

THE DUTIES AND OBLIGATIONS OF THE SECURITIES LAWYER: THE BEGINNING OF A NEW STANDARD FOR THE LEGAL PROFESSION?

Stuart Charles Goldberg, a young lawyer, had specialized in securities work. During 1972, Goldberg assisted in preparing the prospectus for a public offering to be made by his firm's client, Empire Fire and Marine Insurance Company. While in the process of drafting the prospectus, Goldberg became troubled by the lack of disclosure that was being made of certain facts; he felt that there should be full and complete revelation of these matters whereas the law firm and Empire disagreed. Finally, Goldberg chose to resign from the firm because of this controversy. He immediately appeared before the Securities and Exchange Commission (SEC), where he fully disclosed all aspects of his disagreement with his client. Later, when buyers of the issued stock included Goldberg as a defendant in a securities suit brought against Empire, he handed the affidavit which he had given to the SEC, and which was presumably highly damaging to his former client, to the plaintiff's attorney.¹

Some lawyers and law students may find the conduct of Goldberg surprising, even shocking. Anyone, however, who has followed developments in the federal securities law area for the past several years should not be surprised in the least by Goldberg's acts, for despite the damaging revelation of matters confidentially communicated to him as a lawyer by his client, he was only obeying the recent demands made by the SEC upon attorneys caught in similar difficult situations. The increasing pressure brought to bear upon lawyers by the SEC to disclose possible securities law violations by their clients and the reaction of this young lawyer represent only a segment of the increasing duties and liabilities now placed upon attorneys specializing in securities law. This Note will explore the present obligations of the securities lawyer and contrast them with the traditional role of the attorney. Then, it will discuss the possible implications this trend may have upon *all* lawyers, not just those specializing in securities work, and will examine the benefits and problems offered by this stiff new standard.

1. The case is *Meyerhofer v. Empire Fire & Marine Ins. Co.*, 497 F.2d 1190 (2d Cir. 1974), *cert. denied*, 43 U.S.L.W. 3274 (U.S. Nov. 11, 1974).

THE TRADITIONAL FRAMEWORK

The lawyer in the past has been seen fundamentally as an advocate whose primary duty is to fully and adequately represent his client. This notion of the lawyer as advocate has had fundamental effects upon what have been seen as his duties and responsibilities.

The Attorney-Client Privilege

The relationship of an attorney and his client is such that the attorney cannot be forced to disclose information confidentially communicated to him by his client.² This privilege, which is the oldest of the testimonial privileges,³ obviously entails a potential detriment to justice, since it may prevent full disclosure of all facts touching upon a controversy;⁴ however, it is felt that whatever harm may be caused by the attorney-client privilege is outweighed by the beneficial effect it has upon the attorney-client relationship.⁵ Although the justification for the privilege when it first arose in the 16th century was that a man of honor such as a lawyer would never break a confidence,⁶ the reasoning behind it quickly shifted to the promotion of free communication between lawyer and client, a necessity if our advocacy system of law is to be successful.⁷ As one court has stated:

The doctrine [of the attorney-client privilege] is based on public policy. While it is the great purpose of law to ascertain the truth, there is the countervailing necessity of insuring the right of every person to freely and fully confer and confide in one having knowledge of the law, and skilled in its practice, in order that the former may have adequate advice and a proper defense. This assistance can be made safely and readily available only when the client is free from the consequences of apprehension of disclosure by reason of the subsequent statements of the skilled lawyer.⁸

In other words, a lawyer can only adequately represent and advise his client if the client feels safe to disclose all relevant, even damaging, information; our legal system finds this to be so important that the at-

2. For a general discussion of the attorney-client privilege, see C. McCORMICK, *HANDBOOK OF THE LAW OF EVIDENCE* §§ 87-97 (2d ed. E. Cleary 1972).

3. 8 J. WIGMORE, *EVIDENCE* § 2290 (McNaughten rev. 1961).

4. See, e.g., C. McCORMICK, *supra* note 2, § 87.

5. For a strong argument in favor of the attorney-client privilege, see 8 J. WIGMORE, *supra* note 4, § 2291.

6. D. MELLINKOFF, *THE CONSCIENCE OF A LAWYER* 138 (1973). See also 8 J. WIGMORE, *supra* note 4, § 2290.

7. D. MELLINKOFF, *supra* note 6, at 137-38; 8 J. WIGMORE, *supra* note 4, § 2291.

8. *Baird v. Koerner*, 279 F.2d 623, 629-30 (9th Cir. 1960).

torney-client privilege is recognized in order to promote free and total communication between attorney and client.

The attorney-client privilege is not without limits, however. Most importantly, the privilege does not protect the communications of a client and attorney when the client seeks advice in carrying out an illegal or fraudulent scheme.⁹ This exception goes as far back as 1884, when the Queen's Bench decided the now-famous case of *Queen v. Cox*.¹⁰ The court there justified its decision by stating that such communications do not come within the scope of professional employment.¹¹ This result was reached because "it cannot be the solicitor's business to further any criminal object."¹² A more straightforward explanation is that the attorney-client privilege was created to promote the administration of justice and that it would be a mockery of such policy to allow the privilege to further the implementation of criminal or fraudulent schemes.¹³ At any rate, today it is well settled that an attorney must testify concerning such communications.¹⁴

Legal Ethics

The Code of Professional Responsibility of the American Bar Association¹⁵ reveals an underlying assumption that the lawyer owes his primary allegiance to his client.¹⁶ Canon Four, for example, states, "A Lawyer Should Preserve the Confidences and Secrets of a Client."¹⁷ Ethical Consideration (EC) 4-1 under that Canon goes on to state that this requirement is compelled both by the fiduciary duty owed to a client by the lawyer and by the need to preserve professional confidences necessary for the proper functioning of the legal system.¹⁸ Further,

9. C. McCORMICK, *supra* note 2, § 95; 8 J. WIGMORE, *supra* note 4, §§ 2298-99.

10. 14 Q.B.D. 153 (1884).

11. *Id.* at 167.

12. *Id.* at 168.

13. *See, e.g.,* C. McCORMICK, *supra* note 2, § 95.

14. *See, e.g.,* *United States v. Shewfelt*, 455 F.2d 836 (9th Cir. 1972); *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970); *United States v. Bob*, 106 F.2d 37 (2d Cir. 1939).

15. ABA CODE OF PROFESSIONAL RESPONSIBILITY (1969).

16. *See, e.g.,* Lowenfels, *Expanding Public Responsibilities of Securities Lawyers: An Analysis of the New Trend in Standard of Care and Priorities of Duties*, 74 COLUM. L. REV. 412, 418 (1974).

17. ABA CODE OF PROFESSIONAL RESPONSIBILITY Canon 4 (1969).

18. *Id.* EC 4-1. EC 4-1 emphasizes the preservation of confidences for much the same reasons which justify the attorney-client privilege. EC 4-1 reads in full as follows:

Both the fiduciary relationship existing between lawyer and client and the proper functioning of the legal system require the preservation by the lawyer of confidences and secrets of one who has employed or sought to employ him. A client must feel free to discuss whatever he wishes with his lawyer and a

this ethical standard is broader than the attorney-client privilege, for it exists without regard to the nature or source of the information and regardless of who else shares it.¹⁹ It is unethical for a lawyer to use such confidences to the disadvantage of the client or for his own advantage,²⁰ and the obligation of silence continues even after the termination of a professional relationship.²¹ Canon Seven directs that "[a] Lawyer Should Represent a Client Zealously Within the Bounds of the Law."²² A lawyer owes this duty both to his client and to the legal system as a whole.²³ Moreover, a lawyer must not let other interests or people affect his judgments made for his client.²⁴ "Neither his personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute his loyalty to his client."²⁵

Competing considerations may require, or at least allow, the lawyer to take action that harms his client. For instance, if legal authority exists which is directly opposed to the position taken by his client in a judicial proceeding and opposing counsel fails to inform the tribunal of its existence, the lawyer should voluntarily disclose such authority.²⁶ Disciplinary Rule 4-101(C) states, "A lawyer may reveal: . . . (3) The intention of his client to commit a crime and the information necessary to prevent the crime."²⁷ Interestingly, the rule says "may reveal," thus implying that the lawyer has no affirmative ethical duty to make such disclosure.²⁸ Disciplinary Rule 7-102(B), however, is mandatory in its language. It provides:

A lawyer who receives information clearly establishing that: (1) His client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the

lawyer must be equally free to obtain information beyond that volunteered by his client. A lawyer should be fully informed of all the facts of the matter he is handling in order for his client to obtain the full advantage of our legal system. It is for the lawyer in the exercise of his independent professional judgment to separate the relevant and important from the irrelevant and unimportant. The observance of the ethical obligation of a lawyer to hold inviolate the confidences and secrets of his client not only facilitates the full development of facts essential to proper representation of the client but also encourages laymen to seek early legal assistance. (Footnotes omitted).

19. *Id.* EC 4-4.

20. *Id.* EC 4-5.

21. *Id.* EC 4-6.

22. *Id.* Canon 7.

23. *Id.* EC 7-1.

24. *Id.* Canon 5.

25. *Id.* EC 5-1.

26. *Id.* EC 7-23.

27. *Id.* DR 4-101.

28. *But see* ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 314 (1967).

fraud to the affected person or tribunal.²⁹

In its whole, the Code of Professional Responsibility seems to accept the idea that the lawyer is primarily responsible to his client; indeed, it places great ethical duties upon the lawyer to insure that the loyalty of the lawyer flows to the client and that the lawyer does not harm the client. While the attorney does have several other competing considerations which can create difficult situations for him, the duty to the client in general appears strongest. Several ABA Opinions illustrate the difficult decisions a lawyer at times must make. For example, prior to trial a client flees, forfeiting bond; the court issues a warrant for his arrest. Subsequently, the client's family informs his lawyer of his whereabouts. Does the lawyer have an ethical duty to convey this information to the authorities?³⁰ The ABA Committee on Professional Ethics thought not.³¹ Another possible dilemma for an attorney arises when he knows that his client has a criminal record yet hears either his client or the court clerk tell the judge the contrary. The ABA Committee has stated that if the lawyer learned of the record from the client, he has no duty of disclosure.³² The committee reasoned as follows:

We yield to none in our insistence on the lawyer's loyalty to the court of which he is an officer. Such loyalty . . . involves also the steadfast maintenance of the principles which the courts themselves have evolved for the effective administration of justice, one of the most firmly established of which is the preservation undisclosed of the confidences communicated by his clients to the lawyer in his professional capacity.³³

In both opinions cited, policy arguments could be made to force the lawyer to reveal confidential items to the detriment of his client; the duties and responsibilities of the attorney to his client are so strong, however, that such policies were outweighed.³⁴

29. ABA CODE OF PROFESSIONAL RESPONSIBILITY DR 7-102(b) (1969) (footnote omitted).

30. In the actual case, the lawyer chose not to reveal the information; rather he found the client and advised him to return and surrender, which he eventually did. ABA COMM. ON PROFESSIONAL ETHICS, OPINIONS, No. 23 (1967).

31. *See id.* But *see id.* No. 155.

32. *Id.* No. 287. Even if the lawyer learned of the record from an outside source he could remain silent if he felt the court was not relying upon him. If he decided he was being relied upon, his duty then would not be to disclose his knowledge but to resign from the case. *Id.*

33. *Id.* at 637.

34. In this same context, see the assertions of Dean Monroe Freedman that a lawyer must not reveal the confidences of his client, even when the client is thereby able to deceive the court. Freedman, *Professional Responsibility of the Criminal Defense Lawyer: The Three Hardest Questions*, 64 MICH. L. REV. 1469 (1966). Dean Freedman's

Malpractice Liability

The theory that a lawyer owes primary loyalty only to his client also is reflected in the malpractice law. If a lawyer's professional negligence harms his client, the client of course can sue for malpractice and be compensated for his injuries. A lawyer's mistakes, however, can injure a wide range of persons beyond his client. Yet this group of third persons cannot hold the lawyer liable; rather, it has long been recognized that a lawyer is liable only to his client for negligent practice of the law, regardless of the harm done others.³⁵ As the Supreme Court stated many years ago, "[T]he general rule is that the obligation of the attorney is to his client and not to a third party."³⁶

Summary

The result of all these various factors has been to maximize in the minds of both lawyers and laymen the role of the attorney as advocate for his client and to minimize whatever duty he owes to the public. Indeed, the popular conception of the lawyer is far closer to a tireless fighter for his client's interests, regardless of what they may be, than to an independent officer of the court, prepared to sacrifice his client should the client seek improper gains. An extreme example of this feeling is shown by one commentator who begins by stating that a lawyer's "loyalty runs to his client. He has no other master."³⁷ Continuing, this commentator asserts that "[t]he more good faith and loyalty the lawyer owes to his client, the less he owes to others when he is acting for his client."³⁸ A more moderate and appealing statement concerning the advocacy role of the lawyer was made, ironically (considering its later views), by the SEC in 1962: "Though owing a public responsibility, an attorney in acting as the client's advisor, defender, advocate

article prompted strong dissent. See, e.g., Bress, *Professional Ethics in Criminal Trials: A View of Defense Counsel's Responsibility*, 64 MICH. L. REV. 1493 (1966); Noonan, *The Purposes of Advocacy and the Limits of Confidentiality*, 64 MICH. L. REV. 1485 (1966). For a recent discussion of a similar subject by Dean Freedman, see Freedman, *Legal Ethics*, N.Y.L.J., July 24, 1974, at 1, wherein he asserts that a lawyer has a duty to go forward with a case even when he knows that the client has perjured himself.

35. See, e.g., *Sachs v. Levy*, 216 F. Supp. 44, 46 (E.D. Pa. 1963) (mere negligence of attorney to someone other than his client is not actionable); *Sterling v. Jones*, 249 So. 2d 334, 337-38 (La. App. 1971) (wrongful withdrawal of pleadings not actionable by third parties); *Bryan & Amidei v. Law*, 435 S.W.2d 587 (Tex. Civ. App. 1968) ("For such injuries . . . as third persons may sustain by reason of the failure or neglect of the attorney to perform a duty which he owed to his client only, they have no right of action against the attorney." *Id.* at 593).

36. *Savings Bank v. Ward*, 100 U.S. 195, 200 (1879).

37. Curtis, *The Ethics of Advocacy*, 4 STAN. L. REV. 3 (1951).

38. *Id.* at 5-6.

and confidant enters into a personal relationship in which his principal concern is with the interests and rights of his client."³⁹ This statement probably comes extremely close to what most lawyers (and their clients) have traditionally seen as their role. That is, while recognizing a certain amount of responsibility to the public, they predominately have seen themselves as protecting and representing the rights of their clients.

THE LAWYER'S EXPANDING ROLE IN SECURITIES LAW

The traditional (and rather comfortable) view of the role of the lawyer discussed above has been called into question in the securities area, where a vast expansion, actual or potential, of the duties and obligations of the securities lawyer has left specialists in that field bewildered by what function they should play.

Of course, the lawyer, like everyone else, has always been liable under the federal securities laws where he engaged in active fraud.⁴⁰ However, it traditionally has been assumed that lawyers cannot be held liable as lawyers under those acts; that is, the mere fact of failure by a lawyer to prevent his client from breaking the federal securities laws does not render the lawyer himself guilty. As Justice William O. Douglas (while Commissioner of the SEC) stated in 1935, "[T]he long tentacles of the [federal securities laws] do not reach that far."⁴¹ Forty years later, one cannot be quite so certain.⁴²

Public Offering Liability

An example of this expansion of liability can be seen in the area of the law concerning registration statements required to be filed by the issuer in a public offering. Such registration statements, and other offering documents, are prepared almost totally by lawyers with the aid of experts such as accountants. Section 11 of the Securities Act of 1933⁴³ concerns liability for material misstatements or omissions in effective registration statements. Section 11(a) lists five classes of per-

39. *In re American Fin. Co.*, 40 S.E.C. 1043 (1962).

40. *See, e.g.*, *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082 (2d Cir. 1972); *United States v. Benjamin*, 328 F.2d 854 (2d Cir. 1964). *See also* Karmel, *Attorneys' Securities Laws Liabilities*, 27 BUS. LAW. 1153, 1156 (1972).

41. Douglas, *The Lawyers and the Federal Securities Act*, 3 DUKE B. ASS'N J. 66, 69 (1935).

42. *Cf.* Isaacs, *Liability of the Lawyer for Bad Advice*, 24 CALIF. L. REV. 39, 45-47 (1935) (where the author presciently predicted that the securities laws would in time result in wider attorney liability).

43. 15 U.S.C. § 77k (1970).

sons liable for such mistakes.⁴⁴ While lawyers are not mentioned by name in any of these classes, subsection 4 allows suit against anyone who has been named with his consent as having prepared or certified any part of the registration statement, his liability being limited to such segment as purports to have been prepared or certified by him. However, lawyers have shied away from being named as experts who prepared the statement (although in fact it may have been totally written by them), and it long was assumed that lawyers were not included among those liable for misstatements or omissions in registration statements. Today securities lawyers cannot feel so secure.

The landmark case in this area was *Escott v. Barchris Construction Corp.*,⁴⁵ where the buyers of debentures brought a class action under section 11 against the corporate issuer, underwriters, auditors, and signers of the registration statement for false statements and material omissions in the prospectus.⁴⁶ Several lawyers had signed the statement as directors and therefore were included as defendants. Birnbaum was house counsel for the corporation and also its secretary and new director; he had signed an amendment to the prospectus. The court held him liable for lack of due diligence in examining the document. Specific mention was made of his status as attorney: "As a lawyer, he should have known his obligations under the statute."⁴⁷ However, the "obligations" referred to seem clearly to be those created by signing the document and not those arising from his role as lawyer for the issuer. The only significance of Birnbaum's status as a lawyer was that it totally precluded him from asserting as a defense a lack of awareness as to what was required of him under the Securities Act, a defense which would have been doubtful even if put forth by a layman.

More provocative was *Barchris'* handling of the case against defendant Grant. Grant, also an attorney, was an outside director of the issuer; his law firm represented the issuer in its securities matters, and Grant had done a great deal of legal work in preparing the offering. The court made it clear that Grant was being sued solely as a director and signer of the prospectus and not as a lawyer.⁴⁸ However, the court

44. The five categories of persons listed in section 11(a) are as follows: 1. signers of the registration statement; 2. directors; 3. persons who consented to be named in the prospectus as about to become a director; 4. persons named as having prepared or certified part of the statement; 5. the underwriter. *Id.*

45. 283 F. Supp. 643 (S.D.N.Y. 1968).

46. *Id.* at 652. The prospectus was part of an effective registration statement, thus section 11 was applicable. *Id.* at 655.

47. *Id.* at 687.

48. *Id.* at 690.

placed great emphasis upon the role Grant played as a lawyer in the offering:

[I]n considering Grant's due diligence defenses, the unique position which he occupied cannot be disregarded. As the director most directly concerned with writing the registration statement and assuring its accuracy, more was required of him in the way of reasonable investigation than could fairly be expected of a director who had no connection with this work.⁴⁹

It could be argued that this statement only has relevance to the securities lawyer who also serves as director. However, other portions of the opinion seemed aimed directly at Grant as a lawyer. For example, 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. . . . Even honest clients can make mistakes. . . . The way to prevent mistakes is to test oral information by checking the original written record.⁵⁰

This requirement of verifying the accuracy of the client's statements would seem just as applicable to one who serves purely as attorney as to the lawyer who is also a director.

In *SEC v. Frank*,⁵¹ a case decided a few months before *Barchris*, the SEC had obtained an injunction under section 17 of the Securities Act of 1933⁵² and section 10(b) of the Securities Exchange Act of 1934⁵³ prohibiting a lawyer from drafting any misleading documents after the trial court had found that an offering circular drafted by him was misleading.⁵⁴ On appeal, the Second Circuit had these tantalizing remarks to make concerning a lawyer's duty when assisting in an offering of securities:

[A] lawyer, no more than others, can escape liability for fraud by closing his eyes to what he saw and could readily understand. . . . *Whether the fraud sections go beyond this and require a lawyer passing on an offering circular to run down possible infirmities in his 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*

49. *Id.*

50. *Id.*

51. 388 F.2d 486 (2d Cir. 1968).

52. 15 U.S.C. § 77q (1970).

53. *Id.* § 78j(b).

54. Since an effective registration statement was not involved, section 11 was not applicable. However, the case does concern the lawyer's duty when preparing documents involved in a public offering.

his role went beyond a lawyer's normal one.⁵⁵

The court remanded the case for further proceedings to obtain evidence concerning the lawyer's knowledge; thus the court never answered the question it raised concerning the responsibility of a securities lawyer to go beyond the words of his client and make an independent investigation into their truth.

Barchris and *Frank* both leave open as many questions as they answer. The exact responsibilities of a lawyer representing a corporation issuing securities remain uncertain. SEC Commissioner A.A. Sommer, Jr. has asserted that had Grant in *Barchris* been sued in his capacity as a lawyer under Rule 10b-5, the court would have reached the same result for the same reasons.⁵⁶ This conclusion appears speculative. Nonetheless, it must be admitted that *Barchris* and *Frank* could form the basis for a decision by a future court holding a lawyer who had prepared a registration statement or other offering document liable on the basis that although he had no knowledge of fraud, he had failed to make a full investigation of everything his client had told him. Thus, securities lawyers today are in the position of not knowing precisely what their duties are in such situations, but they must realize that on some future day in court, their past acts may be judged by such a standard.

Liability Under the Anti-Fraud Provisions

Under the general anti-fraud provisions it was at one time assumed that lawyers would not be held liable *qua* lawyers. It is true that a lawyer could always be held an aider and abettor because of his representation of a client who violated the securities law. However, most lawyers have assumed that in order for a lawyer to be held liable as an aider and abettor of a fraudulent scheme, it was necessary for a lawyer to have knowledge of the scheme.⁵⁷ In effect, this meant that if one were part of the scheme, he would be held liable; nevertheless, the mere fact of failure to prevent a client's fraudulent scheme was not a violation of the law.

Today, lack of awareness of the fraudulent scheme may not save an unwitting lawyer whose legal skills were used by the client to aid in the success of the fraud. In *SEC v. Spectrum, Ltd.*,⁵⁸ the SEC

55. 388 F.2d at 489 (emphasis added).

56. Sommer, *The Emerging Responsibilities of the Securities Lawyer*, [1973-1974 Transfer Binder] CCH FED. SEC. L. REP. ¶ 79,631 (Jan. 24, 1974).

57. See *SEC v. National Bankers Life Ins. Co.*, 324 F. Supp. 189 (N.D. Tex.), *aff'd*, 448 F.2d 652 (5th Cir. 1971).

58. [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,300 (2d Cir. 1973).

sought an injunction against twelve defendants, including an attorney, charged with violations of section 17 of the Securities Act of 1933⁵⁹ and section 10(b) of the Securities Exchange Act of 1934.⁶⁰ The case concerned a fraudulent scheme to sell to the public unregistered stock of Spectrum; the defendant attorney had given an opinion letter stating that the stock did not need to be registered, which act the SEC charged made him an aider and abettor of securities law violations. The district court refused to grant the injunction against the attorney, finding that he had no knowledge of the attempted fraud, which it felt was needed to prove a defendant guilty of aiding and abetting.⁶¹ The Second Circuit reversed, observing that proof of actual knowledge is not required in such cases; rather, the court held that a negligence standard should be used.

We do not believe . . . that imposition of a negligence standard with respect to the conduct of a secondary participant is overly strict [T]he smooth functioning of the securities markets will be seriously disturbed if the public cannot rely on the expertise proffered by an attorney when he renders an opinion on such matters.⁶²

Thus, the court held that a lawyer whose negligence permits a fraudulent scheme to succeed is susceptible to an injunctive action brought by the SEC.⁶³

The Second Circuit specifically noted in *Spectrum* that its decision did not reach the question of whether a lawyer's negligence could render him liable as an aider and abettor in a criminal or private damage action. However, a recent private suit brought against accountants would seem to imply that such liability could be applicable to attorneys. *Hochfelder v. Ernst & Ernst*⁶⁴ involved a private cause of action brought against the accounting firm of Ernst & Ernst, which had acted as accountants for a brokerage firm that had violated Rule 10b-5. Plaintiffs charged that "Ernst & Ernst was negligent in auditing First Securities thereby aiding and abetting the Rule 10b-5 violation."⁶⁵ The Seventh Circuit stated that "admittedly it [Ernst & Ernst] had no knowledge

59. 15 U.S.C. § 77q(a) (1970).

60. *Id.* § 78j(b).

61. See SEC v. Spectrum, Ltd., [1972-1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,631, at 92,867-68 (S.D.N.Y. 1972).

62. [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,300, at 94,970.

63. For an argument that negligence should not be the basis of an action based on aiding and abetting, see Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Identification, and Contribution*, 120 U. PA. L. REV. 597, 630-38 (1972). Cf. *United States v. Benjamin*, 328 F.2d 854, 863 (2d Cir. 1964).

64. CCH FED. SEC. L. REP. ¶ 94,781 (7th Cir., Aug. 30, 1974).

65. *Id.* at 96,578.

of the fraudulent escrow scheme."⁶⁶ For this reason, the trial court had granted Ernst & Ernst summary judgment. The circuit court, however, reversed, finding that a lack of knowledge of the fraud was not fatal to a private cause of action for aiding and abetting. In holding that Ernst & Ernst's negligence alone could render it liable as an aider and abettor, the court stressed that Ernst & Ernst had breached a duty of inquiry.⁶⁷ Admittedly, accountants historically have been seen as possessing a much greater duty of independent inquiry than have lawyers. However, the case seems to make more likely the eventual application of a *Spectrum*-type decision in the arena of causes of action for private damages.

Should the negligence standard be imported into the law concerning whether a lawyer is the aider and abettor of his client's violation of the anti-fraud provisions in the federal securities law, the essential question will be how far the theory can be pushed. Presumably, whenever a person who has followed legal advice given by an honest lawyer violates the securities laws, the lawyer either gave poor legal counsel or was not fully aware of what his client's scheme involved. The question is whether in either case the lawyer's failure to give correct legal advice or to use due diligence in investigating his client is sufficient to cause him to be an aider and abettor of his client's fraud. Suppose a client asks a lawyer to issue an opinion letter stating that certain privately issued stock could be resold. Although the lawyer honestly feels that the law would allow such resale, he would realize that if he were mistaken, a securities violation would occur. If the lawyer goes ahead and issues the opinion letter and is mistaken as to his view of the law or the facts, should he be personally liable as an aider and abettor of the violation?⁶⁸ If the answer is yes, then it would seem that a securities lawyer would be an aider and abettor whenever he gives mistaken advice which leads to a securities violation.

The fear of every securities lawyer would seem to be that the theory of *Black & Co. v. Nova-Tech, Inc.*⁶⁹ will find its way into this area of the federal securities laws. That case, although decided by a federal district court, concerned the Oregon Blue Sky Law. The interesting issue faced was whether a lawyer and his law firm were "participants" in the alleged securities fraud, as required by the relevant stat-

66. *Id.* at 96,579.

67. *Id.*

68. This is the factual background of *Mariash v. Morrill*, [1973-1974 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,557 (2d Cir., May 10, 1974). No decision on the merits of the case has yet been reached.

69. 333 F. Supp. 468 (D. Ore. 1971).

ute and as alleged by the plaintiffs, purchasers of unregistered securities. First, the court held the lawyer to be a participant. He had prepared the legal papers for the sale, and therefore the sale could not have occurred without him. Next, the court noted that the law firm was named as corporate counsel in the issuer's annual reports. Since these reports were used as promotion for the sale, the law firm was rendered a participant in the sale.⁷⁰ *Black* would seem to say that whenever a lawyer represents a client who commits a securities fraud, the lawyer participates in that fraud.

The importance of lawyers' becoming liable under the federal securities laws for damages for their good-faith acts as lawyers should not be minimized. Beyond the obvious personal and professional embarrassment which such liability would entail for the lawyer, damages under the securities law in general, and most notably under Rule 10b-5 in particular, can be huge.⁷¹ The lawyer's liability would be joint and several with the other defendants held in violation of the securities law. If the corporation involved should be unsound financially and if its insiders should determine that their best interests would be served by leaving the jurisdiction of the court, the lawyer could well turn out to be the only defendant left to satisfy a huge damage claim. This potential for the placing of draconian liability upon the attorney has raised "the question of commensurability between the degree of harm to the investing public and the sanction imposed upon the lawyer."⁷² Further, not only can the individual lawyer be sued but also his law firm.⁷³ Since potential liability in securities cases can literally rise to hundreds of millions of dollars,⁷⁴ the spectre is raised not only of the

70. *Id.* at 472.

71. See, e.g., Bradford, *Rule 10b-5: The Search for a Limiting Doctrine*, 19 *BUFFALO L. REV.* 205 (1970); Ruder, *Texas Gulf Sulphur—The Second Round: Privity and State of Mind in 10b-5 Purchase and Sale Cases*, 63 *Nw. U.L. REV.* 423 (1968); Note, *Rule 10b-5: The Rejection of the Birnbaum Doctrine by Eason v. General Motors Acceptance Corp. and the Need for a New Limitation on Damages*, 1974 *DUKE L.J.* 610; Note, *The Role of Scierter and the Need to Limit Damages in Rule 10b-5 Actions*, 59 *KY. L.J.* 891 (1971).

72. Comment, *SEC Disciplinary Rules and the Federal Securities Laws: The Regulation, Role and Responsibilities of the Attorney*, 1972 *DUKE L.J.* 969, 1022.

73. See, e.g., *SEC v. National Student Marketing Corp.*, [1971-1972 Transfer Binder] *CCH FED. SEC. L. REP.* ¶ 93,360 (D.D.C., complaint filed Feb. 3, 1972), where two distinguished law firms were named as defendants in an SEC complaint asking for injunctions against securities law violations.

74. The *Texas Gulf Sulphur* litigation is illustrative. The facts of the *Texas Gulf Sulphur* (TGS) cases are as follows: TGS made an incredibly rich strike of ore in Canada, which had become apparent by November 12, 1963, when the first test drilling was completed. For a period of five months the results of this and other tests were withheld from the public, but, during this same period insiders, aware of the discovery, purchased TGS stock and calls. On April 12, 1964, TGS issued a somewhat pessimistic press re-

bankruptcy of individual lawyers but also of whole law firms.

It is also interesting to note that if *Spectrum* were to be applied to private damage actions, the traditional notion that a lawyer is not liable to third parties would be changed.⁷⁵ By calling the lawyer's negligence an aiding and abetting of securities fraud rather than malpractice, any member of the public falling within the protection of the anti-fraud provisions could hold the lawyer liable for the harm the lawyer's negligence caused.

SEC Administrative Sanctions

The only formal method of controlling lawyers' conduct possessed by the SEC is by way of Rule 2(e),⁷⁶ which allows the SEC to suspend a lawyer's right "of appearing or practicing before it in any way."⁷⁷ Before the 1960's, this power was almost never exercised; during the 1960's, the rule was increasingly employed. Then in 1970, the rule was revamped in order to make it a more effective tool in influencing attorney conduct.⁷⁸ The 1970 amendments⁷⁹ involved three major changes in Rule 2(e). First, the SEC can suspend any lawyer it finds to have aided or abetted the violation of a federal securities law.⁸⁰

lease intended to quash rumors about the strike. It was not until April 16, 1964, that TGS made an official public announcement revealing the true nature of the discovery. These events resulted in suits brought under Rule 10b-5, based alternatively on either non-disclosure of material facts from November 12th to April 16th or on plaintiffs' reliance on the misleading press release. See *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 843-47 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969). The amount of TGS's potential liability resulting from these cases was tremendous. Professor Ruder estimates that if rescission were used as the measure of damages (including loss of future profits which would have been made) and relief given from November 12th to April 16th, damages would have amounted to over \$390,000,000; this sum would have been \$150,000,000 more than TGS's net worth. Ruder, *supra* note 71, at 428-29. Another writer calculates that if the Utah District Court's formula of damages in *Reynolds v. Texas Gulf Sulphur Co.*, 309 F. Supp. 548 (D. Utah 1970), *aff'd in part and rev'd in part sub nom. Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90 (10th Cir. 1971), *cert. denied*, 405 U.S. 918 (1972) (based on the value the stock reached during a reasonable period after the full announcement), were to be multiplied by the number of shares traded during the eleven trading days following the April 12th press release, damages for that period alone would equal \$30,978,554—or about 23% of total shareholder equity. Note, *The Role of Scienter*, *supra* note 71, at 909-10. Eighty-one New York cases were settled for \$2,700,000; TGS has deposited this amount in escrow in two funds. In the first, \$2,200,000 was set aside for claims based on reliance upon the press release; \$500,000 was placed in the second fund for claims based on non-disclosure during testing. *Canon v. Texas Gulf Sulphur Co.*, 55 F.R.D. 308, 310-11 (S.D.N.Y. 1972).

75. See notes 35-36 *supra* and accompanying text.

76. 17 C.F.R. § 201.2(e)(1) (1974).

77. *Id.*

78. See Comment, *supra* note 72, at 982-85.

79. See generally 35 Fed. Reg. 15,440 (1970).

80. 17 C.F.R. § 201.2(e)(1)(iii) (1974). This is quite important because a con-

Second, if a lawyer should be disbarred, that likewise is grounds for Rule 2(e) suspension.⁸¹ Finally, if a lawyer is permanently enjoined from violating securities laws, he can be suspended from SEC practice.⁸² The effect of the 1970 amendments is to facilitate swift action against any lawyer appearing before the SEC. Since any securities lawyer's livelihood depends on his being able to practice before the Commission, Rule 2(e) provides a potent means by which the SEC can control lawyers and shape their conduct. The SEC has become more active in its use of Rule 2(e) in recent years, even using it against lawyers whose acts were not clearly violative of the securities laws.⁸³

Recently, the SEC has proposed a new amendment to Rule 2(e). Proposed Rule 2(e)(7) provides that all proceedings under Rule 2(e) must be public unless the Commission otherwise directs.⁸⁴ If this proposal becomes effective, the SEC would have a powerful sword to hold over all securities lawyers' heads. As Commissioner Sommer has stated, it is difficult for a securities lawyer ever to regain his professional standing once he has been publicly accused of improprieties.⁸⁵ Just the threat of public hearings under Rule 2(e) undoubtedly frightens most securities lawyers. The ABA has opposed adoption of Proposed Rule 2(e)(7), stating that, among other things, the threat of public hearings impinges upon the independence of the bar. "The potential of a public proceeding is likely to cause apprehension among members of the Bar that too vigorous controversy with the staff is unwise because it could lead to a staff recommendation for public 2(e) proceedings."⁸⁶

Even if the public hearing requirement is never adopted, Rule 2(e) will remain a powerful stimulus to the lawyer to follow the wishes

viction for violation of the securities laws does not mean automatic disbarment. See *In re Richardson*, 15 Cal. 2d 536, 102 P.2d 1076 (1940) (conviction of violation of section 17 was held not to be prima facie proof of moral turpitude).

81. 17 C.F.R. § 201.2(e)(2) (1974).

82. *Id.* § 201.2(e)(3)(i).

83. See, e.g., *In re Murray A. Kivitz*, Securities Act Release No. 5163 (June 29, 1971), [1970-1971 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,144, where a lawyer was suspended from practicing before the SEC for two years for allowing an intermediary to act between his client and him, thereby aiding someone to function improperly before the Commission. Subsequently, the decision was reversed by the District of Columbia Circuit Court of Appeals, which found no substantial evidence supporting the SEC decision. *Kivitz v. SEC*, 475 F.2d 956 (D.C. Cir. 1973).

84. Proposed Rule 2(e)(7) may be found at 248 BNA SEC. REG. & L. REP. E-1 (Apr. 10, 1974).

85. Sommer, *supra* note 56, at 83,692.

86. Comments of the ABA Committee on Federal Regulations of Securities on the Proposed Amendments to Rule 2(e)(7) of the Commission's Rules of Practice, 258 BNA SEC. REG. & L. REP. F-1, F-3 (June 26, 1974).

of the SEC. It also represents one more danger faced by the securities lawyer today that was unimportant ten years ago.⁸⁷

SEC Views of the Role of the Securities Lawyer

The SEC and its Commissioners have in the past several years expressed themselves on the role of the lawyer in the securities laws; their views clash sharply with the traditional notion of the responsibilities of lawyers. Most outspoken has been Commissioner A. A. Sommer.

Commissioner Sommer, speaking unofficially, states that "all the old verities and truisms about attorneys and their roles are in question and in jeopardy"⁸⁸ Noting that securities lawyers are increasingly called upon to serve broader interests than just those of their clients,⁸⁹ he asserts that conduct that was once tolerable is no longer.⁹⁰ Further, this trend is to continue: "[T]he role of the attorney, . . . the integrity of the attorney, and yes, in some measure, the independence of the attorney will be increasingly scrutinized."⁹¹ Most surprisingly, Sommer disputes the traditional notion of the lawyer as advocate; he feels that in the future the lawyer will have to function as an independent auditor:

This means several things. It means he will have to exercise a measure of independence that is perhaps uncomfortable. . . . It means he will have to be acutely cognizant of his responsibility to the public. . . . It means he will have to adopt the healthy skepticism toward the representations of management which a good auditor must adopt. It means he will have to do the same thing the auditor does when confronted with an intransigent client—resign.⁹²

Sommer further asserts that such conduct is not at odds with a lawyer's responsibilities to his client.⁹³

87. For an extensive discussion of Rule 2(e) and the implications of its increased use, see Comment, *supra* note 72.

88. Sommer, *supra* note 56, at 83,689.

89. Sommer, *Directors and the Federal Securities Laws*, [1973-1974 Transfer Binder] CCH FED. SEC. L. REP. ¶ 79,669, at 83,801 (Feb. 21, 1974).

90. Sommer, *supra* note 56, at 83,692.

91. *Id.* at 83,691.

92. *Id.* at 83,689-90.

93. In support of this assertion, Sommer quotes the preface to the ABA Code of Professional Responsibility:

Before the Bar can function at all as a guardian of the public interests committed to its care, there must be appraisal and comprehension of the new conditions, and the changed relationship of the lawyer to his clients, to his professional brethren and to the public. That appraisal must pass beyond the petty details of form and manners which have been so largely the subject of our Codes of Ethics, to more fundamental consideration of the way in which our professional activities affect the welfare of society as a whole. Our canons of ethics for the most part are generalizations designed for an earlier era. *Id.*

Sommer appears to view the role of the lawyer as an arm of the SEC's enforcement of the federal securities law. Although owing his client certain responsibilities, the securities lawyer also has a duty to the public. This latter duty forces the lawyer to remain independent from his client and to assure that the client takes no action violative of the securities laws. In Sommer's own words, the lawyer under this theory is the "keeper of the stop and go signal."⁹⁴ In its landmark complaint in *SEC v. National Student Marketing Corp.*,⁹⁵ the SEC took action against lawyers who did not follow this philosophy, *i.e.*, who did not act properly as "keepers of the stop and go signals."

In 1972, the SEC filed its complaint against the National Student Marketing Corporation (NSMC), its officers and directors, its accounting firm and several of the auditors employed by the accounting firm;⁹⁶ also included as defendants were two law firms and several of their partners. The notoriety surrounding *National Student Marketing* has been due mainly to two facts. First, the law firms are both large, sophisticated firms,⁹⁷ unlike law firms previously charged with securities fraud. Second, the lawyers were charged with fraudulent conduct *qua* lawyers.⁹⁸

The factual background to the case concerns a merger between NSMC and Interstate National Corporation (Interstate). A condition of the merger was that the accountant give a "comfort letter" as an assurance that the accounting firm had no reason to believe that unaudited interim financial statements of NSMC were not prepared according to generally accepted accounting practices or required any material readjustments. In the second claim of its complaint,⁹⁹ the

at 83,693, quoting *Preface to ABA CODE OF PROFESSIONAL RESPONSIBILITY* (1969).

94. *Id.* at 83,691.

95. [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,360 (D.D.C., complaint filed Feb. 3, 1972).

96. In a later action, criminal actions were brought against, among others, these two auditors, one a partner and the other an audit supervisor. They both were found to have acted with "reckless disregard" of their audit duties in connection with a NSMC proxy statement. They were recently sentenced to jail terms. See *Wall Street J.*, Dec. 30, 1974, at 11, col. 1.

97. The firms were White & Case of New York and Lord, Bissell & Brook of Chicago. The accounting firm named as defendant was also a large, sophisticated firm, Peat, Marwick, Mitchell & Co.

98. One commentator has stated that the lawyers actively participated in the fraud, rather than limiting their activities to those of traditional counselors. See Note, *The SEC and the Securities Bar: Adversaries or Allies?*, 23 CATHOLIC U.L. REV. 122, 135-36 (1973). The more accepted view is that the lawyers were charged for acts taken *qua* lawyers. See, *e.g.*, Karmel, *supra* note 40, at 1156.

99. See [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,360, at 91,913-15.

SEC made its important charges against the lawyers. The comfort letter was written by the accountants, but it contained a list of significant adjustments that should have been made in the statements. The SEC asserted that the comfort letter did not satisfy the condition of the merger agreement because the statements did require adjustments.¹⁰⁰ The first instance of fraud charged in the second claim against the attorneys representing NSMC and Interstate was that they had allowed the merger to close, while failing to disclose publicly the contents of the comfort letter, which would have reflected adversely on the value of NSMC's stock.¹⁰¹

At the closing meeting, before the closing of the merger was completed, the accountants informed NSMC's lawyers that they wished to add another paragraph to the letter which would state that if certain adjustments were made to the financial statements, the statements would reveal a net loss. The second charge of fraud was based on the lawyers' lack of action to inform others at the closing of this information.¹⁰²

Both sets of counsel wrote opinion letters that all conditions necessary for the merger had occurred. Feeling that the comfort letter did not satisfy one of the conditions of the merger, the SEC made the giving of these opinions the third and fourth grounds of fraud against the lawyers under the second claim.¹⁰³

The lawyers involved in *National Student Marketing* do not appear to have been active participants in fraud.¹⁰⁴ Rather, it was their actions as counsel that prompted the charges against them. Most interesting is the statement given by the SEC of what the lawyers did wrong. Their first mistake was to give the opinion letters and to fail to insist that the financial statements be revised and the shareholders be resolicited. Further, if that failed, the lawyers should have ceased "representing their respective clients and, under the circumstances, [notified] the . . . Commission concerning the misleading nature of the nine month financial statements."¹⁰⁵ Thus, the SEC seems to assert that if a lawyer feels his client is not taking proper action, he must

100. *Id.*

101. *Id.* at 91,913-16. At this time NSMC's reported earnings had shown a rapid growth which caused investors to value the earnings with a very high price-earnings ratio. A reported loss would have destroyed this illusion of growth and the high multiple that it commanded.

102. *Id.*

103. *Id.*

104. *But see Note, supra* note 98, at 135-36.

105. [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,360, at 91, 913-17.

either resign and disclose to the SEC information damaging to his client or be guilty of violating the securities laws himself.

National Student Marketing has yet to reach a decision on its merits; therefore, it is not known whether this new requirement placed on lawyers by the SEC will be given judicial approval. However, the recent case of *Meyerhofer v. Empire Fire & Marine Insurance Co.*,¹⁰⁶ discussed in the introduction to this Note,¹⁰⁷ gives credence to the propriety of the action prescribed by the SEC for a lawyer with a client who refuses to take the action which the lawyer feels is required by the federal securities laws. It will be recalled that Goldberg, a young lawyer, had tried to include in the prospectus disclosure of certain facts; when the client and the law firm disagreed, Goldberg resigned. He immediately disclosed the whole affair to the SEC. Later, when he was included as a defendant in a securities fraud suit against his former client, he delivered to the plaintiffs' attorney the affidavit which he had given to the SEC. The defendants in that suit asked that Goldberg be enjoined from disclosing confidential information regarding his former client. The trial court granted this injunction. It also dismissed without prejudice plaintiffs' complaint; the basis of this dismissal was that "Goldberg had obtained confidential information from his client Empire which, in breach of relevant ethical canons, he revealed to plaintiffs' attorneys in their suit against Empire."¹⁰⁸ The Second Circuit reversed.

Meyerhofer does not give direct support for the proposition that a lawyer should inform on his client to the SEC, because the decision concerns the disclosure to the plaintiffs' attorney, not the disclosure to the SEC. However, the court seemed to assume that Goldberg did nothing wrong when he went to the SEC. Indeed, the court held that under the circumstances he did not act improperly even when he delivered the affidavit to plaintiffs' counsel.¹⁰⁹

Summary

As is evident, the whole subject of a lawyer's obligations, duties, and liabilities under the federal securities laws remains uncertain. There are few areas that one can point to and tell definitively what a lawyer must do to properly fulfill his function, or at the least to avoid

106. 497 F.2d 1190 (2d Cir. 1974), cert. denied, 43 U.S.L.W. 3274 (U.S. Nov. 11, 1974).

107. See text accompanying note 1 *supra*.

108. 497 F.2d at 1194.

109. See *id.* at 1194-95.

liability. While the exact status of the law on this subject remains difficult to ascertain, several conclusions can be safely made: (1) The responsibilities and liabilities of the securities lawyer have shifted from the traditional view of the attorney. He is given greater responsibility in protecting the public from his client; concomitantly, the onus of harsher sanctions is placed upon him when he fails to fulfill his responsibility. (2) However far this new public responsibility for the securities lawyer has reached at the present time, the SEC desires to see it go farther. The SEC would like the lawyer to obtain a great deal of independence from his client and to act as another enforcer of the securities law should the client go beyond the bounds of the law. (3) If the current trend continues, and there have been no indications that it will not, the securities lawyer will in the future be held to an increasingly higher standard of conduct.

IMPLICATIONS FOR THE LEGAL PROFESSION

As a comparison of the first two parts of this Note clearly indicates, the securities lawyer has in the last ten years found himself separated from the remainder of the legal profession as to his duties and obligations. Whereas lawyers specializing in other areas have experienced little shift from the traditional standards of conduct, the securities bar has been continually threatened with higher liabilities and has been challenged to accept a role basically at odds with the traditional and comfortable view of the lawyer as a loyal advocate for his client. A legitimate question that must be asked is why this revolution of attorney conduct has occurred only in the securities law area. If the trend in that area is beneficial, why should it not be extended to all lawyers? Conversely, if the traditional framework of attorney conduct, duties, and liabilities represents a proper balance between the interests of the client, the public, and the legal profession, why should it be abandoned for securities practice?

Several reasons have been put forth to explain why higher standards of conduct should be expected of the securities bar. To begin with, the SEC's small staff and limited resources require it to be dependent upon the "probity and diligence" of the lawyers who appear before it.¹¹⁰ Without the cooperation of the legal profession, the SEC could not accomplish its mission of policing the securities field. Further, securities lawyers "have since the earliest days of the federal securities laws been at the heart"¹¹¹ of securities regulation. This is because the securities lawyer plays such a vital role for his client:

110. SEC File No. S7-520, 248 BNA SEC. REG. & L. REP. E-1 (Apr. 10, 1974).

111. Sommer, *supra* note 56, at 83,688.

[T]he professional judgment of the attorney is often the "passkey" to securities transactions. If he gives an opinion that an exemption is available, securities get sold; if he doesn't give the opinion, they don't get sold. If he judges that certain information must be included in a registration statement, it gets included . . . ; if he concludes it need not be included, it doesn't get included.¹¹²

Because of this essential function which the securities lawyer plays, it is felt that the easiest way to control participants in securities transactions is to control their attorneys. For example, Justice Douglas, while serving as head of the SEC, asserted in 1935 that "if the mores of our legal bishops were changed, we would have solved the major problems in finance."¹¹³ Further, since the public in general is not represented in securities transactions, it depends to a large degree upon the attorneys and other professionals involved for information and probity.¹¹⁴ The argument runs that it therefore is incumbent upon the attorney to recognize the reliance placed upon him by the public and to accept the responsibility which flows with it.

While the above arguments seem persuasive, analysis shows that they could easily apply to other areas of the law. Take for example the tax lawyer. Certainly there is great public interest in this area. If one person improperly pays too little tax, all other taxpayers are burdened by heavier requirements. Further, the tax lawyer plays a central role in his clients' tax planning; certainly the great majority of transactions entered into to reduce taxes would never occur without the mind of the tax lawyer, aided by the accountant. Although the IRS is a strong agency, a lack of cooperation by the professionals working in the tax field would likewise render it little better than impotent.¹¹⁵ A similar analysis can be made in other specialties, for instance the real estate field where little could be accomplished without the skill of the real estate lawyer and where there exists a great potential for public harm or benefit. Even the general practitioner is an essential cog in modern life and can strongly affect the public welfare.¹¹⁶

112. *Id.* at 83,689.

113. Douglas, *supra* note 41, at 69.

114. SEC File No. S7-520, *supra* note 110, at E-1.

115. *Cf.* J. CAREY & W. DOHERTY, *ETHICAL STANDARDS OF THE ACCOUNTING PROFESSION* 89-90 (1966).

116. It is interesting to note the lax standard of care applied to a general practitioner in *Lucas v. Hamm*, 56 Cal. 2d 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961), *cert. denied*, 386 U.S. 987 (1962). There a lawyer had drafted a will which violated the rule against perpetuities, thereby depriving the plaintiff beneficiaries of their bequest. The beneficiaries were allowed to sue the lawyer for malpractice as third party beneficiaries. However, the court held that the attorney was not guilty of malpractice because the Rule Against Perpetuities is so complex that few lawyers understand it. Compare this with

An examination is needed into the goals, problems, and possible results of the new standards to which securities lawyers are being held. If this trend is desirable, then serious consideration should be given to whether the new role of the securities lawyer should be broadened to all attorneys.

The philosophy behind the new role urged upon securities lawyers, with its emphasis upon the public good and the thwarting of the goals of "money hungry defrauders," certainly has a superficial appeal. This is especially so in this period when public respect for the bar seems quite low.¹¹⁷ However, in an area of such importance and with such great implications not only for the bar but also for the public in general, it is not enough to be swayed by first impressions or surface appearances. Rather, one must go beyond pleasant generalizations and carefully study how such a shift in the role of the lawyer will affect the legal profession, how it will change the legal services clients receive, and what benefits or detriments the public will receive.

The securities bar in general has seemed dismayed by the increasing duties and liabilities that have been placed upon it.¹¹⁸ In response to the new trend, lawyers have made a number of specific complaints. To begin with, there is a bona fide fear that an acceptance of the standards urged by the SEC would prove to be deleterious to the attorney-client relationship.¹¹⁹ It is asserted by the bar that this would prove to be inimical to the interests of both the client and the public. With respect to the public, it is felt that as clients begin to realize that their lawyers' loyalties are not fully owed to them, they will become increasingly unwilling to convey possibly damaging information to their coun-

the standard to which securities lawyers are expected to meet when dealing with equally complex matters. See notes 58-68 *supra* and accompanying text.

117. This ebbing in the public image of lawyers appears to be due in large part to the Watergate scandals and the participation of lawyers in various illegal acts. For several commentaries by the popular media concerning lawyers and Watergate, see *America's Lawyers: "A Sick Profession,"* U.S. NEWS & WORLD REPORT, Mar. 25, 1974, at 23; *Lawyers' Watergate*, N.Y. Times, June 11, 1974, at 40, col. 1; *Criminal Lawyers*, WCBS-TV Editorial (June 18, 1974). For the view of former Chief Justice Warren on the subject, see Warren, *Law, Lawyers and Ethics*, 23 DE PAUL L. REV. 633 (1974). It should not be assumed, however, that all negative feelings towards the legal profession have had their genesis in Watergate. Consider, for example, S.V. Benet, *The Devil and Daniel Webster*, 2 SELECTED WORKS OF STEVEN VINCENT BENET 39 (Farrar & Rinehart 1942) (where the devil was referred to as "King of the Lawyers"). See also W. SHAKESPEARE, *King Henry VI*, Act IV, Sc. 2, Line 86 ("The first thing we do, let's kill all the lawyers.").

118. See generally *A Bid to Hold Lawyers Accountable to Public Stuns, Angers Firms*, Wall Street J., Feb. 15, 1972, at 1, col. 1.

119. See Karmel, *supra* note 40, at 1159-60; Wall Street J., *supra* note 118, at 1, col. 1.

sels. This will render the lawyer less able than at present to insure that his client remains within the securities laws; also, unless the lawyer receives full information, it will be impossible for him to give the client competent advice. Thus, the chance for securities violations might actually increase.¹²⁰ This decline in the attorney-client relationship also could harm the client. Some lawyers may hesitate to represent a client fully when so many sanctions threaten him. One commentator openly charges "a conscious effort [by the SEC] to encourage lawyers to trade off the rights of some clients in order to curry favor with the commission."¹²¹ The great fear is that the attorney will be intimidated from representing his client with zeal, as traditionally has been required of him.¹²² It is questioned whether an attorney who declines to represent his client zealously in order to protect himself would not be allowing "his personal interests . . . to dilute his loyalty to this client," as is forbidden by the Canons of Professional Responsibility.¹²³ Finally, there is the practical question of whether a client is ever going to be able to obtain hard, specific advice from the lawyer. For example, whether privately issued stock can be resold without a registration statement is an exceedingly difficult question under the present state of the law, a matter on which it is essential for a layman to receive the best advice available. After *Spectrum*,¹²⁴ however, it may prove impossible to find a lawyer willing to give an affirmative answer, even when he truly believes that to be the case, for fear that his advice will result in sanctions against him should his opinion prove faulty. Of relevance to this point is the conversation one commentator relates as having occurred between a securities lawyer and his client. The attorney gave his client very cautious advice. The client replied, "Are you saying that for my

120. Comment, *David and Goliath Revisited*, 23 DE PAUL L. REV. 737, 749 (1974); Wall Street J., *supra* note 118, at 17, cols. 3-4; see Messer, *Roles and Reasonable Expectations of the Underwriter, Lawyer and Independent Securities Auditor*, 52 NEB. L. REV. 429, 458 (1973).

121. Freedman, *A Civil Libertarian Looks at Securities Regulation*, 35 OHIO ST. L.J. 280, 285 (1974). In this same article, Dean Freedman levels an extremely harsh criticism at the SEC and its practices. He writes:

In sum, therefore, securities regulation is characterized by denial of the right to counsel, corruption of the independence of the Bar and traditional standards of attorneys' obligations to their clients, a police-state system of investigation, and denial of a variety of other basic due process rights. *Id.* at 288.

122. *Id.* at 285; Messer, *supra* note 120, at 458; Comments of the ABA Committee on Federal Regulations of Securities, *supra* note 86, at F-3.

123. ABA CODE OF PROFESSIONAL RESPONSIBILITY EC 5-1 (1969). There is also the issue of whether a lawyer who informs on his client to the SEC is using "information acquired in the course of the representation of a client to the disadvantage of the client." *Id.* EC 4-5.

124. See notes 58-63 *supra* and accompanying text.

protection or for yours?"¹²⁵

Lawyers also complain that it often is not a case of black or white whether an action is within the securities laws. The securities laws involve many complex issues which seem to be constantly changing.¹²⁶ Attorneys charge it is unfair to hold them liable for acts of their clients which arguably could have been seen as within the law. It likewise is difficult to perceive at what point legitimate, robust advocacy goes too far. As Commissioner Sommer has pointed out, "[I]t is too easy to confuse vigorous, even commendable, representation of a client with countenancing misconduct."¹²⁷

The action prescribed by the SEC of informing on the client is particularly distasteful to the bar. It is interesting to note a court's comment on a charge that a national accounting firm should have made public its disagreement with a client that ended in the firm being fired:

It is at least mildly perplexing to speculate on the prospect of an accountant's public attack upon a client on the occasion of being discharged by the client . . . in an area where responsible accountants could (and did) responsibly differ.¹²⁸

An accountant traditionally has been seen as much more independent from his clients than a lawyer; certainly the embarrassment of a lawyer upon informing on his client would be concomitantly greater.

A final protest leveled at the new trend is that the duties and liabilities of a securities lawyer are changing so rapidly that an attorney

125. Freedman, *supra* note 121, at 286.

126. The changing nature of securities laws is well reflected in court decisions concerning Rule 10b-5. It has become quite difficult to discern the status of each of the various elements needed for Rule 10b-5 recovery. For example, it was once rather uniformly thought that reliance by plaintiffs on the alleged fraud was a prerequisite to recovery in Rule 10b-5 cases. However, in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), the Supreme Court held that, in that particular case, proof of reliance was not necessary for recovery. *Id.* at 152-54. At least one court has interpreted *Ute* as holding that when materiality is shown, proof of reliance is not needed. *In re Penn Cent. Sec. Litigation*, 347 F. Supp. 1327, 1344 (E.D. Pa. 1972), *modified in part*, 357 F. Supp. 869 (E.D. Pa. 1973). Likewise, scienter on the part of the defendants was at one time considered a necessary Rule 10b-5 element. Today there is considerable controversy over whether a showing of mere negligence is sufficient. *Compare Myzel v. Fields*, 386 F.2d 718, 734-35 (8th Cir. 1967) ("Proof of 'scienter' . . . is not required under Section 10(b) . . ."), with *Shemtob v. Shearson, Hammill & Co.*, 448 F.2d 442, 445 (2d Cir. 1971) ("It is insufficient to allege mere negligence . . ."), and *White v. Abrams*, 495 F.2d 724 (9th Cir. 1974). The trend in general has been from strict to more lax standards. For an excellent discussion of the various elements necessary for Rule 10b-5 recovery, see Note, *SEC Rule 10b-5: A Recent Profile*, 13 WM. & MARY L. REV. 860 (1972).

127. Somner, *supra* note 56, at 83,692.

128. *Gold v. DCL, Inc.*, [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,036, at 94,169 (S.D.N.Y. 1973).

cannot know what is expected of him or how he can protect himself. The danger exists that such uncertainty may demoralize and virtually paralyze the securities bar.¹²⁹

Fundamentally, the controversy between the SEC and the securities bar distills down to a basic difference in viewpoint as to how the lawyer can best serve the public. The issue is whether the lawyer as an advocate can effectively serve the public good. The SEC feels that overrepresentation of the client is detrimental to the country as a whole. As Justice Douglas stated while SEC Commissioner: "Service to the client has always been the slogan of our profession. And it has been observed so religiously that service to the public interest has been sadly neglected."¹³⁰ This, however, strikes at a basic assumption long held by the bar, that the whole legal system runs best by lawyers' strong advocacy.

The Code of Professional Responsibility states: "The duty of a lawyer, both to his client and *to the legal system*, is to represent his client zealously."¹³¹ Thus, a lawyer has an ethical duty to the system itself to represent his client loyally and fully. This is not because the legal system is unfeeling about the public good but rather because it traditionally has been felt that the public good is optimized by each participant in the system having strong representation; out of this clash of forces theoretically emerges a solution in the public interest.

The SEC has attempted to supplant this theory of the legal system with a new one, based on the premise that the public good is maximized by requiring lawyers to act with an eye to the public rather than for the best interests of their clients. A strong argument in support of this position would reason that an advocacy system requires all groups to be represented, but the public often stands unprotected; therefore, the legal profession must assume an ethical duty to insure that those they represent do not unfairly take advantage of the vulnerable and the weak.¹³² Unfortunately, the SEC has failed to articulate in any complete and logical fashion a philosophical justification of its theory of the lawyer's proper role. In attempting to discard a view of the lawyer which has its roots in the very fabric of our legal system, the SEC has put forth little more than what the ABA has called "generalized rhetoric."¹³³ Some of the Commission's proposals seem

129. Lowenfels, *supra* note 16, at 437-38.

130. Douglas, *supra* note 41, at 67.

131. ABA CODE OF PROFESSIONAL RESPONSIBILITY EC 7-1 (1969) (emphasis added).

132. Derieux, *Public Accountability Under Securities Laws*, 35 OHIO ST. L.J. 255, 257 (1974).

133. See Comments of the ABA Committee on Federal Regulations of Securities, *supra* note 86, at F-3.

poorly thought-out at best, notably the idea that lawyers should serve the same role as an independent auditor. The auditor represents himself to the public as a totally disinterested expert whose objective reports are designed as much for the public as for the client; no matter how much the lawyer's role changes, it seems doubtful he could ever achieve such a degree of independence. A decade ago, the SEC gave the following description of the roles of lawyers and auditors:

Though owing a public responsibility, an attorney in acting as the client's advisor, defender, advocate and confidant enters into a personal relationship in which his principal concern is with the interests and rights of his client. The requirement of the Act of certification by an independent accountant, on the other hand, is intended to secure for the benefit of public investors the detached objectivity of a disinterested person. The certifying accountant must be one who is in no way connected with the business or its management and who does not have any relationship that might affect [his] independence¹³⁴

It seems doubtful that the SEC really expects such detached objectivity and independence from attorneys; if it does, then the question must arise as to who then is left to protect the bona fide rights of the client. Moreover, while making such proposals which entail a violent reworking of the traditional attorney-client relationship, the SEC has failed to give the lawyer practical advice on how he can reconcile the competing demands of the public and the client, so that the responsibilities of the bar to both are adequately and professionally fulfilled.¹³⁵

CONCLUSION

What can the legal profession as a whole learn from the experi-

134. *In re American Fin. Co.*, 40 S.E.C. 1043, 1049 (1962).

135. Historically, such practical advice has not been beyond the capabilities of the SEC. An example of the ability of the staff of the SEC to provide concrete solutions in situations where lawyers have been implicated in their clients' violations of the securities laws is the settlement between the SEC and an attorney arrived at in *In re Ferguson*, Securities Act Release No. 33-5523 (Sept. 11, 1974), 268 BNA SEC. REG. & L. REP. A-25 (1974). The attorney had assumed principal legal responsibility to review a prospectus which turned out to contain material omissions. The SEC brought a Rule 2(e) proceeding against the lawyer. The lawyer's law firm agreed to take the following steps in exchange for a dismissal of the proceedings: (1) Independent auditors would be utilized and the firm would inquire into the background of the participants of transactions. (2) The firm would explain to all interested parties its duties to the issuer and the securities holders. (3) Every two weeks, all partners would meet to discuss cases. (4) The firm would require representations from parties regarding the accuracy and completeness of their statements. (5) Each partner and associate would attend each year at least one municipal bond workshop or seminar. In this settlement, the SEC proved itself capable of reconciling the competing demands of the public and the client upon the lawyer, with an added emphasis upon the maintenance of expertise in the securities law. Regrettably, such practical advice is extremely rare from the SEC.

ence of the changing role of the securities lawyer? The higher standards to which securities lawyers are being held concerning the quality of their work seems laudable. When a man holds himself out to be a specialist in an area of the law, it is only right that the public be entitled to expect highly skilled advice from him. There would appear to be no reason why this should not apply to all specialists. Moreover, it is perhaps time to hold even the generalist to a higher standard of skill in his work; the law is a profession and the bar can command public respect and admiration only if it requires of its members the highest professional expertise. The huge damage claims to which securities lawyers appear likely to be subjected in the future are unfortunate, since they seem far in excess of the wrong done.¹³⁶ This problem, however, can be solved by some limitation of damages.¹³⁷

More difficult are the problems associated with the SEC's desire for the securities attorneys to stop acting solely as advocates and to maintain independence from their clients. On balance, the SEC's easy generalizations in support of its proposition do not supplant the need for a well thought-out philosophical justification of such a theory and for a thorough examination of all the ramifications such a change would entail; both matters would seem essential when the issue is the abandonment of a theory such as the advocacy role of the bar which has had such a central and fundamental place in our legal system. Still, the SEC has raised troubling questions as to the continued efficacy of the adversary system; these questions appear to go beyond the securities law field. It therefore seems incumbent upon the legal profession to begin a searching and prolonged study into the proper role of the lawyer in modern society to determine if the harm caused by the advocacy system outweighs the benefits derived. As of this moment, such an analysis has not been undertaken; until this inquiry has been made, any wholesale rejection of the advocacy system seems premature.

136. See notes 71-74 *supra* and accompanying text.

137. See, e.g., ALI FEDERAL SECURITIES CODE § 1403 (Tent. Draft No. 2, 1973). For commentary asserting a need for limitations on damages for all defendants, not just lawyers, in actions based on Rule 10b-5, see Note, *Rule 10b-5: The Rejection of the Birnbaum Doctrine*, *supra* note 71, at 624-31. In the past year, several provocative proposals have been made to limit damages under Rule 10b-5. In Comment, *Liability Under Rule 10b-5 for Negligently Misleading Corporate Releases: A Proposal for the Apportionment of Losses*, 122 U. PA. L. REV. 162, 172-78 (1973), the author suggests an apportionment of damages. In Note, *Rule 10b-5: The Rejection of the Birnbaum Doctrine*, *supra* note 7, at 631-33, the author suggests an arbitrary maximum limit on liability for each defendant.