud* in violation of Rule 1.2(d). In these limited circumstances, where silence would result in a violation of the lawyer's duty under Model Rule 1.2(d) not to assist a client's ongoing or intended future fraud, we are persuaded that her duty to keep client confidences must give way to the extent necessary to avoid this result. (Emphasis added).

Tort law suggests that counsel who learns his work product is being used to further a fraud owes a duty to a foreseeable third party who may detrimentally rely on that work product. *See Restatement (Second) of Torts* 551(2)(c) (1977). If a lawyer may or must recall a negligently rendered erroneous opinion, thereby possibly prejudicing the client, then why does the client deserve special protection when the error is due to the client's own fraud? *See* Bermant & Lorne, The Noisy Withdrawal, *Business Law Today*, July/August 1993, at 40, 57.

The course of action espoused by Opinion 92-366 is hardly revolutionary or startling. The noisy notice position taken in Opinion 92-366 actually accords with ethics rules in a majority of states. Thirty-seven states' ethics rules would permit disclosure, while four would require it.

Though the Committee stopped well short of resurrecting the mandatory disclosure mechanism found originally in

DR 7-102(B)(1), the Opinion significantly undermines the protective, pro-client defensive position of Rule 1.6. By holding that whistle-blowing is permissible, the Opinion invites fraud victims to show, through expert testimony, that the fraud-feasor's hapless lawyer was civilly *obligated* to what the ethics rules *permit.* This factor has led some to wonder whether Opinion 92-366 "may have the inevitable effect of requiring lawyers to squeal on the client or join the client as a paying party in litigation." Bermant & Lorne, *supra* at pp. 40, 57.

AGENTS' LIABILITY FOR AIDING THEIR PRINCIPALS' FRAUD

Agency law applies throughout our modern service economy wherever two parties enter into a relationship whereby one manifests a willingness that the other "should act for him and subject to his control," with the other consenting so to act. See *Restatement (Second) of Agency* § 1 (1958). The law of agency has been around for as long as there have been lawyers. Indeed, one would rarely encounter a lawyer who does not make a living functioning as agent for others.

In some respects, the Rules of Professional Conduct are simply agency rules customized for situations lawyers encounter. Sometimes there is direct overlap. Thus, just as Rule of Professional Conduct 1.2(d) bars lawyers from assisting "a client in conduct that the lawyer knows is criminal or fraudulent," *Restatement (Second) of Agency* § 348 (1958) provides in part:

> an agent who ... knowingly assists in the commission of a tortious fraud ... by his principal ... is subject to liability in tort to the injured person, although the fraud ... occurs in a transaction on behalf of the principal.

Knowingly assisting others in perpetrating frauds is anti-social, and for lawyers it is unethical as well. For lawyer-agents, such misconduct is not only unethical, it is actionable under section 348, or at least it would seem to be. But one recent Fourth Circuit case holds to the contrary. Does that case, *Schatz v. Rosenberg*, 943 F.2d 485 (4th Cir. 1991), presage a pro-lawyer trend or merely feature wrong-headed reasoning?

In *Schatz*, the defendant law firm was charged with engineering its client's purchase of two close corporations' control stock for debt through bogus assurances of financial solidity. The client-buyer's name was Rosenberg. The defendant law firm "had represented Rosenberg and his entities throughout" the period preceding the purchase, during which "Rosenberg's financial empire had crumbled." *Id.* at 488. The demise of Rosenberg's empire was concealed from the control sellers, Mr. and Mrs. Schatz, which presumably is why they were willing to take a note and Rosenberg's guarantee, rather than cash.

After obtaining control, Rosenberg siphoned off the companies' liquid assets, in part to pay counsel's fee, thereby, in the court's eyes, adding "insult to injury." Id. at 488. In short order the acquired firms were as broke as its new owner,with Mr. and Mrs. Schatz unpaid. They sued the buyer's counsel, alleging knowing complicity in his use of fraudulent financial statements.

Purporting to apply Maryland law, the Fourth Circuit dismissed, holding that plaintiffs could not sue Rosenberg's lawyers under any set of facts. Mr. and Mrs. Schatz premised their case in part on *Restatement (Second) of Agency* section 348, quoted above. The section is dead on point and would have barred a dismissal at the pleading stage had it been found applicable. Instead, the Court ruled that the *Restatement* section does not apply to agent-lawyers.

Missing from Schatz is an explanation why certain types of agents, such as bankers, realtors, used car dealers, and aluminum siding salesmen, merit a higher culpability standard than lawyers. The court expressly rejected plaintiffs' attempt to use an ethics opinion they had obtained from the Maryland State Bar Committee on Ethics "on the facts of the present case." *Id.* at 492. The Committee had ruled that the lawyer's ethical obligation was to "either withdraw ... or disclose the misrepresentation to the third person." *Id.* The Fourth Circuit dismissed the ethics ruling as irrelevant, holding expressly that "ethical rules do not create a legal duty of disclosure on lawyers." *Id.*

SCIENTER IN AIDER AND ABETTOR CASES

Schatz, joined the trend toward cutting back lawyer (and accountant and lender) exposure to indirect liability in investment fraud cases. *E.G. Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490 (7th Cir. 1986); *DiLeo v. Ernst & Young*, 901 F.2d 624 (7th Cir.), *cert. denied*, 111 S.Ct. 347 (1990). Aside from its agency ruling, the Fourth Circuit in *Schatz* joined the Fifth Circuit in suggesting that where the wrongdoer owes no affirmative disclosure duty to the victim, the scienter element for aider and abettor liability under the securities laws demands proof of "high conscious intent," rather than recklessness.

This "high conscious intent" scienter formulation has a dubious pedigree. For example, an August 1993 WESTLAW search of the (United States Supreme Court) and state court databases found that phrase in no decision in either database. The first use of the term in a federal court WESTLAW database was in *Woodward v. Metro Bank of Dallas*, 522 F. 2d 84 (5th Cir. 1975), which posited that for aiding and abetting in a fraud case, "the scienter requirement scales upward when activity is more remote," *Id.* at 95, with "high conscious intent" being the standard in cases where the aider and abettor owed no affirmative duty of disclosure to the victim. *Id.* at 97.

The *Schatz* pro-lawyer leaning was not confined to scienter. It also ruled that showing "substantial assistance" in an aider and abettor case requires proof that the lawyer did more than prepare the crucial documentation. *Schatz* implied that substantial assistance demands participation beyond handling the paperwork for the client perpetrating the primary violation. 943 F.2d at 497.

The Fourth Circuit's legal scholarship in *Schatz* left ethics experts unimpressed. Professor Geoffrey Hazard scornfully appraised the result as "obviously and egregiously wrong," and tantamount to giving corporate lawyers a "license to steal." He dismissed the court's reasoning as bad enough to "embarrass a first-year law student." Hazard, "*Schatz* Ruling Errs on Legal, Moral Basis," *Nat'l. L. J.* Jan. 20, 1992, at 17. As Hazard suggested, it is not easy to find a principled policy basis for the agency law ruling in *Schatz.* Perhaps the court believed that immunizing lawyers from accountability for aiding clients' fraudulent misbehavior would further the free flow of communication between client and counsel. However, the common law has never seen fit to shelter attorney-client communications in furtherance of fraud. Indeed, prima facie proof that lawyer-client communications were intended to assist a client fraud serves as grounds for invoking the "crime-fraud" exception to the attorney-client privilege. *See generally, Developments in the Law — Privileged Communications*, 98 Harv. L. Rev. 1450, 1509-14 (1985).

One consequence of the *Schatz* scienter formulation is that defrauded in-

vestors will find that scienter is hardest to show where proving it is most important: in the massive, sophisticated nationwide swindles like the tax-shelter scams of the 1980s. As the size and cruelty of the scam increase, the likelihood of personal contact or fiduciary ties between ringleaders and victims declines. Under the Woodward/ Schatz formulation, proof of scienter against remote aider and abettors ascends to the level of practical impossibility.

IMPENDING CLARIFICATION

On June 7, 1993, the Supreme Court granted certiorari in *First Interstate Bank of Denver, N.A. v. Pring*, 969 F.2d 891 (10th Cir. 1992), *cert. granted sub nom. Central Bank of Denver v. First Interstate Bank*, 61 U.S.L.W. 3818 (1993). The parties were directed to brief two issues: Whether rule 10b-5 gives rise to a claim for aider and abettor liability; and, if so, whether recklessness satisfies rule 10b-5's scienter requirement absent "breach of a duty to disclose or act."

By asking the parties to brief the first point, the Court signaled its intention to resolve the issue it left open in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.7 (1976), namely, "whether civil liability for aiding and abetting is appropriate" under rule 10b-5, as all circuit courts confronted with the issue have held. Indeed, the appellant in *Central Bank of Denver* had not even sought certiorari on the issue, evidently considering the point unwinnable, as it probably is. Cutting in favor of upholding aider and abettor liability is the rule's text, which makes it illegal for "*any* person, directly or *indirectly* ... to employ any device, scheme, or artifice to defraud [or] to engage in *any* act, practice or course of business which operates or would operate as a fraud or deceit upon any person." (Emphasis added). Validating aider and abettor liability seems likely, but by no means certain, given the Court's enthusiasm for pruning back 10b-5's reach.

Assuming aider and abettor claims are upheld, the Court will then address the 10th Circuit ruling in *Central Bank of Denver* that, even where there is no duty to disclose, *recklessness* (as opposed, for example, to "high conscious intent") suffices to meet the knowledge requirement. 969 F.2d at 900-902. *Central Bank of Denver* thus conflicts with cases such as *Schatz* and *Woodward*.

The defendant bank in *Central Bank of Denver* served as indenture trustee for a municipal bond issue. It allegedly took "affirmative action" by agreeing to postpone, until months after the bond issue was sold, independent review of a dubious appraisal for the real estate securing the bonds. The land was supposed to be worth 160 percent of the bond's outstanding principal and interest. It was not. The bonds went into default, and suit followed. The Tenth Circuit held that the bank's agreement to postpone inquiry, with knowledge of inadequacies in the appraisal, and occurring at a time when it was preparing to be indenture trustee, provided an inference of reckless misconduct. *Id.* at 904.

Though proof of "high conscious intent" was not required, the plaintiff was not necessarily given a free ride. The recklessness scienter standard applied in the Tenth Circuit is very demanding:

> "highly unreasonable" conduct involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care ... which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.

O'Connor v. R.F. Lafferty & Co., Inc., 965 F.2d 893, 899 (10th Cir. 1992), *quoting Sunstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir.) *cert. denied*, 434 U.S. 875 (1977).

THE CRIMINAL LAW ANALOGY

The Tenth Circuit's recklessness formulation is rigorous: it accords with the culpability standard for *criminal* recklessness. The Model Penal Code provides in relevant part:

> 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 risk must be of such a nature and degree that, considering the nature and purpose of the actor's conduct and the circumstances known to him, its disregard involves a gross deviation from the standard of conduct that a law-abiding person would observe in the actor's situation.

Model Penal Code § 2.02(c) (1985).

The Model Code's criminal recklessness definition has been "substantially accepted" as a model for the formulation of recklessness in many states' penal codes. Moreover, Model Penal Code section 2.02(3) provides that any criminal law element that does not have a culpability level prescribed for it can be satisfied if the person acted recklessly. Model Penal Code § 2.02(c). In other words, recklessness suffices to establish criminal culpability absent evidence of a contrary legislative intent. This represents "what usually is regarded as the common law position." 1 Model Penal Code & Commentaries to § 2.02, Comment 5, p. 244 (1985). A fair question is why a level of culpability that suffices for criminal convictions is inadequate for 10b-5 cases.

The symmetry between criminal recklessness and 10b-5 recklessness illustrates the great leap taken in cases like *Schatz* and *Woodward* to protect 10b-5 fraud defendants: the scienter standard has been ratcheted upward beyond the level traditionally needed to sustain a criminal conviction.

POLICY QUESTIONS

How can scienter standards in 10b-5 civil suits be raised without also raising them in criminal prosecutions? If professionals who "merely papered the deal" deserve protection from prosecution in 10b-5 civil cases on policy grounds, why should the safe harbor's limits stop at the securities laws' boundaries? Should not professionals who further their clients' frauds enjoy special protection from liability under the mail fraud, wire fraud, and false statement statutes?

Skeptics like Professor Hazard may rightfully puzzle over cases giving lawyers, but not other classes of agents, special protection when they have facilitated client fraud. Why, for example, should lawyers who "merely papered the deal" be held to a less demanding liability standard than the executive they advised? Does giving lawyers preferential treatment under agency law raise an equal protection problem? What does Rule 11 precedent tell us about the federal judiciary's position on bad lawyer papering jobs, at least when it is the judges who are getting papered? If, as *Schatz* held, ethical duties are irrelevant in civil lawsuits, then why are experts in legal malpractice cases often allowed to rely on ethical norms when evaluating defendant lawyers' conduct in civil cases? E.g., *Hizey v. Carpenter*, 119 Wash. 2d 251, 830 P.2d 646 (1992).

Some years ago, in *Neel v. Magana, Olney, Levy, Cathcart & Gelfand*, 6 Cal.3d, 176, 98 Cal. Rptr. 837, 491 P.2d 421 (1971), California's Supreme Court brought the law covering tolling of limitations periods in suits against lawyers into line with standards covering other service providers. In

doing so it observed that

> [I]n our complex and interdependent society, human relations are ever being further fit into a framework of legal rights and responsibilities, and, in this process, the role of the lawyer has become increasingly crucial. As more individuals come to depend on him, his responsibility must broaden and deepen. The legal calling can ill afford the preservation of a privileged protection against responsibility ...." *Id.* at 194, 98 Cal.Rptr. at 849, 491 P.2d at 433.

Many lawyers and jurists are becoming increasingly concerned over the profession's negative public image. Let's face it: that image is not enhanced when lawyers are found to have furthered client frauds. Lawyers who knowingly or recklessly allow their services to become instruments for inflicting tortious injury on others deserve to be punished. Most lawyers would agree that the result reached in Formal Opinion 92-366 makes sense. Indeed, it already is the law in a majority of states. Likewise, *Restatement (Second) of Agency* § 348 sets forth a reasonable rule governing an agent's legal liability, and there is no reason lawyers should be exempt. In *Central Bank of Denver*, the Supreme Court has the opportunity to validate *Schatz*'s pro-lawyer scienter formulation as the law of the land. The Supreme Court's ruling should guide us to a better understanding of how far our professional obligations extend.

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WILLIAM FREIVOGEL

Conflicts of Interest and the Business Lawyer: A Professional Liability Epidemic

Cases have originated from an increasing attitude among clients that every unsatisfactory result creates a cause of action against their lawyers. Add to that lawyers without enough work to do and willing to sue just about anybody for just about anything. Result: more cases against lawyers for alleged conflicts of interest!

For many years conflicts of interest were considered to be the private preserve of litigators. And, the consequences of having a conflict were seldom little more than the aggravation and lost fees resulting from a disqualification order. All that has changed, and lawyers — both litigators and non-litigators — are being sued for, and are paying, substantial damages flowing from real or perceived conflicts of interests.

Nowhere is this trend more startling than in the case of business lawyers. I shall discuss here several cases involving business lawyers who paid substantial damages, principally because they had apparently debilitating conflicts, and some of the lessons of those cases.

Where appropriate the Delaware Lawyers' Rules of Professional Conduct, which substantially mirror the ABA Model Rules of Professional Conduct, will be referred to as "Delaware Rule 1.7," and so forth.

RELEVANCE OR ADMISSIBILITY OF ETHICS RULE VIOLATIONS IN CIVIL CLAIMS AGAINST LAWYERS

The introduction to the ABA Model Rules of Professional Conduct in a section entitled "Scope" contains the following language:

> Violation of a Rule should not give rise to a cause of action or should it create any presumption that a legal duty has been breached....They are not designed to be a basis for civil liability.

Many of the states that adopted the Model Rules also adopted that language, including Delaware. Notwithstanding that language, courts around the country have taken at least three different approaches to the role, if any, that the ethics rules play in civil damage litigation against lawyers:

A. Legal Ethics Rules Have Absolutely No Role in Civil Damage Litigation Against Lawyers. An extraordinary statement of that approach is the opinion in *Schatz v. Rosenberg*, 943 F.2d 485 (4th Cir. 1991), discussed in some detail by Professor Freeman in the preceding article. In opposing a motion to dismiss the complaint, the plaintiff invoked the prevailing ethics rule (Maryland's Rule 1.2(d), which is the same as Delaware Rule 1.2(d)). The court responded that while the rule might require some sort of disciplinary proceeding against the law firm; it had no role in the damages case.

Hizey v. Carpenter, 119 Wash. 2d 251, 830 P.2d 646 (1992) is in the same vein. There, the court held that expert witnesses in civil damage cases against lawyers could not refer to legal ethics rules in their testimony. The court said that experts could refer to principles embodied in the rules but could not tell the jury about the rules or refer specifically to them.

B. The Ethics Rules Provide Some Guidance to Courts and Juries. Several courts have taken the position that a violation of an ethics rule can either create a rebuttable presumption of malpractice or that ethics codes constitute standards of care in professional malpractice actions. Peters, *The Model Rules as a Guide for Legal Malpractice*, 6 Georgetown J. Legal Ethics 609, 617 (1993); Restatement, Third, Law Governing Lawyers 74 (2), Comment g, Reporters' Notes 71-73 (Preliminary Draft No. 9, July 12, 1993).

C. The Jury Should Know All

About the Ethics Rules and Precisely How They Affect the Case. The following very recent cases hold that not only should expert witnesses be permitted to refer to the ethics rules, but that courts are permitted *to instruct the jury* as to their content and the role that they play. *Mirabito v. Liccardo,* 5 Cal. Rptr. 2d 571 (Cal. App. 1992); *Mayol v. Summers,* 585 N.E.2d 1176 (Ill. App. 1992).

The author is not aware of any holding that violation of an ethics rule *alone* provides a civil cause of action against a lawyer. In other words, probably no jurisdiction would allow a plaintiff to plead a separate count based upon the violation of an ethics rule — particularly those jurisdictions that have language in their ethics codes similar to the ABA Model Rule introductory language quoted above.

Nevertheless, the ethics rules will play a role in many cases. The two fundamental bases of conflict of interest rules are clients' reasonable expectations regarding: (1) the confidentiality of information they give to their lawyers; and, (2) their lawyers' loyalty to them. C. Wolfram, *Modern Legal Ethics* 313 (1986). Because negligence and breach of duty causes of action frequently involve a failure of clients' reasonable expectations either as to confidentiality or loyalty or both, the ease with which the conflicts rules can be woven into claims against lawyers — without pleading a separate count for breach of an ethics rule — should be apparent. The cases discussed below illustrate the importance of these principles in the professional liability context.

DAMAGE CASES INVOLVING CONFLICTS OF INTEREST IN THE TRANSACTIONAL CONTEXT

The Ivan Boesky Limited Partnerships. The following recitation is based largely upon the complaint filed in the United States District Court for the Southern District of New York, in Case No. 87 Civ. 1865 (MP). The truth of those allegations was never tested, because the case was settled.

Fried, Frank, Harris, Shriver & Jacobson in New York City had represented Ivan Boesky in a variety of ventures. In early 1986 Fried, Frank represented Boesky in setting up several limited partnerships, raising about $1 billion from limited partner/investors. Fried, Frank allegedly held itself out to the limited partner/investors as "counsel for the partnerships."

When Boesky realized that his illegal insider trading had come to the atten-

tion of the SEC and the Justice Department, he asked Fried, Frank to represent him in highly confidential plea bargaining negotiations with those agencies. The firm did so but failed to tell the limited partner/investors about Boesky's problems. The negotiations remained confidential for almost six months without the law firm's telling the limited partners what was going on.

When the results of the plea bargaining were made public, and the limited partners learned what had happened, they sued Boesky, his associates, an accounting firm and Fried, Frank, among others. Fried, Frank's alleged conflict of interest was an important feature in the claim.

The firm's perceived lack of loyalty to the limited partners in failing to tell them of Boesky's crimes when they might have been able to cut their losses most likely contributed to the firm's desire to settle, which they did for an undisclosed sum, believed to be several million dollars. See, *Wall St. J.*, July 9, 1991; *Palm Beach Rev.*, July 12, 1991.

Conflict Leads to Fee Forfeiture. *Eriks v. Denver,* 118 Wash. 2d 451, 824 P.2d 1207 (1992). A lawyer attempted to represent both the general and limited partners in an IRS audit of the limited partnership. The lawyer was unsuccessful, resulting in tax assessments and penalties against all concerned. The limited partners brought a class action against the lawyer for malpractice. The trial court granted summary judgment on behalf of the limited partners and ruled that the lawyer should return all the fees that he collected from them.

The Oklahoma Oil Field Case. Adco Oil Co, a small oil and gas company, hired an Oklahoma lawyer to attempt to persuade the Oklahoma Corporation Commission to order the division of an Oklahoma oil field. The lawyer then discovered that his long-time client, Mobil Oil Corp., was opposed to the granting of that order. The lawyer dropped Adco as a client, and, instead, represented Mobil in its opposition to the division order.

Adco then sued the lawyer, claiming, among other things, that the lawyer either used, or conveyed to Mobil, confidences he had received from Adco. At the conclusion of the trial, the jury returned a verdict for $120 million, the largest jury verdict ever returned against a lawyer in this country. *Wall St. J.*, Oct. 29, 1992. The parties settled for an amount reported to be substantially less.

Representing the Buyer and Seller of Real Estate. In *Baldasarre v. Butler,* 254 N.J. Super. 502, 604 A.2d 112 (1992), a lawyer attempted to represent both the sellers and the buyer in the sale of a parcel of undeveloped real estate. The lawyer made full disclosure to the sellers of all his and his firm's relationships with the buyer, and obtained the sellers' consent to represent both sides.

The buyer had a right to assign his interest in the contract. The buyer found an assignee who was willing to pay him almost double what the buyer had agreed to pay the sellers. The lawyer knew about the assignment, but allegedly failed to tell the sellers about it.

Litigation ensued, and after trial a New Jersey appellate court ordered judgment against the buyer, the lawyer, and his firm for $1.93 million. The court held that the lawyer had an absolute obligation to tell the sellers about the assignment, and that his failure to do so constituted legal and equitable fraud.

During an appeal to the New Jersey Supreme Court, and just before argument, the lawyer and the law firm settled. The Supreme Court reversed judgment as to the buyer but concluded with the holding that a lawyer may not represent both buyer and seller "in a complex commercial real estate transaction" even with the informed consent of both. *Baldasarre v. Butler,* 1993 N.J. LEXIS 126 (1993).

A Note on Representing Lender and Borrower in the Same Transaction. At least one state bar ethics committee has opined that it is appropriate for a lawyer to represent both the lender and borrower in the same transaction *only* if the transaction involves a single-family mortgage loan and, then, only if all the essential terms have been agreed upon. *Massachusetts Bar Association, Committee on Professional Ethics, Opinion No. 90-3,* June 15, 1990.

Similar to the holding in *Baldasarre,* the Committee's opinions required that if the lawyer learns something from one of the parties that would be important to the other, he must, absent an agreement to the contrary, disclose it.

Thus, a lawyer representing both the borrower and the lender in the same transaction should understand that he faces the same exposure as in *Baldasarre.* Indeed, the Resolution Trust Corporation and the Federal Deposit Insurance Corporation have sued counsel for failed thrifts and banks in precisely those circumstances, J. Villa, *Bank Directors', Officers' and Lawyers' Civil Liabilities,* Sec. 2.01[A] (1992).

Representing Business Competitors. *Maritrans GP Inc. v. Pepper, Hamilton & Scheetz,* 602 A.2d 1277 (Pa. 1992) involved the attempt by Pepper, Hamilton to represent at the same time several competing maritime shipping companies in delicate labor negotiations. The oldest of those clients, Maritrans, objected and sued Pepper, Hamilton to enjoin representation of Maritrans' competitors and for damages. The Pennsylvania Supreme Court upheld the injunction count, and later Pepper, Hamilton paid Maritrans $3 million. *Wall St. J.*, Nov. 17, 1992.

LESSONS

Representation of multiple interests has never been uniformly prohibited. The ethics rules, particularly DR5-105 of those codes based upon the older ABA Model Code of Professional Responsibility and Rule 1.7 of those rules (including Delaware Rule 1.7) based upon the current ABA Model Rules of Professional Conduct, do prohibit some multiple representations; more frequently, however, rather than prohibiting them, they lay down guidelines for them.

Some of the results noted above and elsewhere do betray poor judgment by some lawyers and, unfortunately, venality by others. Just as frequently, however, the cases have originated from an increasingly prevailing attitude among clients that every unsatisfactory result creates a cause of action against their lawyers. Add to that a surplus of lawyers without enough good work to do and their willingness to sue just about anybody for just about anything, and you are going to see more damage cases against lawyers for alleged conflicts of interest.

To keep such cases to a minimum (they will never be eliminated) lawyers should consider the following:

A. At the outset of a representation where more than one person or entity will be involved, identify for all involved who is and who is not the client. Doing it in writing will be of great benefit later when someone on the fringes of a deal claims that you were that person's lawyer but did nothing to protect that person's interests.

B. Consider whether disclosures and consents are required by DR 5-105, Rule 1.7 or other applicable rules.

C. Become familiar with ABA Model Rule 2.2, including Delaware Rule 2.2. It will apply in many multiple representation con-

texts, and it imposes several strict requirements. Most business lawyers unwittingly ignore Rule 2.2 because of its misleading title, "Lawyer as Intermediary." For an exhaustive discussion of Model Rule 2.2, see Dzienkowski, *Lawyers as Intermediaries: The Representation of Multiple Clients in the Modern Legal Profession*, 1992 Ill. L. Rev. 741.

D. Where disclosures and consents are appropriate, consider whether it is time to put more of them in writing.

E. Deal specifically with secrets at the outset of the representation. That is, provide in writing what you are permitted or required to do when you learn a confidence from one client that would be useful to another client in the same transaction. Failure to do so could result in an intolerable position for the lawyer.

F. Finally, consider whether the trends noted above mandate that you be more choosy in deciding whether to represent more than one person or entity in a matter. While in this economy, it is sometimes difficult to resist client demands for multiple representations, upon careful analysis, the fees in some cases may simply not be worth the potential for grief that is likely to follow.

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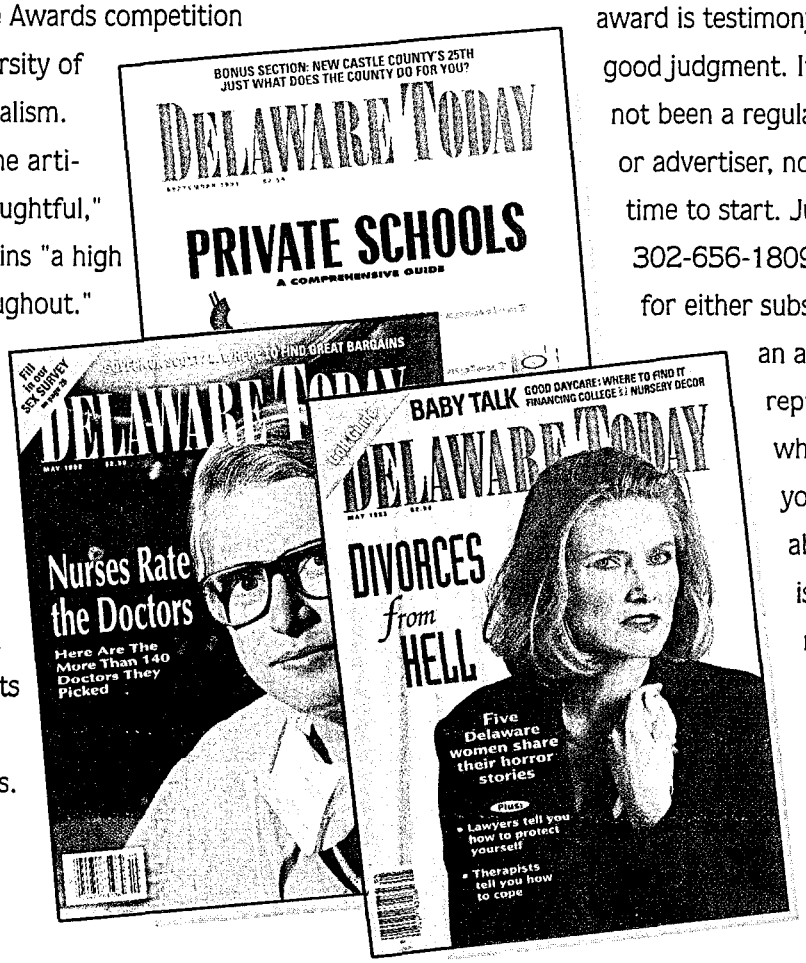

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GEORGE STEPHEN DE CHERNEY, M.D.

Actionable Medical Ethics: Informed Consent

Some years ago we devoted an issue of DELAWARE LAWYER to "The Golden Age of the Disgruntled Consumer". Now gold has yielded precedence to platinum: more and more professionals encounter the sting of litigation — as defendants. Dr. De Cherney's account furnishes an illuminating parallel for members of our profession to ponder. Ed.

Illustration by Jane Marinsky

The presumption of battery obtains unless the patient has specifically agreed to contact by a physician.

In 1914, then chief Judge Benjamin Cardozo of the New York Court of Appeals ruled that a Mrs. Schloendorff[1] was entitled to control her own destiny in so far as she might refuse an operation:

"Every human being of adult years and sound mind has a right to determine what shall be done with his own body. A surgeon who performs an operation without his patient's consent commits an assault, for which he is liable in damages, except in cases of emergency where the patient is unconscious and where it is necessary to operate before consent can be obtained."

The patient had a gynecological tumor removed without permission. Cardozo ruled that a patient should not undergo surgery without prior consent. Henceforth all doctors have been required to explain to their patients (and research subjects) about the procedures and medicines they prescribed. Much litigation has turned on the nature and content of the interaction between the physician and patient now known as "informed consent".

Definition

Like attorneys and clients, physicians and patients enter into a special relationship, protected by tradition, case law, and statute. Informed consent is implied in the earliest contact of a patient with a physician. During the initial office visit, both an oral history is given and an examination is performed. Although a physical exam performed without permission of the patient constitutes a battery — physicians almost never explicitly ask beforehand. Often physicians will reduce the anxiety of patient by telling the patient what to expect of the visit, such as listening to the heart and lungs or tapping reflexes. During more sensitive situations, such as a pelvic exam, cross-gender physicians will generally request attendance of a same-gender witness. Female physicians may request the presence of a male witness during the genital or rectal exam of a male patient. This may not be easily accomplished in a solo practice in which the office staff are also female.[2]

Implied Consent

By making an appointment with the doctor, the patient consents to certain preliminary contacts such as the history and physical. This is an example of implied consent.[3] In general, the burden to restrict such remains with the patient, as the weight of tradition and reasonable expectation would be in favor of these simple explorations. While it is true that

many patients now visit physicians for "second opinions" and may only want to interview the physician, it is up to the patient to so state. In fact, were a physician not to examine a patient for the problem that brought the patient to his or her office, then the physician would likely be held negligent.

There is another, even more abstract level of implied consent. Patients choose physicians either for geographic convenience (near home or work) or by referral (either doctor or friend). The overwhelming majority of patients are unaware of even the most basic credentials of the physicians they have chosen. In most cases, they are tacitly assured that the doctors have current and valid licenses issued by the State. To obtain a license to practice in Delaware, a physician must pass a general national medical exam, after graduating from an accredited medical school (either U.S. or foreign) and having served an internship for at least one year. Those are the *minimum* requirements. Most doctors practicing in Delaware have completed another 2-5 years of training ("residency") in a specialty such as Internal Medicine or Surgery. Almost half the physicians practicing in this state have "subspecialty training" such as Cardiology or Neonatology. This subspecialty training requires an additional 2-4 years beyond the residency. After both residency and subspecialty training, doctors may elect to "sit for the Boards". The Board Certification is an extremely rigorous 1-2 day examination, in which the failure rate still approximates 33% in many cases. The failure rate is set by the Boards to maintain a high level credibility for those who pass. There is no limit to the amount of training a physician may undertake during his career. Many have attended short micro-training courses on specific topics such as laparoscopic gallbladder surgery. Patients almost never know whether their physicians possess the requisite training to diagnose and treat their illnesses.

A proposal has been submitted to a member of the House of Representatives, suggesting that all physicians be mandated to inform patients of the physician's training at least through Board Certification. How can a patient consent to a procedure, or even discuss the benefits and risks, if he is not assured at the outset that he is speaking with someone competent to discuss them? Certainly many acts of negligence with resulting injury have occurred by physicians practicing above their level of competence.

Historical versus Current Standards

Cardozo did not hold either the doctor or hospital responsible for informing the patient beyond obtaining her permission to proceed with surgery. In 1993, however, much more is expected. The common standard of practice requires that the patient understand the benefits and risks of the test or procedure. Patients then sign an "informed consent document". Unfortunately, many physicians believe that a signed informed consent means that they have discharged their responsibility. This is patently false.

The patient must truly understand, to a reasonable measure, the benefits and risks of that to which he has consented. It is the "informed" part of the phrase which is important. What constitutes a reasonable measure?

The physician is mandated to make sure the patient comprehends and assimilates the main benefits of what is being proposed, both immediate and long term. This doctrine has been supported by *Wooley v. Henderson,* Me. Supr., 418 A.2d 1123 (1980) and *Fain v. Smith*, Ala. Supr., 479 So.2d 1150 (1985). These rulings affirmed that a reasonable person must be sufficiently informed to make a decision to proceed with the doctor's recommendations. The standard of medical practice in the community is not a standard by which informed consent is to be measured. With the exponential rise of dissemination of medical information to the layman, he has become increasingly sophisticated. The transient style of paternalism of the 1950's (perhaps better called Olympus-ism), supported by the advent of miraculous antibiotics, which cured diseases once uniformly fatal, has long since departed. Patients are more informed about medical problems, illnesses are openly discussed among friends, new therapies are noted in the lay press prior to publication in scholarly journals, etc.* Additionally, doctors have had a difficult time in the age of the consumer. They are unaccustomed to being questioned about their knowledge or wisdom, however innocently. The Courts, by contrast, have affirmed the Cardozo doctrine. Patients are entitled to autonomy regarding their bodies. Their presence in a doctor's office no more implies that the doctor has a free hand than that a merchant may take what money he pleases from you when you browse through his wares.

* * *

**And thus we evolve into a nation of litigious hypochondriacs. Ed.*

Practically speaking, the reasonable patient must be able to acknowledge the consequences of both an expected unwelcome outcome and an unexpected untoward event. After gallbladder surgery, many patients will have abdominal pain for a few days. This is an example of an expected unwelcome outcome. By contrast, a heart attack during a gallbladder operation would be extremely unusual — an unexpected untoward event.

Should the physician warn his patient of every possible outcome? The answer is no. The logical absurdity of this is proven by requiring a physician to warn his patient that in crossing the street from the doctor's office for a blood test, he could get run over by a truck. In truth, the patient might not have walked across that street, at that time, except at the request of the physician, but it is unlikely that a court would find the physician liable for the resulting injury.

Probably, however, the doctor should warn the patient of every possible *serious* deleterious risk. This rule was established during the appeal of *Natanson v. Kline* Kan. Supr., 350 P.2d 1093 (1960). In this case, the patient was scarred by the radiation therapy to her chest wall following mastectomy for breast cancer. The Court ruled that she needed to know the risks inherent in the procedure as well as the potential benefits thereto.

Two further landmark decisions extended the principle of "patients' rights" to complete disclosure. In *Canterbury v. Spence*, 464 F.2d 772, 780 (D.C. Cir. 1972). the Court ruled that the patient was entitled to know and understand potential risks such as the heart attack example above.

Attorneys reviewing a case for injury due to lack of informed consent should seek the physician's documentation that he explained to the patient about the benefits and risks described above. This documentation should be a physician's note in the chart to the effect that he discussed them directly with his patient. If possible, the documentation should note that ample time and opportunity were available for the patient to question the doctor. For example, a quick note — "reviewed operation with patient" — on the evening before a major operation would be suspect. Whereas, a note in the office chart 2 weeks beforehand that also included details of the discussion would strongly defend against the plaintiff's charge.

The facility in which the procedure is performed has, in the main, not been

held liable for failing to inform a patient about a procedure [4,5,6].

The presumption of battery obtains unless the patient has specifically agreed to contact (i.e. a test or procedure) by a physician. This agreement has a specific form, commonly called "informed consent". Physicians have a duty to disclose sufficient information about the benefits and risks of that which they are asking of their patients so that the average patient may decide if proceeding is, indeed, in his best interest.

Supplemental References

1. Beauchamp and McCullough 1984. *Medical Ethics, The Moral Responsibilities of Physicians.* Prentice-Hall, Inc. Englewood Cliffs, NJ.

2. Pozger 1990. *Legal Aspects of Health Care Administration (4th ed).* Aspen Publishers, Inc., Rockville, MD.

3. American College of Legal Medicine. 1991. *Legal Medicine, Legal Dynamics of Medical Encounters (2nd ed.).* Mosby Year Book, St. Louis, MO.

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Constraints of space make it impossible to include the author's extensive footnotes, but the numbers to these footnotes appear. The full footnotes will be available upon request to the offices of this magazine.

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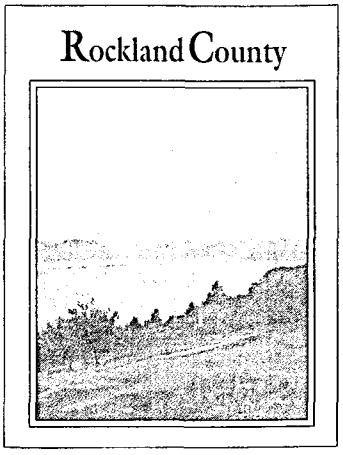

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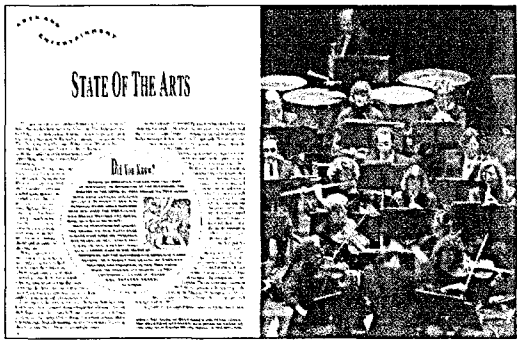

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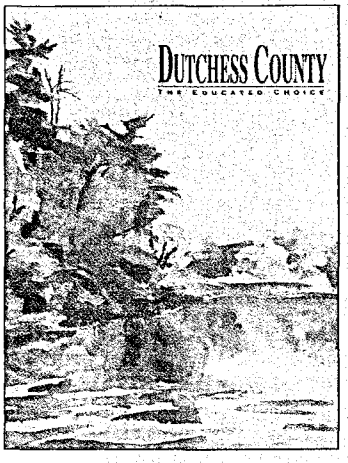

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