# COMMENT

## SEC DISCIPLINARY RULES AND THE FEDERAL SECURITIES LAWS: THE REGULATION, ROLE AND RESPONSIBILITIES OF THE ATTORNEY

The need to maintain high standards of legal conduct and prevent sharp practices by attorneys has long been recognized and fulfilled through a variety of means and restraints.[1] In the securities and public investment areas, lawyers have had a paramount role in ensuring compliance with securities laws and "full disclosure" of information to investors.[2] As a result, their professional and individual conduct has been subject to additional restraints imposed by the securities laws and the rules and informal controls of the Securities and Exchange Commission (SEC).[3]

Although the SEC has regulated attorney conduct in one manner or another since the Commission's inception, there have been several indications in the last two years of an increasing effort on the part of the SEC to augment the scope and intensity of this regulation.[4] An

1. *See generally* H. DRINKER, LEGAL ETHICS 22-55 (1953).

2. *See* Cohen, *The Lawyer's Role in Securities Regulation*, 24 BUS. LAW. 305 (1968); Douglas, *The Lawyer and the Federal Securities Act*, 3 DUKE BAR ASS'N J. (1935); Kennedy & O'Donnell, *Practice of Law Before the Securities and Exchange Commission*, 6 JOHN MARSHALL L.Q. 244 (1940); Throop, *Practice Before the Securities and Exchange Commission*, 4 J.D.C. BAR ASS'N 4 (Sept. 1937). *See also* note 241 *infra*.

3. Rule 2(e) of the SEC's Rules of Practice is a primary control. 17 C.F.R. § 201.2(e) (1972). See notes 58-201 *infra* and accompanying text. However, both state and federal securities laws directly and indirectly regulate and affect the practice of attorneys. See notes 33-36, 202-46 *infra* and accompanying text. *See also* Note, "BarChris" *and the Securities Acts: Practical Responses for Attorneys*, 10 B.C. IND. & COM. L. REV. 360 (1969). Although the SEC has a number of informal controls at its disposal—for example the timing, wording and use of its releases—this Comment will not consider such controls.

4. The reasons for the SEC's attitude favoring increased regulation of attorney conduct are unclear. The inaction or ineffectiveness of non-SEC controls over improper attorney conduct may be one factor. See notes 14-57 *infra* and accompanying text. An increase in sharp practices by attorneys in SEC matters may be another factor. *But see* note 61 *infra*. Additionally, the increasing demands upon the limited resources of the SEC necessitate the implementation of more efficient ways to protect the investing public. See note 244 *infra*. Increased regulation of attorney conduct may have the effect of protecting investors since the attorney is in a position to regulate and oversee securities practice. See note 241 *infra* and accompanying text.

An advisory committee of the SEC has also recognized this change in attitude:

> A major development in the past several years has been the expansion of the Com-

accelerated level of SEC control over attorney conduct has presented itself in two major forms. First, the Commission has recently buttressed its personal arsenal of direct regulatory controls over attorney conduct. It has accomplished this by promulgating comprehensive and stringent amendments to its attorney disciplinary rules and by increasing the frequency with which attorney disciplinary proceedings are prosecuted.[5] Furthermore, the Commission has intensified its use of the federal securities laws as a tool for restraining attorney misconduct. Specifically, the SEC is attempting to revitalize the specter of civil liability of attorneys for securities laws violations.[6] In recent litigation, for example, the SEC has sought to impose on attorneys new, implied duties of disclosure owed to the SEC and the investing public under the federal securities laws—duties which would expose an attorney to a new threat of civil liability based on the attorney's own securities malpractice or the active securities laws violations of his client.[7] It is the thesis of this Comment that these recent developments are indicative of a new policy on the part of the SEC to impose on the legal profession an unparalleled level of strict and aggressive disciplinary regulation.

The increasing demands and responsibilities imposed upon attor-

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mission's oversight over the activities of lawyers . . . . In a number of court actions and administrative proceedings the Commission has taken the position that these professionals in certain circumstances are accountable under the securities laws for actions undertaken in their professional capacities. The position adopted by the Commission in these cases has been controversial and is compelling a rethinking of traditional professional-client relationships and obligations. The process of articulating appropriate standards of conduct and reconciling fiduciary and public responsibilities, however, has only begun. SEC, REPORT OF THE ADVISORY COMMITTEE ON ENFORCEMENT POLICIES AND PRACTICES 9 (June 1, 1972).

Rule 2(e), under which the SEC can discipline attorneys, was originally promulgated in 1935 as Rule II(k). 1 Fed. Reg. 1753 (1936).

5. For a discussion of the 1970 and 1971 amendments of Rule 2(e), see notes 51-57, 107-110 *infra* and accompanying text. For a discussion of the frequency of SEC enforcement of Rule 2(e), see notes 58-77 *infra* and accompanying text.

6. Wrongful securities conduct by an attorney has increasingly become a basis for civil relief and liability. *E.g.*, SEC v. Frank, 388 F.2d 486 (2d Cir. 1968). *See also* notes 212-39 *infra* and accompanying text. *See generally* Knauss, *Disclosure Requirements—Changing Concepts of Liability*, 24 BUS. LAW. 43 (1968); Note, "BarChris" *and the Securities Acts*, *supra* note 3.

7. SEC v. National Student Marketing Corp., Civil Action No. 225-72 (D.D.C., filed Feb. 3, 1972). Such an extension of civil liability has caused an uproar among securities practitioners in particular. *See* Green, Irate Attorneys: *A Bid to Hold Lawyers Accountable to Public Stuns, Angers Firms*, Wall St. J., Feb. 15, 1972, at 1, col. 1; *Lawyers: The Confidence Game*, NEWSWEEK, March 6, 1972, at 60; *S.E.C. Alleges Fraud in Stock Transaction*, N.Y. Times, Feb. 4, 1972, Business—Finance section, at 39, col. 6. *See also* notes 230-34 *infra* and accompanying text.

neys by the SEC and the federal securities laws presumably are designed to promote the underlying policy of the securities laws—protection of the investing public.[8] A more profound analysis of the propriety of these augmented controls, however, must be predicated upon an examination of several additional factors. First, any stepped-up regulation of attorney conduct can be justified only if it is clear that additional protection to investors is in fact warranted. Even if the additional protection is needed, a second question arises as to whether the *attorney* is a proper subject upon which to impose the extra regulation needed to obtain the additional investor protection. Finally, if the attorney is to bear the burden of providing the extra protection, one must then determine the proper way to make him fulfill this new role.

In attempting to answer the above questions and thereby examine the propriety of any increased level of regulation of attorney conduct by the SEC and the federal securities laws, this Comment will first present a basic model for the regulation of attorney conduct. The model will serve as an analytical tool in the discussion of the actual role which the SEC and securities laws have in regulating attorney conduct. Second, since increased pressure from the SEC presumably will be appropriate only if alternative modes of disciplining attorney conduct are failing or impotent, the utility and effectiveness of traditional non-SEC and non-securities laws controls will be considered. Third, the mechanics and scope of the formal SEC disciplinary proceedings against attorneys will be reviewed. Finally, attorney duties and responsibilities under the federal securities laws will be discussed and evaluated.

## A Basic Model For Regulating Attorney Conduct

In formulating a basic model of what the role of the SEC and securities laws *should* be in regulating attorney conduct, a number of fundamental principles must be accommodated. A threshold principle is that some aspects of a securities lawyer's conduct and practice should be left untouched by the SEC and securities laws.[9] Similarly, due to its limited resources, the Commission by itself will not, as a

8. See Cohen, *supra* note 2. *See generally* Ruder, *Corporate Disclosures Required by the Federal Securities Laws: The Codification Implications of* Texas Gulf Sulphur, 61 Nw. U.L. Rev. 872 (1967); Knauss, *supra* note 6.

9. For example, certain practices of lawyers, such as advertising, are a more proper concern for the bar association than the SEC.

practical matter, be able to regulate all relevant attorney conduct.[10] Consequently, there will always be some reliance upon non-SEC and non-securities laws controls to regulate attorney conduct.

Another basic principle which must be incorporated into any viable model for SEC attorney-conduct regulation dictates that, although there are various types of conduct which will be regulated by the SEC and the federal securities laws, discriminations between the different types of conduct must be made in determining the proper controls to employ in the regulatory system. Therefore, any resulting disciplinary system must be designed so that each sanction and procedure used is tailored to fit the particular type of attorney conduct sought to be regulated. In determining whether the requisite harmony between controls and classes of conduct is present in any given system of SEC regulation of attorney conduct, at least four factors must be considered and balanced.

A proper correlation between the degree of regulation and the type of conduct regulated will depend, first, on the existence and extent of any nexus between the lawyer's conduct and the SEC or securities law practice. Attorney conduct directly before or related to the SEC or securities practice, which can be classified as "core conduct," should be subject to the greatest scrutiny and regulation by the SEC and the federal securities laws. The SEC justifiably has a strong interest in controlling core conduct activities such as the preparation and filing of registration statements, representation of witnesses or respondents testifying in the course of SEC investigations or appearing in SEC proceedings, and the consultation with, and solicitation of advice from, the SEC staff.[11] In contrast to core conduct are

10. For a discussion of the Commission's limited financial and manpower resources and the increasing new demands and problems facing the SEC, see note 244 *infra*. *See generally* ENFORCEMENT POLICIES AND PRACTICES, *supra* note 4, at 9. Because non-SEC enforcement is financed by the private sector, it will reduce the cost of securities regulation to taxpayers, *Id.* at 8; thus, there is a public policy justification for the Commission's reliance on non-SEC controls. Lastly, the SEC is concerned with its inadequacy of resources, since it detracts from the Commission's development of appropriate responses to emerging problems and impedes long range planning. *Id.* at 10.

11. Throop, *supra* note 2, at 7-9.

Under its Rules of Practice, the SEC has given its own definition of practice:

> *Practice defined.* For the purposes of this rule, practicing before the Commission shall include, but shall not be limited to (1) transacting any business with the Commission; and (2) the preparation of any statement, opinion or other paper by any attorney . . . filed with the Commission in any registration statement, notification, application, report or other document with the consent of such attorney . . . . 17 C.F.R. § 201.2(g) (1972).

*See also* note 36 *infra*.

peripherally-related securities conduct and non-securities conduct, both of which demand less SEC and securities law control.[12]

Another factor which should affect the intensity of the regulation employed in any attorney-conduct disciplinary system is the degree of scienter or specific intent. Securities laws violations which are intentionally committed, as compared to negligent violations, demand greater sanctions and restraint.[13] For example, a misrepresentation in a registration statement should be accorded harsher treatment when it results from a deliberate intent to mislead the investor rather than mere careless preparation.

The propriety of the controls used in any scheme of SEC attorney-conduct regulation will also depend upon a balancing of two final factors—the interests sought to be protected by the regulatory system, and the rights of the attorney being regulated. The greater the risk of attorney misbehavior to the investing public, the more restraints which should be imposed upon attorney conduct. However, where the attorney is more adversely affected and his rights are more fundamental, the restraints upon him must become more circumscribed. Furthermore, in the event action taken against the lawyer is wrongful or unfounded, remedial devices should be accorded to him.

The above principles and factors should be considered in discussing and evaluating any restraint or sanction imposed upon an attorney by the SEC or under the federal securities laws. Each case will involve a balancing process, and the outcome will vary depending upon the weight ascribed to each of the four factors. In this manner, the investing public will be adequately protected, and the individual attorney will receive fair treatment.

## ADEQUACY OF NON-SEC CONTROLS IN REGULATING ATTORNEY CONDUCT

The availability and effectiveness of non-SEC and non-securities laws controls upon attorney conduct will invariably affect the fre-

12. The Commission has also recognized this distinction. *See In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971), *on appeal*, No. 71-1602 (D.C. Cir. 1971), *reprinted in* 29 AD. L.2D 361 (1971).

13. While the public interest often may require that a formal proceeding be commenced and that it be publicly announced, we recommend that the Commission give due consideration in cases which appear to involve honest mistake or good faith efforts at compliance to exercising its discretion against bringing a formal proceeding notwithstanding the appearance of a violation. ENFORCEMENT POLICIES AND PRACTICES, *supra* note 4, at 30.

quency and vigor with which the Commission will regulate attorney conduct by means of the prosecution of its own disciplinary proceedings and the enforcement of the federal securities laws against attorneys. Where non-SEC controls are minimal and of no consequence, there is greater pressure on the SEC to implement more controls of its own, whether a particular act of securities misconduct is intentional or negligent.[14] Furthermore, to the extent that the controls are ineffective, there will be greater reliance upon federal securities laws to restrain wrongful attorney conduct. Similarly, to the extent that the SEC has limited financial and human resources available, one would expect greater pressure on the Commission to rely on and incorporate other controls to regulate attorney conduct in the sphere of public investment.

It seems clear, therefore, that one must analyze the viability of the traditional non-SEC, non-securities laws controls in order to understand and evaluate the present role of the SEC and the federal securities laws in regulating attorney conduct. Accordingly, the utility of alternative controls such as local disciplinary proceedings, codes of ethics, blue sky laws, and the sanctions of other federal agencies will be examined in this Comment. To the extent that any non-SEC controls are determined to be adequate or at least helpful to the SEC, the efficacy of this alternate source of regulation will depend in turn on whether the SEC can rely on these non-SEC controls to function independently, or whether the Commission must expressly incorporate them into its own rules and regulations in order to derive any benefits from their operation.[15]

*Local Disciplinary Proceedings*

The most direct control upon attorney conduct is a local disciplinary proceeding, with its surrounding adverse publicity and threat of disbarment.[16] An action for disbarment may be based on any of a number of offenses[17] and is generally initiated by the attorney's bar

14. The SEC has expressly recognized that this pressure exists. *See* 35 Fed. Reg. 15440 (1970).

15. For a discussion of the 1970 and 1971 amendments' incorporation of the SEC attorney disciplinary rules, see notes 51-57, 107-10 *infra* and accompanying text.

16. For a general discussion of attorney disciplinary proceedings, see H. DRINKER, *supra* note 1, at 33-35.

17. Offenses culminating in disbarment generally involve two distinct characteristics: (1) the attorney is unfit to advise others; or (2) he is impugning the dignity of the court and the reputation of the profession, and therefore is unworthy to continue in the legal profession. *Id.* at 42-46.

association or a local court.[18] Despite their influence on attorney behavior in general, local disciplinary proceedings for several reasons are an inadequate means of controlling attorney misconduct for securities regulation purposes. First, there are deficiencies in enforcement. Many attorney offenses either go unreported, or if reported, are never disciplined.[19] Second, the distance between the location where the improper conduct occurs and the location of the disciplining body is often substantial and therefore creates serious barriers to the initiation of local disciplinary proceedings.[20] For example, a core securities conduct offense may occur in Washington, D.C., whereas the attorney's general law practice and the disciplinary body may be located in his state of residence. Furthermore, assuming that the geographical and other barriers can be overcome and local proceedings are brought, it is certain that there will be a long delay between the occurrence of the violation and the disbarment of the attorney.[21] Yet, if the violator is a risk to the investing public, he remains a threat to its safety during this interim period.[22]

In addition to these often-cited inadequacies of local regulation, an equally important drawback to local disciplinary proceedings is that some offenses, although representing a substantial harm to the investing public for securities regulation purposes, are not grounds

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18. *Id.* at 35, 41-42.

19. Attorneys are not prone to report the violations of fellow practitioners. There is also an inherent discretion in the bar association not to bring a proceeding against its own members. *See* Note, *Disbarment: A Case for Reform*, 17 N.Y. L.F. 792, 800 (1971). For a general criticism of attorney disciplinary proceedings, *see* Comment, *Controlling Lawyers by Bar Associations and Courts*, 5 HARV. CIVIL RTS. L. REV. 301 (1970).

20. There is another similar problem of distance between the disciplining body and the lawyer. Thus,

> there is need for administrative regulations and enforcement of ethical standards. Because so many Washington lawyers are not members of the local bar, the only Grievance Committee to which they are amenable is that of their own bar, which may be remote, uninformed and even uninterested. C. HORSKY, THE WASHINGTON LAWYER 154 (1952).

21. *See, e.g., In re* Paul M. Kaufman, SEC Securities Exchange Act Release No. 8925 (July 2, 1970). See notes 46-57 *infra* and accompanying text for a discussion of the SEC's response to the *Kaufman* problem. A subtle aspect of the "time delay" problem is the period of time between an initial determination and the final decision after all appeals. *Kaufman* also involved this drawback, but the SEC effectively curtailed this limitation in its 1970 amendments. See note 56 *infra*.

22. The SEC has been particularly concerned with this problem:

> The need for . . . revision . . . is apparent from a recent situation in which the attorney, who had been convicted of violating certain provisions of the federal securities laws, was able to file numerous documents with the Commission during the approximately 11 months between the conviction and his disqualification by the Commission. 35 Fed. Reg. 15440, 15441 (1970).

for local disbarment. For example, it is possible for an attorney to violate the federal or state securities laws without suffering disbarment.[23] In this type of situation, there can be intense pressure on the SEC to implement its own controls and sanctions.

Even if all of the obstacles and weaknesses could be overcome and the local disciplinary proceedings were made to function efficiently, there would still remain an inherent drawback to the SEC's reliance on local disciplinary proceedings as an adequate and *independent* control of attorney conduct for securities regulation purposes. Absent an express incorporation of these controls into Rule 2(e)[24] in a manner which would enable them to take effect automatically for SEC purposes, the burden of affirmative action would remain with the SEC to prevent the attorney from continuing his practice before the Commission. Until the recent promulgation of amendments to Rule 2(e), for example, even if an attorney was disciplined locally he could still practice before the SEC until the Commission initiated a Rule 2(e) disciplinary proceeding.[25] Consequently, there would remain a continuing risk to the investing public during this interim period. Furthermore, since the SEC might waive marginal disciplinary cases to preserve its limited resources for more effective utilization elsewhere,[26] there is a possibility that the locally disciplined attorney might never be restrained for securities regulation purposes. The recent express incorporation into Rule 2(e) of the outcome of local disciplinary proceedings might ameliorate some of these problems arising from the SEC's burden of affirmative action,[27] but it may not be a satisfactory solution in view of the many remaining disadvantages inherent in the alternate controls themselves.

*Professional Codes of Conduct*

Codes of conduct, which have been in existence since 1887, remain

23. *E.g., In re* Richardson, 15 Cal. 2d 536, 102 P.2d 1076 (1940), *order to show cause discharged*, 20 Cal. 2d 894, 123 P.2d 11 (1942) (federal securities law violations, but on the face of record no moral turpitude shown); *cf.* Schaeffer v. State Bar Ass'n, 26 Cal. 2d 739, 160 P.2d 825 (1945).

24. 17 C.F.R. § 201.2(e).

25. *See, e.g., In re* Paul M. Kaufman, SEC Securities Exchange Act Release No. 8925 (July 2, 1970). *But see* note 107 *infra* where through express amendments to Rule 2(e) in 1970, the burden of affirmative action was removed for particular offenses by providing for automatic suspensions—that is, no SEC hearing is required.

26. *See* ENFORCEMENT POLICIES AND PRACTICES, *supra* note 4, at 10.

27. See notes 107-10 *infra* and accompanying text for instances where the SEC has done so.

the primary guidelines by which an attorney may fashion his professional conduct.[28] They were originally promulgated in order to standardize what was felt to be proper attorney conduct,[29] but have been severely criticized as inadequate for providing the proper guidance and regulation for attorney conduct in general.[30] Securities-related conduct is not expressly treated by the codes of conduct, nor can ethical standards be adequately relied on to control peripherally-related and non-securities conduct in that the codes of conduct are vague, ambiguous and amorphous—offering little help to the lawyer in conducting himself within the confines of proper professional behavior.[31] Nevertheless, despite these drawbacks, the SEC often relies on canons of ethics in its attorney disciplinary proceedings as benchmarks for proper legal conduct.[32]

*State Securities Laws*

Blue sky laws are directed at the mechanics of securities transactions and do not expressly consider attorney conduct or enunciate

28. *See, e.g.*, Code of Ethics, Alabama State Bar Association (1887), *reprinted in* H. DRINKER, *supra* note 1, at 352-66. *See* Note, *Disbarment: A Case for Reform, supra* note 19, at 795.

The canons of ethics of the various codes are considered to have no statutory force, but they are regarded as standards of conduct. Thus, it was stated that

> [c]odes of ethics adopted by bar associations, of course, have no statutory force. They are indicative, however, of and reflect the attitude of the profession as a whole upon those courses of action which they frown upon and interdict, and they are commonly regarded by the bench and bar alike as wholesome standards of professional ethics. Herman v. Acheson, 108 F. Supp. 723, 726 (D.D.C. 1952).

*But cf.* E. F. Hutton & Co. v. Brown, 305 F. Supp. 371, 377 n.7 (S.D. Tex. 1969) (suggesting that the codes have quasi-statutory force).

29. See Note, *Disbarment: A Case for Reform, supra* note 19, at 795. The Code of Professional Responsibility succeeded the Canons of Ethics because substantive revision, treatment of omitted areas of attorney conduct, practical improvement, and adaptation to changing legal conditions were needed. ABA, CODE OF PROFESSIONAL RESPONSIBILITY i (1969).

30. See Note, *Disbarment: A Case for Reform, supra* note 19, at 795-97. See also Comment, *supra* note 19. One problem has been the failure of the legal profession to provide standards for lawyers in their roles in the administrative process. L. PATTERSON & E. CHEATHAM, THE PROFESSION OF LAW 173 (1971). This failure may have the result that in the administrative process, lawyers will adhere to ethical standards which are really more appropriate for judicial proceedings. *Id.* at 174. In the *National Student Marketing* case, this dilemma is quite apparent. See notes 227-39 *infra* and accompanying text.

31. See Note, *Disbarment: A Case for Reform, supra* note 19, at 796-97.

32. The SEC has used a number of ethical canons in disciplining a lawyer. *E.g., In re* Murray M. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971) (Canons 34 and 35); *In re* Irwin L. Germaise and Thomas F. Quinn, SEC Securities Act Release No. 5216 (Dec. 7, 1971) (Canon 6); *In re* Erwin Pincus and Pace Reich, SEC Securities Act Release No. 4619 (June 27, 1963).

ethical guidelines for the legal profession. Consequently, the state securities laws are not designed to control the peripherally-related securities conduct and the non-securities conduct of the practicing attorney. These blue sky laws, however, do serve as a non-SEC control upon core securities conduct, since a violation may be grounds for initiating a local disciplinary proceeding.[33]

The adequacy of state securities laws as a restraint even on improper core securities conduct is, for SEC purposes, limited. First, since the use of blue sky laws as a control on attorney conduct depends on the adequacy of local disciplinary proceedings, any effective reliance on state securities laws to regulate attorneys for SEC purposes will be limited by the problems which are inherent in local disciplinary proceedings.[34] Furthermore, unless the violation of a state security law is considered a felony or a crime of moral turpitude, the lawyer will not necessarily be disbarred.[35] Since this is not always the case, the state securities laws cannot always be relied on to trigger SEC attorney disciplinary controls. Finally, even if the lawyer is disciplined for a blue sky law violation, he may still become involved in core or peripherally-related securities conduct.[36] Thus, the attorney may remain a continuing risk to the investing public until the SEC bars him from activities related to federal securities practice.

*Federal Administrative Agencies*

Under the present system each separate federal agency must be relied upon to restrain improper attorney conduct relating to the practice of law before that particular agency. Although most agencies have provided for disciplinary measures over attorneys appearing before them,[37] the disciplinary proceedings of *other* agencies have

33. The general rule is that the violation of a state or federal securities law constitutes a ground for local disciplinary action against an attorney. *See, e.g., In re* Langford, 64 Cal. 2d 489, 413 P.2d 437, 50 Cal. Rptr. 661 (1966); *In re* Greenhill, 21 App. Div. 2d 79, 248 N.Y.S.2d 452 (1964); Cincinnati Bar Ass'n v. Shott, 10 Ohio St. 2d 117, 226 N.E.2d 724 (1967); State v. Kelly, 39 Wis. 2d 171, 158 N.W.2d 554 (1968); State v. Rogers, 226 Wis. 39, 275 N.W. 910 (1937). *See also* Attorneys—Discipline—Securities, 18 A.L.R.3d 1408 (1968).

34. See notes 16-32 *supra* and accompanying text.

35. *E.g., In re* Richardson, 15 Cal. 2d 536, 102 P.2d 1076 (1940), *aff'd mem.*, 20 Cal. 2d 894, 123 P.2d 11 (1940).

36. If the attorney is disbarred, he can no longer practice law. However, since securities practice is not limited to the practice of law, the attorney who is disbarred may still "practice" before the SEC. See note 11 *supra*. For a discussion of the broad scope of "securities practice," see note 148 *infra*.

37. Commodity Exchange Authority, 17 C.F.R. §§ 0.11(c)(1), .61(c)(1) (1972); Federal

limited utility for SEC purposes. The ability of the SEC to rely on the disciplinary measures of other agencies to restrain improper securities-related conduct is limited inherently to situations in which the attorney is practicing before *both* the SEC *and* the other agency.[38] Moreover, since there is no formal inter-agency reciprocity of sanctions, disciplinary action over an attorney by another agency will not necessarily prevent the attorney from appearing before the SEC.[39] Consequently, as is the case with most non-SEC, attorney-conduct regulatory controls, the burden remains with the Commission to take affirmative action to restrain the attorney for securities law purposes.

A "federal administrative bar," which would control the practice and conduct of attorneys appearing and practicing before all federal agencies, might serve as a viable non-SEC control over improper attorney conduct.[40] Although the need for such a regulatory body has been pointed out[41] and legislation proposing such a body has been

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Communications Commission, 47 C.F.R. § 1.24(a) (1972); Federal Power Commission, 18 C.F.R. § 1.4(b)(1) (1972); Federal Trade Commission, 16 C.F.R. § 4.1(d)(2) (1972); Immigration and Naturalization Service, 8 C.F.R. § 292.3 (1972); Internal Revenue Service, 31 C.F.R. § 10.50 (1972); Interstate Commerce Commission, 49 C.F.R. § 1100.13 (1972); Patent Office, 37 C.F.R. § 1.348 (1972). *See also* Cheatham, *The Reach of Federal Action Over the Profession of Law*, 18 STAN. L. REV. 1288 (1966); Henley, *Admission To and Control of Practice Before Federal Administrative Agencies*, 19 OHIO ST. L.J. 400 (1958); Robinson, *Lawyers and Practitioners: A Study in Contrasts*, 21 A.B.A.J. 277 (1935); Waterman, *Federal Administrative Bars: Admission and Disbarment*, 3 U. CHI. L. REV. 261 (1936); Note, *Admission to Practice Before and Disbarment From Federal Administrative Agencies*, 12 SYRACUSE L. REV. 477 (1961).

38. See note 37 *supra* for examples of other agencies which discipline attorneys. However, even in this instance there is another drawback, since administrative disciplinary proceedings are rarely initiated. *See* Henley, *supra* note 37, at 401.

39. Rule 2(e), as originally promulgated, did not provide for interagency reciprocity of attorney disbarments or suspensions. The 1970 amendments, in adding subsection 2, did provide for automatic suspension from SEC practice where an attorney had been disbarred by a court, but made no express provision for such reciprocity in the event of a disbarment by another federal agency. Rule 2(e)(2) does mention "convicting agency," but only for the purpose of determining when a non-SEC disbarment "shall be deemed to have occurred." 17 C.F.R. § 201.2(e)(2). However, and more importantly, Rule 2(e)(2) does not use the word "agency" in stating the general rule for imposing the automatic suspension from SEC practice. *Id.*

40. *See generally* Robinson, *supra* note 37; Waterman, *supra* note 37.

41. A federal administrative agency "practitioners bar" was proposed at a very early date.

> The time is perhaps approaching for a general coordination of the functions, rules, and practices of these [federal] agencies. . . .
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> By this proposal a uniform method of rules of practice and procedure would exist before all the various departments of the administrative tribunal. In addition, it would no doubt mean the beginning of a new practitioners bar. Robinson, *supra* note 37, at 280 (footnote omitted).

introduced,[42] a federal practitioners' bar has not yet been established. In addition to a federal administrative bar, a number of other similar alternatives—including a separate federal agency overseeing federal practitioners and a uniform code of federal administrative practice—have been suggested and rejected.[43] Consequently, the general rule remains that each agency controls the practice of attorneys who appear before it.[44] However, in the event that uniformity of federal administrative practice is achieved, it is not clear whether any of the various suggested alternatives would be desirable from a securities law point of view.[45]

*Need for Affirmative SEC Controls*

Although non-SEC controls are available to guide and regulate attorney conduct, their effectiveness for SEC and securities laws purposes has not been satisfactory. To the extent that harmful and unethical practices are not reported, not covered, or not disciplined, there is great pressure on the SEC to implement a regulatory system of its own in order to achieve maximum protection for the investing public. As will be discussed more fully in subsequent sections of this Comment, the SEC has responded, at least partially, by means of its Rules of Practice and recent amendments thereto.

The general ineffectiveness of alternative regulatory systems for SEC purposes is illustrated by a recent disciplinary proceeding, *In re Paul M. Kaufman*.[46] In the *Kaufman* proceeding, the SEC was confronted with a situation in which a lawyer had been convicted of willfully violating a federal securities law but had not yet been disbarred from the practice of law by any local disciplinary body.[47]

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*See also* Waterman, *supra* note 37.

42. *See, e.g.*, S. 932, 85th Cong., 1st Sess. (1958). *See also* HOOVER COMMISSION, TASK FORCE REPORT (1955).

43. *See, e.g., Hearings on H.R. 2657 Before Subcomm. on Practice Before Gov't Agencies of the House Comm. on the Judiciary*, 80th Cong., 1st & 2d Sess. (1948). *See also* S. 318 & S. 1466, 88th Cong., 1st Sess. (1963); S. 17, 83d Cong., 1st Sess. (1953).

44. See note 37 *supra*. However, each agency does *not* control the admission of attorneys to its practice. See note 95 *infra* and accompanying text. *But see* note 96.

45. For example, a drawback to a uniform code of federal administrative practice and a separate agency overseeing federal practitioners is that the special needs of the SEC in controlling certain practices may be sacrificed by treating all agencies uniformly. Furthermore, the SEC, by regulating harmful attorney conduct itself, can better integrate the sanctions for the attorney vis-à-vis the federal securities laws.

46. SEC Securities Exchange Act Release No. 8925 (July 2, 1970).

47. *Id.* at 2 n.3. *See also* 35 Fed. Reg. 15440, 15441 (1970), the text of which appears in note 22 *supra*.

During the interim period between conviction and possible disbarment, the attorney practiced before the Commission and continued to handle securities work. Although the SEC had no express power under its disciplinary Rule 2(e) to disbar an attorney from SEC practice for violation of a federal securities law,[48] the Commission did have authority under that rule to deny the right to practice before the SEC to any attorney whom the Commission found, after a hearing, "not to possess the requisite qualifications to represent others," to be lacking in character or integrity, or "to have engaged in unethical or improper professional conduct."[49] Consequently, the SEC, using its broad powers under Rule 2(e), brought its own disbarment proceedings and finally suspended Kaufman from further securities practice on the basic ground that he was "unqualified" to practice before the SEC.[50] Although the local disciplinary control had failed altogether for SEC purposes in *Kaufman*, the SEC took affirmative action and found the necessary flexibility and protection within its own disciplinary rule in order to remove the wrongdoer from securities practice.

In 1970, immediately after *Kaufman*, the SEC expressly amended Rule 2(e) to remedy some of the problems associated with the Commission's burden of taking affirmative action in order to discipline an attorney who had violated provisions of the federal securities laws or certain other types of statutes.[51] After the 1970 amendments, the willful violation of a securities law became a specific ground for initiating a Rule 2(e) disqualification hearing.[52] More importantly, the Commission is now, on the basis of other 1970 amendments to Rule 2(e), empowered to suspend automatically from SEC practice, without any burden of affirmative action on its part, any attorney who has been suspended or disbarred by local proceedings or convicted of a felony or misdemeanor involving moral turpitude.[53] The 1971 amendments to Rule 2(e) reduce the SEC's burden of affirmative action even further by providing for automatic temporary suspension from SEC practice where a lawyer has been convicted of a

48. *See* 17 C.F.R. §§ 201.2(e)(1)(i), (ii) (1972), which was the original disciplinary rule. *See also In re* Paul M. Kaufman, SEC Securities Exchange Act Release No. 8925, at 2-3 (July 2, 1970). *Cf.* 35 Fed. Reg. 15440 (1970), where the SEC stated that in view of *Kaufman*, a clarification of Rule 2(e) was needed.

49. 17 C.F.R. §§ 201.2(e)(1)(i), (ii) (1972).

50. SEC Securities Exchange Act Release No. 8925, at 4 (July 2, 1970).

51. *See generally* 35 Fed. Reg. 15440 (1970).

52. 17 C.F.R. § 201.2(e)(1)(iii) (1972).

53. *Id.* § 201.2(e)(2). The text of this amendment is provided in note 107 *infra*.

federal securities law violation, enjoined from further violating the federal securities laws, or has consented to such an injunction.[54]

As will be more fully developed in the remainder of this Comment, the Commission's solution to the deficiencies of non-SEC controls, therefore, has been threefold. First, due to its limited resources, the SEC continues to rely on these alternative controls. However, the Commission has found that it can do this effectively only by incorporating the other controls expressly into the mechanics of Rule 2(e).[55] Second, the SEC has removed any possible time lags by providing that the suspensions from SEC practice based on the consummation of these alternative controls, where applicable, will be automatic.[56] No longer will the SEC's burden of affirmative action cause delays between the consummation of the local controls and the effectuation of the SEC disciplinary measures. Finally, the Commission has shown that it will use and restructure Rule 2(e) where necessary to meet the inadequacies of non-securities controls.[57]

## SEC Disciplinary Proceedings

The SEC has only one formal method by which it directly controls attorney conduct—Rule 2(e) of its Rules of Practice.[58] Rule 2(e), as originally and presently worded, applies to the core, peripherally-related, and non-securities conduct of practicing attorneys. The SEC apparently can impose sanctions for either intentional or negligent offenses. The SEC has consistently attempted to apply the rule, and when necessary restructure it, in order to provide a sufficient amount of protection to the investing public, while at the same time affording some degree of fairness to the attorney.[59]

### *Historical Development of Rule 2(e)*

The development of Rule 2(e) may be divided conveniently into three overlapping stages. During the early period of its history, from 1935 to 1960, the Rule remained as originally promulgated, was

54. *Id.* § 201.2(e)(3)(i).

55. *See id.* § 201.2(e)(2). *See also* 35 Fed. Reg. 15440, 15441 (1970).

56. 17 C.F.R. § 201.2(e)(2). The text of this amendment appears in note 107 *infra*. This provision is quite drastic in that a decision, with an appeal pending, is considered final for Rule 2(e)(2) purposes.

57. *See* 35 Fed. Reg. 15440 (1970).

58. 17 C.F.R. § 201.2(e) (1972).

59. *See* 35 Fed. Reg. 15440 (1970); SEC Securities Act Release No. 5147 (May 10, 1971).

seldom used by the SEC, and was never judicially construed.[60] The second period, the 1960's, was characterized by increased implementation of the rule and an awareness by the SEC of a number of deficiencies inherent in Rule 2(e) as originally drafted. The third period, the 1970's, has been characterized by major structural and substantive revisions to the Rule, and at present, judicial definition and development of Rule 2(e) is occurring.

*Prior to 1960.* There are no SEC attorney disciplinary proceedings appearing on record prior to 1950.[61] This initial dormancy of Rule 2(e) was probably due to the Commission's philosophy of "self-regulation" with respect to the functioning of the legal profession.[62] Apparently, the SEC waited for any control, change and reform of the legal profession to come from within.[63]

During the 1950's, a total of four disciplinary actions were brought.[64] Each proceeding was directed at intentional and flagrant violations of core securities conduct—violations generally arising from a failure to disclose material information to the SEC and the investing public.[65] Peripherally-related and non-securities conduct

60. The Rule was slightly altered to eliminate certain problems in admission requirements. *See* SEC Securities Act Release No. 1761 (June 27, 1938). In 1957, an attorney sought to enjoin a 2(e) proceeding. However, this attempt at a preliminary injunction failed, and the Rule itself was not considered. Although the district court spoke of the SEC power to promulgate Rule 2(e), the appellate court held that the lower court was in error in considering the SEC's power to discipline an attorney. Schwebel v. Orrick, 153 F. Supp. 701 (D.D.C. 1947), *aff'd on other grounds*, 251 F.2d 919 (D.C. Cir.), *cert. denied*, 356 U.S. 927 (1958). For a discussion of *Schwebel*, see note 170 *infra*.

61. It is possible that attorney disciplinary actions are not publicly disclosed. This was true before the Rule's recent amendments, *e.g.*, *In re* Murray A. Kivitz, SEC Securities Act Release No. 5163, at 1 (June 29, 1971) and was expressly made possible in 1971:

> All hearings held under this paragraph [Rule 2(e)] shall be non-public unless the Commission on its own motion or the request of a party otherwise directs. 17 C.F.R. § 201.2(e)(7) (1972).

Thus, it should be noted that the SEC may be merely disclosing more attorney disciplinary proceedings rather than initiating a greater number of them.

62. For a discussion of the SEC's self-regulation philosophy, *see* Jennings, *Self-Regulation in the Securities Industry: The Role of the SEC*, 20 LAW & CONTEMP. PROB. 663 (1964). *See also* ENFORCEMENT POLICIES AND PRACTICES, *supra* note 4, at 57-61.

63. *Cf.* ENFORCEMENT POLICIES AND PRACTICES, *supra* note 4, at 9. Reform of attorney conduct from within was originally considered a prerequisite to SEC success in regulating public investment. See note 241 *infra*.

64. *In re* Sol M. Alpher, 39 S.E.C. 346 (1959); *In re* James T. DeWitt, 38 S.E.C. 879 (1959); *In re* William A. Dougherty, 38 S.E.C. 82 (1957); *In re* Albert J. Fleischmann, 37 S.E.C. 832 (1950).

65. For a detailed factual summary of these four disciplinary proceedings, see Kemp, *Disciplinary Proceedings by the S.E.C. Against Attorneys*, 14 CLEV.-MAR. L. REV. 23, 27-32 (1965). For shorter summaries, see Goldberg, *Practicing Before the SEC: Commission's Rule of Practice—Rule 2(e)*, N.Y.L.J., April 14, 1972, at 1, cols. 1-2, at 5, cols. 1-3.

were not expressly disciplined during this period.

*1960's.* During the 1960's, the SEC used Rule 2(e) extensively, initiating a total of eleven disciplinary proceedings.[66] All of these involved an intentional failure to disclose material information on the part of the disciplined attorney.[67] However, several of the SEC decisions indicated, in dictum, that negligent offenses would also constitute a Rule 2(e) violation.[68] Furthermore, the SEC in several proceedings imposed its own sanctions in addition to those levied against the attorney by some other disciplinary authority.[69] This transitional period of the 1960's can best be characterized as revealing (1) an uneasiness and concern on the SEC's part for unethical and improper attorney conduct which adversely affects the investing public, and (2) an SEC willingness to use its own resources to prevent such practices.

*1970's.* During the most recent period in Rule 2(e)'s history, SEC disciplinary proceedings are being employed with more frequency than ever before. Within the last two years, a total of six disciplinary proceedings have been brought.[70] As in the past, most

66. *In re* Irving S. Reamer, SEC Securities Act Release No. 4864 (May 1, 1967); *In re* Marshall I. Stewart, SEC Securities Act Release No. 4829 (April 29, 1966); *In re* Leonard Maizlish, SEC Securities Act Release No. 4739 (Dec. I, 1964); *In re* Donald Keltner, SEC Securities Act Release No. 4738 (Nov. 30, 1964); *In re* John D. Glynn, SEC Securities Act Release No. 4734 (Nov. 27, 1964); *In re* Ronald H. Freedmond, SEC Securities Act Release No. 4736 (Nov. 24, 1964); *In re* Leonard A. Nikoloric, SEC Securities Act Release No. 4642 (Sept. 19, 1963); *In re* Erwin Pincus and Pacc Reisch, SEC Securities Act Release No. 4619 (June 27, 1962); *In re* Nathan Wechsler, SEC Securities Exchange Act Release No. 6932 (Nov. 5, 1962); *In re* Arnold D. Naidich, SEC Securities Act Release No. 4372 (June 8, 1961); *In re* Morris Mac Schwebel, 40 S.E.C. 347 (1960), *modified*, 40 S.E.C. 459 (1961).

67. For a detailed factual summary of the attorney disciplinary proceedings brought during the 1960-63 period, see Kemp, *supra* note 65, at 32-40. For shorter summaries, see Goldberg, *supra* note 65, at 5, cols. 2-3.

68. Whether or not respondent intended to facilitate evasions of the law, his conduct evidenced at least a gross indifference to the observance of legal requirements which an attorney in particular should strive to foster . . . . *In re* Morris Mac Schwebel, 40 S.E.C. 347, 371 (1960), *modified*, 40 S.E.C. 459 (1961).

*See also In re* Leonard Maizlish, SEC Securities Act Release No. 4739 (Dec. 1, 1964) (a filing done by the lawyer contained material misrepresentations and omissions which he reasonably should have known were false and misleading).

69. *E.g., In re* Morris Mac Schwebel, 40 S.E.C. 347 (1960), *modified*, 40 S.E.C. 459 (1961); *In re* Irwin L. Germaise and Thomas F. Quinn, SEC Securities Act Release No. 5216 (Dec. 7, 1971).

70. *In re* Elliot S. Blair, SEC Securities Exchange Act Release No. 9666 (July 14, 1972); *In re* Ivan Allen Ezrine, SEC Securities Act Release No. 5268 (July 7, 1972); *In re* Thomas R. Blonquist, SEC Litigation Release 5397 (May 25, 1972); *In re* Irwin L. Germaise and Thomas F. Quinn, SEC Securities Act Release No. 5216 (Dec. 7, 1971); *In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971), *on appeal*, No. 71-1602 (D.C. Cir. 1971); *In re* Paul M. Kaufman, SEC Securities Act Release No. 8925 (July 2, 1970).

offenses which have been prosecuted involved core securities conduct and were intentional and flagrant violations of the securities laws.[71] However, for the first time in Rule 2(e) history, the SEC in two disciplinary proceedings has redressed peripheral securities misconduct as well.[72] Because of its increased use of Rule 2(e) in recent years, the SEC is beginning to establish a "common law" of SEC disciplinary decisions, a development which will provide more meaning to Rule 2(e).

In addition to the increased frequency of SEC disciplinary proceedings, the 1970's have already been marked by two major developments in the substantive evolution of Rule 2(e). First, as previously discussed, the SEC has responded to some of the inherent deficiencies in the original Rule 2(e) and amended the rule twice in order to ensure a more efficient SEC use of non-SEC disciplinary controls and in general provide a more active SEC response to improper attorney conduct.[73] To some extent, the SEC has achieved this result at the expense of the procedural safeguards of an attorney's constitutional rights.[74] Yet, despite all the amendments, there still are a number of additional changes to Rule 2(e) which should be made.[75]

A second major development in the substantive evolution of Rule 2(e) during the 1970's is the judicial review which is being afforded the Rule for the first time. In *SEC v. Ezrine*,[76] for example, the District Court for the Southern District of New York gave major consideration to the scope of Rule 2(e) and provided additional judicial enforcement to an SEC sanction. Furthermore, in *Kivitz v. SEC*[77] the Court of Appeals for the District of Columbia Circuit has the opportunity to examine and clarify several aspects of a Rule 2(e) proceeding.

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71. For a brief factual summary of each disciplinary proceeding, see Goldberg, *supra* note 65, at 5, col. 3.

72. *In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971) (improper use of layman as an intermediary); *In re* Irwin L. Germaise and Thomas F. Quinn, SEC Securities Act Release No. 5216 (Dec. 7, 1971) (non-disclosure to client of a secret partnership).

73. See notes 46-57 *supra* and accompanying text. *See also* notes 107-10 *infra* and accompanying text.

74. See notes 82-88 *infra* and accompanying text.

75. See notes 194-96 *infra* and accompanying text.

76. ___ F. Supp. ___ (S.D.N.Y. 1972), *reported in* 164 BNA SEC. REG. & L. REP. A-12 (1972). Ezrine had been involved in a civil securities action. *See* SEC v. Manor Nursing Centers, Inc., 340 F. Supp. 913 (S.D.N.Y. 1971), *aff'd*, 458 F.2d 1082 (2d Cir. 1972). See notes 145-49 *infra* and accompanying text.

77. D.C. Cir. No. 71-1602 (D.C. Cir. 1971). Oral argument was held on Oct. 27, 1972. For a discussion of the *Kivitz* case, see notes 179-91 *infra* and aceompanying text.

*Nature of a Rule 2(e) Proceeding*

The Rule 2(e) proceeding, like other agency proceedings, is quasi-judicial.[78] As a consequence, certain inherent powers, such as the contempt and subpoena authority, are available to the SEC.[79] However, because the ultimate sanction of a Rule 2(e) proceeding is exclusion from securities practice rather than *total disbarment* from the practice of law,[80] it is not clear what procedural protections are guaranteed to an attorney by either the Federal Constitution or the Administrative Procedure Act (APA).[81]

Disciplinary actions brought by a federal agency are ostensibly subject to constitutional safeguards.[82] However, the scope of constitutional protection afforded the disciplined attorney in a Rule 2(e) proceeding may be somewhat limited, since

> the end result . . . is not disbarment in the sense in which that term is generally understood—but an order excluding him from appearing as counsel before the Commission. The distinction is one in kind and not degree.[83]

Because of this distinction in the nature of the sanction imposed, a disciplined attorney would receive less constitutional protection in a Rule 2(e) proceeding than in a disbarment proceeding by a local bar association.[84] A reduction of an attorney's procedural safeguards might also be justified on the basis that the ability to practice or

78. *E.g.*, Herman v. Acheson, 108 F. Supp. 723 (D.D.C. 1952); Camp v. Herzog, 104 F. Supp. 134 (D.D.C. 1952), *aff'd*, 190 F.2d 605 (D.C. Cir. 1951).

79. *Id.* In addition, a quasi-judicial body is considered to have inherent power to discipline under its rule-making authority. See notes 91-98 *infra* and accompanying text.

80. In essence, the argument is that the attorney is only deprived of his securities practice, and therefore still has other areas of professional opportunity available. However, such reasoning must be rejected, since

> [t]he economic consequences of an attorney . . . being unable to practice before the commission can be significant. In addition to being precluded from appearing in administrative actions, disqualified individuals would be foreelosed from being named as experts in registration statements and in annual reports. Goldberg, *supra* note 65, at 1, cols. 1-2.

81. 5 U.S.C. § 551 *et. seq.* (1970).

82. *Cf.* Schware v. Board of Bar Examiners, 353 U.S. 232 (1956).

83. Herman v. Acheson, 108 F. Supp. 723, 726 (D.D.C. 1952). *Herman* involved a disciplinary action against an attorney by the International Claims Commission. However, its rationale is clearly applicable to an SEC proceeding.

84. See *In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971), where the attorney was given a harsher sanction "on account of the fact that a suspension from practice before this Commission would not be as serious as a court-ordered suspension which would completely bar the attorney from engaging in any form of law practice during the period of suspension."

appear before the SEC is a mere privilege,[85] rather than a right, and consequently there are no constitutional safeguards attached to it. However, this argument appears to be unsound, and the Commission has not relied on it.[86]

The failure of the SEC to grant the SEC-disciplined attorney a full constitutional arsenal of procedural safeguards is best illustrated by the relatively low burden of proof which the SEC must sustain in order to discipline an attorney successfully in a Rule 2(e) proceeding. If the maximum level of constitutional protection were extended to the attorney, then the SEC presumably would be required to establish a Rule 2(e) violation by "clear and convincing" proof.[87] However, the SEC has recently determined that the Commission in a Rule 2(e) proceeding need only prove its case by a "preponderance of the evidence."[88] Accordingly, the SEC has denied the attorney maximum constitutional protection with reference to the requisite burden of proof in SEC disciplinary proceedings, and this result, if adopted by the judiciary, might serve as a basis for justifying the erosion of other procedural rights in Rule 2(e) cases.

Contrary to the general uncertainty over the applicability of constitutional procedural safeguards in a Rule 2(e) proceeding, the degree of protection afforded an SEC-disciplined attorney under the APA is more certain. Although initial decisions in analogous discipli-

85. Rule 2(e) expressly states that practice before the SEC is a "privilege." 17 C.F.R. § 201.2(e) (1972). The Commission has also stated: "[t]he right to appear and practice before this Commission as an attorney is, like membership in the bar itself, a privilege burdened with conditions." *In re* Morris Mac Schwebel, 40 S.E.C. 347, 371 (1960). A former Commissioner has indicated that the privilege to appear before the SEC imposes duties on the lawyer to assist in achieving the protection of the investing public. *See* Cohen, *supra* note 2, at 306.

86. Although the commission refers to the "privilege" of practicing or appearing before it, the Commission is aware that the "right" versus "privilege" dichotomy has long been challenged. Goldberg, *supra* note 65, at 1, col. 2.

*See generally* Van Alstyne, *The Demise of the Right-Privilege Distinction in Constitutional Law*, 81 HARV. L. REV. 1439 (1968), for a discussion of the problems in relying on the "privilege" argument when the federal government or agency thereof denies constitutional protection.

87. *Cf. In re* Fisher, 179 F.2d 361, 370 (7th Cir. 1950), *cert. denied*, 340 U.S. 825 (1951); *In re* Ryder, 263 F. Supp. 360, 361 (E.D. Va. 1967). *But cf.* Herman v. Dulles, 205 F.2d 715, 717 (1963).

The Supreme Court has not ruled on which standard of proof is required; however, it has characterized disbarment actions as "adversary proceedings of a quasi-criminal nature." *In re* Buffalo, 390 U.S. 544, 551 (1968). Under this view, the Court may require the higher standard of clear and convincing evidence for attorney disciplinary proceedings, including those initiated by federal agencies such as the SEC.

88. *In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971).

nary proceedings indicated that the APA was not applicable to Rule 2(e) proceedings,[89] more recent decisions and the SEC itself have taken the position that the APA safeguards do apply.[90]

*SEC Power to Discipline Attorneys*

The SEC has been given no express statutory authority to regulate or discipline attorney conduct, nor has the SEC imposed any prescribed limits in exercising any implied power. Consequently, Rule 2(e) proceedings are often challenged on the basis that the Commission either is without power to discipline an attorney or has transgressed the limits of that power in a given case.[91]

Despite the lack of express statutory authority to regulate attorney conduct, both the courts and the SEC have recognized that the Commission has implied power to discipline an attorney.[92] The source of this authority is the SEC's rule-making power under the securities laws.[93] Perhaps the only limitation on the exercise of this rule-

89. *E.g.*, Herman v. Dulles, 205 F.2d 715, 717 (D.C. Cir. 1953).

90. *E.g.*, Schwebel v. Orrick, 153 F. Supp. 701, 704-06 (D.D.C. 1957), *aff'd on other grounds*, 251 F.2d 919 (D.C. Cir.), *cert. denied*, 356 U.S. 927 (1958).

91. *E.g., In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971); Initial Decision *In re* Paul M. Kaufman, SEC Administrative Proceedings, File No. 3-2113 (Dec. 19, 1969) (W. Blair, Hearing Examiner).

92. Rule 2(e) has been promulgated and amended pursuant to section 23(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78w(a) (1970), which provides in pertinent part that the Commission shall have "power to make such rules and regulations as may be necessary for the execution of the functions invested in [it] . . . by this title." *See also* 36 Fed. Reg. 8933 (1971); 35 Fed. Reg. 15440 (1970), both of whieh cite section 23(a) as the source of attorney disciplinary power. Other implied statutory sources of SEC disciplinary power are 15 U.S.C. §§ 77s, 77sss, 79t, 80a-37, 80b-11 (1970).

In dicta, the district court in connection with a Rule 2(e) disciplinary proceeding in Schwebel v. Orrick, 153 F. Supp. 701, 704 (D.D.C. 1957), *aff'd on other grounds*, 251 F.2d 919 (1958), expressly upheld the *authority* of the SEC to promulgate Rule 2(e) under its general rule making authority. However, the court of appeals held that plaintiff failed to exhaust his administrative remedy and stated that the lower court erred in reaching the question of SEC authority to disbar. Nevertheless, the lower court's position on attorney-disciplinary authority is viewed as sound. *See* Kemp, *supra* note 65, at 26. *See also* note 170 *infra*. This implied source of attorney-disciplining power has been upheld in analogous agency disciplinary proceedings. See Goldsmith v. United States Board of Tax Appeals, 270 U.S. 117 (1926); Herman v. Dulles, 205 F.2d 715 (D.C. Cir. 1953). Under these decisions no specific authority to discipline was necessary, since such power is inherent in a quasi-judicial body's rule-making authority.

93. This requirement was imposed in an analogous NLRB attorney disciplinary proceeding. Camp v. Herzog, 104 F. Supp. 134 (D.D.C. 1952), *aff'd*, 190 F.2d 605 (D.C. Cir. 1951). The court in *Camp* stated that

> [t]he rule making power is a very different thing from the adjudicatory process. It is one thing for the Congress to say that an administrative agency shall have the right to prescribe by rule for the admission and disciplinary measures of attorneys practicing

making authority as an implied source of disciplinary power is that the SEC must promulgate the necessary attorney disciplinary rules *before* bringing any disciplinary action, a requirement with which the SEC has long complied.[94]

More recently, recognition of implied SEC power to discipline attorneys under its rulemaking authority has come from the Administrative Practice Act (APrA).[95] Although Congress, by means of the APrA, has expressly pre-empted the power of each federal agency to regulate independently the *admission* of attorneys to that agency's practice,[96] the APrA does not authorize or deny the power of an agency to *discipline* the attorney once he is admitted. Thus, under the wording of the APrA, it is arguable that Congress has not denied that each agency has implied disciplinary power derived from *other* statutory sources.[97] Although there are some problems with the validity of this argument, it is supported by much authority.[98]

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before it, and quite another to say that Congress intended such an agency to adjudicate and enforce disciplinary action without any statutory provision or rule promulgated in pursuance of statutory authority. The force of this difference is readily apparent when viewed in the confusing and conflicting situations that beset the whole subject of admission to and control over practice before administrative agencies. *Id.* at 138.

94. *See* 1 Fed. Reg. 1753 (1935), which promulgated Rule 2(e) originally as Rule II(k).

95. 5 U.S.C. § 500 (1970) provides in pertinent part that

(d) This section does not

. . .

(2) authorize or limit the discipline, including disbarment, of individuals who appear in a representative capacity before an agency. . . .

The Act basically eliminated agency-established admission requirements and bars for attorneys practicing before federal agencies. *See generally* Sagar & Shapiro, *Administrative Practice Before Federal Agencies*, 4 U. RICHMOND L. REV. 76 (1969).

96. It should be pointed out that the SEC has provided in its own regulations for the admission of attorneys in Rule 2(b). See 17 C.F.R. § 201.2(b) (1972). The Commission is of the opinion that the APrA "only makes automatically eligible a certain class of attorneys, i.e. those admitted to the highest court of a State. It does not preclude an agency's admission to practice before it of other individuals bearing other credentials or qualifications." Initial Decision, *In re* Murray A. Kivitz, SEC Administrative Proceeding at 5, File No. 3-1972 (April 17, 1970) (D. Markun, Hearing Examiner). Consequently, under this view, although the APrA has set *minimum* standards for admission to federal agency practice, the Act does not preempt the power of agencies to set lower admission requirements.

97. There are several matters regarding agency practice before federal administrative agencies which are not covered by the Administrative Practice Act . . . . More importantly, the Act specifically does not authorize or limit discipline, including disbarment, of persons appearing before any agency. Consequently, agencies maintain authority to deal with these matters, and regulations in regard thereto are in effect. Sagar & Shapiro, *supra* note 95, at 88.

98. The legislative history of the APrA suggests that the Act was intended not to affect the power of agencies to discipline attorneys but only the various formal admissions procedures.

Assuming the SEC has the general power to discipline attorneys, it then becomes necessary to examine the scope of that disciplinary authority in terms of the types of wrongful attorney conduct which are cognizable by the Commission under Rule 2(e). Although the SEC has provided a general rule for the scope of its Rules of Practice,[99] the definition found therein is totally unworkable for purposes of determining the scope of Rule 2(e). One would expect that peripherally-related securities conduct and non-securities conduct would not be cognizable by the SEC due to the attenuated relationship between these types of conduct and the proper interests of the SEC. Nevertheless, the SEC has stated that conduct which is unrelated to the securities practice is still within Rule 2(e)'s ambit.[100] The

*See* H.R. REP. No. 1141, 89th Cong., 1st Sess. (1965). Furthermore, in introducing the bill leading to the enactment of the APrA, Congressman Willis stated: "It does not affect the power of agencies to discipline persons who appear before them." 111 CONG. REC. 27193 (1965). Disciplinary procedures require a case by case determination of misconduct and not reliance upon uniform criteria of qualification. For a discussion of these arguments, see Brief for Appellee at 37-46, Kivitz v. SEC, Civil Action No. 71-1602 (D.C. Cir. 1972). *See also* Sagar and Shapiro, *supra* note 95, at 88.

The problems in this implied recognition argument arise because for several reasons it can also be argued that the APrA has *precluded* the power of any federal agency to discipline an attorney unless such power has been expressly given to the agency. First, since the APrA states that it "does not authorize or limit the discipline, or disbarment," it can be contended that Congress, by prohibiting any construction by which the APrA itself can become an implied source of power, is in effect requiring express grants of attorney disciplinary power to the agencies. Therefore, even if agencies did have implied power, upon the enactment of the APrA such power was preempted. Secondly, it seems anomalous that a lawyer has a right to practice law granted to him by Congress under the APrA, and yet can effectively be denied this right by an agency through its disciplinary proceeding. Lastly, confusing results among the agencies could occur if each agency were left to determine its own power and the extent thereof. For a discussion of these and other arguments why the SEC has no power to discipline attorneys, see Brief for Appellant at 47-51, Kivitz v. SEC, Civil Action No. 71-1602. (D.C. Cir. 1972).

99. The Commission has promulgated the following provision concerning the scope of its Rules of Practice:

> These rules of practice are generally applicable to proceedings before the Commission under the statutes which it administers, particularly those which involve a hearing or opportunity for hearing before the Commission or its duly designated officer. In connection with any particular matter, reference should also be made to any special requirements of procedure and practice that may be contained in the particular statute involved or the rules and forms adopted by the Commission thereunder, which special requirements are controlling. These rules do not apply to investigations, except where made specifically applicable by the Rules Relating to Investigations. 17 C.F.R. § 201.1 (1972).

100. *In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971), *on appeal*, Civil Action No. 71-1602 (D.C. Cir. 1971). In *Kivitz*, the Commission stated,

> [t]his language [of Rule 2(e)(i), (ii)] does not limit our disciplinary control to cases of misconduct committed in actual dealings with us or our staff, or, indeed, in connection

Commission's opinion seems justified. If an attorney's general professionalism must be demonstrated, by virtue of the APrA, as a prerequisite to admittance to practice before the SEC, the SEC presumably would have a valid interest in ensuring that those who later demonstrate a lack of these requisite qualities can be suspended from further SEC practice.[101] Consequently, the ultimate limitation upon the scope of Rule 2(e) must be a constitutional one: there must be a rational nexus between the offense being sanctioned and the objective of the SEC in sanctioning the lawyer for that offense.[102] In practice, the Commission has kept within this limitation.

*Grounds for Bringing a Rule 2(e) Proceeding*

In determining what types of attorney misconduct will constitute grounds for initiation of disciplinary proceedings, the SEC did not circumscribe its broad disciplinary powers by drafting Rule 2(e) narrowly. Rather, since Rule 2(e) was drafted broadly,[103] grounds for initiation of Rule 2(e) disciplinary action appear to be limited only by the scope of the Commission's power—constitutional, statutory, or otherwise—to discipline attorney conduct. Therefore, core, peripheral and non-securities conduct theoretically can be brought within the reach of the SEC's Rule 2(e) proceedings and sanctions.

The grounds for which the SEC is authorized under Rule 2(e) to

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with any form of practice before this Commission. But it is not necessary to decide here whether we may discipline an attorney practicing before us on the basis of conduct totally unrelated to Commission practice. *Id.* at 3.

101. The policy of protecting the public from abuses by persons licensed to practice law requires that the standards of professional ethics regulate much more than those aspects of a lawyer's professional activity which involve actual dealings with judicial or administrative officers. Even personal conduct unconnected with the practice of law will justify suspension or disbarment where it reflects on the integrity of the attorney involved.

Like a court, an agency may protect itself and members of the public having business before it from the misconduct of attorneys practicing before it even where the charges of unethical conduct do not relate to practice before that agency. Brief for Appellee, at 48, Kivitz v. SEC, Civil Action No. 71-1602 (D.C. Cir. 1972).

102. *Cf.* Schware v. Board of Bar Examiners, 353 U.S. 232 (1956).

103. This conclusion is reached in view of the original and express language of the Rule, which provides:

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

17 C.F.R. § 201.2(e)(1) (1972).

bring disciplinary action can be divided into three basic categories. Rule 2(e)(1) authorizes the SEC to discipline an attorney where the SEC finds the attorney "not to possess the requisite qualifications to represent others," or "to be lacking in character or integrity or to have engaged in unethical or improper professional conduct," or "to have willfully violated, or willfully aided and abetted the violation of any provision of the federal securities laws."[104] Before the SEC can determine formally that the attorney possesses one of the above grounds for discipline and therefore can be made subject to the SEC's disciplinary sanctions, Rule 2(e)(1) requires the Commission to grant a hearing to the attorney.[105] Hence, this procedural prerequisite for effecting the first ground for taking disciplinary action became known as a "qualification hearing."[106]

In 1970, the SEC added a second and more specific class of disciplinary grounds for invoking Rule 2(e)'s sanctions—a previously adjudged suspension or disbarment, or the conviction of a felony or a misdemeanor involving moral turpitude.[107] If such grounds exist, the SEC will suspend the attorney automatically under Rule 2(e)(2).

In 1971, the SEC incorporated the third and most narrow disciplinary ground into Rule 2(e). Under Rule 2(e)(3), an attorney can be temporarily or permanently suspended from practice where a court has permanently enjoined the attorney from further securities laws violations or has found him to have violated such laws.[108] Moreover,

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104. *Id.*

105. *Id.*

106. Goldberg, *supra* note 65, at 1.

107. Any attorney who has been suspended or disbarred by a Court of the United States or in any State, Territory, District, Commonwealth, or Possession, or any person whose license to practice as an accountant, engineer or other expert has been revoked or suspended in any State, Territory, District, Commonwealth, or Possession, or any person who has been convicted of a felony, or of a misdemeanor involving moral turpitude, shall be forthwith suspended from appearing or practicing before the Commission. A disbarment, suspension, revocation or conviction within the meaning of this subparagraph (2) shall be deemed to have occurred when the disbarring, suspending, revoking or convicting agency or tribunal enters its judgment or order, regardless of whether appeal is pending or could be taken, and includes a judgment or order on a plea of nolo contendere. 17 C.F.R. § 201.2(e)(2) (1972).

108. The Commission, with due regard to the public interest and without preliminary hearing, may by order temporarily suspend from appearing or practicing before it any attorney, accountant, engineer or other professional or expert who, on or after July 1, 1971, has been by name:

(A) permanently enjoined by any court of competent jurisdiction by reason of his misconduct in an action brought by the Commission from violation or aiding and abetting the violation of any provision of the Federal securities laws (15 U.S.C. §§ 77a- to 80b-20) or of the rules and regulations thereunder; or

(B) found by any count of competent jurisdiction in an action brought by the Commission to which he is a party or found by this Commission in any adminis-

the amended rule provides that the attorney will be *presumed* "to have been enjoined by reason of the misconduct alleged in the complaint" where he consents to a permanent injunction.[109] This express incorporation of consent injunctions under the federal securities laws as a ground for suspension under Rule 2(e) can produce at least two undesirable results. First, to the extent that the attorney is not aware, at the time of his original consent to the injunction, of the possibility of a subsequent Rule 2(e)(3) proceeding against him, the imposition in the later disciplinary proceeding of a suspension sanction based on the consent injunction is an unanticipated, adverse consequence of the attorney's settlement of the injunction suit and seems somewhat unfair. Furthermore, even if the attorney is aware of the threat of a subsequent Rule 2(e)(3) disciplinary proceeding based on any injunction he might consent to, an indirect effect of this 1971 amendment will be to force attorneys to litigate federal securities cases rather than consent to an injunction.[110] The end result of the promulgation of Rule 2(e)(3), therefore, may be an erosion of the policy considerations which favor the settlement of causes of action in civil cases.

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the violation of any provision of the federal securities laws (15 U.S.C. §§ 77a-to 80b-20) or of the rules and regulations thereunder (unless the violation was found not to have been willful).

. . . .

*Id.* § 201.2(e)(3).

109. In any hearing held on a petition filed in accordance with subdivision (ii) of this subparagraph (3), the staff of the Commission shall show either that the petitioner has been cnjoined as described in paragraph (i)(A) or that the petitioner has been found to have committed or aided and abetted violations as described in paragraph (i)(B) and that showing, without more, may be the basis for censure or disqualification; that showing having been made, the burden shall be upon the petitioner to show cause why he should not be censured or temporarily or permanently disqualified from appearing and practicing before the Commission. In any such hearing the petitioner shall not be heard to contest any findings made against him or facts admitted by him in the judicial or administrative proceeding upon which the proceeding under this paragraph (3) is predicated, as provided in subparagraph (i) hereof. A person who has consented to the entry of a permanent injunction as described in subparagraph (i)(A) of this paragraph (3) without admitting the facts set forth in the complaint shall be presumed for all purposes under this paragraph (3) to have been enjoined by reason of the misconduct alleged in the complaint. *Id.* § 201.2(e)(3)(iv).

110. For example, prior to the addition of section 3 to Rule 2(e) in 1971, an attorney could forego the defense of a costly federal securities action by consenting to the imposition of an injunction against him and thereby save himself undue expense and adverse publicity. However, such an option is not, as a practical matter, available to the attorney after the 1971 amendment because such a consent to an injunction is now tantamount to conceding defeat in a subsequent Rule 2(e)(3) disciplinary proceeding.

*Rule 2(e) Procedure*

*SEC Selection of Disciplinary Method.* With the exception of the provisions of Rule 2(e)(2) for automatic suspension of attorneys from SEC practice under certain circumstances, the SEC must take several steps in bringing a Rule 2(e) proceeding. The initial step involves a decision whether or not to bring a disciplinary action against a given attorney. Discretion in this matter is given to the SEC staff, whose decision will be based primarily on the findings of its prior investigation of the particular lawyer. However, the attorney himself may become involved in the decision process through written correspondence and informal conferences—neither of which is publicly disclosed.[111] Although such subliminal action offers some potential for abuse, the secrecy which enshrouds this preliminary step can be justified as protecting the attorney from unnecessary and harmful publicity in the event that the charges are later found to be unsubstantiated.

Once the SEC has made the initial decision to seek disciplinary action against a given attorney, the particular type of procedure to be followed under Rule 2(e) is usually dictated by the nature of the offense allegedly committed by the attorney. For example, a qualification hearing is the only procedure available in response to charges of unethical attorney conduct.[112] However, for certain other offenses the SEC may exercise discretion in choosing which Rule 2(e) procedure to employ.[113] Furthermore, if the SEC is unsuccessful in disciplining the attorney under the particular procedure selected, the SEC is implicitly authorized to make a second attempt by means of the alternative procedure. Rule 2(e)(6) negates any estoppel arguments against the Commission by providing that "[a]ny proceeding brought under any of the above sections shall not preclude a proceeding under any other section."[114]

111. This informal procedure was not consistently followed; consequently the Advisory Committee on Enforcement Policies and Practices has suggested "that where circumstances permit, the Commission should as a general practice give a party against whom the staff proposes to recommend proceedings an opportunity to present his own version of the facts by affidavit or testimony under oath." ENFORCEMENT POLICIES AND PRACTICES, *supra* note 4, at 19-20. The SEC has agreed to comply with this recommendation. SEC Securities Act Release No. 5310, (Oct. 4, 1972), *reprinted in* 1972 CCH FED. SEC. L. REP. ¶ 79,010.

112. *Compare* 17 C.F.R. § 201.2(e)(1) (1972) *with id.* §§ 201.2(e)(2) *and* (3).

113. For example, certain securities laws violations may be disciplined under Rule 2(e)(1)(iii) or Rule 2(e)(3).

114. 17 C.F.R. § 201.2(e)(6) (1972).

Although the SEC may be presented with alternative procedures for prosecuting a given offense, it often will find one procedure more efficient or advantageous than the other. For example, certain offenses, such as a willful violation of a federal securities law, can be disciplined under either section 1 or section 3 of Rule 2(e).[115] Yet, there are several reasons why the latter route—Rule 2(e)(3)—is more advantageous for the Commission to pursue.[116] First, Rule 2(e)(3) affords the SEC the initial sanction of automatic temporary suspension from SEC practice of the adjudged securities law violators, whereas the Commission can impose no sanction under Rule 2(e)(1) until the requisite qualification hearing has been completed.[117] Furthermore, since the SEC is not required to hold a hearing under Rule 2(e)(3) unless the attorney petitions for such within 30 days of his temporary suspension,[118] it is possible that the Commission under Rule 2(e)(3) can impose upon the disciplined attorney the ultimate sanction—censure or permanent or temporary disqualification—without even expending the time and resources needed for the conduct of a hearing.

Should the adjudged federal securities law violator elect to contest his temporary suspension under Rule 2(e)(3) and apply for a hearing, there nevertheless are relative advantages in the Rule 2(e)(3) hearing procedure which enable the Commission to discipline the attorney more effectively under section 3 of Rule 2(e) than under section 1. First, the SEC in the subsequent hearing under Rule 2(e)(3) must show only that a court has permanently enjoined the attorney or found him to have committed the violation.[119] Once this initial showing is made, the burden shifts to the lawyer to show why he should not be sanctioned.[120] Furthermore, in a Rule 2(e)(3) hearing the lawyer "cannot be heard to contest any findings made against him or facts admitted by him in the [prior] judicial or administrative pro-

115. *Id.* §§ 201.2(e)(1), (3).

116. Rule 2(e)(1)(iii) provides that *willfully* violating a federal securities law is a ground for a qualification hearing. See 17 C.F.R. § 201.2(e)(1)(iii) (1972). In contrast, *any* violation of a securities law is a sufficient ground for Rule 2(e)(3). *See id.* § 201.2(e)(3). Despite this apparent difference in scope, it seems clear that Rule 2(e)(1) can be used for other securities laws violations by relying on the general subsections (i) and (ii).

117. *Compare id.* § 201.2(e)(3)(i) *with id.* § 201.2(e)(1). This is assuming the temporary suspension has not been ordered more than three months after a final judgment of the securities law violation. See note 130 *infra* and accompanying text.

118. *Id.* § 201.2(e)(3)(ii).

119. *Id.* § 201.2(e)(3)(iv).

120. *Id.*

ceeding . . . ," and where the lawyer has consented without admitting anything, he will be subject to certain presumptions.[121]

*Rule 2(e)(1) Disqualification Procedure.* After the SEC has decided to seek disciplinary action against an attorney and has weighed the relative merits of the alternative procedures available, the Rule 2(e)(1) qualification hearing, if chosen by the SEC as the method to follow in a given case, provides a relatively simple procedure incorporating many safeguards for the disciplined attorney.

As discussed previously, the SEC is empowered to disbar an attorney from SEC practice pursuant to a Rule 2(e)(1) qualification proceeding if the Commission finds that the attorney (1) is not qualified to represent others, or (2) is lacking in charaeter or integrity or has engaged in unethical or improper professional conduct, or (3) has willfully violated the federal securities laws.[122] The SEC's Rules of Practice require that the Commission, in bringing disciplinary action under Rule 2(e)(1), first give notice and a statement of the charges to the attorney.[123] Thereafter a private hearing before an SEC hearing examiner is held, unless the Commission or the disciplined party requests otherwise.[124]

At the hearing stage, the attorney is afforded a fair investigation and a reasonable opportunity to answer the charges.[125] In addition, since the same adjudicatory and evidentiary rules used in other SEC hearings are employed in the Rule 2(e)(1) qualification hearing, the disciplined attorney is provided with uniform rules of evidence upon which to rely.[126] This standardization is also important to the SEC in that it ensures the use of evidentiary inferences—a tool made

121. *See id.*

122. *Id.* § 201.2(e)(1).

123. *Id.* For a discussion of the factors used in determining whether the SEC has afforded satisfactory notice, see Initial Deeision, *In re* Irwin L. Germaise and Thomas F. Quinn at 21-23, SEC Administrative Proceeding, File No. 3-2606 (Oct. 29, 1971) (D. Markun, Hearing Examiner).

124. 17 C.F.R. § 201.2(e)(7). See note 61 *supra.* Although the SEC has recently changed the title "hearing examiner" to "administrative law judge," SEC Securities Act Rcleases Nos. 5309, 5311 (Oct. 4, 1972), *reprinted in* 1972 CCH FED. SEC. L. REP. ¶¶ 79,009, 79,014, this Comment will continue to use the former term.

125. *See* Schwebel v. Orrick, 153 F. Supp. 701, 706 (D.D.C. 1957), *aff'd*, 215 F.2d 919, *cert. denied*, 356 U.S. 927 (1958).

126. *See generally* Orrick, *Organization, Procedures, and Practices of the SEC*, 28 GEO. WASH. L. REV. 50 (1959); Timbers & Garfinkel, *Examination of the Commission's Adjudicatory Process: Some Suggestions*, 45 VA. L. REV. 817 (1959); Timbers, *SEC Litigation—Before the Commission and the Courts*, 13 RECORD OF N.Y.C.B.A. 286 (1958).

valuable because of the frequent lack of direct testimony in disciplinary proceedings.[127]

During the course of the qualification hearing, the hearing examiner reviews all evidence and testimony, makes factual findings, and then makes a final determination whether the attorney should be sanctioned. After the hearing examiner has made his final determination, the disciplinary decision can be appealed to the Commission itself. If an appeal is secured by the attorney or if the SEC determines on its own initiative to review the hearing examiner's decision, the Commission will then make an independent review of the facts and charges and render its own findings.[128]

*Rule 2(e)(3) Procedure for Temporary Suspension or Disqualification.* The procedure followed in obtaining a temporary suspension and, ultimately, a temporary or permanent disqualification under Rule 2(e)(3) is more detailed and intricate than the mechanics of a Rule 2(e)(1) qualification proceeding. As soon as an attorney is permanently enjoined by a court from violating the federal securities laws or is convicted of such a violation, the SEC has the power under Rule 2(e)(3) to suspend the attorney from SEC practice temporarily,[129] provided that the order of temporary suspension is not entered

127. *See, e.g., In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971), *on appeal*, No. 71-1602 (D.C. Cir. 1971).

128. *See, e.g., id.* at 1.

129. An order of temporary suspension shall become effective when served by certified or registered mail directed to the last known business or residence address of the person involved. No order of temporary suspension shall be entered by the Commission pursuant to this subdivision (i) more than three months after the final judgment or order entered in a judicial or administrative proceeding described in subparagraph (a) or (b) of this subdivision (i) has become effective upon completion of review or because further review or appeal procedures are no longer available.

(ii) Any person temporarily suspended from appearing and practicing before the Commission in accordance with suhdivision (i) of this subparagraph (3) may, within thirty days after service upon him of the order of temporary suspension, petition the Commission to lift the temporary suspension. If no petition has been received by the Commission within 30 days after service of the order by mail the suspension shall become permanent.

(iii) Within 30 days after the filing of a petition in accordance with subdivision (ii) of this subparagraph (3), the Commission shall either lift the temporary suspension or set the matter down for hearing at a time and place to be designated by the Commission or both, and after opportunity for hearing, may censure the petitioner or may disqualify the petitioner from appearing or practicing before the Commission for a period of time or permanently. In every case in which the temporary suspension has not been lifted, every hearing held and other action taken pursuant to this subparagraph (3) shall be expedited in every way consistent with the Commission's other responsibilities. 17 C.F.R. § 201.2(e)(3) (1972).

more than three months after the effective date of the final judgment of the securities law injunction or violation.[130] After entering the order of temporary suspension, the SEC must deliver the order to the attorney.[131] After being served with notice of the SEC order, the attorney may, within thirty days, petition the Commission to lift the temporary suspension. In the absence of such petition, "the suspension shall become permanent."[132] Once the petition is filed, the SEC must, within thirty days, either lift the suspension or schedule the matter for a hearing.[133] If the SEC decides to hold a hearing, it presumably will use the same procedures available under Rule 2(e)(1) for the qualification hearing, except that Rule 2(e)(3) expressly requires the Commission to conduct the hearing in an expeditious manner.[134] After completion of the hearing, the SEC is empowered under Rule 2(e)(3) to censure or disbar the attorney from SEC practice permanently or for a period of time.[135]

*Sanctions Available to the SEC Under Rule 2(e)*

With the exception of a Rule 2(e)(2) violation, which *requires* the sanction of automatic suspension from SEC practice for attorneys who are disbarred locally or convicted of a felony or a misdemeanor involving moral turpitude,[136] the Commission has discretion to impose a variety of sanctions in its disciplinary proceedings. In a qualification proceeding under Rule 2(e)(1), for example, the Rule expressly provides that "[t]he Commission may deny [an attorney], temporarily or permanently, the privilege of appearing or practicing before it *in any way*,"[137] provided that the attorney is found to be unqualified, lacking in character, or unethical, or to have willfully violated the federal securities laws. This broad language certainly authorizes the lesser sanction of censure.[138] Furthermore, Rule 2(e)(1) appears sufficiently broad to empower the SEC to impose fines upon disciplined

130. *Id.* § 201.2(e)(3)(i).

131. *Id.*

132. *Id.* § 201.2(e)(3)(ii).

133. *Id.*

134. *Id.* § 201.2(e)(3)(iii) ("[E]very hearing held . . . pursuant to this subparagraph (3) shall be expedited in every way consistent with the Commission's other responsibilities").

135. *Id.*

136. *Id.* § 201.2(e)(2).

137. *Id.* § 201.2(e)(1) (emphasis added).

138. *See* the opinion of Commissioner Needham, (concurring in part and dissenting in part), *In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971).

attorneys, although the SEC to date has not done so.[139]

Contrary to the broad discretion which the SEC apparently has in choosing sanctions under a Rule 2(e)(1) disqualification proceeding, the Commission's sanctioning authority appears to be more narrowly circumscribed under Rule 2(e)(3). Under the latter section, where an attorney has been permanently enjoined or convicted by a court for a federal securities law violation, the SEC is empowered to impose only the sanctions of temporary suspension, censure or disqualification.[140]

Despite the variable flexibility in the SEC to fashion sanctions under different aspects of Rule 2(e), the sanction which will normally be imposed by the Commission under that Rule can be characterized either as an outright disqualification or a suspension from SEC practice. Either sanction is severe in several respects. The most dramatic effect will occur when an entire law firm or partnership is enjoined or convicted "by name" for a federal securities law violation. In such a case, the suspension sanction of Rule 2(e)(3) will achieve the result that "[p]artners and associates of a disqualified firm . . . may not practice before the Commission so long as they remain members of or associated with the firm."[141] Even when the disciplinary measure is limited to the individual lawyer, the sanctions are still severe since the attorney is precluded, either permanently or during the suspension period, from participating in any aspect of securities or SEC practice.[142] Furthermore, in addition to excluding the disqualified attorney from engaging personally in activities which are directly related to the SEC, the SEC has stated that the individual attorney may not *indirectly* benefit in any way from his firm's securities practice.[143]

139. Consideration of the use of fines has been recommended in broker-dealer disciplinary proceedings. *See* ENFORCEMENT POLICIES AND PRACTICES, *supra* note 4, at 46. The availability of fines is equally as desirable in attorney disciplinary proceedings since fines offer a less severe sanction than suspension or disqualification but a more severe sanction than censure or a suspended disqualification.

140. *See* 17 C.F.R. § 201.2(e)(3)(ii) (1972).

141. SEC Securities Act Release No. 5147, at 3 (May 10, 1971), *reprinted in* 1971 CCH FED. SEC. L. REP. ¶ 78,064, at 80,313 *and in* 36 Fed. Reg. 8933, 8935 (1972).

142. *See* SEC v. Ezrine, ___ F. Supp. ___ (S.D.N.Y. Aug. 2, 1972), *reported in* 164 BNA SEC. REG. & L. REP. A-12 (1972). *See also* note 148 *infra*. This sanction as apparently construed in *Ezrine* may be viewed as quite harsh since it bars the attorney from much of his corporate practice.

143. Partners of a disqualified individual may not permit such persons to participate to any extent in matters coming before tbe Commission, to participate in profits from their Commission business or to hold himself out as entitled to practice before the Commission. SEC Securities Act Release No. 5147 (May 10, 1971), *reprinted in* 1971 CCH FED. SEC. L. REP. ¶ 78,064, at 80,313; *and in* 36 Fed. Reg. 8933, 8935 (1972).

Hence, the disqualified attorney is barred from the receipt of profits from the firm's SEC business.[144]

The first judicial definition of the breadth and severity of the disqualification sanctions available to the SEC under Rule 2(e) was recently articulated in *SEC v. Ezrine*.[145] In that case, attorney Ezrine had been permanently enjoined from further securities laws violations based on his wrongdoing in connection with a public offering.[146] In April, 1972, acting in response to the permanent injunction, the SEC temporarily suspended Ezrine from SEC practice. The suspension became permanent in May, 1972 after Ezrine had pleaded guilty to a felony count for violation of Federal Reserve Board Regulation T.[147] Nevertheless, Ezrine ignored the suspension and represented certain parties in an SEC hearing examiner proceeding. In further disregard of his permanent disqualification from SEC practice, Ezrine continued to serve as house counsel for a registered broker/dealer, advising and assisting the broker with respect to federal securities laws and SEC transactions.

The SEC, seeking *judicial* aid in its efforts to preclude Ezrine from practice before the Commission, filed a suit to enjoin Ezrine from further appearance and practice before the Commission. In addition, the SEC requested in its complaint that Ezrine (1) be required to disclose his Rule 2(e) disqualification from SEC practice to all those who might seek his services with respect to matters arising under the federal securities laws and (2) be restrained from receiving or retaining any legal fees for services rendered during the period of disqualification. The district court agreed that an injunction was necessary, granted all the SEC requests, and issued a permanent injunction which encompassed such a wide variety of activities that Ezrine could no longer, as a practical matter, influence the investing public in any capacity without violating the injunction.[148] Since the court's

144. *Id.*

145. ___ F. Supp. ___ (S.D.N.Y. Aug. 2, 1972), *reported in* 164 BNA SEC. REG. & L. REP. A-12 (1972).

146. See SEC v. Manor Nursing Centers, Inc., 340 F. Supp. 913 (S.D.N.Y. 1971), *aff'd*, 458 F.2d 1082 (2d Cir. 1972).

147. See *In re* Ivan Allen Ezrine, SEC Securities Act Release No. 5268 (July 7, 1972). *See also* SEC Litigation Release No. 5477 (July 25, 1972). Regulation T is promulgated in 12 C.F.R. § 220 (1972).

148. In granting the injunction, Judge Frankel prohibited Ezrine from further "securities practice":

(A) Participating directly or indirectly, in a representative capacity, in

(1) any administrative proceeding or investigation instituted by order of the

injunction in essence gave judicial sanction to the SEC's original Rule 2(e) disqualification order, the breadth of the injunction issued in *Ezrine* can be interpreted as a judicial resolution and approval of the expansive SEC sanctioning power within Rule 2(e) itself.

Although the sanctions available to the SEC under Rule 2(e) are broad and drastic, they need not be employed to the fullest extent possible. For example, the SEC has the power to alleviate a sanction imposed by the hearing examiner which it considers to be too severe.[149] Sanctions can be mitigated by either the hearing examiner or the Commission where the conduct and character of the offender subsequent to the commission of the offense have been exemplary.[150] Other factors which may influence the decision to reduce a sanction are the age and physical condition of the violator,[151] the length of time since the violation occurred,[152] and the attorney's conduct prior to the commission of the offense.[153] The SEC, however, does not always follow a consistent pattern in reviewing the Rule 2(e) sanctions imposed by hearing examiners and sometimes has increased the harshness of the disciplinary sanction originally imposed or has failed to

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plaintiff Commission;

(2) any formal or informal conference with the jurisdiction of the Commission; or

(3) in connection with any matter within the jurisdiction of the Commission at such time as it appears or reasonably should appear that a proceeding or investigation will be instituted by the Commission in connection therewith, other than communications incidental to the conduct of litigation other than litigation before the Commission;

(B) Representing or advising any entity or person in connection with the preparation or filing of such documents as may be required to be filed with the plaintiff Commission under the federal securities laws; and

(C) Representing, in connection with any matter arising under or related to the federal securities laws, any broker or dealer in securities, investment company, or investment adviser, registered or required to be registered with the plaintiff Commission. 164 BNA SEC. REG. & L. REP. at A-12.

149. See *In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971). It should be noted that the converse situation—a hearing examiner's sanction which is too lenient—has also arisen. *E.g., In re* Albert J. Fleischmann, 37 S.E.C. 832, 836 (1950).

150. *See In re* Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971). However, the Commission was also quick to point out that beginning with the initiation of the proceedings the attorney has "acted on notice that his conduct might be under scrutiny."

151. *E.g., In re* Nathan Wechsler, SEC Securities Exchange Act Release No. 6932 (Nov. 5, 1962).

152. See the opinion of Commissioner Needham (concurring in part and dissenting in part) in the *Kivitz* case. *In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971).

153. *See In re* Albert J. Fleischmann, 37 S.E.C. 832, 836 (1950).

mitigate a sanction which seemed clearly unjustified.[154]

*Settlement of Disciplinary Proceedings*

The SEC can, and frequently does, terminate a Rule 2(e) proceeding by negotiating a settlement via a consent or stipulation with the disciplined attorney.[155] A settlement may have distinct advantages to each of the parties involved. The SEC staff through the means of a settlement can forestall further depletion of the limited resources it has available for disciplinary proceedings and avoid the risk of losing on the merits. At the same time, the settlement method has several advantages for the disciplined attorney. First, the attorney is able to avoid prolonged and undue adverse publicity. Furthermore, the sanction agreed upon is seldom more severe than the sanction which would have been imposed upon the final adjudication of a Rule 2(e) proceeding.[156] Finally, a negotiated settlement may be conducive to reinstatement of the attorney to SEC practice.[157]

In the past, there have been several elements comprising settlement agreements. Generally, the attorney must admit to the SEC allegations contained in the statement of notice and hearing, must withdraw from further appearance and practice before the SEC, and must agree to seek SEC approval prior to any future practice before the Commission.[158] Apparently, the Commission is adhering to these elements in its recent Rule 2(e) settlements.[159]

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154. For example, in the recent disciplinary action of *In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971), the SEC ignored an apparently justifiable opportunity to impose a more lenient sanction. In *Kivitz*, the SEC investigation was initiated five years after the offense occurred; two years later, the Rule 2(e) proceeding was brought. Kivitz' conduct prior to the alleged offense, and his conduct in the succeeding seven years, had been exemplary. In view of these factors, Commissioner Needham, in his dissent, felt only a formal censure was warranted. However, the majority of the Commissioners felt otherwise and suspended Kivitz from SEC practice for a period of two years.

155. *E.g., In re* Sol M. Alpher, 39 S.E.C. 346 (1959); *In re* Arnold D. Naidich, SEC Securities Act Release No. 4372 (June 8, 1961) (the disciplinary order was entered on the basis of a stipulation); *In re* Nathan Wechsler, SEC Securities Exchange Act Release No. 6932 (Nov. 5, 1962).

156. *Compare* the sanctions imposed in Rule 2(e) settlements, *cited in* notes 158-59 *infra*, *with* the sanctions imposed under a Rule 2(e) proceeding, *cited in* notes 149-54.

157. *See, e.g., In re* Thomas F. Bionquist, SEC Litigation Release No. 5397 (May 25, 1972); *cf. In re* Elliot S. Blair, SEC Securities Exchange Act Release No. 9666 (July 14, 1972).

158. *E.g., In re* Arnold D. Naidich, SEC Securities Act Release No. 4372 (June 8, 1961); *In re* Nathan Wechsler, SEC Securities Exchange Act Release No. 6932 (Nov. 5, 1962); *In re* Erwin Pincus and Pace Reich, SEC Securities Act Release No. 4619 (June 27, 1963); *In re* Leonard Nikoloric, SEC Securities Act Release No. 4642 (Sept. 19, 1963).

159. *E.g., In re* Elliot S. Blair, SEC Securities Exchange Act Release No. 9666 (July 14,

The use of settlements in Rule 2(e) proceedings has been criticized on the basis that premature termination prevents the SEC from molding and further defining the substantive law of Rule 2(e).[160] Without express resolution of the confines of Rule 2(e), it becomes difficult for attorneys to become fully informed of what conduct should be avoided. However, the countervailing considerations which support the use of settlement agreements seem to prevail. The deficiencies in developing the substantive law aspects of Rule 2(e) can be remedied by the SEC through careful, precise drafting of its Rule 2(e) charges.[161] At the same time, a settlement agreement allows an attorney to avoid adverse publicity which may injure even his non-SEC practice. Thus, the lawyer who settles with the SEC can ensure that he will receive a sanction commensurate with the offense and not aggravated by any stigma carried over from the harmful publicity of an SEC disciplinary proceeding.

*Readmittance to SEC Practice*

Prior to 1971, Rule 2(e) did not expressly provide a method for readmitting a suspended attorney to SEC and securities practice, and the appropriate method of reinstatement often had to be implied from the nature of the sanction originally imposed. Thus, if the SEC suspended an attorney from practice for two years, the attorney presumably had an implied right to be readmitted to practice automatically upon termination of the suspension period.[162] When the lawyer was indefinitely suspended from SEC practice or consented not to practice in a settlement agreement, the method of reinstatement was not as clear. Apparently, under these circumstances a reapplication was required and readmittance was subject to the SEC's discretion.[163]

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1972); *In re* Thomas R. Blonquist, SEC Litigation Release No. 5397 (May 25, 1972).

160. See Kemp, *supra* note 65, at 42.

161. *Id.* at 42-43.

162. It is not clear whether an implied right to readmission upon termination of the suspension period existed prior to the enactment of the APrA. However, after the Act, it can be argued that when the attorney's sanction has expired, his right under the APrA to practice before any federal agency—including the SEC—governs. See notes 85-87 *supra* and accompanying text. Furthermore, since the SEC has also provided that an attorney suspended under Rule 2(e)(2) *must* be readmitted to practice when his local disciplinary sanction terminates, by analogy, the attorney *must* be readmitted when his SEC disciplinary sanction terminates. See text following note 168 *infra*.

163. In the case of permanent disqualification any action by the Commission on a petition for reinstatement would appear to be wholly discretionary. The Commission would not be confined to those matters appearing in its public files of the instant

The deficiencies and uncertainties surrounding the right to and method of readmittance to SEC practice were partially remedied by the 1971 amendments to Rule 2(e).[164] Under Rule 2(e)(4), the applicable reinstatement procedure depends upon the type of disciplinary proceeding originally used to suspend the attorney.[165] Accordingly, the first method of readmittance, specified in Rule 2(e)(4)(i), applies only to *permanent* disqualifications and suspensions imposed under Rule 2(e)(1) and (3). The Rule 2(e)(4)(i) procedure provides that the permanently disbarred attorney may at any time apply for readmittance, may at the discretion of the SEC be afforded a hearing, and must show "good cause" in order to be reinstated.

The second method of readmittance, specified in Rule 2(e)(4)(ii) and declared applicable to automatic suspensions under Rule 2(e)(2), provides that the attorney *shall* be reinstated, upon appropriate application, where "all the grounds for application of the provisions of [Rule 2(e)(2)] are subsequently removed" because the underlying prior adjudged violation is reversed or the non-SEC suspension or disbarment has been terminated.[166] In addition, an attorney suspended under Rule 2(e)(2) may apply for reinstatement at any time, even if the underlying conviction or disbarment has not been overturned or terminated. In this event, the lawyer *must* be accorded an opportunity for a hearing,[167] and, similar to the Rule 2(e)(4)(i) reinstatement applicant who was disciplined originally under Rules 2(e)(1) and (3), the attorney must show good cause in order to be readmitted.

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petitioner, but could look at any of its files which have bearing on the matter. Kemp, *supra* note 65, at 43 n.42.

164. (4)(i) An application for reinstatement of a person permanently suspended or disqualified under paragraphs (1) or (3) of this paragraph (e) may be made at any time, and the applicant may, in the Commission's discretion, be afforded a hearing; however, the suspension or disqualification shall continue unless and until the applicant has been reinstated by the Commission for good cause shown.

(ii) Any person suspended under subparagraph (2) of this paragraph (e) shall be reinstated by the Commission, upon appropriate application, if all the grounds for application of the provisions of that subparagraph are subsequently removed by a reversal of the conviction or termination of the suspension, disbarment or revocation. An application for reinstatement on any other grounds by any person suspended under subparagraph (2) of this paragraph (e) may be filed at any time and the applicant shall be accorded an opportunity for a hearing in the matter; however, such suspension shall continue unless and until the applicant has been reinstated by order of the Commission for good cause shown. 17 C.F.R. § 201.2(e)(4) (1972).

165. *Compare id.* § 201.2(e)(4)(i) *with id.* § 201.2(e)(4)(ii).

166. *Id.* § 201.2(e)(4)(ii).

167. *Id.*

Unfortunately, the 1971 amendments do not expressly consider readmittance after a "suspension" to which an attorney consents in a settlement agreement or a *temporary* suspension under Rule 2(e)(1) or 2(e)(3). However, it seems apparent that unless the SEC provides otherwise in its original suspension order,[168] an attorney who is suspended only temporarily under either section 1 or section 3 of Rule 2(e) should have the right to readmittance as soon as the suspension is terminated or lifted. As discussed previously, for example, an attorney who is suspended from general law practice by local proceedings and thereby suspended automatically from SEC practice by Rule 2(e)(2) has an express right to be reinstated by virtue of Rule 2(e)(4)(ii), without any need to show "good cause," in cases where the underlying *local* suspension from law practice is later terminated.[169] It would appear consistent to grant the same right to reinstatement, upon proper application, and unless the SEC provides otherwise in its original suspension order, to an attorney whose temporary suspension from SEC practice was imposed originally by Rule 2(e)(1) or 2(e)(3) itself.

*Judicial Relief*

Rule 2(e) does not provide for any type of judicial relief for a SEC-disciplined attorney. The availability of relief *prior* to the completion of a Rule 2(e) proceeding is limited; pursuant to *Schwebel v. SEC*,[170] for example, it is not possible to enjoin the Commission from

168. *Cf. In re* Leonard A. Nikoloric, SEC Securities Act Release No. 4642 (Sept. 19, 1963) (in which the SEC requested the attorney to reapply for practice). An alternative argument to support this right of readmission is based on the APrA. See notes 95-96 *supra*. In essence, once the attorney's SEC sanction has terminated, the right to practice granted by the APrA governs.

169. *See* 17 C.F.R. § 201.2(e)(2) (1972).

170. 153 F. Supp. 701 (D.D.C. 1957), *aff'd on other grounds*, 251 F.2d 919 (D.C. Cir.), *cert. denied*, 356 U.S. 927 (1958). In *Schwebel*, the court summarily dismissed the attorney's complaint and thereupon rejected his motion for a preliminary injunction. The SEC had made three contentions—plaintiff had failed to exhaust his administrative remedies, he had alleged no legal cognizable injury, and the Commission had acted properly in bringing the action. The court did not require exhaustion of remedies; instead, it viewed the irreparable injury exception as applicable, since at stake was "the peculiar delicacy of an attorney's good reputation, his chief asset in his profession, and the fact that some members of the public may assume guilt from disbarment proceedings despite final exoneration." 153 F. Supp. at 704. However, the court held that the SEC had the power to discipline attorneys, and had done so properly in this case.

The Circuit Court of Appeals for the District of Columbia reversed per curiam, holding that the attorney had failed to exhaust his administrative remedies. In addition, the appellate

bringing a disciplinary action. However, the availability of judicial relief to the disciplined attorney *after* termination of the SEC proceeding has long been recognized by the SEC and the courts.[171]

Enforcement of an SEC-imposed disciplinary sanction may be stayed either by a court or the SEC, pending judicial review of the Rule 2(e) proceeding.[172] Since the judicial granting of a stay is considered "extraordinary relief," a petitioning attorney bears a heavy burden in justifying his right to a stay.[173] Arguably, the availability of such relief should be even more limited in Rule 2(e) cases since the Commission's ability to achieve quick and decisive action against a continuing threat to the investing public is undermined whenever the SEC sanctions and suspensions are judicially stayed. However, the availability of this relief does not appear to be so limited, for in *Kivitz v. SEC*[174] the attorney's motion for a stay was granted despite the vigorous opposition of the Commission.[175]

Judicial review of an SEC disciplinary proceeding can be secured pursuant to the various judicial review provisions of the federal securities acts, which provide the requisite jurisdictional source for the petitioning attorney.[176] The reviewing court is limited by the federal securities laws and the APA in the scope of review which it may exercise, and it must sustain the SEC's disciplinary findings once it finds they are supported by substantial evidence.[177] The real problem,

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court stated that the district court was in error in reaching the question of the authority of the Commission to disbar.

171. *See* Kivitz v. SEC, No. 71-1602 (D.C. Cir. 1972), where judicial review is presumed by both parties.

172. *See, e.g.*, Kivitz v. SEC, No. 71-1602 (D.C. Cir. 1972), where Kivitz was granted a 15-day stay by the Commission until he could obtain a judicial stay. *Commission Announcement*, SECURITIES AND EXCHANGE COMMISSION NEWS DIGEST, July 28, 1971, at 1 (Issue No. 71-145). Soon thereafter the court of appeals did grant Kivitz a stay pending judicial review of his SEC disciplinary proceeding.

173. *E.g.*, Virginia Petroleum Jobbers Ass'n v. FPC, 259 F.2d 921, 925 (D.C. Cir. 1958). Under *Virginia Petroleum*, a movant for a stay must show: (1) he is likely to prevail on the merits of his appeal; (2) without a stay he will suffer irreparable injury; (3) the issuance of a stay will not substantially harm other persons interested in the proceedings; and (4) there will be no harm to the public interest if a stay is granted.

174. *In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971), *on appeal*, Civil Action No. 71-1602 (D.C. Cir. 1971).

175. See Memorandum of the SEC in Opposition to Petitioner's (Kivitz) Motion for a Stay of the Effectiveness of an Order of the Commission Pending Review, *In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971), *on appeal*, No. 71-1602 (D.C. Cir. 1971).

176. 15 U.S.C. §§ 78y(a), 79x(a), 80a-42(a), 80b-13(a) (1970).

177. *E.g.*, Hughes v. SEC, 174 F.2d 969, 974 (1949). *See also* 5 U.S.C. § 706(2)(E) (1970), and the statutes cited in note 176 *supra*. The two other judicial review sections of the federal

therefore, lies in the determination of what constitutes substantial evidence, an issue which becomes difficult where there is conflicting, unsubstantiated, or circumstantial evidence.[178]

### Kivitz v. SEC: *Judicial Review of Rule 2(e) Proceedings*

The pending case of *Kivitz v. SEC*[179] represents the first instance of judicial review of a Rule 2(e) proceeding and presents an opportunity for the judiciary to eliminate many of the uncertainties underlying Rule 2(e). In *Kivitz*, the SEC initiated a Rule 2(e) proceeding against an attorney who allegedly had served as a contact for an unscrupulous person who planned to gain SEC approval of a registration statement by bribing various influential people.[180] Basing its case on conflicting evidence, hearsay testimony, and circumstantial evidence, the SEC sought to establish that Kivitz lacked the requisite character and integrity to engage in SEC practice and therefore should be disqualified from practice under Rule 2(e)(1).[181]

The hearing examiner in *Kivitz* made the initial findings that the APrA did not "divest the Commission of its long-recognized and long-exercised power to discipline attorneys practicing before it . . ."[182] and that clear and convincing proof was required, and had been shown. The hearing examiner then found that Kivitz had exhibited unethical and improper conduct within Rule 2(e) by allowing a lay intermediary to exploit Kivitz' SEC privilege and by setting legal fees contrary to canons 34 and 35 of the ABA Canons of Ethics.[183] Consequently, the hearing examiner determined under Rule 2(e) that Kivitz should be denied the privilege of practicing before the SEC.

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securities laws, 15 U.S.C. §§ 77i(a), vvv(a), refer only to "supported by evidence." However, this distinction is apparently a matter of semantics. *Cf.* 3 L. Loss, SECURITIES REGULATION 1931 n.43 (2d ed. 1961).

178. *See, e.g., In re* Murray A. Kivitz, SEC Securities Act Release No. 5163 (June 29, 1971).

179. No. 71-1602 (D.C. Cir. 1972).

180. Kivitz attended a meeting at which time the final plan to clear the registration statement was discussed. Allegedly, Kivitz wrote the terms of this illegal agreement on paper bearing his letterhead. In addition, his fee charged was substantially above the amount which he had charged for similar services in the past. The retainer was never accepted by the issuing company, and no attempt was made to illegally clear the registration statement. However, five years after this incident, the SEC brought disciplinary charges against Kivitz for his involvement in an attempted illegal registration.

181. For a discussion of Rule 2(e)(1), see notes 122-28 *supra* and accompanying text.

182. Initial Decision, *In re* Murray A. Kivitz, Administrative Proceeding File No. 3-1972, at 2-3, 5-8, 21-23 (April 17, 1970) (Markun, Hearing Examiner).

183. *Id.* at 24 n.34.

On review before the Commission, the SEC affirmed the hearing examiner's determination of Kivitz' disqualification and entered an order denying Kivitz the privilege of practicing before the SEC.[184] In its opinion, the SEC indicated that a preponderance of the evidence, rather than the examiner's standard of clear and convincing proof, was the proper standard of proof for the SEC in a Rule 2(e) proceeding, since a Rule 2(e) proceeding did not affect the attorney's general practice but only his "*privilege* to practice before [the SEC]."[185] Nevertheless, the Commission decided that the evidence against Kivitz satisfied the more stringent standard of clear and convincing evidence as well.[186] The Commission also rejected an argument that the SEC had no power to discipline attorneys under Rule 2(e) or, alternatively, that unrelated securities conduct was not within the scope of whatever power the Commission did have.[187] However, the SEC went on to note that Kivitz' conduct could be conceptualized as "peripherally related" since it was ancillary to the filing of a registration statement. Kivitz thereupon obtained a judicial stay of the SEC sanction pending further judicial review.

Although the appeal from *Kivitz v. SEC* is still pending,[188] it seems likely that the Court of Appeals for the District of Columbia Circuit will affirm the SEC suspension of Kivitz by finding that there was substantial evidence to support the Commission's decision. More importantly, *Kivitz* gives the appellate court the opportunity to hold squarely that the Commission does have the power to discipline attorneys.[189] Because more than fifteen other federal agencies discipline attorneys and regulate their conduct from a similar source of power, this aspect of the *Kivitz* case could have catastrophic results if no disciplinary authority were found.[190] The opinion should also provide a judicial resolution of the burden of proof which the SEC must meet in a Rule 2(e) proceeding and a determination of the type of evidence which the Commission can consider in imposing the ultimate discipli-

184. SEC Securities Act Release No. 5163 (June 29, 1971), *reprinted in* 29 AD. L.2D 361 (1972).

185. *Id.* at 3 n.2, 29 AD. L. 2D at 363 n.2.

186. *Id.*

187. This language does not limit our disciplinary control to cases of misconduct committed in actual dealings with us or our staff, or, indeed, in connection with any form of practice before this Commission. *Id.* at 4, 29 AD. L.2D at 369.

188. Oral argument was scheduled for June, 1972; however, it was postponed until October, 1972. A decision should be forthcoming at the time of publication of this article.

189. Such a holding has been long advocated. See Kemp, *supra* note 65, at 26.

190. See note 37 *supra*.

nary sanction. Despite the strong arguments on both of these points advanced by Kivitz, the court in all likelihood will approve the SEC's adoption of the lesser burden of proof—a "preponderance of the evidence" rather than "clear and convincing proof"—and probably will allow the Commission broad discretion in imposing sanctions.[191]

*Rule 2(e) in Perspective*

The present operation of Rule 2(e) is in general consistent with the model proposed in this Comment for the regulation of attorney conduct. For example, the severity of Rule 2(e) treatment varies in proportion to the potential harmfulness of the offense to the investing public; while at the same time, the attorney is afforded a number of procedural safeguards in the Rule 2(e) disciplinary proceeding.[192] Furthermore, the apparent severity of Rule 2(e)'s censure, suspension, and disqualification sanctions is mitigated by the fact that the SEC has directed its disciplinary proceedings at attorney misconduct which is patently offensive.[193] Finally, the incorporation in recent Rule 2(e) amendments of automatic disciplinary action triggered by the consummation of certain non-SEC controls—automatic suspension from SEC practice under Rule 2(e)(2), for example, for attorneys who are disbarred locally or convicted of a felony or a misdemeanor involving moral turpitude—is understandable in view of the spiraling demands placed upon its limited staff and resources. Armed with these recent amendments, the Commission is empowered to trigger outside controls automatically without suffering any burden of affirmative action, thereby freeing SEC resources to be directed elsewhere.

Despite the recent attempts to reshape and fortify Rule 2(e), there remain a number of deficiencies in the operation and structure of the rule. First, the existence of vague and ambiguous terms raises consti-

191. See notes 82-90 *supra* and accompanying text.

192. See notes 9-13 *supra* and accompanying text. The SEC has always attempted to balance the interests of the attorney with those of the public:

> The overall purpose of the [1971] amendment is to prevent situations in which the investing public places its trust in, or reliance upon, attorneys . . . who have demonstrated an unwillingness or inability to comply with the requirements of the federal securities laws, while assuring that such professionals . . . will have a fair opportunity to show why the interests of the investing public will not be materially jeopardized if they are permitted to continue to appear and practice before the Commission. 36 Fed. Reg. 8933, 8935 (1972).

193. *See* Karmel, *Attorneys' Securities Laws Liabilities*, 27 BUS. LAW. 1155, 1156 (1972). *See also* Kemp, *supra* note 65, at 42.

tutional questions and creates numerous enforcement problems.[194] Second, the lengthy time delays incurred before a proceeding is finally brought are unfair to the attorney; a remedial provision, such as a statute of limitations, is needed to afford the requisite protection for the attorney.[195] Furthermore, express elimination of estoppel concepts in Rule 2(e) could lead to harassment through a multiplicity of disciplinary proceedings.[196] Finally, the operation of Rule 2(e)'s temporary suspension procedure is rigid and may be unfair under certain circumstances. For example, an attorney who consents, for reasons beyond his control, to an injunction for a securities law violation may have a severe handicap in a subsequent Rule 2(e)(3) proceeding, where the imposition of an injunction against the attorney, albeit with his consent, is sufficient grounds for automatic suspension from SEC practice.[197] At present, the only safeguard in this type of situation is the Commission's sense of fair play.

Despite the increased scope and frequency of Rule 2(e) proceedings in recent years, it is still apparent that the Rule is directed towards regulating a narrow area of securities conduet—the attorney's intentional and flagrant disregard of the federal securities laws.[198] SEC disciplinary actions as presently designed are incapable of achieving regulation of attorney conduct on any comprehensive or refined basis, and a substantial burden of affirmative action remains on the Commission to employ local, non-automatic disciplinary measures through Rule 2(e)(1).[199] In order to protect the investing public from anything less than flagrant disregard by the attorney of his professional duties, therefore, it becomes necessary to impose a

194. See notes 82-90 *supra* and accompanying text.

195. The SEC has implicitly recognized the unfairness that may result in a delayed diseiplinary proceeding. In a Rule 2(e)(3) proceeding, the SEC itself is required to enter an order within 90 days of the final judgment of a securities offense. See 17 C.F.R. § 201.2(e)(3)(i) (1972).

196. See notes 113-14 *supra* and accompanying text.

197. See note 110 *supra*. See also notes 120-21 *supra* and accompanying text. Rule 2(e)(3) was originally announced in a version similar to the present provision. See 35 Fed. Rcg. 15441 (1970). There was some critical commentary, consisting of two letters of public response. Letter from Stephen Crystal to Orval DuBois, Sept. 30, 1970; Letter from Mark Rollinson to Securities & Exchange Commission, Oct. 2, 1970. Both letters raised a numuer of problems, including constitutional ones. However, despite this criticism, the final version is much harsher than the one which was originally proposed. *Compare* 17 C.F.R. § 201.2(e)(3) (1972) *with* 35 Fed. Reg. 15441 (1970).

198. *See* disciplinary proceedings cited in notes 64, 66, 70. *See generally* Kemp, *supra* note 65; Goldberg, *supra* note 65.

199. For a discussion of the problems which such reliance on other controls may encounter, see notes 14-45 *supra* and accompanying text.

threshold duty upon the attorney to insure that his and his client's everyday conduct is proper.[200] The SEC is attempting to implement judicially this broader scope of lawyer responsibility in *SEC v. National Student Marketing Corp.*[201]

## EXPANDING ATTORNEY DUTIES UNDER THE FEDERAL SECURITIES LAWS

### *Existing Attorney Liability Under the Federal Securities Laws*

The attorney, like any other person, has always been under a duty to comply with the federal securities laws.[202] Among the more likely statutory bases of liability for the attorney are sections 11 and 17(a) of the Securities Act of 1933[203] and sections 10(b) and 18(a) of the Securities Exchange Act of 1934.[204] For violations of these laws, the attorney *may* be subject to a variety of enforcement actions, including civil, criminal, and Rule 2(e) proceedings.[205] Adjudication of civil liability resulting in a damage judgment against the attorney has been rare; furthermore, there is evidence that some attorneys and law firms have taken "practical responses" in order to minimize the impact of monetary damages.[206] However, injunctive relief for an attorney's violations of federal securities laws has frequently been granted in recent years,[207] with each case involving an intentional or knowing violation.[208] Instances of criminal liability have occurred, but in each case SEC prosecution was directed at "fairly patent frauds."[209]

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200. To a certain extent the attorney must do so under the federal securities laws. See notes 202-09 *infra* and accompanying text. However, it is clear that under existing case law, the attorney has received minimum judicial consideration of his role in securities regulation. See notes 210-11 *infra* and accompanying text.

201. Civil Action No. 225-72 (D.D.C. filed Feb. 3, 1972). The SEC complaint for injunctive and other relief is partially reprinted in 1972 CCH FED. SEC. L. REP. ¶ 93,360.

202. *See generally* Note, "BarChris" *and the Securities Acts, supra* note 3.

203. 15 U.S.C. §§ 77k, *l* (1970).

204. *Id.* §§ 78j(b), r(a).

205. *See* Karmel, *Attorneys' Securities Laws Liabilities, supra* note 193, at 1155-60; Note, "BarChris" *and the Securities Acts, supra* note 3.

206. The responses include refusing to handle registration work, obtaining an indemnification agreement, obtaining a release from a client, and purchasing malpractice insurance for liability for misrepresentations in securities matters. See Note, "BarChris" *and the Securities Acts, supra* note 3, at 368-73. For a criticism of liability in cases involving attorney misstatements, see Knauss, *supra* note 6, at 57-60.

207. Karmel, *supra* note 193, at 1156.

208. *Id.*

209. *Id. See also* United States v. Crosby, 294 F.2d 928 (2d Cir. 1961), *cert. denied*, 368 U.S. 984 (1962).

Originally, attorneys were not subject to special rules or duties under the federal securities laws.[210] Furthermore, the attorney's involvement in a securities law violation by virtue of his professional status was seldom expressly considered by a court.[211] Consequently, for many years there were no explicit guidelines to aid the attorney in performing his proper role in the regulation of public investment.

Of the few cases to consider the issue, *SEC v. Frank*[212] and *Escott v. BarChris Construction Corp.*,[213] involving misstatements in an offering circular and registration statement, respectively, provide the only determinable criteria for establishing attorney liability under the federal securities laws. In *Frank*, an attorney assisted his client, a manufacturing company, in the preparation of an offering circular but had no knowledge of the allegedly false nature of the technical information supplied by his client in describing the company's primary product. On procedural grounds, the Second Circuit reversed the issuance of a preliminary injunction against the attorney for violation of section 17(a) of the Securities Act and section 10(b) of the Exchange Act. However, in dicta, the court established two standards for attorney liability based on the intentional and negligent misconduct of the attorney with reference to his client's violations of the federal securities laws.

According to the *Frank* court, an attorney can be held liable for misrepresentations in an offering circular or prospectus when he has assisted in the preparation of the statements and has actual knowledge of the misrepresentations contained therein;[214] such conduct is tantamount to a knowing violation of the federal securities laws. Furthermore, even if he is not aware of the misstatements in an offering circular or similar document, the attorney who assists in the drafting of such documents will be liable where the misleading infor-

210. Attorneys are not primary targets of the Securities Acts since, in their professional capacity, they are neither issuers nor "buyers" and "sellers." However, the Securities Acts do attempt to regulate the conduct of individuals who, while they are not "buyers" or "sellers," may become liable because they are peripherally connected with purchases and sales. An attorney, by virtue of the professional advice which he renders in the preparation of a registration statement, is such an individual peripherally connected with purchases and sales. Note, "BarChris" *and the Securities Acts*, *supra* note 3, at 361.

*See also* Nicewarner v. Bleavins, 244 F. Supp. 261, 266 (D. Colo. 1965).

211. Karmel, *supra* note 193, at 1156. *E.g.*, United States v. Benjamin, 328 F.2d 854, 863 (2d Cir. 1964).

212. 388 F.2d 486 (2d Cir. 1968), *noted in* Karmel, *supra* note 193, at 1157.

213. 283 F. Supp. 643 (S.D.N.Y. 1968).

214. 388 F.2d at 489.

mation is actually presented to him by his client and where, as a non-expert in technical matters, he has the ability to "readily understand" or "recognize" its falsity.[215] The standards were summarized by the court as follows:

> A lawyer has no privilege to assist in circulating a statement with regard to securities which he knows to be false simply because his client has furnished it to him. At the other extreme it would be unreasonable to hold a lawyer who was putting his client's description of a chemical process into understandable English to be guilty of fraud simply because of the failure to detect discrepancies between their description and technical reports available to him in a physical sense but beyond his ability to understand. . . . The SEC's position is that Frank had been furnished with information which even a non-expert would recognize as showing the falsity of many of the representations . . . . If this is so, the Commission would be entitled to prevail; a lawyer, no more than others, can escape liability for fraud by closing his eyes to what he saw and could readily understand.[216]

In view of the court's language, the *Frank* case appears to represent the first judicial recognition of an attorney's duty of reasonable care with reference to the preparation of securities filings. After the *Frank* decision, the attorney who helps his client draft an offering circular can be held liable for *negligently* failing to detect and resolve discrepancies which a non-expert should be able to recognize from the material supplied by the client. Thus, the federal securities laws would appear to have the capacity to control core securities conduct of the attorney which is negligent in nature.[217]

Although the attorney's liability for negligence in *Frank* was established in connection with discrepancies which the attorney could "readily understand," as a non-expert, from the face of material actually presented to him by his client, the Second Circuit raised the possibility that this standard would not be an absolute limit on the types of attorney conduct which can be redressed by a liability-for-negligence standard.[218] In this regard, the *Frank* court left open the possibility of the existence of a broader attorney duty to inquire independently into any discrepancies of which he has constructive notice:

> Whether the fraud sections of the securities laws go beyond this and require a lawyer passing on an offering circular to run down possible infirmities in his

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215. *Id.*

216. *Id.*

217. *Cf.* SEC v. Century Inv. Transfer Corp., 1971 CCH FED. SEC. L. REP. ¶ 93,232 (S.D.N.Y. 1971); Karmel, *supra* note 193, at 1156. See notes 225, 228 *infra*. *Cf.* SEC v. Spectrum, Ltd., CCH 1972 FED. SEC. L. REP. ¶ 93,637 (S.D.N.Y. 1972) (suggesting reliance may be necessary where an attorney is negligent).

218. 388 F.2d at 489.

> client's story of which he has been put on notice, and if so what efforts are required of him, is a closer question on which it is important that the court be seized of the precise facts including the extent . . . to which his role went beyond a lawyer's normal one.[219]

*Escott v. BarChris* seemed to answer and go beyond the question left open in *Frank* by implying that the attorney may be required to conduct a reasonable, independent investigation of all information in the non-expert portions of a registration statement.[220] In *BarChris*, purchasers of convertible debentures successfully brought suit under section 11 of the Securities Act against various directors and officers of BarChris, all of whom had signed a registration statement filed with the SEC which contained misstatements and omissions of material facts. Among the defendants sued were two attorneys. One attorney, who served as house counsel and secretary for BarChris but was not considered a member of BarChris' inside management, had signed several amendments to the registration statement. The other attorney, who was a member of BarChris' outside-counsel law firm and also a director of BarChris, had drafted and signed the registration statement for the debentures. Both attorneys pleaded the affirmative, "due diligence" defense provided by section 11 of the Securities Act for any person who, after reasonable investigation of the non-expert portions of the registration statement, had "reasonable ground to believe and did believe . . . that the statements therein were true and that there was no omission to state a material fact."[221]

In holding both attorneys liable for the misrepresentations in the registration statement, the *BarChris* court determined that each attorney had a duty under section 11 of the Securities Act "to make a reasonable investigation of the truth of all the statements in the unexpertised portion of the document which he signed."[222] It is clear, however, that the attorneys in *BarChris* were being treated primarily in their roles as directors and/or signers of the registration statement.[223] Consequently, the precise holding of the decision does not

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219. *Id.*

220. See Israels, *Preparation of Registration Statement—Issuer's Counsel—Advice to My Client*, 24 BUS. LAW. 537 (1969).

221. Securities Act of 1933 § 11, 15 U.S.C. § 77k (1970).

222. 283 F. Supp. at 687.

223. *Id.* at 689-92. *See also* Folk, *Civil Liabilities Under the Federal Securities Acts: The* BarChris *Case*, 55 VA. L. REV. 1, 199 (1969); Jordan, BarChris *and the Registration Process*, 22 SW L.J. 790 (1968); Wyant & Smith, BarChris: *A Revaluation of Prospectus Liability?*, 3 GA. L. REV. 122 (1968); Note, *Section 11 Liability—Directors, Underwriters, and Accountants Held Liable for Failure To Use Due Diligence in Preparing Registration Statement*, 43 N.Y.U. L. REV. 1030 (1969).

unequivocally place a duty of reasonable independent investigation upon the attorney by mere virtue of his professional role as legal counsel in a securities transaction. However, in dicta, the *BarChris* court indicated that such a duty does exist. In examining the duties of the outside counsel/director *as if* he were connected with the registration statement *solely* by virtue of his role as attorney, the court stated:

> It is claimed that a lawyer is entitled to rely on the statements of his client and that to require him to verify their accuracy would set an unreasonably high standard. This is too broad a generalization. It is all a matter of degree. To require an audit would obviously be unreasonable. On the other hand, *to require a check of matters easily verifiable is not unreasonable.* Even honest clients can make mistakes. The statute imposes liability for untrue statements regardless of whether they are intentionally untrue.[224]

The *BarChris* decision appears to enhance the liability-for-negligence, or duty of reasonable care, standard imposed on the attorney in *Frank*. An attorney, pursuant to *Frank*, will be held responsible for potential discrepancies which a non-expert has the ability to understand upon an examination of material actually supplied to him by his clients. After *BarChris*, however, the attorney no longer can discharge his obligations under the federal securities laws by merely detecting discrepancies which appear on the face of the information supplied to him. Rather, the language in *BarChris* indicates that the attorney must make a reasonable *independent* investigation of the truth of all information in the non-expert portions of the registration statement.[225]

Despite the apparent far-reaching scope of the attorney's duties imposed by the *Frank* and *BarChris* decisions, the opinions leave two important questions unanswered. First, it is not clear whether the attorney's duty of reasonable independent investigation is limited

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224. 283 F. Supp. at 690 (emphasis added).

225. As emphasized in the case of *Escott v. BarChris*, . . . the lawyer, to protect his client must do more than merely ask questions and rely on what is supplied to him by others. He must independently make an investigation and independently verify the information which is included in the Registration Statement. Shade, *Securities Act of 1933—An Outline*, 25 BUS. LAW. 437, 449-50 (1970) (footnotes omitted).

It is arguable that the SEC was of the opinion that such a duty of independent verification existed at a much earlier date:

> Indeed, if an attorney furnishes an opinion based solely upon hypothetical facts which he made no effort to verify, and if he knows that his opinion will be relied upon as the basis for a substantial distribution of unregistered securities, a serious question arises as to the propriety of his professional conduct. SEC Seeurities Act Release No. 4445 (Feb. 2, 1962).

only to transactions involving registration statements and therefore within the purview of section 11 of the Securities Act, or whether the duty applies to all core securities conduct, or even peripherally-related securities conduct, of the attorney. Second, there are no suggestions in either opinion as to the appropriate course of conduct for the attorney once he has made the requisite independent investigation and has determined that his client may be in violation of the federal securities laws. Surely, the attorney will be held accountable if he takes no action whatsoever and the client commits an actual violation. The question remains, however, whether the attorney may escape liability merely by advising his client to desist from the prohibited activity or whether more affirmative action on his part will be required. To some extent, the SEC is attempting to provide a possible solution to both of these questions by initiating litigation which seeks to impose on the attorney an implied duty of public disclosure.[226]

National Student Marketing: *Attorney Duty of Public Disclosure*

In the recently filed *SEC v. National Student Marketing Corp.* case,[227] the SEC is bringing suit under section 17(a) of the Securities Act and section 10(b) of the Exchange Act against two law firms and several of the firms' partners individually. The Commission alleges that the law firms and lawyers failed to disclose to the SEC, prior to the closing of a merger transaction involving National Student Marketing Corp. (NSMC), material financial information which they acquired from the accounting firm which certified the merger. According to the terms of the merger, the closing of the transaction would not be consummated until two conditions were satisfied. First, the certifying accounting firm would be required to stipulate that it had no reason to believe that the unaudited financial statements were not prepared in accordance with generally accepted accounting principles and practices. Second, the accounting firm would have to state in its comfort letter that NSMC had not suffered any material change in its financial position or results of operations since the date of the merger agreement. When the accounting firm submitted its comfort letter to the parties, however, it disclosed that certain significant and retroactive adjustments in NSMC's financial statement were neces-

226. SEC v. National Student Marketing Corp., Civil Action No. 225-72 (D.D.C. filed Feb. 3, 1972). For a discussion of *National Student Marketing*, see notes 227-38 *infra* and accompanying text.

227. *Id.*

sary. The law firms, their attorneys, and the directors of the two merging corporations knew of the letter's contents, but the information was not disclosed to the SEC or the stockholders of the companies. Despite receipt of the comfort letter and certain additional accounting information of a material nature, the law firms and their attorneys issued opinions indicating that the appropriate steps for a merger had been taken and that to their knowledge no violation of any federal or state securities law had occurred. In its complaint, the SEC has taken the position that the attorneys were required (1) to disclose the new financial information, (2) to revise the financial statements and resolicit the shareholder proxies, and *failing that*, (3) to cease representing their clients and notify the Commission of the potential securities law violation. Broad injunctive relief is being sought against the firms and the attorneys—a remedy which is seemingly "inappropriate to a case of first impression."[228]

In effect, the SEC is contending in *National Student Marketing* that the attorney, by virtue of his professional responsibility as legal counsel, has an implied duty under the federal securities laws to police and regulate the everyday securities conduct of his client and those around him at a "grass-roots" level. Thus, as if to resolve the two questions left unanswered in *Frank* and *BarChris*,[229] the SEC would first impose on the attorney a duty to investigate his client and

228. Karmel, *supra* note 193, at 1155. Although the complaint charges that the attorneys directly violated Exchange Act § 14(a), 15 U.S.C. § 78n(a) (1970) and the rules promulgated thereunder, the SEC also is contending that the attorneys aided and abetted the violation of Exchange Act § 10(b), *id.* § 78j(b), and Securities Act § 17(a), *id.* § 77*l*. This itself is a significant development since aiding and abetting "has never been applied to lawyers acting solely as counsel," Note, *Attorney's Liability—Advising, Abetting, and the SEC's National Student Marketing Offensive*, 50 TEXAS L. REV. 1265, 1268 (1972). Furthermore, in cases involving a failure to act or a negligent affirmative act, there appears to be a greater likelihood of success against an aider-abettor defendant. *See, e.g.*, McKy v. Hochfelder, CCH 1972 FED. SEC. L. REP. ¶ 93,601 (7th Cir. 1972); United States v. Sarantos, 455 F.2d 877 (2d Cir. 1972). *See* Note, *supra*, at 1268-72. *See also* Ruder, Wheat & Loss, *Standards of Conduct Under the Federal Securities Acts*, 27 BUS. LAW. 75 (Special Issue, Feb. 1972). *See generally* Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution*, 120 U. PA. L. REV. 597, 620-44 (1972).

It would appear, therefore, that under the aiding and abetting theories the SEC could reach the negligent conduct of an attorney in matters involving core or peripherally related securities conduct. *See* Note, *supra*, at 1271. *But cf.* Bucklo, Scienter *and Rule 10b-5*, 67 NW. L. REV. 562 (1972). Nevertheless, it has been suggested that the attorneys in *National Student Marketing* will prevail since "[n]egligence cases against attorneys are notoriously difficult to win, as the courts are reluctant to hold lawyers for errors in subjective judgment." Note, *supra*, at 1271. *See also SEC Action in NSMA Case: Securities Bar Assured on Attorney-Client Ties*, N.Y.L.J., Nov. 6, 1972, at 1, col. 3 (Statements given by Milton Cohen and Francis Wheat at the Fourth Annual Institute on Securities Regulation).

apparently would extend this duty to *all* of the core and peripherally-related securities conduct of the attorney and not merely transactions involving registration statements. Second, the SEC would combine this duty of independent investigation with a duty to disclose *to the SEC* any potential securities laws violations of the attorney's clients. In this manner, false or mislcading information and practices will either be prevented or reported to the SEC by the attorney before the investing public is adversely affected.

A number of views have been expressed with respect to *National Student Marketing* and its implications. On the one hand, some commentators view the action as beneficial, since it represents a long-overdue recognition of higher standards for attorney conduct, with the result that " 'lawyers are just beginning to feel the responsibilities they have had all along.' "[230] As a corollary, the case may be viewed as an attempt to erode the citadel of attorney-client privity.[231] On the other hand, a number of problems may arise if the SEC position in *National Student Marketing* is upheld. The attorney will be subject to unlimited, unwarranted and perhaps unavoidable, securities laws violations.[232] Furthermore, such a result could infringe upon the attorney's advocacy rights[233] and ultimately undermine the basic lawyer-client relationship by requiring the "compulsory 'ratting on the client.' "[234]

Whether or not the changes in attorney responsibilities which *National Student Marketing* threatens to effectuate are welcomed with enthusiasm or criticism, it seems clear that the issues in that case are part of a fundamental and long recognized conflict of interest dilemma facing the attorney in his law practice in the financial world.[235] In order for the investment protection purposes of the federal sccurities laws to be fulfilled, the attorney must be made to serve two masters—his client *and* the investing public. Since the attorney's natural propensity is to favor the former to the disadvantage of the latter,[236] there is a strong need for augmentation of an attorney's duties with reference to the investing public.

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230. *Lawyers: The Confidence Game*, NEWSWEEK, March 6, 1972, at 60, 61.

231. *See Are Lawyers Confidants or Informers?*, 58 A.B.A.J. 943 (1972).

232. *See* Green, Irate Attorneys, *A Bid to Hold Lawyers Accountable to Public Stuns, Angers Firms*, *supra* note 7, at 1, col. 1, at 17, cols. 1-3.

233. *See* Karmel, *supra* note 193. *See also Are Lawyers Confidants or Informers?*, *supra* note 231.

234. *Id.* at 944.

235. *See* Douglas, *The Lawyer and the Federal Securities Act*, *supra* note 2.

236. *Id.* at 67.

Commentators have indicated that this conflict-of-interest problem cannot be resolved satisfactorily through a stepped-up level of direct SEC control over attorney conduct;[237] rather, changes in the fundamental attitudes and social responsibilities of the attorney are necessary. Perhaps as an indication that this latter source of change has failed for securities regulation purposes, the SEC is now advocating that the federal securities laws, by means of the ultimate specter of civil liability, be employed as the source of augmenting the attorney's sense of responsibility to the investing public. As indicated by its complaint in *National Student Marketing*, the SEC seeks to resolve the attorney's conflict-of-interest dilemma by imposing on him an implied duty to police the public investment practices of his client. If the SEC is successful in *National Student Marketing*, the attorney can no longer "close his eyes"[238] to improper conduct of his clients, but must advise his clients "how they should behave."[239] Where his client's compliance with the federal securities laws is unlikely to be secured, the attorney's public responsibility justifiably dictates that he be required to disclose any potential securities laws violations to the SEC.

## CONCLUSION

The SEC, in attempting to maximize the protection afforded the investing public, has increased the utilization and effectiveness of its direct disciplinary controls over the attorney. In addition, the Commission, through pending litigation, is attempting to delineate more precisely the proper role of the attorney under the federal securities laws.[240] To the extent that the additional protection being sought for the investing public is warranted, the imposition of these increased demands upon the *lawyer* is necessary. The paramount role which the attorney occupies in the SEC's efforts to protect the investing public mandates that greater controls and responsibilities be placed upon him.[241] To the extent that non-SEC controls are insufficient to regu-

237. *See* Cohen, *The Lawyer's Role in Securities Regulation, supra* note 2, at 306. *See also* Douglas, *The Lawyer and the Federal Securities Act, supra* note 2.

238. SEC v. Frank, 388 F.2d 486, 489 (2d Cir. 1968).

239. Cohen, *The Lawyer's Role in Securities Regulation, supra* note 2, at 307.

240. See notes 226-39 *supra* and accompanying text.

241. Since the Commission under the statutory scheme does not approve or pass upon the accuracy of the various statements and reports filed with it, it is particularly important that attorneys who prepare and verify these materials . . . assume the obligation and responsibility of diligently verifying the accuracy and completeness of such

late attorney conduct for securities regulation purposes, the Commission must take additional steps of its own under Rule 2(e). Furthermore, as long as attorneys do not fulfill their sense of social responsibility with respect to the investing public, the imposition of implied duties under the federal securities laws does present a viable alternative.[242] The augmentation of the attorney's responsibilities by means of both SEC disciplinary controls and the federal securities laws is justified in that "the privilege of appearing and practicing before the Commission imposes . . . a corresponding obligation to assist in achieving the protection of investors and the public interest that the securities laws are designed to bring about."[243]

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documents. The Commission has by the promulgation of Rule 2(e) of its Rules of Practice established a means for disqualifying attorneys who have proved themselves unable or unwilling to carry out such responsibilities. Initial Decision, *In re* Irwin L. Germaise and Thomas F. Quinn, SEC Administrative Proceeding File No. 3-2606 at 26 (Oct. 29, 1971) (Markun, Hearing Examiner).

For a general discussion of the central role of the attorney in directing and coordinating securities filings, see Israels, *supra* note 220, at 542. *See also* Wyant & Smith, *supra* note 223, at 137. Former SEC Commissioner and now Supreme Court Justice Douglas colorfully described the lawyer as setting the stage and directing the action in many of the financial matters facing the Commission. *See* Douglas, *The Lawyer and the Federal Securities Act, supra* note 2, at 70.

242. At a very early date, 1937, it was pointed out that the public-mindedness of an attorney was a crucial factor in the SEC's ability to protect the investing public:

> [T]he need for . . . regulation will be perenially acute. But until the elite of our profession can bring to their own work a larger degree of social consciousness, there can be but little time and energy to convert the stock peddling heathens in our midst. It is safe to say that if the mores and ethical standards of our legal bishops were changed, we would have solved the major problems in finance. Their forms, their practices, their methods are copied by the lesser lights. They set the fashion. . . .
>
> Until that transformation takes place you can with confidence state that any such administrative agency as the Securities and Exchange Commission has before it the most difficult and at the same time most significant task in the history of American finance. . . . So long as the high priests of our profession are not imbued with the spirit of legal statemanship, administrative control in the field of finance must continue to reap . . . criticism . . . . And if, in absence of fundamental change in ethical and moral standards of our high priests, such criticism turns to praise and opposition to confidence, . . . rest assured that administrative control has become stodgy, that high finance has won a pyrrhic victory. . . . Douglas, *The Lawyer and the Federal Securities Act, supra* note 2, at 69.

Although the comment of Douglas seems to suggest that direct control by the SEC over attorney conduct—for example, Rule 2(e) proceedings—are ineffective, the implied duties under *Frank, BarChris*, and perhaps *National Student Marketing* are not.

243. Cohen, *The Lawyer's Role in Securities Regulation, supra* note 2, at 306. This "corresponding obligation" might also lead to future duties being imposed upon the securities practitioner, among which would include assisting the SEC in solving many of the problems facing public investment today. *Id. Cf.* ENFORCEMENT POLICIES AND PRACTICES, *supra* note 4, at 12-13.

The fundamental issue is, however, whether the added restraints and responsibilities imposed upon the attorney by the SEC and implied under the federal securities laws have been properly designed and implemented. For SEC purposes, the recent restructuring of attorney disciplinary rules achieves the quick and decisive action necessary to adequately protect the investing public. The often automatic operation of the disciplinary rules reduces the demands which are made upon the Commission's limited resources.[244] In general, the procedures and sanctions now in effect are commensurate with the degree of harm resulting from the attorney's offense. Furthermore, since the SEC has used its disciplinary powers fairly and in good faith, the implementation of disciplinary proceedings cannot be criticized. However, deficiencies in the wording and operation of Rule 2(e), which work to the disadvantage of the attorney, are apparent. Many of the Rule's provisions and sanctions can be viewed as overly broad, unnecessary or unfair,[245] and revision in these areas is needed.

*National Student Marketing* represents a major opportunity in the 1970's to expand further the role which the attorney occupies under the federal securities laws by virtue of his professional capacity. A decision sustaining the SEC's allegations would impose upon the attorney broader duties to advise and investigate than apparently exist under *SEC v. Frank* and *Escott v. BarChris Construction Corp.*[246] More importantly, if the Commission prevails in its contention that the lawyer must disclose potential securities laws violations of its clients, then it has obtained a highly effective means of regulating attorney conduct. Despite its potential advantage for the SEC,

244. For a variety of reasons, the SEC's resources are becoming more limited:

> Since the passage of the Securities Act in 1933, the Congress, by additional legislation, has expanded the legal responsibilities of the Securities and Exchange Commission. These responsibilities have also been expanded by the quantitative increase and growing diversity in offerings of securities, by the quantitative increase in trading, by the development of additional trading markets, by an increasing variety in trading practices and by the necessity of applying the statutes to a growing and increasingly complex economy.

ENFORCEMENT POLICIES AND PRACTICES, *supra* note 4, at 4-5.

*See also* Gadsby, *The Securities and Exchange Commission*, 11 B.C. IND. & COM. L. REV. 833 (1970) (finding that the SEC has streamlined certain procedures in response to the increasing pressure on its limited resources).

It has been pointed out that limited resources may have an effect on others involved in securities filings: "The greatly increased work-load of an already overworked staff, as a practical matter, increases the responsibility of all concerned . . ." Cohen, *The Lawyer's Role in Securities Regulation*, *supra* note 2, at 306.

245. See notes 194-97 *supra* and accompanying text.

246. See notes 213-26 *supra* and accompanying text.

however, the pending *National Student Marketing* case threatens to disrupt the very nature of the attorney-client relationship and undermine the lawyer's role as an advocate for his client. The potential for unlimited and perhaps unavoidable liability raises the question of commensurability between the degree of harm to the investing public and the sanction imposed upon the lawyer. Due to the profound impact which the result is likely to have on the regulation and responsibilities of the attorney under the federal securities laws, there is an acute need for a clear judicial resolution of the broad spectrum of issues confronting the court in *National Student Marketing*.