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# Attorney's Responsibilities: Adversaries at the Bar of the SEC

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# ATTORNEYS' RESPONSIBILITIES: ADVERSARIES AT THE BAR OF THE SEC

By  
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## I. INTRODUCTION

In speeches by Commissioners, articles by employees, briefs submitted in pending litigation, and responses to criticism, the Securities and Exchange Commission (SEC) has proposed that the securities bar owes certain new duties of care and disclosure to the investing public.<sup>1</sup> The successful imposition upon attorneys of these responsibilities could change radically their traditional relationship to corporate clients.<sup>2</sup> The proposals have been justified as necessary because the SEC has an inadequate budget and a limited staff for regulation of the securities industry;<sup>3</sup> however, the proposals have been criticized as contrary to ethical standards, unauthorized by statute and disruptive of future securities regulation.<sup>4</sup>

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<sup>1</sup> See Garrett, *Professional Responsibility and the Securities Laws*, Address to State Bar of Texas, July 4, 1974; Sommer, *The Emerging Responsibilities of the Securities Lawyer*, [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 79,631 [hereinafter cited as Sommer]; Sonde, *The Responsibility of Professionals Under the Federal Securities Laws—Some Observations*, 68 Nw. U.L. REV. 1 (1973). For an extended discussion of the impact of these new duties see Proceedings, National Institute, American Bar Association, *Responsibilities and Liabilities of Lawyers and Accountants*, 30 BUS. LAW. 1 (Special Issue: March 1975).

<sup>2</sup> See Cooney, *The SEC's Enforcement Theory*, 30 BUS. LAW. 29 (Special Issue: March 1975); Corso, *Opinions of Counsel: Responsibilities and Liabilities*, 17 CLEV.-MAR. L. REV. 375 (1968).

<sup>3</sup> See *In re Emanuel Fields*, SEC Securities Act Release No. 5404, [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 79,407 (1973); Loomis, P.L.I. SECURITIES REGULATION TRANSCRIPT SERIES No. 3, at 255 (1972).

<sup>4</sup> See Lipman, *The SEC's Reluctant Police Force: A New Role for Lawyers*, 49 N.Y.U.L. REV. 437 (1975); 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 (1974) [hereinafter cited as Lowenfels]; Johnson, *The Expanding Responsibilities of Attorneys in Practice Before the SEC: Disciplinary Proceedings Under Rule 2(e) of the Com-*

Except for a passing invocation to the general provisions of Rule 10b-5 under the Securities Exchange Act of 1934<sup>5</sup> (Exchange Act) and for references to subjective beliefs of early government officials as to why the Securities Act of 1933<sup>6</sup> (Securities Act) and the Exchange Act were enacted, neither the source nor the limitations of the new duties have been explained. This article will explore possible sources for SEC authority over the securities bar and the methods by which the SEC has exerted authority over attorneys. We will argue that because government attorneys and private attorneys act as adversaries, the SEC is not a proper agency to regulate the securities bar.

Although the bar's responsibility for the SEC's limited staff and inadequate budget has never been explained, the SEC has resolved to implement the new proposals not only by persuasive exhortation but also by employing two enforcement techniques—injunctive and disbarment proceedings.<sup>7</sup> This article will consider the problems which the new proposals present to attorneys who represent clients in securities transactions and SEC investigations, with particular emphasis upon the impact of the new proposals on representation of a client during an SEC investigation. The lack of common law or statutory bases for SEC regulation of attorneys as professionals indicates that the new proposals involve the SEC and the courts in the effort to impose on attorneys ambiguous standards which are based upon parochial policy considerations. Further, because these standards are not applied even-handedly to private and government attorneys, they are unfair and corrosive of a free and adversary bar.

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*mission's Rules of Practice*, 25 MERCER L. REV. 637 (1974); Sargent, *The SEC and the Individual Investor: Restoring His Confidence in the Market*, 60 VA. L. REV. 553 (1974); Karmel, *Attorney's Securities Laws Liabilities*, 27 BUS. LAW. 1153 (1972).

<sup>5</sup> 15 U.S.C. § 78a *et seq.* (1970). The Exchange Act has been extensively amended by the Securities Act Amendments of 1975, Public Law No. 94-29, approved June 4, 1975, most of the provisions of which will not become effective until 180 days after enactment. The citations herein do not take into account such amendments, unless specific reference to Public Law No. 94-29 is made. See generally Rowen, *Securities Acts Amendments of 1975*, 8 REV. SEC. REG. No. 12 (June 27, 1975).

<sup>6</sup> 15 U.S.C. § 77a *et seq.* (1970).

<sup>7</sup> Garrett, *Professional Responsibility and the Securities Laws*, Address to State Bar of Texas, July 4, 1974. See also 30 BUS. LAW. at 153 (Special Issue: March 1975) (Summary of criminal cases related to SEC matters where lawyers have been defendants); Sommer, *supra* note 1.

## II. PRINCIPLES APPLICABLE TO ATTORNEYS' CONDUCT

### A. Sources of Attorneys' Duties

#### 1. Common Law

The novelty of the SEC's new proposals can be observed by considering the traditional sources by which attorneys' conduct has been regulated. The privileges and responsibilities of an attorney to his client or anyone else are grounded in the common law. In England the legal profession regulated itself. The bar associations in the United States also have played a role in regulating attorneys and have acted as sifting agencies in determining the fitness of persons to practice law.<sup>8</sup> The canons of ethics of the bar associations represent a codification and interpretation of common law principles applicable to attorneys' conduct.<sup>9</sup> However, the primary regulator of attorneys is the judiciary.

##### a. Malpractice

The relation between attorney and client is governed by the common law of agency, inasmuch as the attorney is the client's agent as well as a fiduciary<sup>10</sup> occupying a position of trust and confidence. The duty an attorney owes to his client allows the client to sue for fraud or for breach of fiduciary duty and affords the attorney no special defenses to such actions. In addition, attorneys are responsible for conduct which would subject them to malpractice suits. Whether by a theory arising out of contractual obligation or a breach of duty in tort to employ due care, an attorney may be made liable to his client through malpractice suits for negligence in any activities which manifest a lack of ordinary skill and diligence.<sup>11</sup>

An attorney is generally not liable to third persons for negligence in the performance of professional activities.<sup>12</sup> The attorney's duty extends only to his client or, in certain cases, to third party benefi-

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<sup>8</sup> See L. PATTERSON & E. CHEATHAM, *THE PROFESSION OF LAW* 43-49 (1971).

<sup>9</sup> See *Schwartz v. Board of Bar Examiners*, 353 U.S. 232, 248 (1956).

<sup>10</sup> 7 C.J.S. *Attorney and Client* § 67 (1937).

<sup>11</sup> See Note, *Attorney Malpractice*, 63 COLUM. L. REV. 1292 (1963).

<sup>12</sup> See *Savings Bank v. Ward*, 100 U.S. 195 (1879); Annot., 45 A.L.R.3d 1181, 1187 (1972); Wade, *The Attorney's Liability for Negligence*, 12 VAND. L. REV. 755 (1959) [hereinafter cited as Wade].

aries who the attorney could foresee would rely on his conduct.<sup>13</sup> Further, the attorney is obligated to follow his client's instructions unless the instructions are unlawful.<sup>14</sup>

Cases relating to malpractice construe the degree of care required of an attorney as that exercised by the ordinary attorney. Accordingly, attorneys are not liable even to their clients for errors of judgment and are not generally held to the standard of a particular attorney skilled in specialized fields.<sup>15</sup> Moreover, the attorney's liability for interpretation and application of statutes, regulations, and cases extends only to such matters which are clear and unambiguous.<sup>16</sup> The attorney's liability in malpractice for damages arising out of negligence has not been considered by state tribunals as being coequal with standards for professional disbarment; that is to say, attorneys guilty of malpractice are not, *ipso facto*, subject to disbarment proceedings.

#### b. *Duty to the Court*

An attorney is an officer of the court and has a duty to the courts and the public to assist in the proper and efficient administration of justice. If a conflict arises between a lawyer's duty to his client and the court, his duty to the court must prevail.<sup>17</sup> This duty in-

<sup>13</sup> See Wade, *supra* note 12; 82 U. PA. L. REV. 876 (1934). *But see* Lucas v. Hamm, 56 Cal. 2d 583, 364 P.2d 685, 15 Cal. Rptr. 821 (1961), *cert. denied*, 368 U.S. 987 (1962). The SEC's charges against attorneys in SEC v. Century Inv. Transfer Corp., [1971-72 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,232 (S.D.N.Y. 1971) and SEC v. Everest Management Corp., SEC Litigation Release No. 5209 (S.D.N.Y. 1971) indicate a different view. For cases limiting or extending accountants' duties to third parties see Hochfelder v. Ernst & Ernst, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 97,781 (7th Cir. 1974), *cert. granted*, \_\_\_ U.S. \_\_\_ (1975); Herzfeld v. Laventhol, Krekstein, Horwath & Horwath, [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,574 (S.D.N.Y. 1974); Rusch Factors, Inc. v. Levin, 284 F. Supp. 85 (D.R.I. 1968); Ultramares v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931).

<sup>14</sup> See Lally v. Kuster, 177 Cal. 783, 171 P. 961 (1918); ABA CODE OF PROFESSIONAL RESPONSIBILITY AND CANONS OF JUDICIAL ETHICS, Canon 7 and Ethical Consideration 7-5 [hereinafter cited as ABA CODE Canon or ABA CODE EC]; Annot., 56 A.L.R. 962 (1928).

<sup>15</sup> See Savings Bank v. Ward, 100 U.S. 195, 199-200 (1879); Note, *Attorney Malpractice*, 63 COLUM. L. REV. 1292, 1294 (1963). See also Glenn v. Haynes, 192 Va. 574, 66 S.E.2d 509 (1951); Note, *The Bases of the Attorney's Liability to His Client for Malpractice*, 37 VA. L. REV. 429 (1951); Wade, *supra* note 12, at 776.

<sup>16</sup> See Wade, *supra* note 12; *cf.* SEC v. Frank, 388 F.2d 486 (2d Cir. 1968) (attorney's limitations on technical matters).

<sup>17</sup> See Hickman v. Taylor, 329 U.S. 495, 510 (1947); *People ex rel. Karlin v. Culkun*, 248

cludes aiding the court in the dignified and orderly trial of cases, refraining from entering into any engagement in which the attorney has a personal interest, and devoting himself to his client with ability, skill, and diligence in accordance with professional ethics.<sup>18</sup> The court's power over attorneys for obstructing the administration of justice is similar to the power to cite attorneys for contempt.<sup>19</sup> An attorney has no such special relationship to the legislative or executive branches of government.

It should be noted that the government lawyer, unlike other government employees, also owes a primary duty to the court rather than to the agency or department for which he is employed and which is his client. This means that the SEC staff attorney owes a greater allegiance as an attorney to the court which admitted him to practice than to the SEC.<sup>20</sup>

In the context of the special relationship which an attorney has to the courts, jurisdiction over the practice of law resided in the state judiciaries which preceded the Constitution. The state courts have an inherent power to regulate the conduct of attorneys as officers of the court. This power may be exercised over the admission, suspension, discipline, and disbarment of attorneys as well as the prevention of the unauthorized practice of law.<sup>21</sup> Legislative action with respect to the admission or disciplining of attorneys is in aid of judicial power and does not supplant it.<sup>22</sup> The power to determine whether an attorney has committed an act for which he should be suspended or disbarred is a judicial function which can be exercised only by a court.<sup>23</sup>

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N.Y. 465, 470-77, 162 N.E. 487, 489 (1928).

<sup>18</sup> See *State v. Barto*, 202 Wis. 329, 232 N.W. 553 (1930); 7 C.J.S. *Attorney and Client* § 4(a) (1937).

<sup>19</sup> See *In re Kelly*, 243 F. 696, 705 (D. Mont. 1917). But courts do not have a summary contempt power to disbar an attorney. *Cammer v. United States*, 350 U.S. 399 (1956).

<sup>20</sup> See *In re Nebraska State Bar Ass'n*, 133 Neb. 283, 275 N.W. 265 (1937); Poirier, *The Federal Government Lawyer and Professional Ethics*, 60 A.B.A.J. 1541 (1974).

<sup>21</sup> See *In re Nebraska State Bar Ass'n*, 133 Neb. 283, 275 N.W. 265 (1937); Poirier, *The Federal Government Lawyer and Professional Ethics*, 60 A.B.A.J. 1541 (1974). See also *In re Baker*, 8 N.J. 321, 85 A.2d 505 (1951); *People ex rel. Chicago Bar Ass'n v. Goodman*, 366 Ill. 346, 8 N.E.2d 941, cert. denied, 302 U.S. 728 (1937).

<sup>22</sup> *Hallinan v. Committee of Bar Examiners*, 65 Cal. 2d 447, 421 P.2d 76, 55 Cal. Rptr. 228 (1966); *People ex rel. Chicago Bar Ass'n v. Goodman*, 366 Ill. 346, 8 N.E.2d 941, cert. denied, 302 U.S. 728 (1937); *Mrotek v. Nair*, 231 A.2d 95 (Conn. Cir. Ct. 1967).

<sup>23</sup> *In re Mackay*, 416 P.2d 823 (Alaska 1964), cert. denied, 384 U.S. 1003 (1966); *Brotsky*

There is no federal bar examination. However, the federal courts as a coequal judiciary have the power to admit and discipline attorneys who practice before them.<sup>24</sup> In so doing, the courts act pursuant to federal rather than state law.<sup>25</sup> Federal administrative agencies such as the SEC have received no grant of judicial power to regulate lawyers. Contrarily, they are prohibited by statute from establishing substantive standards for licensing practitioners before them.<sup>26</sup> This prohibition may be justified on the ground that such agencies are creatures of the legislature whose actions are reviewable by the courts. Although regulation is conducted by the courts, it rises to the level of state action and is subject to the Due Process Clause and Equal Protection Clause of the Fourteenth Amendment to the Constitution.<sup>27</sup>

Because administrative agencies are not courts, laymen may be authorized to practice before them.<sup>28</sup> However, representing clients before an administrative agency may be deemed to be practicing law and such conduct is subject to regulation by the judiciary.<sup>29</sup> In *Emanuel Fields*,<sup>30</sup> an attorney who was subject to a disbarment proceeding by the SEC argued that only the courts in the state in which he was admitted may bar him from practice before the SEC. The SEC rejected this contention and took an expansive view of its own authority in stating that the SEC is

under a duty to hold *our bar* to appropriate rigorous standards of professional honor. To expect this vital function to be performed *entirely* by overburdened state courts who have

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v. State Bar, 57 Cal. 2d 287, 368 P.2d 697, 19 Cal. Rptr. 153 (1962); *In re Saddler*, 35 Okla. 510, 130 P. 906 (1913). A court of limited jurisdiction, which has no power to admit attorneys to practice before it, does not have the power to suspend or disbar. *Mullen v. Confield*, 105 F.2d 47 (D.C. Cir. 1939).

<sup>24</sup> *Theard v. United States*, 354 U.S. 278 (1957); *Ex parte Garland*, 71 U.S. 333 (1866).

<sup>25</sup> See Cheatham, *The Reach of Federal Action Over the Profession of Law*, 18 STAN. L. REV. 1288 (1966).

<sup>26</sup> *Camp v. Herzog*, 104 F. Supp. 134 (D.D.C. 1952); 5 U.S.C. § 500(b) (1970).

<sup>27</sup> *Schware v. Board of Bar Examiners*, 353 U.S. 232 (1956). See also *United Mine Workers v. Illinois State Bar Ass'n*, 389 U.S. 217 (1967).

<sup>28</sup> See *Goldsmith v. Board of Tax Appeals*, 270 U.S. 117 (1926).

<sup>29</sup> *People ex rel. Chicago Bar Ass'n v. Goodman*, 366 Ill. 346, 8 N.E.2d 941, cert. denied, 302 U.S. 728 (1937).

<sup>30</sup> SEC Securities Act Release No. 5404, [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 79,407 (1973).

little or no contact with the matters which which we deal would be to shirk that duty<sup>31</sup> (emphasis added).

It is questionable whether the SEC has a legally cognizable bar or whether the SEC's solicitude for the work load of the state courts is an adequate justification for the expansion of the Commission's jurisdiction to regulate attorneys' conduct. Violation of the securities laws is ground for disbarment by the state courts and there are numerous decisions involving these breaches as a basis for a disciplinary proceeding by the state judiciary.<sup>32</sup>

### c. *Canons of Ethics*

Historically the practice of attorneys who are members of the American Bar Association has been regulated by the Canons of Professional Ethics as amplified by specific reference to the Code of Professional Responsibility (CPR). These regulations have been endorsed or adopted by state judicial committees, and attorneys, upon admission, swear to abide by the Canons applied by their particular court and bar. Although the Canons and CPR seek to express comprehensive norms to guide attorneys' conduct in relationship to courts and clients, several Canons, Disciplinary Rules, and Ethical Considerations have particular reference to attorneys' conduct in representing clients in investigations under the securities laws.<sup>33</sup>

Canon 4 and its related rules require a lawyer, as agent, to preserve the confidences and secrets of his client in a fashion which extends beyond the attorney-client privilege. The justification for such confidentiality is to encourage laymen to seek legal assistance early and develop facts broadly enough to allow full representation. The lawyer may not reveal such confidences or secrets to the client's disadvantage or a third party's advantage unless with the client's full consent, when required by law or court order, when necessary beyond a reasonable doubt to prevent a crime by the client, or when

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<sup>31</sup> *Id.* at 83,174 n.21.

<sup>32</sup> Annot., 18 A.L.R.3d 1408 (1968).

<sup>33</sup> Canons, Ethical Considerations, and Disciplinary Rules have been accepted by the states and provide general guidance to securities problems for lawyers. See Panel Discussion, *Responsibility of Lawyers Advising Management*, 30 Bus. Law. 13, 14 (Special Issue: March 1975).



involved in a bona fide dispute with the client.<sup>34</sup> By contrast the SEC has argued that attorneys can be charged with fraud if they fail to notify the Commission of information which arose from confidences from their client.<sup>35</sup>

An attorney has a duty to exercise independent professional judgment on behalf of a client under Canon 5, which has been interpreted to mean that the lawyer for a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity. Dual representation of the entity and such individuals is permitted only after full disclosure to both and only when the lawyer is convinced that differing interests are not present.<sup>36</sup> In exercising independent professional judgment, neither the interests nor desires of third parties, including legislatures or administrative agencies, should dilute an attorney's principal allegiance to his client. The SEC contends, however, that a corporation attorney's real clients are the stockholders, so that disclosure of confidential information to the public and to the SEC for the benefit of stockholders is only disclosure to the client.<sup>37</sup>

Canon 7 urges a lawyer to represent a client zealously within the bounds of the law. One related Ethical Consideration suggests that in uncertain areas the lawyer's zeal may be affected depending on whether the lawyer is an adviser or an advocate for the client. This distinction is stated in relation to the facts and actions of the client which are considered by the lawyer; an adviser primarily deals with advice on a future course of conduct; the advocate deals with the effects of past conduct.<sup>38</sup> Administrative agencies like the SEC are

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<sup>34</sup> ABA CODE DISCIPLINARY RULE 4-101 [hereinafter cited as ABA CODE DR]; ABA COMM. ON ETHICS AND PROFESSIONAL RESPONSIBILITY, OPINIONS, No. 335 (1974) [hereinafter cited as ABA OPINIONS].

<sup>35</sup> See *SEC v. National Student Marketing Corp.*, [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,610 (D.D.C. 1974); Practising Law Institute on Securities Regulation (R. Mundheim, A. Fleischer, Jr., John D. Shipper ed. 1973) 187, 224, 233 [hereinafter cited as PLI Fourth Institute].

<sup>36</sup> ABA CODE EC 5-18, 5-19.

<sup>37</sup> See Lowenfels, *supra* note 4; Sommer, *supra* note 1; PLI Fourth Institute, *supra* note 35, at 231-37.

<sup>38</sup> ABA CODE EC 7-3. Such a distinction may provide no practical solution. See Jennings, *The Corporate Lawyer's Responsibilities and Liabilities in Pending Legal Opinions*, 30 BUS. LAW. 73, 74-75 (Special Issue: March 1975).

recognized in the Ethical Considerations not as tribunals but as legislative or quasi-judicial bodies.<sup>39</sup> For this reason, the attorney appearing before the SEC owes the same duty to both the legal system and his client: to advance the cause of his client as an advocate.<sup>40</sup> The bounds of the lawyer's zeal are restricted by responsive duties in that he shall not knowingly use perjured or false evidence and shall not state facts falsely.<sup>41</sup> However, he has no duty to volunteer information which would affect his client's cause adversely.

Affirmative duties to disclose a client's civil fraud are imposed only in very limited circumstances:

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 fraud to the affected person or tribunal, except when the information is protected as a privileged communication.

(2) A person other than his client has perpetrated a fraud upon a tribunal shall promptly reveal the fraud to the tribunal.<sup>42</sup>

This rule requires that the fraud, presumably common-law fraud, be clearly established, that it occur during the course of representation, and that the lawyer first call on the client to rectify it.<sup>43</sup> Thereafter the lawyer's affirmative duty is to reveal the fraud to the tribunal or to the person affected. Under the Canons, the SEC is not recognized as a tribunal except when acting as an adjudicatory body.<sup>44</sup> The SEC staff, however, may believe, and commenta-

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<sup>39</sup> ABA CODE DR 7-102(B); ABA CODE EC 7-15. See Definitions appended to CPR.

<sup>40</sup> ABA CODE EC 7-19.

<sup>41</sup> ABA CODE DR 7-102(A).

<sup>42</sup> ABA CODE DR 7-102(B). The affirmative duties imposed by the Rule appear to arise during the course of representation and not during the course of the fraud. Efforts to impose an affirmative duty for fraud which occurred prior to representation when the fraud may be "continuing" suggest additional problems. See PLI Fourth Institute, *supra* note 35, at 232-37. Hopefully, even after discharge of the affirmative duty, the client is still entitled to full right to counsel.

<sup>43</sup> To meet statutory frauds in the development of the securities law under Rule 10b-5, it has been suggested that the affirmative duty of the lawyer may be coequal with expanded disclosure. See Panel Discussion, *Responsibility of Lawyers Advising Management*, 30 BUS. LAW. 13, 23 (Special Issue: March 1975).

<sup>44</sup> See 30 BUS. LAW. 25 (Special Issue: March 1975). As to the questionable standing of

tors have assumed, that it is a tribunal to whom attorneys must reveal their client's fraud. An affected person, even under Rule 10b-5, may be the purchaser or seller who was a party to the fraud, but not the SEC. Moreover, during SEC investigations where fraud is not clearly established, the corporate lawyer should function as an advocate who represents an adversary point of view. Where his client's case is arguable he should be under no more obligation to disclose its weakness, factual or legal, to the SEC as an affected person than he would be to make such disclosure to an opposing lawyer.<sup>45</sup>

The tension between the duty to preserve a client's confidences and the duty to disclose fraud was discussed in a recent Bar Association Committee Report which concluded that the Canons "would appear to mandate disclosure by a lawyer of his client's material representations or omissions only in those instances where the misstatement or omission clearly constitutes fraud under the securities laws and the lawyer knows it." Further, the Report seriously questioned whether the SEC is a tribunal to which a duty to disclose fraud is owed, except for fraud perpetrated upon the tribunal in an adjudicatory proceeding.<sup>46</sup>

The Canons and their related interpretations assure clients a maximum defense unless and until the attorney is certain that his client is engaging in illegal conduct or that his client has made false statements. Logically, the duty to defend a client arises from the first contact with the SEC when the attorney begins his representation of the client and perceives the adversary threat to his client.<sup>47</sup>

The disagreement between the SEC and the private bar was highlighted by a Statement of Policy on Lawyers' Responsibilities and Liabilities when Advising with Respect to Laws Administered by the SEC adopted by the House of Delegates of the American Bar

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the SEC to prevent crimes, see 15 U.S.C. § 77t(b) (1970), requiring prosecution by the Department of Justice. As to the obligation to disclose a communication of a crime, see DR 4-101(B)(3); ABA OPINIONS No. 155, 314.

<sup>45</sup> EC 7-15 states "A lawyer appearing before an administrative agency, regardless of the nature of the proceeding it is conducting, has the continuing duty to advance the cause of his client within the bounds of law." This EC cites ABA OPINION No. 314 (1965): "But as an advocate before a service which itself represents the adversary point of view, where his client's case is fairly arguable a lawyer is under no duty to disclose its weaknesses, any more than he would be to make such a 'disclosure to a brother lawyer.'"

<sup>46</sup> *The Code of Professional Responsibility and the Responsibility of Lawyers Engaged in Securities Law Practice—A Report by the Committee on Counsel Responsibility and Liability*, 30 BUS. LAW. 1289, 1298-99, 1301 (July 1975).

<sup>47</sup> Freeman, *Legal Ethics*, N.Y.L.J. (April 24, 1974).

Association on August 12, 1975. The Statement of Policy stresses that the "confidentiality of lawyer-client consultations and advice and the fiduciary loyalty of the lawyer to the client . . . are vital to the basic function of lawyer as legal counselor." Further, the Statement of Policy squarely rejects the "general principle that lawyers must inform the SEC or others regarding confidential information" received from clients because "such compelled disclosure would seriously and adversely affect the lawyers' function as counselor, and may seriously and adversely affect the ability of lawyers as advocates to represent and defend their clients' interests." In addition to contesting the idea that a lawyer can be regarded by a government agency as a source of information concerning possible wrongdoing by clients, the Statement of Policy suggests that when a lawyer considers whether his client's conduct establishes the prospective commission of a crime or perpetration of a fraud, the lawyer is not required to uncritically accept the SEC's interpretation of the law. "The client's actions should not be improperly narrowed through the insistence of an attorney who may, perhaps unconsciously, eliminate available choices from consideration because of his possible personal risks if the position is taken which, though supportable, is subject to uncertainty or contrary to a known, but perhaps erroneous, position of the SEC or a questionable lower court decision."

The Canons have been applied by the SEC as standards for the conduct of attorneys in its proceedings under Rule 2(e) of the SEC's Rules of Practice.<sup>48</sup> However, unless the CPR has been specifically adopted by a court, the court is not bound to apply it, but may use it as an aid to determining acceptable practice.<sup>49</sup> The judiciary has inherent supervisory power over attorneys, and when a bar association acts to discipline an attorney it is functioning as an arm of the court and not independently.<sup>50</sup> In so acting, the self-regulatory bar associations may not impair the independence of the bar.

A bar composed of lawyers of good character is a worthy objective but it is unnecessary to sacrifice vital freedoms in order to obtain that goal. It is also important both to society and the bar itself that lawyers be unintimidated—free to think, speak, and act as members of an Independent Bar.<sup>51</sup>

From time to time the suggestion is made that the adversarial

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<sup>48</sup> 17 C.F.R. § 201.2(e) (1974).

<sup>49</sup> *Handelman v. Weiss*, [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,214, (S.D.N.Y. 1973).

<sup>50</sup> *Brotsky v. State Bar*, 57 Cal. 2d 287, 368 P.2d 697, 19 Cal. Rptr. 153 (1962).

<sup>51</sup> *Konigsberg v. State Bar*, 353 U.S. 252, 273 (1956).

ideal of the legal profession be made subservient to some other ideal, such as the search for truth. The SEC's present enforcement program against attorneys is essentially an effort to impose upon the securities bar a duty to pursue truth at the expense of adversary defense. As an eminent jurist has pointed out, however, the CPR does not contain a Canon on either "Duty to the Truth," or "Duty to the Community."<sup>52</sup>

## 2. Securities Laws

Although attorneys are subject to the same responsibilities and duties as other persons when acting in the capacity of officers, directors, stockholders, experts or, where qualified, accountants, the securities laws impose few special duties or responsibilities on attorneys, as attorneys.<sup>53</sup> Legislative history and the provisions of Schedule A of the Securities Act support the proposition that the Congress declined to recognize or impose any special duties on attorneys to the investing public in regard to registration of securities. In contrast, Section 19 of the Securities Act expressly authorized the SEC to implement regulations of substantive effect in the field of accounting and Schedule A imposed duties upon experts, as experts, in regard to designated portions of a prospectus.<sup>54</sup>

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<sup>52</sup> See Frankel, *The Search For Truth—An Umpireal View*, 30 RECORD OF N.Y.C.B.A. 14, 34 (1975). Judge Frankel's Address also appears in 123 U. PA. L. REV. 1031 (1975), and is then criticized by two authors who argue that the adversary system is fundamental to a free society. Freedman, *Judge Frankel's Search for Truth*, 123 U. PA. L. REV. 1060 (1975); Uviller, *The Advocate, The Truth, and Judicial Hackles: A Reaction to Judge Frankel's Idea*, 123 U. PA. L. REV. 1067 (1975).

<sup>53</sup> See Sommer, *Professional Responsibility: How Did We Get Here*, 30 BUS. LAW. 100 (Special Issue: March 1975).

<sup>54</sup> 15 U.S.C. § 77aa (Schedule A) (1970) and 15 U.S.C. § 77s (1970) which provides in pertinent part:

Among other things, the Commission shall have authority, for the purposes of this subchapter, to prescribe the form or forms in which required information shall be set forth, the items or details to be shown in the balance sheet and earning statement, and the methods to be followed in the preparation of accounts, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer; but insofar as they relate to any common carrier subject to the provisions of section 20 of Title 49, the rules and regulations of the Commission with respect to accounts shall not be inconsistent with the requirements imposed by the Interstate Commerce Commission under authority of such section. The rules and regulations of the

The power of the SEC to promulgate accounting standards has been generally exercised. Nevertheless, the distinction between imposing affirmative duties of detached objectivity upon accountants and recognition of some separate and pre-existing responsibility of attorneys in SEC practice is recognized in *American Finance Company, Inc.*,<sup>55</sup> where the SEC stated:

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. This 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 the independence which at times may require him to voice public criticisms of his client's accounting practices.<sup>56</sup>

Although the SEC mentions that in addition to the paramount duty to his client an attorney owes a "public responsibility," the sources or limitations of such responsibility, if different from common law or judicial precedent, are not articulated. The *American Finance* opinion does not distinguish between an attorney's public responsibility and the public responsibility of all persons. In cases imposing on directors subjective standards such as knowledge and understanding or ability to ask meaningful questions, the fact that a director is an attorney has been taken into account in determining whether the director exercised and discharged his duty of due diligence.<sup>57</sup> But aside from participation as an expert passing on the legality of the security's issuance, there is no requirement to name counsel in a registration statement and, presumably, neither the role nor the identity of counsel was deemed material by Congress in the context of Schedule A of the Securities Act.

Although Section 19(a) of the Securities Act also confers authority upon the SEC to define other persons whose professions confer

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Commission shall be effective upon publication in the manner which the Commission shall prescribe.

<sup>55</sup> 40 S.E.C. 1043 (1962).

<sup>56</sup> *Id.* at 1049.

<sup>57</sup> See *Escott v. BarChris*, 283 F. Supp. 643 (S.D.N.Y. 1968); *In re Spater*, N.Y.L.J. (April 25, 1974); Panel Discussion, *Lawyers As Directors*, 30 BUS. LAW. 41, 45 (Special Issue: March 1975); Cheek, *Counsel Named In A Prospectus*, 6 SEC. L. REV. 203 (1973); Folk, *Civil Liabilities Under the Federal Securities Acts: The BarChris Case*, 55 VA. L. REV. 1 (1969).

special authority to statements in a prospectus, the SEC has never included attorneys within such definition except with respect to narrowly confined expertise relating to the legality of the issuance of a security. Accordingly, the requirements of Section 11 with respect to statements contained in a prospectus on the authority of an attorney, as an attorney, would be confined to statements of expertise relating to legality of the issuance of the securities, special litigation, or specific legal questions such as tax, international law, patent law or property law.<sup>58</sup> If the SEC has made its forms so complicated that clients must turn to attorneys to prepare these forms, this should not extend the liability imposed on attorneys who undertake the task.

There is no requirement in the Exchange Act nor in its related forms to identify or name counsel with respect to his activities in the preparation of required reports or related forms under that Act unless the attorney has a material relationship with the issuer in addition to serving as an attorney.<sup>59</sup>

The Public Utility Holding Company Act<sup>60</sup> and its regulations contain no mention of special duties for attorneys. The Trust Indenture Act, however, contains a provision which requires qualified indentures to include an opinion of counsel on the recording and filing which is necessary to make and maintain an effective lien and to comply with conditions precedent to the operation of the indenture.<sup>61</sup> The regulations adopted pursuant to the Trust Indenture Act contain neither standards nor forms to guide the attorney in the preparation or issuance of these required opinions.

The Investment Company Act of 1940 contains no special requirements for attorneys which distinguish them from other persons.<sup>62</sup> Similarly, the Investment Advisers Act of 1940 imposes no special duties upon attorneys, but, in its definition of investment adviser, provides an exemption for any attorney whose performance of advisory services is solely incidental to the practice of his profession.<sup>63</sup>

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<sup>58</sup> 15 U.S.C. § 77g (1970); 17 C.F.R. § 230.435-7 (1974); see also SEC Securities Act Release No. 5051 (1970).

<sup>59</sup> For examples, see proxy rules 17 C.F.R. § 240.14a-3, Regulation 14A, Item 7; Form 10, Item 9.

<sup>60</sup> 15 U.S.C. § 79 *et seq.* (1970).

<sup>61</sup> 15 U.S.C. § 77aaa *et seq.* (1970).

<sup>62</sup> 15 U.S.C. § 80(a) *et seq.* (1970). See, however, the provisions of 15 U.S.C. § 80(a)(2)(19)(vi) (1970) on the definition of "interested persons" and the interpretation by the SEC in *Alpha Investors Fund Inc.*, [1971-72 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,618 (1971), that a lawyer is an interested person ineligible to serve as a disinterested director.

<sup>63</sup> 15 U.S.C. § 80b-2(11)(B) (1970).

Under the Securities Investor Protection Act of 1970 (SIPA),<sup>64</sup> the Securities Investor Protection Corporation (SIPC), a non-profit membership corporation, selects a trustee for the bankrupt broker-dealer and an attorney to the trustee.<sup>65</sup> However, once the trustee and his attorney are appointed, they become officers of the court like any other bankruptcy trustee or attorney.<sup>66</sup> Neither SIPC nor the SEC determines whether the attorney who has been selected is sufficiently "disinterested" to serve in the proceedings,<sup>67</sup> or what compensation the attorney may receive.<sup>68</sup> These are matters of judicial prerogative. Similarly, any ethical questions which may arise in the course of the proceeding with regard to the conduct of any attorneys for any of the parties may be decided by the court under its general supervisory powers.<sup>69</sup>

Where the SEC participates as a party under Chapter X of the Bankruptcy Act, it does not have any direct authority over the attorneys for other parties. Although the SEC may make recommendations as to fees to be awarded to attorneys, and its recommendations may be given great weight, the determination as to such fees is a judicial function.<sup>70</sup> If the SEC believes an attorney is not "disinterested" it may so argue before the court like any other party, but the SEC has no power either to disqualify the attorney or to take disciplinary action against him.<sup>71</sup>

The latest draft of the codification of all federal securities laws similarly does not increase attorneys' liabilities.<sup>72</sup> The legislation

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<sup>64</sup> 15 U.S.C. § 78aaa *et seq.* (1970) [hereinafter cited as SIPA]. SIPA is a putative amendment to the Exchange Act, SIPA § 2, 15 U.S.C. § 78bbb, and provides a procedure for liquidating broker-dealers which have failed financially. Although SIPA is primarily a bankruptcy law, incorporating by reference various provisions of the Bankruptcy Act, SIPA § 6(c)(1), 15 U.S.C. § 78fff(c)(1), the SEC has rulemaking and other authority under the statute. SIPA § 7, 15 U.S.C. § 78ggg.

<sup>65</sup> SIPA § 5(b)(3), 15 U.S.C. § 78eee(b)(3) (1970). SIPC plays a role under SIPA vis-a-vis the SEC similar to the role played by the national securities exchanges under the Exchange Act.

<sup>66</sup> Guttman, *Broker-Dealer Bankruptcies*, 48 N.Y.U.L. REV. 887, 934 (1973).

<sup>67</sup> *SIPC v. Schreiber Bosse & Co., Inc.*, [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,461 (N.D. Ohio 1973).

<sup>68</sup> *SIPC v. Charisma Securities Corp.*, 506 F.2d 1191 (2d Cir. 1974).

<sup>69</sup> *Handelman v. Weiss*, [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,214 (S.D.N.Y. 1973).

<sup>70</sup> See *In re Imperial "400" National, Inc.*, 432 F.2d 232 (3d Cir. 1970). In an equity receivership obtained upon application by the SEC, the court similarly limited SEC authority. See *SEC v. Fifth Avenue Coach Lines*, [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,187 (S.D.N.Y. 1973).

<sup>71</sup> See *Commonwealth Fin'l Corp.*, Civ. Action No. 30108 (E.D. Pa.), described in SEC, 35th Annual Report 160 (1969).

<sup>72</sup> See Loss, *Summary Remarks*, 30 BUS. LAW. 163, 166 (Special Issue: March 1975).



enacted as the Securities Reform Act of 1975 and the statements of the SEC in support of the components of this legislation contain no reference to imposing specific statutory duties on attorneys.<sup>73</sup>

For these reasons, the source as well as the application of the new proposals on attorneys' duties must be found not in the statutes or regulations but in SEC policy considerations or in staff conclusions based on investigations.

### 3. *Rules of Practice*

In its Rules of Practice the SEC has adopted, pursuant to its general rule-making authority, general provisions relating to proceedings before the SEC, particularly those which involve adjudicatory hearings.<sup>74</sup> Most of the Rules have application only according to their intended scope. Rules 5 through 25 relate to administrative procedures. Rule 2(e)<sup>75</sup> contains express provisions for suspension

<sup>73</sup> See note 5, *supra*.

<sup>74</sup> 17 C.F.R. § 201.1 *et seq.* (1974).

<sup>75</sup> 17 C.F.R. § 201.2(e) (1974). Rule 2(e) provides in pertinent part:

(1) The Commission may 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 notice of and opportunity for 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, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the federal securities laws . . . .

(2) An attorney who has been suspended or disbarred by a Court . . . 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 . . . .

(ii) Any person temporarily suspended from appearing and practicing before the Commission in accordance with paragraph (i) 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 thirty days after service of the order by Mail the suspension shall become permanent.

(3)(i) 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, . . . 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 . . . ; or

(B) found by any court of competent jurisdiction in an action brought by the Commission to which he is a party or found by this Commission in any administrative proceeding to which he is a party to have violated or aided and abetted the violation of any provision of the federal securities laws . . . or of the rules and regulations thereunder (unless the violation was found not to have been wilful). . . .

and disbarment of any person, whether lawyer or non-lawyer, although historically the SEC has applied it only to attorneys and accountants.

The constitutionality of Rule 2(e) has not been adequately tested in the courts, and the Rule is subject to attack on a number of grounds. The SEC does not have either an inherent contempt power<sup>76</sup> or an inherent power over attorneys who practice before the agency,<sup>77</sup> but has only that limited power to discipline attorneys which may be essential to the exercise of its other powers.<sup>78</sup> To the extent that the SEC has tried to use Rule 2(e) to set substantive standards for the practice of law,<sup>79</sup> it has acted in contravention of federal law.<sup>80</sup> To the extent that Rule 2(e) gives the SEC summary power to discipline attorneys, more serious questions as to the constitutional validity of the Rule are raised.<sup>81</sup> To the extent that the SEC may disbar an attorney without proving "wilful" misconduct,<sup>82</sup> the SEC is subjecting attorneys to a different and higher standard of conduct than persons directly subject to SEC regulation.<sup>83</sup>

The SEC has utilized Rule 2(e) in an attempt to interpret "practicing before the Commission" to encompass the practice of securities law as a specialty. Rule 2(g) of the SEC's Rules of Practice defines the term "practicing before the Commission" to include:

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<sup>76</sup> See notes 149-50 *infra* and accompanying text.

<sup>77</sup> See notes 145-46 *infra* and accompanying text.

<sup>78</sup> See *Ex parte* Robinson, 86 U.S. 505 (1873).

<sup>79</sup> See, e.g., *Kivitz v. SEC*, 475 F.2d 956 (D.C. Cir. 1973).

<sup>80</sup> 5 U.S.C. § 500(b) (1970). See notes 141-58 *infra* and accompanying text.

<sup>81</sup> See *Ex parte* Robinson, 86 U.S. 505 (1873). The SEC contends that practice before the agency is a privilege, rather than a right. See Johnson, *The Expanding Responsibilities of Attorneys in Practice Before the SEC: Disciplinary Proceedings Under Rule 2(e) of the Commission's Rules of Practice*, 25 MERCER L. REV. 637, 646-47 (1974). This contention is very questionable and cannot justify summary disciplinary proceedings. See *Willner v. Committee on Character and Fitness*, 373 U.S. 96 (1963). To the extent that the right to counsel in the Sixth Amendment was an inherent condition to ratifying the Constitution, any infringement on that right by the SEC, a creature of congressional power over interstate commerce, is historically and constitutionally troublesome.

<sup>82</sup> See Rule 2(e)(3), 17 C.F.R. § 201.2(e) (1974); *SEC v. Spectrum, Ltd.*, 489 F.2d 535 (2d Cir. 1973).

<sup>83</sup> See, e.g., Securities Exchange Act of 1934 § 15(b)(5), 15 U.S.C. § 78o(b)(5) (1970). See notes 124-26 *infra* and accompanying text.

- (1) transacting any business with the Commission; and
- (2) the preparation of any statement, opinion or other paper by any attorney, . . . or other expert, filed with the Commission in any registration statement, notification, application, report or other document with the consent of such . . . expert.<sup>84</sup>

However, in *SEC v. Ezrine*,<sup>85</sup> this definition was extended to include:

Representing or advising, in connection with any matter arising under or related to the federal securities laws or the rules and regulations promulgated thereunder, any broker or dealer in securities, national securities exchange, investment company, investment adviser, or public utility holding company, registered or required to be registered with the Commission, except where such representation or advice directly relates to the conduct of litigation in the courts of the United States or of any state or to a proceeding or investigation being conducted by or before any governmental department or agency other than the Commission; and

Rendering formal or informal advice to any person, whether in the form of a written opinion of counsel or otherwise, expressing an opinion with respect to the legality of any act, transaction, practice or course of conduct under, the nature of any duty, obligation or liability imposed by, or the interpretation of, any provision of the federal securities laws or the rules and regulations promulgated thereunder . . . .<sup>86</sup>

In the *Ezrine* case, an attorney had been automatically suspended from practice before the SEC as the result of having been enjoined in one securities fraud case and convicted of a felony in another case. Instead of contesting the Rule 2(e) proceeding, the attorney sent a letter to the Commission purporting to resign from practice. He nevertheless continued to represent clients before the Commission, including in an adjudicatory proceeding. The SEC then instituted an injunctive action to enjoin him from further violations of Rule 2(e). A preliminary injunction was obtained on the basis of the SEC's "undisputed allegations";<sup>87</sup> a permanent injunction was ob-

<sup>84</sup> 17 C.F.R. § 201.2(g) (1974).

<sup>85</sup> [1972-73 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,594 (S.D.N.Y. 1972).

<sup>86</sup> Final Judgment of Permanent Injunction, Civ. Action No. 3161 (June 11, 1974).

<sup>87</sup> Order of Preliminary Injunction, 72 Civ. Action No. 3161 (S.D.N.Y. Aug. 3, 1972). The

tained on consent. Although obtaining an expanded definition of the concept of practicing securities laws was not necessary to the enforcement objectives of the particular case, the Commission seized the opportunity to try to expand its jurisdiction over attorneys.

To the extent that the Commission is attempting to exercise authority over the rendering of advice under the federal securities laws, whether in connection with a proceeding, investigation or conference, or document filed at the SEC, the Commission would appear to be usurping a judicial prerogative.

### B. *Fallacious Distinctions*

The SEC's notion that an attorney has a responsibility to the Commission and the investing public greater than the attorney's responsibility to his client rests upon a number of fallacious assumptions and distinctions.

#### 1. *Adversary or Advisory*

One of the most significant of the SEC's erroneous premises is that its relation to the securities bar is that of a court instead of an adversary. The SEC has tried to rationalize a compulsion for attorneys to come forward with evidence of corporate fraud by drawing a distinction between an attorney's advisory and adversarial roles.<sup>88</sup> The SEC has suggested that attorneys for corporate clients in the disclosure process or in considering exemptions serve in an advisory capacity and have a responsibility to the public investor,<sup>89</sup> and only in litigation do attorneys serve as adversary to the SEC. Accordingly, only then are they entitled to avail themselves of all legitimate means to protect the interests of the corporate client.<sup>90</sup> This is

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SEC was required to go to court because it does not have inherent power to discipline attorneys.

<sup>88</sup> Commissioner Sommer has stated:

There is a difference between an adviser and an advocate. An advocate deals with the past and he deals with the past conduct of his client when that conduct is questioned in court. On the other hand the lawyer is serving as an advisor in looking to the future.

Sommer, *Lawyers—Where Does Responsibility Fall in Cases of Private Placement?* COM. & FIN'L CHRON. 7 (July 8, 1974).

<sup>89</sup> See Sommer, *supra* note 1.

<sup>90</sup> See Garrett, *Professional Responsibility and the Securities Laws*, Address to State Bar of Texas, July 4, 1974.

a distinction without a difference in a situation where an attorney is representing a client at any stage before a governmental agency which acts as a legislator, prosecutor and judge.<sup>91</sup>

An attorney who advises a client respecting a registration statement must consider the possibilities of a "stop-order"<sup>92</sup> proceeding. An attorney who requests a "no-action" letter must consider the consequences of failing to obtain a letter.<sup>93</sup> The attorney who requests an exemptive order under the Investment Company Act<sup>94</sup> or any other statute must consider what alternatives are open to a client if the order is not forthcoming. Each of these representations involves as adversarial a posture as that of an attorney representing a witness who has been subpoenaed to testify in an SEC investigation. The attorney has a duty to obtain the best possible result for his client, not to assist the SEC in the general administration of the federal securities laws.<sup>95</sup>

The SEC may choose to regulate the securities industry by promulgating new rules or novel legal theories. A client should be entitled to adversarial review of such regulation by a private attorney. The securities bar should not be compelled, under threat of prosecution, to advise clients based upon what the SEC says the law is, as

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<sup>91</sup> See B. SCHWARTZ, AN INTRODUCTION TO AMERICAN ADMINISTRATIVE LAW (2d ed. 1962); cf. Johnson, *The Expanding Responsibilities of Attorneys in Practice Before the SEC*, 25 MERCER L. REV. 637, 642 (1974). The Ash Commission pointed out that although the SEC exercised judicial functions, its "authority most resembles that of a prosecutor" and further, there was a conflict between the agency's adjudicatory role and its "responsibilities to prosecute and formulate policy." President's Advisory Council on Executive Organization 101, 104 (1971).

<sup>92</sup> A stop order issued pursuant to the Securities Act § 8(d), 15 U.S.C. § 77h(d) (1970), suspends the effectiveness of a registration statement. A stop order proceeding is adjudicatory and adversary. However, an order declaring a registration statement effective is also adjudicatory and should not be considered non-adversary merely because it is agreed to by the issuer registrant.

<sup>93</sup> The adversary nature of a "no-action" request was recognized in *Potomac Federal Corp. v. SEC*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,704, *dismissed on other grounds*, ¶ 94,815 (D.D.C. 1974).

<sup>94</sup> The difference between the functioning of a court and the functioning of the SEC in granting an exemption under the Investment Company Act was discussed in *Contran Corp.*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 80,105 (Dec. 24, 1974).

<sup>95</sup> In the SEC investigation, the SEC and not the client decides whether to litigate, so an adversary relationship must be assumed at the moment of first meeting the SEC. *But see* Jennings, *The Corporate Lawyer's Responsibilities and Liabilities in Pending Legal Opinions*, 30 Bus. Law. 73 (Special Issue: March 1975).

opposed to what a lawyer in good faith believes a court may say the law is.<sup>96</sup>

The adversarial role of counsel should not depend upon whether a client is being represented with respect to developing current facts or historical facts. Today's elusive reality is tomorrow's trial record. In dealing with the Government, a client has the right to undivided loyalty from his lawyer from the outset of a retainer.<sup>97</sup>

## 2. *Enforcement or Processing*

The SEC's staff is presently divided into various divisions. In its present organization a distinction is drawn between divisions which are engaged in regulatory functions and divisions which are engaged in enforcement functions. Although these divisions may have a valid administrative basis, there is nothing sacrosanct about them. The responsibilities now handled by the Division of Enforcement and the Division of Market Regulation were once handled by the single Division of Trading and Markets.<sup>98</sup>

The SEC staff is attempting to impose on the securities bar generally its own internal administrative divisions. It is positing the view that attorneys' work can be divided into either enforcement and litigation or interpretation and processing. The business world in which the attorney or his corporate client operates, however, is not similarly divided into neat bureaucratic compartments. The SEC is not entitled to restructure the multifarious securities industry and

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<sup>96</sup> Compare Sommer, *supra* note 1 and Shipman, *The Need For SEC Rules to Govern the Duties and Civil Liabilities Under the Federal Securities Statutes*, 34 OHIO ST. L.J. 231 (1973) with SEC v. Spectrum, Ltd., 489 F.2d 535 (2d Cir. 1973). The reappraisal suggested as to modern roles of an advisor or advocate depends on the client's approach, not the SEC's subsequent view. The role of the private practitioner in curtailing an abuse of authority by a regulatory agency in the agency's interpretation of its powers is extremely important and should be protected. See Smith v. FTC, SRLR No. 296, A-11 (D. Del. 1975) (involving a proper and successful attack on FTC's line of business reporting program).

<sup>97</sup> The SEC's contention that the securities lawyer should not be allowed to look for loopholes like the tax lawyer is improper. An attorney is permitted to show his client how to avail himself fully of business opportunities permitted by law. EC 7-1, 7-2, 7-4. See Johnson, *The Expanding Responsibilities of Attorneys in Practice Before the SEC*, 25 MERCER L. REV. 637, 661 (1974); Paul, *The Lawyer as a Tax Adviser*, 25 ROCKY MT. L. REV. 412, 418 (1953). See also Harper, *To Cooperate With the Service or Not? Obligations and Rights of the Practitioner*, J. TAX. 220 (April 1975).

<sup>98</sup> SEC Securities Act Release No. 5289 (1972). See PLI, *The SEC Speaks Again*, 99-100, 161 (1973).

the multidisciplinary bar to suit its own administrative convenience.

Just as there is no real difference between the roles of the staff attorney and the private practitioner in processing work or SEC investigations, there is little difference between investigations and prosecutions. Although there is a significant distinction between a formal order of investigation and an order for administrative proceedings, in the vast majority of cases the function of the staff attorney conducting the investigation is to obtain the evidence necessary for prosecuting a case.

### 3. *Management or Stockholders*

Two SEC Commissioners recently have defined the corporation to be its shareholders. Commissioner Sommer has expressed the view that a suggested dichotomy between the shareholders and the corporation is "absurd." "As if the corporation is distinguishable from the shareholders. Perhaps the management is, perhaps the directors are, but far more truly than either of those groups the shareholders are the corporation."<sup>99</sup>

Commissioner Pollack, in the course of a panel discussion on professional responsibility, stated that a lawyer's clients are the corporation and the public, not incumbent management.<sup>100</sup> This view of the corporation attorney's client as (present and future) stockholders is both unrealistic and legally invalid.

The CPR provides for representation of the corporate entity, which means neither its stockholders nor its officers.<sup>101</sup> In *Garner v. Wolfenbarger*,<sup>102</sup> communications between a corporation attorney and officers of the corporation were held not to be privileged in a derivative stockholders suit. The court viewed the engagement of counsel as being for the benefit of the stockholders, stating:

Corporate management must manage. It has the duty to do so

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<sup>99</sup> Sommer, "Going Private": A Lesson In Corporate Responsibility, Address to Law Advisory Council, Notre Dame University, reprinted in [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 80,010 (1974).

<sup>100</sup> BNA SEC. REG. & L. REP. No. 277, A-9 (Nov. 13, 1974).

<sup>101</sup> ABA CODE EC 5-18.

<sup>102</sup> 430 F.2d 1093 (5th Cir. 1970), cert. denied, 401 U.S. 974 (1971).

and requires the tools to do so. Part of the managerial task is to seek legal counsel when desirable, and, obviously, management prefers that it confer with counsel without the risk of having the communications revealed at the instance of one or more dissatisfied stockholders. The managerial preference is a rational one, because it is difficult to envision the management of any sizeable corporation pleasing all of its stockholders all of the time, and management desires protection from those who might second-guess or even harass in matters purely of judgment.

But in assessing management assertions of injury to the corporation it must be borne in mind that management does not manage for itself and that the beneficiaries of its action are the stockholders. Conceptualistic phrases describing the corporation as an entity separate from its stockholders are not useful tools of analysis. They serve only to obscure the fact that management has duties which run to the benefit ultimately of the stockholders.<sup>103</sup>

This case may throw into question, but is not necessarily inconsistent with, the traditional view that although a corporation may function for the benefit of its stockholders, it can operate only through its officers and directors. Accordingly, communications between a corporation attorney and the corporation's officers and directors are deemed to be covered by the attorney-client privilege but communications between the attorney and stockholders are not covered. Ordinarily, stockholders cannot bind the corporation.<sup>104</sup>

It has been suggested that we live in an age of the consumer, and accordingly the corporation attorney should be charged with a duty to public stockholders.<sup>105</sup> If the attorney is the guardian of the public interest, an equally good argument could be made that he should put the interests of employees, creditors (who may be security holders), purchasers of the corporations' products, or those concerned for the environment ahead of the interests of management.<sup>106</sup> A more

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<sup>103</sup> *Id.* at 1101.

<sup>104</sup> See Simon, *The Attorney-Client Privilege as Applied to Corporations*, 65 *YALE L. J.* 953, 956-57, 966-69 (1956). See also Sonde, *The Responsibility of Professionals Under the Federal Securities Laws—Some Observations*, 68 *Nw. U.L. REV.* 1, 9 (1973).

<sup>105</sup> See Sommer, *supra* note 1.

<sup>106</sup> See *Corporations Under Attack*, 28 *BUS. LAW.* (Special Issue: March 1973). The SEC's



reasonable view is that the corporation attorney represents those interests which management and the stockholders have in common.

In a recent report by a Bar Association Committee the inadequacy of the traditional view that the corporate entity is the client of the corporation attorney was commented upon. "Management, the board of directors, and shareholders all may have varying and sometimes conflicting interests in the resolution of a particular issue; and each may claim to represent the best interests of the corporation."<sup>107</sup> Nevertheless, it seems clear that the corporation attorney in no way represents the SEC or the general public.

By adoption of articles of incorporation and by-laws and by ratification through proxy machinery and annual meetings the stockholders have elected directors who are able to select management who, in turn, are authorized to employ all agents including lawyers. To require attorneys to represent stockholders directly is to undermine the legal processes by which directors and officers are elected and manage. It is unlikely that the SEC could or would take the position that a principal or majority stockholder is owed a duty by a corporate attorney which transcends the attorney's duty to management.<sup>108</sup>

In certain recent injunctive cases the SEC, by way of consent decree in situations involving particularly egregious facts of fraudulent conduct by management, has had special counsel appointed. It is very unclear what status such special counsel may have or whom such counsel is representing.<sup>109</sup> Because the special

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concern for investors evidences a parochial view of the public interest. On equal employment, environmental and other similar issues, the SEC has taken a very limited view of its responsibility to consumers other than investors. *Id.* at 232. See SEC Securities Act Release No. 5569 (Feb. 11, 1975).

<sup>107</sup> *The Code of Professional Responsibility and the Responsibility of Lawyers Engaged in Securities Law Practice—A Report by the Committee on Counsel Responsibility and Liability*, 30 BUS. LAW. 1289, 1293 (July 1975).

<sup>108</sup> The SEC's view positing a duty beyond elected management would disenfranchise shareholders who vote to retain management and reaffirm agency commitments. It also obviates the lawyer's duty to represent management until he perceives a conflict with shareholders. See Coleman, *The Different Duties of Lawyers and Accountants*, 30 BUS. LAW 91 (Special Issue: March 1975), and fails to consider the identity of the lawyer's duty and the director's duty to represent all shareholders even in cases of cumulative voting. See Panel Discussion, *Lawyers as Directors*, 30 BUS. LAW. 41, 60 (Special Issue: March 1975).

<sup>109</sup> See notes 174-87 *infra* and accompanying text.

counsel is a creation of the SEC, the staff now seems to believe that he represents the ideal corporation attorney. However, in the case of a going concern such independence on the part of counsel would be more harmful than useful. An attorney is not an independent contractor; he is an agent.<sup>110</sup> He does not represent the public interest. He represents a particular client. He is retained by and reports to management.

The class of persons protected by the anti-fraud provisions of the securities acts are purchasers and sellers of securities.<sup>111</sup> However, the corporation attorney owes his primary duty to the corporation as it exists at the time of his representation. Any actual or potential conflict of interest between existing security holders and future purchasers and sellers must be resolved by management against potential investors. The corporation attorney represents a constituency which is different from, although it may include, public investors. Moreover, the corporation attorney owes no special duties to minority or majority stockholders and must give independent advice concerning the rights and liabilities of the corporate entity as a whole.

#### 4. *Private Attorney or Government Attorney*

The government attorney, like the private practitioner, is an officer of the court. The government attorney, like the private practitioner, may therefore sometimes be required to put the demands of justice over the demands of his client or employer. Federal government lawyers, whether they work for the executive branch in an administrative agency or the legislative branch, are subject to the Code of Professional Responsibility of the American Bar Association and whatever local canons of ethics may apply to lawyers in the state in which they were admitted to practice.<sup>112</sup>

The SEC is charged with taking such action as it may find to be in the public interest and for the protection of investors. The SEC staff attorney is likewise a public servant, who frequently must act

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<sup>110</sup> F. MECHEM, AGENCY § 76 (1952).

<sup>111</sup> *Blue Chip Stamps v. Manor Drug Stores*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,200 (June 9, 1975).

<sup>112</sup> Poirier, *The Federal Government Lawyer and Professional Ethics*, 60 A.B.A.J. 1541 (1974).

according to the dictates of his own conscience.

In private practice the client is a definite person or an organization officered by individuals with whom the lawyer deals. The client's interest influences the lawyer's position. Where the client is the Government itself he who represents this vague entity often becomes its conscience, bearing a heavier responsibility than usually encountered by the lawyer.<sup>113</sup>

However, the government attorney does not have a monopoly on deciding what is in the public interest. He is merely an advocate and official in an adversary system and a political process.<sup>114</sup> The client of the federally employed lawyer "is the agency where he is employed including those charged with its administration insofar as they are engaged in the conduct of the public business."<sup>115</sup> The SEC staff attorney customarily and properly takes his direction from the Commission. In terms of professional responsibility, the government attorney's relationship to his supervisors and the SEC is the same as a corporation attorney's relationship to the management and the board of directors of a corporation. Although the federally employed attorney carries a public trust, his client is not the public, but rather his client is the governmental organization of which he is a part.<sup>116</sup>

The notion that a private attorney owes a duty to the public which overrides his duty to his client is alien to the traditions and ethical standards of the legal profession.<sup>117</sup> Similarly, the notion that

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<sup>113</sup> Address by Fahy, *Special Ethical Problems of Counsel for the Government*, reprinted in 33 *FED. B.J.* 331, 335 (1974).

<sup>114</sup> Cf. Panel Discussion: *What is the Public Interest? Who Represents It?*, 26 *ADMIN. L. REV.* 385, 385-88 (1974).

<sup>115</sup> Opinion 73-1 of the Committee on Professional Ethics of the Federal Bar Association, in 32 *FED. B. J.* 71 (1973).

<sup>116</sup> *Id.* In *SEC v. National Student Marketing Corp.*, [1973-74 Transfer Binder] CCH *FED. SEC. L. REP.* ¶ 94,610 (D.D.C. 1974), the SEC claimed the attorney-client privilege in relation to communications between the Commission and staff attorneys. Although the court regarded the claim as one of "dubious relevance," it assumed that a government attorney could assert the attorney-client privilege in a proper case. If, however, private and government attorneys represented the investing public, rather than their corporate or government clients, neither would be entitled to claim the attorney-client privilege. Moreover, the SEC staff attorney would have to communicate to and consult with members of the investing public and the securities industry rather than, or in addition to, the Commission.

<sup>117</sup> See Lipman, *The SEC's Reluctant Police Force: A New Role for Lawyers*, 49 *N.Y.U.L. REV.* 437, 448 (1974).

a government attorney's allegiance is to an abstract ideal, like the investing public, rather than to his employer is contrary to the Federal Ethical Considerations which were adopted for federal government lawyers.<sup>118</sup> Several of these canons are relevant to the topics discussed in this article.

Canon 5 of the CPR requires a lawyer to exercise independent professional judgment on behalf of a client, and further requires the corporation lawyer to be loyal to the entity, not to a stockholder, director, officer, employee, representative, or any other person.<sup>119</sup> For the government attorney, independence means that "his immediate professional responsibility . . . is to the department or agency in which he is employed, to be performed in light of the particular public interest function of the department or agency."<sup>120</sup>

A governmental lawyer, like a private lawyer, is required to represent a client zealously within the bounds of the law.<sup>121</sup> A public prosecutor, however, has the duty to seek justice and not merely to convict.<sup>122</sup> There is no reason why a duty to refrain from the prosecution of unfair cases should not apply to an SEC staff attorney conducting a formal investigation. Further, where an agency is attempting to expand its jurisdiction by bringing novel cases, as the SEC has on occasion been inclined to do, the government attorney has an obligation to consider the constitutional implications of his advocacy. Unfortunately, as one critic has pointed out, the SEC staff attorney has not demonstrated the same readiness to assume that liability for his client's improprieties which the SEC is attempting to impose upon private attorneys.<sup>123</sup>

The only canon of legal ethics which has a different application for the government attorney is the duty to preserve the confidences and secrets of a client.

In respects not applicable to the private practitioner the fed-

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<sup>118</sup> See Poirier, *The Federal Government Lawyer and Professional Ethics*, 60 A.B.A.J. 1541 (1974).

<sup>119</sup> ABA CODE EC 5-18.

<sup>120</sup> ABA CODE EC 5-1.

<sup>121</sup> ABA CODE Canon 7.

<sup>122</sup> ABA CODE EC 7-13.

<sup>123</sup> See Lipman, *The SEC's Reluctant Police Force: A New Role for Lawyers*, 49 N.Y.U.L. REV. 437, 445 n.47 (1974).

eral lawyer is under obligation to the public to assist his department or agency in complying with the Freedom of Information Act, 5 U.S.C. § 552 (1970), and regulations and authoritative decisions thereunder.<sup>124</sup>

### C. *Illusory Sources of SEC Authority*

Even if, as the SEC claims, it has been authorized by common law or by the judiciary or by express statutory authorization to enact substantive standards for attorneys' conduct, current exhortations to the securities bar avoid reference to such recognized sources.<sup>125</sup> Instead, current doctrine seems based on duties which the SEC derives from (1) an extension of its general licensing powers related to direct subjects of regulation, including accountants; or (2) an extension in court cases of the aider-abettor doctrine.

#### 1. *Licensing*

With a few exceptions relating to objective standards such as application forms and minimum financial qualifications, securities laws do not impose substantive licensing standards for entry into the securities industry upon broker-dealers, investment advisors, investment companies or publicly traded companies. Instead, licensing procedures under the securities laws are primarily directed toward adjudicative proceedings designed to suspend or bar persons who are already in the securities industry from further participation. Since 1964 these procedures have been extended to allow the SEC to bring administrative actions against individuals associated with licensees to determine whether the license should be suspended or revoked if the SEC finds that such individuals have committed violations of securities laws.<sup>126</sup>

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<sup>124</sup> ABA CODE EC 4-4.

<sup>125</sup> There are no citations in Garrett's July 4, 1974 address to the State Bar of Texas, but a reference to the hope that to induce professionals to be less cooperative may prevent major frauds. See Sonde, *The Responsibilities of Professionals Under the Federal Securities Laws—Some Observations*, 68 Nw. L. Rev. 1 (1973). But see Lowe and Kripke, *Summary and Conclusions*, 30 Bus. Law. 223, 224 (Special Issue: March 1975).

<sup>126</sup> The provisions of the Exchange Act are illustrative:

(5) The Commission shall, after appropriate notice and opportunity for hearing, by order censure, deny registration to, suspend for a period not exceeding twelve months, or revoke the registration of, any broker or dealer if it finds that

This extension to individuals represents a significant departure from SEC practice prior to the congressional amendments enacted in 1964.<sup>127</sup> To the extent that the SEC has used such authority to proceed against persons not licensed by the agency, its power is greater than the regulatory authority of other agencies. The extension of authority recommended in the Special Study of the Securities Markets and followed in the SEC's position in seeking the 1964 amendments was thought necessary in order to give the Commission effective regulatory powers over individuals such as broker-dealer employees, particularly registered representatives.<sup>128</sup> It should be

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such censure, denial, suspension, or revocation is in the public interest and that such broker or dealer, whether prior or subsequent to becoming such, or any person associated with such broker or dealer, whether prior or subsequent to becoming so associated— . . .

(D) has willfully violated any provision of the [federal securities laws], or of any rule or regulation under any of such statutes.

(E) has willfully aided, abetted, counseled, commanded, induced or procured the violation by any other person of the [federal securities laws] or of any rule or regulation under any of such statutes or has failed reasonably to supervise, with a view to preventing violations of such statutes, rules and regulations, another person who commits such a violation, if such other person is subject to his supervision. . . .

15 U.S.C. § 780(b)(5) (1970).

<sup>127</sup> See SEC Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., Part 5, 52-56 (1963); 2 L. LOSS, *SECURITIES REGULATION* 1314-23 (2d ed. 1961); 5 L. LOSS, *SECURITIES REGULATION* 3379-88 (Supp. 1969); Phillips & Shipman, *An Analysis of the Securities Acts Amendments of 1964*, 1964 DUKE L.J. 706, 812-15; Milton J. Wallace and Joshua L. Becker, SEC Securities Exchange Act of 1934 Release No. 11252 (1975). For a discussion of SEC authority against salesmen prior to 1964, see *Berko v. SEC*, 316 F.2d 137 (2d Cir. 1963).

<sup>128</sup> The Report of Special Study of Securities Markets reviewed the existing statutes, rules and procedures administered by the SEC, and NASD and the New York Stock Exchange for the protection of investors. The Report noted that the SEC could institute administrative proceedings only to revoke a broker-dealer's registration or to suspend or terminate membership in the NASD, but it could not apply intermediate sanctions or proceed directly against a salesman. While the Report found that the NASD rules allowed the NASD to impose a wide range of sanctions directly to an individual salesman, it could not proceed directly against a salesman without involving the firm. 1 SEC Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., Part 5, 52-53 (1963). As a result of the existing statutory scheme the Report found that unscrupulous salesmen are able to participate in improper selling practices and either escape detection or avoid sanctions. Therefore, the Report made the following recommendation to the Congress:

The sanctions now available to the Commission in respect of selling practice and similar violations—revocation of a firm's registration with the Commission, or expulsion from or suspension (for up to 12 months) of membership in an exchange or national securities association—are sometimes unsuitable to the needs of partic-

noted that, unlike the procedure which is allowed by Rule 2(e)(3) for attorneys, the extension of the procedure for revoking licenses of brokers on the basis of aiding and abetting violations of other persons requires a hearing and places the burden of proof upon the SEC. Further, even in the exercise of administrative authority over individuals, the SEC is limited in that its jurisdiction to proceed is initially based on a licensing case and its sanctions are limited to preventing the individual from being associated with a licensed entity, such as a broker or investment company, over whom the SEC has direct regulatory authority.

The amendments to the Exchange Act made by the Securities Reform Act of 1975 would appear to limit the Commission's authority to sanction individuals who are not engaged in the securities business as principals or employees of a licensed entity. The prior jurisdiction of the SEC under Section 15(b)(7) to sanction "any person" has been replaced by the phrase "any person associated, or seeking to become associated with a broker or dealer."<sup>129</sup>

The SEC now proposes to extend its authority from the licensee to the licensee's attorney even though an attorney would not fall within the definition of "associated person" under the Exchange Act.<sup>130</sup> It also seeks to change the duty of the attorney to his clients in SEC matters to a duty comparable to that of the auditor by claiming that the attorney must exercise independence from his clients.<sup>131</sup> The suggestion that the attorney must take into account

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ular cases, especially where the disciplinary action relates to only one or few salesmen or only one of many branch offices of a firm. The Commission should have more flexible powers to deal with the latter type of situation, so that it may invoke measures appropriate for dealing with particular kinds and degrees of misconduct rather than being limited to the choice between no sanction or an excessive or inappropriate one.

*Id.* at 56.

<sup>129</sup> See note 126, *supra*. Such change was effected by Section 11 of the Securities Amendments Act of 1975. Public Law No. 95-29, approved June 4, 1975. The effect of the change on pending cases is under consideration in an administrative proceeding. See Exchange Act Rel. No. 11501 (Sept. 5, 1975).

<sup>130</sup> Securities Exchange Act § 3(a)(18), 15 U.S.C. § 78c(a)(18) (1970).

<sup>131</sup> See Sonde, *Professional Disciplinary Proceedings*; 30 BUS. LAW. 157, 161 (Special Issue: March 1975); Sommer, *supra* note 1; as to whether this independence would or could be prescribed by the SEC even as to accountants see Isbell, *An Overview of Accountants' Duties and Liabilities Under Federal Securities Laws and a Closer Look at Whistle-Blowing*, 35 OHIO ST. L.J. 261 (1974); ALI FED. SEC. CODE § 1503 (Tent. Draft No. 3, 1974).

the interest of the public stockholder is not expressly authorized by Section 19 of the Securities Act and the SEC has not indicated any other statutory or legal bases for the theory that the public qualifies as a third party beneficiary of an attorney's representation.

Better authority indicates that the attorney is not required to represent the public investor to the exclusion of his corporate client. The SEC's analogy of attorneys to auditors is disruptive of the attorney's duty to his client.<sup>132</sup> In issuing opinions addressed to clients, the idea that an attorney must independently investigate and verify facts proposes an obligation inconsistent with the position taken by the American Bar Association. In such opinions, the ABA has concluded that, unless facts supplied by a client are materially incomplete or on their face suspicious or inconsistent, the attorney may rely on facts known to him and may assume on the basis of the facts and the record that the facts related by his client are accurate for the purposes of delivering an opinion.<sup>133</sup>

## 2. *Aiding and Abetting*

The distinctions between the direct liabilities of corporate agents as directors, officers or experts who may be attorneys and the limited responsibility of attorneys working solely as attorneys for such corporate clients was recognized as a part of the holding of the *BarChris* case.<sup>134</sup> These distinctions have been blurred in enforcement cases where the SEC has argued that attorneys should be enjoined from violations of the securities laws, not because their actions violated the securities laws, but rather because the attorney's actions in some fashion aided and abetted another who violated the specific wording of the statute.<sup>135</sup> By borrowing the criminal concept that an aider and abettor is punishable as a principal, the statutory standards for liability are expanded when an injunc-

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<sup>132</sup> See *American Finance, Inc.*, 40 S.E.C. 1043 (1962); Coleman, *The Different Duties of Lawyers and Accountants*, 30 BUS. LAW. 91 (Special Issue: March 1975); Freeman, *Liability of Counsel for Issuer*, 24 BUS. LAW. 639 (1969).

<sup>133</sup> ABA OPINION No. 335 (1974).

<sup>134</sup> *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968). See Sommer, *Professional Responsibility: How Did We Get Here?*, 30 BUS. LAW. 95, 100 (Special Issue: March 1975); Folk, *Civil Liabilities Under The Federal Securities Acts: The BarChris Case*, 55 VA. L. REV. 1 (1969).

<sup>135</sup> See *SEC v. Spectrum, Ltd.*, 489 F.2d 535 (2d Cir. 1973); *SEC v. National Student*



tion names not only the issuer, underwriter, director or office specifically mentioned in the statute (together with their agents, employees and assignees), but also the attorney not named in the statute. By reference to the criminal concept of conspiracy, the staff of the SEC has also argued that proof as to whether attorneys have aided and abetted requires only evidence of participation, even by negligence, in an overt action in furtherance of the primary violation. However, these criminal concepts are inapposite if the courts do not require proof of the attorney's scienter.<sup>136</sup>

Unless an attorney has a pre-existing duty of care which runs to some unforeseeable portion of the investing public, as does the auditor, he should not be held liable, in an SEC enforcement action or civil action by anyone other than his client, for negligence in the performance of his duties. This does not mean that the attorney who becomes a participant in a securities transaction should be entitled to escape liability as an aider and abettor merely because he is an attorney. But, we submit, an agent cannot be held liable for his principal's torts where the agent owed no duty to the injured party. This is precisely the point at which the liability of an accountant and an attorney diverge.<sup>137</sup> By refusing to acknowledge the differ-

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Marketing Corp., [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,610 (D.D.C. 1974); SEC v. Allegheny Beverage Corp., [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,183 (D.D.C. 1973); SEC v. Century Investment Transfer Corp., [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,232 (S.D.N.Y. 1971); see generally Ruder, *Aiding and Abetting*, 7 REV. SEC. REG. 882 (1974). As to defendants who are not attorneys see Brennan v. Midwestern United Life Ins. Co., 417 F.2d 147 (7th Cir. 1969), cert. denied, 397 U.S. 989 (1970); cf. SEC v. Coffey, 493 F.2d 1304 (6th Cir. 1974).

<sup>136</sup> See SEC v. Spectrum, Ltd., 489 F.2d 535, 542 (2d Cir. 1973); United States v. Koenig, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,765 (S.D.N.Y. 1974). Judge Kaufman further confused the holding of *Spectrum* in SEC v. Management Dynamics, Inc., [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,017 (2d Cir. 1975) where he stated:

To be sure, the standards of criminal liability for aiding and abetting are not applicable to SEC enforcement proceedings . . . but to apply *Spectrum* as sanctioning the district court's conclusion here, as the SEC urges, is to distort that holding. In *Spectrum* we ruled that the liability of a lawyer as an aider and abettor was to be measured by the negligence standard generally applicable to SEC injunction actions and the high degree of carelessness present there. . . .

<sup>137</sup> See Hochfelder v. Ernst & Ernst, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,781 (7th Cir. 1974) (accountants' duty under Rule 17a-5 of the Exchange Act); cf. Competitive Associates, Inc. v. Laventhal, Krekstein, Horwath & Horwath, [1974-75 Trans-

ences between the duties of accountants and attorneys, the SEC does a disservice to both professions, and fails to provide the courts with meaningful standards for imposing liability.

By further erosion as to what constitutes acts in furtherance of statutory violations, facts are allowed to control responsibilities. Three examples indicate these extensions. First, the SEC argues if an attorney prepared an issuer's prospectus (even though only the officers, directors and experts are required by statute to sign and file the prospectus), the attorney aids and abets the violation.<sup>138</sup> Second, if an attorney agrees to prepare an opinion for his own client's protection, although no statute or regulation of the SEC requires such an opinion, the attorney aids and abets the violation of others involved in the transaction by making errors relating to the extraneous opinion.<sup>139</sup> Third, an attorney who prepares an opinion addressed to a potential selling shareholder and corrects the opinion four days later may be alleged to have aided and abetted violation of the securities laws in connection with the earlier opinion.<sup>140</sup> In none of these examples drawn from recent SEC enforcement cases was an injunction against the attorney *sine qua non* to establishing the primary violation; that is to say it was not shown that the violation could not be enjoined unless the attorney was enjoined; nor was it shown that the violation could not have occurred absent the attorney's conduct. Carried to its extreme, this factual analysis could be extended to impose liability as an aider and abettor upon anyone who performed acts in furtherance of a securities transaction, such as secretaries, printers, delivery men or even post office employees. If bad facts ordinarily make bad law, bad facts selected by a prosecutor to achieve a desired precedent in the implementation of an enforcement program make even worse law.

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fer Binder] CCH FED. SEC. L. REP. ¶ 95,090 (2d Cir. 1975); *Landy v. FDIC*, 486 F.2d 139 (3d Cir.), *cert. denied*, 416 U.S. 960 (1973).

<sup>138</sup> See *SEC v. Frank*, 388 F.2d 486 (2d Cir. 1968).

<sup>139</sup> See *SEC v. National Student Marketing Corp.*, [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,610 (D.D.C. 1974).

<sup>140</sup> See *SEC v. Spectrum, Ltd.*, 487 F.2d 535 (2d Cir. 1973).

### III. SEC EFFORTS TO OBTAIN AUTHORITY OVER THE SECURITIES BAR

#### A. *Licensing As Representatives of Others*

Although the securities laws do not provide for explicit regulation of lawyers, the SEC's Rules of Practice do regulate the conditions under which any person, including a lawyer, may practice as a representative of others. This regulation, however, cannot, consistent with existing legislation, be extended by the SEC to initial licensing of lawyers. Because the SEC lacks the requisite judicial power and expertise, it should not be extended to lawyers' conduct which occurs outside an SEC adjudicatory proceeding.

Federal administrative agencies, with the exception of the Patent Office, do not have the right to license attorneys for initial practice before them. Federal law provides that

An individual who is a member in good standing of the bar of the highest court of a State may represent a person before an agency or on filing with the agency a written declaration that he is currently qualified . . . and is authorized to represent the particular person in whose behalf he acts.<sup>141</sup>

The purpose of this statute was to eliminate agency-established admission requirements for licensed attorneys.<sup>142</sup>

At the time this statute was enacted in 1965, the Treasury Department had an elaborate admissions procedure for the licensing of attorneys. The Internal Revenue Service was enabled to conduct an investigation into an attorney's background to determine whether he was a person of good character and reputation as well as professional competence.<sup>143</sup> The Treasury Department opposed repeal of such licensing authority on the ground that taxpayers should not "be represented in their dealings with the service by those who are themselves tax cheats or otherwise guilty of unethical conduct." It was pointed out that there was no uniformity of standards among states on admission or disbarment and, in addition, the states did

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<sup>141</sup> 5 U.S.C. § 500(b) (1970).

<sup>142</sup> H.R. Rep. No. 1141, 2 U.S. Code Cong. & Admin. News, 89th Cong., 1st Sess. 4170, 4171 (1965).

<sup>143</sup> *Id.* at 4172.

not have access to important information available to the Department on the undesirability of certain practitioners.<sup>144</sup>

All these arguments were rejected by Congress, which felt that surveillance by state bar associations was a sufficient guarantee of professional integrity.<sup>145</sup> It would seem to follow from this well-considered prohibition against the licensing of attorneys by federal agencies that the SEC has no legislative authority to establish initial professional standards for the securities bar. It is submitted that this prohibition prevents the SEC from judging the competence of securities lawyers, establishing procedures for their practice of law other than in a representative capacity in adjudicatory proceedings, or promulgating legal ethics for securities lawyers.

When Congress gave any attorney in good standing in a state the right to practice federal administrative law, it did not either "authorize or limit the discipline, including disbarment, of individuals who appear in a representative capacity before an agency."<sup>146</sup> This provision helped assure support of the bill by the Department of Justice, which wished to retain an element of control over attorneys and its procedures for disciplining attorneys "on the basis of misconduct observed by Department Boards and Agencies."<sup>147</sup> This legislative history indicates that the SEC's power to discipline attorneys like other agencies may be confined to situations where the attorney has improperly conducted himself in representing clients before the Commission.

Since the SEC's authority to discipline attorneys is an implied power which emanates from the agency's rule-making authority, this power should be narrowly construed. It is a power which is very similar to the power of governmental bodies to punish for contempt.<sup>148</sup> It has been held, however, that the SEC has no inher-

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<sup>144</sup> *Id.* at 4175.

<sup>145</sup> *Id.* at 4173.

<sup>146</sup> 5 U.S.C. § 500(d)(2) (1970).

<sup>147</sup> Letter from Nicholas deB. Katzenbach to Hon. James O. Eastland, June 10, 1963, in 2 U.S. Code Cong. & Admin. News, 89th Cong., 1st Sess. 4178 (1965).

<sup>148</sup> Contempt has been defined as "a disregard of, or disobedience to the rules or orders of a legislative or judicial body or an interruption of its proceedings by disorderly behavior or insolent language in its presence or so near thereto as to disturb its proceedings or to impair the respect due to such a body." 17 C.J. *Contempt* § 1.

ent contempt power, but must resort to enforcement of its processes by the courts.<sup>149</sup> Since the extent of the SEC's authority to discipline attorneys is thus unclear, it should not be assumed as easily as the Commission has assumed it, particularly respecting misconduct occurring otherwise than in the practice of law before the Commission.

In *Camp v. Herzog*,<sup>150</sup> the district court vacated an order of the National Labor Relations Board suspending an attorney. The court held that

. . . the power to control, by admission and disciplinary action, persons who appear before an administrative agency as representatives of the parties at interest is a highly important one, but it is not, as is the case in judicial courts of general jurisdiction, an inherent power, but is one which, if it exists, is given by the legislative authority creating such agency.<sup>151</sup>

In the court's view, the provision of the National Labor Relations Act giving the Board such rule-making authority as may be necessary to carry out the provisions of the Act was sufficient to give the Board power to prescribe rules relating to practice before it. However, the Board had not exercised such rule-making power and, hence, the Board was not empowered to discipline attorneys.

In *Herman v. Dulles*,<sup>152</sup> the right of an agency like the SEC to disbar an attorney from practice before it was upheld by the circuit court. The bases for disbarment were violations of canons of ethics of the American Bar Association. Before the proceeding was initiated, the agency had published rules specifying the qualifications for practice before it. In holding that an agency which had general

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<sup>149</sup> *Shasta Minerals & Chemical Co. v. SEC*, 328 F.2d 285 (10th Cir. 1964). *Accord*, *City of Chicago v. Federal Power Comm'n*, 385 F.2d 629, 642 (D.C. Cir.), *cert. denied*, 390 U.S. 945 (1947). The reason for this holding is that federal agencies have no judicial power under the Constitution. *I.C.C. v. Brimson*, 145 U.S. 447 (1894). Although the power to punish for contempt is a judicial power, Congress has a limited power to punish for contempt which flows from its legislative authority. However, since this is an implied power, it can be used only to punish conduct before the legislative body which threatens its ability to function. *Marshall v. Gordon*, 243 U.S. 521 (1917). It is doubtful that an agency which has neither the power to admit attorneys nor cite them for contempt can have the power to disbar them. *See Mullen v. Confield*, 105 F.2d 47 (D.C. Cir. 1939).

<sup>150</sup> 104 F. Supp. 134 (D.D.C. 1952).

<sup>151</sup> *Id.* at 136.

<sup>152</sup> 205 F.2d 715 (D.C. Cir. 1953).

authority to prescribe its rules of procedure also had authority to set standards for regulating practice before it,<sup>153</sup> the court cited and relied only on the Supreme Court's decision in *Goldsmith v. Board of Tax Appeals*.<sup>154</sup> The *Goldsmith* case, however, involved a petition for a writ of mandamus by a certified public accountant to compel the Board of Tax Appeals to enroll him as an attorney with the right to practice before it. Therefore, the court was not required to consider that special relationship between courts and attorneys which gives the courts general control over a lawyer's professional life.<sup>155</sup> Nevertheless, the Supreme Court did hold that

. . . the character of the work to be done by the Board, the quasi-judicial nature of its duties, the magnitude of the interests to be affected by its decisions, all require that those who represent the tax-payers in the hearings should be persons whose qualities as lawyers or accountants will secure proper service to their clients and to help the Board in the discharge of its important duties.<sup>156</sup>

In *Schwebel v. Orrick*,<sup>157</sup> an attorney disbarred from securities practice by the SEC attacked the Commission's authority to discipline him. The district court held that the SEC had implied authority under its general statutory power to make rules and regulations and to take disciplinary action against attorneys found guilty of unethical or improper professional conduct. Further, the SEC had adequately implemented this authority by adopting the specific provisions of Rule 2(e). The court of appeals never considered the question of whether the SEC had properly exercised its authority, inherent or expressed, to discipline Schwebel. Rather, it affirmed the district court's dismissal because of failure to exhaust administrative remedies. The effect of the 1965 legislation on the SEC and the prior holdings of *Herman v. Dulles* and *Schwebel v. Orrick* has not been considered by any court.

In a pending proceeding before the Federal Communications

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<sup>153</sup> *Id.* at 716.

<sup>154</sup> 270 U.S. 117 (1926).

<sup>155</sup> See *Theard v. United States*, 354 U.S. 278 (1957).

<sup>156</sup> 270 U.S. at 121. It should be noted that the Board of Tax Appeals has neither investigatory nor prosecutorial functions.

<sup>157</sup> 153 F. Supp. 701 (D.D.C. 1957), *aff'd*, 252 F.2d 919 (D.C. Cir.), *cert. denied*, 356 U.S. 927 (1958).

Commission a Bar Association has filed a petition which takes the position that because of the 1965 legislation a federal administrative agency has no jurisdiction or authority to disbar an attorney or to suspend his right to practice before it. Rather, such an agency's jurisdiction to discipline attorneys is limited to the inherent necessary authority to take such remedial action as might be necessary to assure that adjudicatory proceedings are conducted in an orderly and decorous manner.<sup>158</sup>

### B. *Rule 2(e)*

The decisions in which Rule 2(e) was enforced did not discuss either the extent of the SEC's substantive authority over lawyers or the question of constitutional or procedural fairness. In particular, the power to suspend an attorney on the basis of an injunction has several serious constitutional problems, which must be considered in the light of *Kivitz*<sup>159</sup> and *Ferguson*.<sup>160</sup> In these cases, the SEC imposed sanctions pursuant to Rule 2(e) upon attorneys whose conduct occurred not in connection with their appearances before the SEC, their filing of documents with the SEC, or their discharge of any statutory duties under the securities laws but rather in their conduct as attorneys for clients where no appearance before the SEC was required.

In *Kivitz*, the Court of Appeals for the District of Columbia reversed a Commission decision which sought to extend its disciplinary authority to cover conduct not directly related to an attorney's statutory obligation as an expert under the Securities Act. The SEC had suspended Kivitz based on the conclusion that five years earlier he had engaged in unethical and improper conduct in regard to conferences on the preparation of a registration statement. Significantly, the company had filed no registration statement and, therefore, Kivitz had not filed with the SEC a consent to be named as an expert. The Commission had found that Kivitz allowed a non-lawyer to set the terms of the legal fee to be received for the registration statement.

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<sup>158</sup> Petition of FCBA Addressed to FCC Jurisdiction, In the Matter of Benedict P. Cotton, F.C.C. Docket No. 20293.

<sup>159</sup> *In re Kivitz*, SEC Securities Act Release No. 5163 (1971), *rev'd*, 475 F.2d 956 (D.C. Cir. 1973).

<sup>160</sup> *In re Ferguson*, SEC Securities Act Release No. 5523 (1974). *See also* SEC v. The Senex Corp., [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,001 (E.D. Ky. 1975).

The court found suspension had been based upon inferences from hearsay testimony that Kivitz would share his fee with another who would use political influence and employ an accountant willing to stretch a point to expedite the processing of a registration statement. The court observed that the Commission's opinion had characterized the fee arrangements as "misconduct" but refused to accept these inferences as sufficient. The court carefully observed that an attorney's license to practice was a right relating to his general reputation. It refused to accept the characterization of the disbarment from SEC practice as a specialty developed in the administration of a statute delegated to the agency.<sup>161</sup> Moreover, the court declined to accept the Commission's findings with respect to an attorney's conduct as an issue within the particular expertise of the agency so as to compel the court to accept the Commission's findings of fact as conclusive if supported by any substantial evidence. On review of the extension of the SEC's regulation of attorneys' conduct, the court not only reversed the Commission's findings but directed it to dismiss the proceeding.

A somewhat different standard as to attorneys' duties was suggested, although not in the context of a Rule 2(e) case, in *SEC v. Spectrum, Ltd.*,<sup>162</sup> in which the court of appeals reversed and remanded for hearing an injunctive case to the district court. This appellate court accepted with less critical review the SEC's allegations as to an attorney's misconduct and held an attorney could be subject to an injunction for negligent reliance upon factual representations in issuing a legal opinion relating to a proposed sale of unregistered securities. (Presumably, the court was not asked to consider the effect of such an injunction against an attorney pursuant to Rule 2(e)(3)(i), which would authorize the Commission without public hearing to suspend an attorney permanently enjoined from aiding and abetting securities violations.)

The judge below had reviewed conflicting affidavits and noted that there was insufficient evidence that any unregistered stock had been sold on the basis of the attorney's first opinion and that a subsequent legal opinion was issued four days after the opinion which was allegedly negligent.<sup>163</sup> The appellate court deemed

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<sup>161</sup> *SEC v. Csapo*, CCH FED. SEC. L. REP. ¶ 97,746 (D.D.C. 1974).

<sup>162</sup> 489 F.2d 535 (2d Cir. 1973).

<sup>163</sup> *Id.* at 538-39.



this latter opinion ineffectual and extended its application of the aiding and abetting standard to obviate, for purposes of the injunction, the requirements of actual knowledge by the attorney of the improper scheme or intent to further the scheme. It accepted an argument that negligence could be the basis for an injunction against the attorney.<sup>164</sup> Without citing authority or considering the numerous instances in which unregistered securities may be distributed without legal opinions, the court concluded that the preparation of an opinion letter is somehow essential for an exemption for unregistered securities and that the reliance of the public on these opinions is high. No explanation was made of how the public relies on the attorney's opinion when it may have been prepared for and addressed to the benefit of a particular client or the corporation or its transfer agent but not the purchaser or the general public. The court sought to emphasize that the standard of culpability for an attorney on an opinion letter was that of a central participant and not that standard applicable to "more peripheral participants in an illicit scheme."<sup>165</sup>

In *Ferguson*,<sup>166</sup> the SEC instituted, decided and announced a disciplinary sanction against a municipal bond attorney and his firm by the same administrative order. Because the order accepted an offer of settlement which was submitted in advance of any SEC order, the specific charges against respondent Ferguson were not clear. Nevertheless, the SEC censured the attorney and found that he aided and abetted violations of Section 17(a) of the Securities Act and Rule 10b-5 under the Exchange Act.<sup>167</sup> Although the SEC

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<sup>164</sup> This argument had been rejected as a basis for criminal liability in *United States v. Koenig*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,765, at 96,507 (S.D.N.Y. 1974). It has also repeatedly been rejected as a basis for civil liability. In *Jenny v. Hammill & Co. Inc.* [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,021 (S.D.N.Y. 1975), the court stated:

It is settled in this circuit that to state a claim under Section 10b there must be an allegation of facts amounting to scienter, intent to defraud, reckless disregard for the truth or knowing use of a device, scheme or artifice to defraud.

*Cf.*, *Rich v. Touche Ross & Co.*, [Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,084 (S.D.N.Y. 1975).

<sup>165</sup> *SEC v. Spectrum, Ltd.*, 489 F.2d 535, 542 (2d Cir. 1973).

<sup>166</sup> SEC Securities Act Release No. 5523 (1974).

<sup>167</sup> *Id.* The same attorney, however, was not advised of critical material facts by the primary violators. According to the decision in the related case dependence upon the attorney's opinion was unsupported by the evidence and misplaced as a matter of law. *SEC v.*

order must have been premised on a Commission determination that some offeror was the principal violator of those provisions, the offeror was a municipality not subject to an SEC administrative proceeding.

The order described certain undisclosed facts but failed to explain how counsel's conduct aided and abetted violations. In a related court case some of these omissions were held not to be material.<sup>168</sup> It was implied in the SEC order that the attorney's review of the official statement, his pre-existing relationship with the developer on other offerings and other unstated factors which came to his

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The Senex Corp., [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,001 (E.D. Ky. 1975). See also Muth v. Dechert Price & Rhoads, [Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,030 (E.D. Pa. 1975).

<sup>168</sup> [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 96,001 (E.D. Ky. 1975). The SEC order described its findings as follows:

[R]espondent was bond counsel and . . . in addition he assumed principal legal responsibility for reviewing a prospectus (or 'official statement') used in the offer and sale through the mails of \$4,425,000 in City of Covington Health Care Project revenue bonds, issued in 1972 to finance the construction of a nursing home in Covington, Kentucky. It is further found that while acting in this capacity, respondent willfully aided and abetted violations of Section 17(a) of the Securities Act and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder in that:

1. The prospectus failed to disclose that:

- a. Senex Corporation, developer of the project, had entered into a contract with a local contractor to construct the nursing home for a contract price which was \$650,000 less than the price for which it had negotiated and agreed with city officials to construct the facility;
  - b. The purportedly independent consultant who passed on the need for and feasibility of the project had an agreement to share 50 percent of the developer's profits;
  - c. Two feasibility consultants, one of which had been specifically hired to render an opinion about the project had rendered reports bearing unfavorably on the need for such a project;
  - d. The project's financial adviser, which received a fee of \$135,000, was owned and controlled by the developer;
  - e. An independent securities dealer could not be found to underwrite the bonds; and
  - f. The financial adviser caused itself to be appointed underwriter for the issue.
2. Because of his review of the prospectus, his pre-existing relationship with the developer on other offerings of municipal bonds, and other factors which had come to his attention, respondent should have known, if he did not know, that the prospectus omitted material facts.

The District Court decision held the failure to disclose the information described in paragraphs b, c, d, e and f was fraudulent but that the item in paragraph a was not material.

*Id.* at 97,461.

attention should have alerted him to the omission of material information. But the order does not find that the attorney had a duty to review the official statement nor does it seek to define which portions bond attorneys must generally review. Rather, it states that he "assumed principal legal responsibility." The allegations of omissions in the complaint referred to shed no light on these matters. That the attorney consented to a sanction and the imposition of certain compliance procedures on his firm would not cure the SEC's apparent lack of subject matter jurisdiction. Municipal securities are exempt from registration and an official statement is not required to be filed with the SEC by state or federal law.<sup>169</sup> The order endorses responsibilities which are not imposed as a matter of state law upon bond counsel who issue opinions on municipal securities.

*Ferguson* includes a finding with respect to a related complaint for an injunction against sellers of such securities, but unlike *Spectrum* the attorney was not a party to that injunction so that no findings could have been used against him if the proceeding had been brought under paragraph (3) of Rule 2(e). In regard to the omission, the attorney in *Ferguson* was neither an expert, director nor an officer of the municipal issuer or the development company. Presumably, this is a further extension of the contention by the staff of the SEC that disbarment proceedings are appropriate against an attorney who aids and abets another's alleged violation, as yet unproven in court, but who is unnecessary to the relief sought in the injunctive action.

Moreover, the imposition of the unique sanctions in *Ferguson* raise several questions. Unlike the injunctive actions in several earlier cases against attorneys, the *Ferguson* case is a proceeding against an individual attorney, although some matters relate to his entire firm. The five mitigating conditions which were set out in the SEC's order require, as to municipal bonds, maintaining specific records as to due diligence, attending educational lectures, employing letters of representation, maintaining standards of review, and insisting on certified financial statements. These procedures appear to involve substantive standards for practice not imposed on SEC filings, not required to deliver a typical municipal opinion

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<sup>169</sup> 15 U.S.C. § 77c(a)(2) (1970).

as to tax exemption and not related to comparable remedies by state bar association committees. These undertakings resemble compliance procedures which the SEC has required of brokers and dealers over whom it has direct licensing authority. Also, the specific sanction of censure is not mentioned in Rule 2(e).

Such procedures affect the independence of securities attorneys from the SEC. To preserve their right to defend clients with total loyalty, it is imperative that attorneys remain independent of the federal government and not their clients. To the extent that substantive standards and compliance procedures may be necessary for attorneys, it would be more appropriate if such standards and their enforcement were carried out by the states and the traditional committees empowered by the judiciary in each state for the regulation of attorneys.

The Supreme Court has pointed out that although disciplinary proceedings against attorneys are designed to protect the public, they are nevertheless a punishment or penalty imposed on the lawyer. Accordingly, the proceedings are not only adversary but of a "quasi-criminal nature."<sup>170</sup> Since the SEC is invested with prosecutorial functions, it should not be permitted to institute quasi-criminal proceedings against the attorneys for those corporations and individuals it regulates. The potential for abuse of power is real and should be more obvious to the Commission than it apparently is. Justice may be too easily corrupted if the prosecutor can punish his vigorous adversaries by initiating disciplinary proceedings against them.

If the reasoning in *Spectrum* is followed, the SEC will be allowed to enjoin an attorney for aiding and abetting an uncompleted transaction and thereafter suspend the attorney without any hearing on the basis of the injunction. Further, *Spectrum* and *Ferguson* would seem to give the SEC authority to regulate the procedures by which attorneys render legal opinions on securities matters. However, a direct proceeding pursuant to Rule 2(e) relating to an attorney's ethical or professional conduct would, under the *Kivitz* case, have been beyond the administrative expertise of the Commission. The SEC would thus accomplish indirectly what it cannot do directly.

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<sup>170</sup> *In re Ruffalo*, 390 U.S. 544 (1968).

Since *Spectrum* and *Kivitz* were decided by different courts, the cases need not be reconcilable. The approach of the District of Columbia Circuit Court in *Kivitz* suggests it might have followed the reasoning of the district rather than the circuit court in *Spectrum*.

### C. Court Implementation

In seeking to establish its policy of changing professional standards, the staff of the SEC has elected not to comment publicly on existing standards imposed on attorneys by the judiciary within each state or the national bar associations but instead has sought to obtain on a case by case basis court implementation of its views on professional responsibility. This tendency is reflected in actions for an injunction against many defendants where some defendants are subject directly to statutory prescriptions (e.g., issuer, underwriter, seller or reporting company) and other individual defendants are named in multiple counts as having assisted the primary violator. The individual defendants are sought to be enjoined from aiding, abetting, counseling and commanding the primary violators. This is a departure from the traditional complaint where a corporation or other legal entity is named defendant and the SEC has sought an injunction against primary violators and their officers, agents, servants, employees, attorneys and those persons in active concert or participation with them.<sup>171</sup> Accordingly, if the complaint were confined to the primary violator and the court were to grant specific injunctive relief, there would be no practical reason to extend the injunction to named officers, directors, attorneys and other professionals. The contempt power of the court to enforce the injunction could not be seriously questioned by any individual receiving notice and acting in the capacity of an officer, agent or employee of the corporate entity.

In practice, however, the SEC uses injunctive actions for punitive and not merely remedial and equitable objectives, and obtains indirect consequences which are not a direct result of the equitable relief sought in injunctions.<sup>172</sup> As pointed out above, the SEC can use an

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<sup>171</sup> Rule 65(d), Fed. R. Civ. P.

<sup>172</sup> The standard relief paragraph of an SEC complaint for an injunction requests a court order that the primary defendants and "their officers, directors, subsidiaries, affiliates, agents, servants, employees, attorneys, successors and assigns, and each of them and those

injunction against an attorney summarily to disbar the attorney from practice before the Commission. The courts have not focused upon the inappropriateness of relaxing standards of proof to grant the SEC an injunction in a case like *Spectrum*, on the ground that the injunctive action is remedial, when the Commission then uses the injunction as the basis for a quasi-criminal proceeding. Further, in particular actions seeking injunctions in recent years the staff of the SEC has sought to extend its proposals relating to professional responsibility into new areas involving ancillary relief requested of courts of equity.<sup>173</sup> Most important to the securities attorney are the cases involving the appointment of special counsel for a corporate defendant. In administering such ancillary relief, the equity courts have not had the benefit of judicial experience afforded by common law precedent nor have they had the benefit of legislative history or statutory construction afforded by specific statutory remedies.

The duties of special counsel, if any, apart from those imposed upon a lawyer by common law, state judiciary committees, or the canons of ethics, have not been requested or set forth in court orders.<sup>174</sup> Moreover, assuming special counsel were able to define its

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persons acting in concert or participation with them" be enjoined. See 30 BUS. LAW 135 (Special Issue: March 1975) (summary of consequences of SEC injunctions). For an instance where a court declined to extend injunctions against agent-employees to cover the principal-employer, although the SEC urged respondeat superior liability, see *SEC v. Sorg Printing Co.*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 96,034 (S.D.N.Y. 1975); compare *SEC v. Management Dynamics*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,017 (2d Cir. 1975). The SEC apparently made an effort to have legislation enacted which would clearly deprive the courts of their historic equity discretion to issue or deny injunctive requests. See Letter from Five Securities Lawyers to Conferees on Proposed Change of '34 Act § 21(e) 302, reprinted in BNA SEC. REG. & L. REP. No. H-1 (May 14, 1975).

<sup>173</sup> *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082 (2d Cir. 1972) (disgorgement of profits); *SEC v. Coastal States Gas Corp.*, SEC Litigation Release No. 6054 (S.D. Tex. 1973) (removing or replacing directors); *SEC v. Westgate-California Corp.*, SEC Litigation Release No. 6142 (S.D. Cal. 1972) (appointment of a receiver without insolvency). The arguments advanced for these ancillary remedies rely primarily on implied court powers to fashion and supervise their administration after the related injunction is entered.

<sup>174</sup> The order appointing special counsel in *SEC v. Westgate-California Corp.*, SEC Litigation Release No. 6142 (S.D. Cal. 1972), reads in pertinent part as follows:

This court shall appoint a Special Counsel satisfactory to the Board of Directors of WESTGATE and the plaintiff Commission. The Special Counsel . . . shall not be liable for any action taken or omitted to be taken by him or for any error in judgment made in good faith by him in his capacity as Special Counsel unless it shall be proved that he was grossly negligent in connection with such action, omis-

particular duties, the injunctions have not identified the particular client owed such duties and have left important questions unanswered. For example, if, as the SEC claims, the special counsel like other attorneys owes a duty to shareholders, what is the effect of the preference of the majority of such shareholders by proxy to retain prior counsel or to discharge special counsel? What is the duty of special counsel with respect to annual meetings of shareholders and the proxy soliciting authority? What are the relationships between prior counsel selected by management and special counsel in the event prior management seeks to continue to function? What is the effect on subsequent corporate decisions of the provisions in the injunction which require SEC approval before special counsel can be selected? What is the effect of selection of special counsel on pending class actions where at least a portion of the shareholders are represented by different attorneys? In the event of a simultaneous or subsequent receivership and the appointment of a trustee under traditional equitable or bankruptcy powers, does counsel for the trustee supplant or replace special counsel?

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sion, or judgment; . . . The Special Counsel, under the supervision of the Board of Directors of WESTGATE, shall have the power and be directed to: a. conduct a full investigation into the previous financial and other affairs of WESTGATE and shall submit a report to the Board of Directors of WESTGATE, this Court and plaintiff Commission of his findings and recommendation for action. . . . b. take all appropriate action with respect to the previous financial affairs of WESTGATE and any other matters as the Board of Directors of WESTGATE and this Court may direct, including, but not limited to, the institution and prosecution of suits on behalf of WESTGATE to recover all assets or monies improperly used, taken, wasted, misappropriated, dispensed, obligated or paid to anyone (i) without appropriate authorization, approval or ratification of the Board of Directors of WESTGATE or (ii) in breach of duties owed to defendant WESTGATE or its subsidiaries by present or former officers, directors or employees of WESTGATE or any other person. The Special Counsel may consult with the Board of Directors of WESTGATE and this Court in the resolution of all claims WESTGATE may have. He shall neither decline to pursue any claim . . . c. pending the investigation by the Special Counsel, he shall, subject to the approval of the Board of Directors of WESTGATE, take immediate necessary or appropriate action to protect WESTGATE's claims, interests, and rights and pursue all possible claims against the defendants herein or any persons, . . . ; and d. take such further action, subject to the approval of this Court, as may be necessary or appropriate for the protection of the shareholders of WESTGATE.

The SEC's authority to obtain ancillary relief of this kind has been criticized as "an unwarranted and presently unjustified extension of the SEC's power over corporations." Comment, *Equitable Remedies in SEC Enforcement Actions*, 123 U. Pa. L. Rev. 1188, 1210 (1975).

To date these questions have been dealt with on the basis of a court of equity retaining jurisdiction over the SEC complaint so that court permission under expanded equitable principles can be sought by concerned parties. The number of questions raised by the ancillary remedy of special counsel indicates the widespread effect of this new theory upon the attorneys who serve as counsel for prior management, counsel for the primary defendant or even as special counsel. They indicate that the novelty of the relief may be proceeding far ahead of the courts' ability to define what standards shall be applicable to attorneys' conduct.

#### IV. ROLE OF ATTORNEY IN SEC PROCESSING

The SEC's pronouncements on an attorney's responsibility rests upon a misconception of his work on registration statements. This was stated in *Fields*:<sup>175</sup>

Very little of a securities lawyer's work is adversary in character. He doesn't work in a court room where the pressure of vigilant adversaries and alert judges checks him. He works in his office where he prepares prospectuses, proxy statements, opinions of counsel, and other documents that we, our staff, the financial committee, and the investing public must take on faith.<sup>176</sup>

This characterization was adopted by SEC Commissioner Sommer in a subsequent speech to the Bar.<sup>177</sup> As a practical matter, work as counsel for an issuer or counsel for an underwriter involves a series of decisions which are adversary. For example, counsel to the issuer has been required by the instructions of his client and case law to interpret, at his risk, the exemptions from registration. If an exemption is not available, the negotiations in connection with the preparation of a registration statement are frequently adversary. The review of exhibits and closing papers for the client's protection frequently takes counsel far from his office as a matter of risk as well as geography. Even items of routine corporate practice such as annual reports, proxy statements, press releases and minutes of Board

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<sup>175</sup> See *In re Emanuel Fields*, SEC Securities Act Release No. 5404 (1973), [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 79,407 (1973).

<sup>176</sup> *Id.* at 83,174-75 n.20.

<sup>177</sup> Sommer, *supra* note 1.



meetings frequently involve the attorney in work where the interests and even the directions of his client are contrary to those of other persons, including the SEC. Recent cases on attorneys' liability demonstrate that such interests require careful and adversary construction not only of the securities laws but also of corporate law and evidence.<sup>178</sup> The attorney for a registered broker-dealer or investment company is particularly involved in giving advice where adversary consequences must be evaluated.<sup>179</sup> In addition to reviewing reports and documents for the SEC, such counsel may review market letters, negotiate for private placements and defend claims by customers. The counseling of banks, lending agencies and transfer agents involves the securities attorney in similar adversary problems. In each of these practical circumstances the attorney must assess the developing facts and documents with a careful view toward claims which could be made against his client by numerous vigilant adversaries, including the SEC.

A review of the instances in which attorneys have found themselves the subjects of enforcement actions demonstrates the need for vigilance from the beginning of any securities transaction through any filing with the SEC and even after filing. The attorney in *Kivitz* was charged with conduct that originated in preliminary discussions as to representing a client.<sup>180</sup> In *SEC v. Everest*,<sup>181</sup> an attorney was charged in connection with a transaction which was never consummated and which, if consummated, would have required no communication with the SEC. In *SEC v. Spectrum* the attorney was involved in the preparation of an opinion which may never have been used and which may have been corrected four days later.<sup>182</sup> Charges

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<sup>178</sup> See *SEC v. Mattell, Inc.*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,754 (D.D.C. 1974); *SEC v. Clinton Oil Co.*, SEC Litigation Release Nos. 5715 and 5798 (D. Kan. 1973); *In re Kivitz*, SEC Securities Act Release No. 5163 (1971).

<sup>179</sup> The provisions of §§ 15(b)(5)(E)(i) and (ii), 15 U.S.C. §§ 78o(b)(5)(E)(i) and (ii) have special relevance in this regard because compliance counsel is generally an employee. He must elect whether to defend his employer on the grounds of having established and applied a reasonable supervisory system or having no liability for employees' violations under a theory of respondeat superior. His involvement as an associated person under § 3(a)(18), 15 U.S.C. § 78c(a)(18) (1970) must also be considered if he has any duty to report the violations of his employer-client to the SEC. See *In re Cabel*, SEC Securities Exchange Act Release No. 9362 (1971); *In re Slater*, SEC Securities Exchange Act of 1934 Release No. 8830 (1970).

<sup>180</sup> *In re Kivitz*, SEC Securities Act Release No. 5163 (1971).

<sup>181</sup> SEC Litigation Release No. 5209 (S.D.N.Y. 1971).

<sup>182</sup> 489 F.2d 535 (2d Cir. 1973).

by the Department of Justice in *United States v. Mitchell* concerning practice before the SEC arose from activities in which there was never any allegation or proof of an attorney-client relationship.<sup>183</sup> In *SEC v. Frank*, the attorney's activities involved a technical, non-legal description of a chemical process.<sup>184</sup> The attorneys involved in *SEC v. National Student Marketing* are charged with activities relating principally to the use of a letter which the SEC and statutes did not require to be filed and which, presumably, had been insisted on as a special precaution by the attorneys.<sup>185</sup> In both *Feit*<sup>186</sup> and *SEC v. National Student Marketing*, the underlying transaction involved an exchange offer in which adversary parties were represented by separate counsel. Illustrative of a development which occurred after filing with the SEC is the case of *SEC v. Manor Nursing*.<sup>187</sup>

These sad experiences require an attorney during each stage of the process of representation to be concerned not only with the consequences to his client, but also, in light of the expansion of Rule 2(e) and the doctrine of aiding and abetting, with his own involvement and possible liability. The extensive authority of the SEC to investigate pursuant to Sections 8 and 20 of the Securities Act and Section 21(a) of the Exchange Act requires attorneys to analyze every securities transaction as a potential subject of investigation.

If, as the SEC has suggested, the attorney must act more like an auditor, the attorney would have to notify his client at the beginning of representation that the client must choose between instructing the attorney to act as an advocate or as an independent auditor. Carried to its extreme, the attorney-auditor would be precluded from representing a client who instructed him to test adversarially the constitutionality or fairness of a securities statute, an SEC rule or a court interpretation.

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<sup>183</sup> 372 F. Supp. 1239 (S.D.N.Y. 1973).

<sup>184</sup> 388 F.2d 486 (2d Cir. 1968).

<sup>185</sup> [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,610 (D.D.C. 1974).

<sup>186</sup> *Feit v. Leasco Data Processing Equipment Corp.*, 332 F. Supp. 544 (E.D.N.Y. 1971).

<sup>187</sup> 458 F.2d 1082 (2d Cir. 1972).

## V. ROLE OF THE ATTORNEY IN SEC INVESTIGATIONS

### A. Rules Relating to Investigations

A witness in an SEC investigation is not constitutionally entitled to all of the procedural safeguards guaranteed in a hearing,<sup>188</sup> because an investigation is a fact-finding rather than adjudicative proceeding.<sup>189</sup> Such an inquiry may be but rarely is used as an aid to the agency's legislative or judicial functions. Its purpose is to inform and report, and it has frequently been analogized to, although it significantly differs from, a grand jury investigation.<sup>190</sup> The SEC may conduct formal investigations pursuant to Commission Order<sup>191</sup> whenever it appears that the statutes it administers have been or are about to be violated. The purpose is to ascertain whether information in the Commission's possession tending to show a violation is accurate, and if so, whether the facts justify the institution of administrative or injunctive proceedings.<sup>192</sup>

<sup>188</sup> See *Hannah v. Larche*, 363 U.S. 420 (1960); *In re Groban*, 352 U.S. 330 (1957); *United States v. Steel*, 238 F. Supp. 575 (S.D.N.Y. 1965); *SEC v. Torr*, 15 F. Supp. 144 (S.D.N.Y. 1936). See generally Mathews, *Witnesses in SEC Investigations*, 3 REV. SEC. REG., No. 9 (1970).

<sup>189</sup> The classic distinction between rule-making and adjudication is that between government functions which historically were legislative and those which historically were judicial. It has been suggested that a more useful distinction would be between proceedings having general applicability and future effect and those which do not. See *The 12 ABA Recommendations for Improved Procedures for Federal Agencies*, 24 ADMIN. L. REV. 389, 389-91 (1972). Rule 1 of the SEC's Rules Relating to Investigations states that the rules "do not apply to adjudicative or rule making proceedings." 17 C.F.R. § 203.1 (1974).

<sup>190</sup> See *Jenkins v. McKeithen*, 395 U.S. 411, 430 (1969); *Hannah v. Larche*, 363 U.S. 420, 449 (1960); *United States v. Morton Salt Co.*, 338 U.S. 632, 642 (1950); *Consolidated Mines v. SEC*, 97 F.2d 704, 708 (9th Cir. 1938).

<sup>191</sup> Formal investigations are conducted pursuant to Sections 19(b) and 20(a) of the Securities Act, and Section 21(b) of the Exchange Act. 15 U.S.C. §§ 77s(b), 77t(a), 78u(a), (b) (1970). Comparable provisions are contained in Sections 209(a) and (b) of the Investment Advisers Act of 1940 and Sections 42(a) and (b) of the Investment Company Act of 1940. 15 U.S.C. §§ 80b-9, 80a-41 (1970).

<sup>192</sup> See *Mines and Metals Corp. v. SEC*, 200 F.2d 317, 321 (9th Cir. 1952); *Consolidated Mines v. SEC*, 97 F.2d 704 (9th Cir. 1938). In *White, Weld & Co.*, 1 S.E.C. 574, 575 (1936), the Commission described an investigation as "a preliminary inquiry conducted by the Commission to enable it to determine whether grounds exist for the institution of formal proceedings against the respondents. It is not a hearing. It is not in any sense an adversary proceeding. There are no parties. There are no issues." See also *Woolley v. United States*, 97 F.2d 258 (9th Cir. 1938); *In re Securities and Exchange Commission*, 84 F.2d 316, 317 (2d Cir. 1936). The decision to institute an investigation is discretionary with the Commission. *Crooker v. SEC*, 161 F.2d 944 (1st Cir. 1947). But see *National Resources Defense Council, Inc. v. SEC*, CCH FED. SEC. L. REP. ¶ 94,910 (D.D.C. 1974).

The right of a witness subpoenaed to testify in an SEC investigation to be represented by counsel is not constitutionally guaranteed,<sup>193</sup> but is established by Section 6(a) of the Administrative Procedure Act ("APA"), which provides: "A person compelled to appear in person before an agency or representative thereof is entitled to be accompanied, represented, and advised by counsel . . . ."<sup>194</sup> The right to counsel is also guaranteed to witnesses in SEC investigations by Rule 7(b) of the SEC's Rules Relating to Investigations, which provides:

Any person compelled to appear, or who appears by request or permission of the Commission, in person at a formal investigative proceeding may be accompanied, represented and advised by counsel, as defined . . . in Rule 2(b) of the Commission's Rules of Practice . . . .<sup>195</sup>

The SEC's Division of Enforcement has acknowledged that an unfair denial by the staff of a witness' right to counsel of his choice might constitute a denial of due process under the Constitution.<sup>196</sup>

The role of the private attorney in SEC investigations is recognized by the Commission as adversary.<sup>197</sup> However, if the essential nature of an investigation were indeed fact-finding, rather than adversarial, for purposes of the Constitution and the APA, the role of the government attorney should be no more adversarial than his role in processing a registration statement. By the same token, if the role of the private attorney in an investigation is truly adversary, it should be no less adversary in a licensing proceeding, which is what the registration process is. Indeed, under the APA it is probably

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<sup>193</sup> See *Boruski v. SEC*, 340 F.2d 991 (2d Cir.), *cert. denied*, 381 U.S. 917 (1965); *United States v. Steel*, 238 F. Supp. 575 (1965).

<sup>194</sup> 5 U.S.C. § 555(b) (1970). Although there is some authority to the contrary, *Hannah v. Larche*, 363 U.S. 420, 445-46 (1959), *F.C.C. v. Schreiber*, 329 F.2d 517, 525-26 (9th Cir. 1964), the better view is that Section 6(a) applies to agency investigations. K. DAVIS, *ADMINISTRATIVE LAW* 381 (1970 Supp.); Administrative Conference of the U.S. Report, S. Doc. No. 24, 88th Cong., 1st Sess. 223, 229-30 (1963). See *SEC v. Higashi*, 359 F.2d 550 (9th Cir. 1966); *Backer v. Commissioner*, 275 F.2d 141 (5th Cir. 1960); *Wanderer v. Kaplan*, Trade Cas. 77159 (D.D.C. 1962).

<sup>195</sup> 17 C.F.R. § 203.7(b) (1974).

<sup>196</sup> See *Merrill, Lynch, Pierce, Fenner & Smith, Inc.* [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 79,608 (1972).

<sup>197</sup> *Sommer, The Commission and the Bar: Forty Good Years*, 30 BUS. LAWYER 5, 10 (1974).

easier to argue that the Commission's order which declares a registration statement effective is adjudicatory, and therefore the registrant's attorney and the SEC attorney are clearly functioning as adversaries.<sup>198</sup>

Under the new SEC policy the dilemma of the private practitioner *cum* public auditor is apparent to any securities lawyer who has received an inquiry for information about a client's securities action.<sup>199</sup> He is confronted with having to act in any or all of three roles: (1) as the lawyer for the client at the time of the transaction ("transaction-attorney"); (2) as the lawyer called by the SEC to testify ("witness-attorney"); or, (3) as the lawyer who will represent the company in any SEC investigation ("defense-attorney"). The transaction-attorney must consider whether he and his client should take the same legal position at the time of the SEC inquiry as they did at the time of the transaction, confronting all the problems which hindsight brings to previous transactions. The witness-attorney must consider such critical issues as whether to testify, whether to obtain waiver of privileges as to evidence, and whether to retain separate counsel. Later, he may have to face whether and in what manner he submits a memorandum to the SEC to counteract a staff recommendation and to explain why he should not be named in an enforcement proceeding.<sup>200</sup> In answering these particular questions, the witness-attorney should be aware of the SEC's new views on attorney responsibility, because he is not entitled to see the staff memorandum. The defense-attorney should be aware of the positions to be taken by the attorneys in their other roles. The attorney's dilemma is confounded by the SEC's notion that an attorney is not an adversary until a formal investigation is commenced against him or his client.

The reason that SEC investigations are more readily recognized as adversarial than are registration procedures is that the SEC enforcement attorney customarily views his work as prosecutorial. He is seeking admissions and other evidence for purposes of recom-

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<sup>198</sup> See *American Airlines, Inc. v. CAB*, 359 F.2d 624 (D.C. Cir. 1966); *The Wolf Corp. v. SEC*, 317 F.2d 139 (D.C. Cir. 1963); 1 K. DAVIS, *ADMINISTRATIVE LAW* § 65.02 (1958).

<sup>199</sup> See *SEC v. National Student Marketing Corp.* CCH FED. SEC. L. REP. ¶ 95,011 (D.D.C. 1975).

<sup>200</sup> See notes 241-49 *infra* and accompanying text.

mending the institution of proceedings by the Commission and subsequently proving the charges brought.<sup>201</sup> Our argument that an investigation is no more adversary than a registration is intended to point out the difficulties of subjecting an attorney representing a client in either type of proceeding to a different standard of duty to either his client or the SEC. We would not deny the adversarial qualities of a staff investigation. The facts discovered in an investigation may constitute the primary evidence in a subsequent disciplinary or court proceeding. Often, the investigation is utilized by the SEC prosecutor as a discovery tool not available to the defending attorney.

Indeed, as an investigator and prosecutor, the SEC staff attorney is a tough opponent who may exhibit far more concern with winning his cases or helping shareholder suits than protecting the public interest. There are three areas where the Commission's staff is particularly vulnerable to criticism in the conduct of its investigations. These are its utilization of its sequestration rule, its attitude toward the Fifth Amendment and its refusal to permit discovery except under compulsion.

### B. *Sequestration*

One of the more obscure areas in which the SEC staff has been attempting to impose its views as to the new duties of attorneys is in the administration of its sequestration rule. This rule provides that

. . . all witnesses shall be sequestered, and unless permitted in the discretion of the officer conducting the investigation, no witness or the counsel accompanying any such witness, shall be permitted to be present during the examination of any of the witnesses called in such proceeding.<sup>202</sup>

Prior to 1960, the Commission's Rules of Practice provided that where a witness in an investigation was represented by counsel

. . . such counsel may not represent any other witness or any .

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<sup>201</sup> See *SEC v. Grinnell F. Oliver & Co.*, 1 S.E.C. 204 (D.C. Ill. 1936); SEC Minute, [1970-71 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,905.

<sup>202</sup> 17 C.F.R. § 203.7(b) (1974). This is the same rule which gives witnesses the right to be represented by counsel. See note 194 *supra* and accompanying text.

person being investigated unless permitted in the discretion of the officer conducting the investigation or of the Commission upon being satisfied that there is no conflict of interest in such representation and that the presence of identical counsel for other witnesses or persons being investigated did not intend to hinder the course of the investigation.<sup>203</sup>

The reason for the change was not explained either in the release promulgating the rule,<sup>204</sup> or in the subsequent release in which the Commission separated its Rules Relating to Investigations from its Rules of Practice and set forth the sequestration rule in its present form.<sup>205</sup> The SEC's present sequestration rule contains no standard by which the discretion of the investigating officer can be exercised in deciding whether to exclude counsel from representing a witness.

The purpose of the SEC's sequestration rule is to facilitate investigations and prosecutions, not to protect the rights of witnesses. In one case the court justified the necessity and general propriety of the sequestration rule as follows:

. . . The Commission points out that violations of Federal Securities laws are often difficult to detect and require extensive investigation; that it may be necessary to determine whether or not individuals are acting in concert; that investigations frequently are sought to be frustrated by non-cooperation and even subornation of perjury; that the purpose of sequestration could be defeated by an attorney advising witnesses as to the testimony which had been given by others.<sup>206</sup>

Consequently, the SEC's enforcement of its sequestration rule has at times collided with witnesses' right to counsel.

In *SEC v. Higashi*,<sup>207</sup> the SEC sought to enforce a subpoena upon a director of a corporation who wished to be represented by a corporation's attorney who had previously appeared as counsel for other witnesses in the investigation. The Commission's request for an

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<sup>203</sup> Former Rule 3(c) of the Commission's Rules of Practice.

<sup>204</sup> SEC Securities Act Release No. 4242 (1960).

<sup>205</sup> SEC Securities Act Release No. 4677 (1964).

<sup>206</sup> *SEC v. Higashi*, 359 F.2d 550, 552 (9th Cir. 1966).

<sup>207</sup> *Id.*

order enforcing the subpoena was granted on the condition that corporate counsel be permitted to represent the director. The court held that the right to counsel was granted to witnesses in SEC investigations by the APA and that right entitled witnesses to counsel of their choice. This right was infringed by the SEC's attempt to sequester the corporation's attorney. In so holding, the court pointed out that a director may himself be liable for the acts of the corporation and, accordingly, the corporation and the director have interests that may be common. Sequestration of corporation counsel deprived the director of the services of the attorney most familiar with the source of his vulnerability and prejudiced the witness' rights. The court exhibited a sensitivity to the additional cost which would have to be borne if independent counsel were retained and the relationship between such costs and the right to counsel conferred by the APA.

An earlier opinion, *United States v. Steel*,<sup>208</sup> upheld the SEC's use of its sequestration rule to prevent one attorney from representing both a corporation whose affairs were under investigation and a former officer of the corporation. The case arose on a motion to dismiss an indictment against the officer. After the corporation's attorney had been sequestered, the officer appeared to testify in an SEC investigation without counsel. She thereafter claimed that her right to counsel had been infringed. The court held that she had no constitutional right to counsel under the circumstances, and that even if she had a right to counsel, under the APA the SEC could impose reasonable limitations on the selection of counsel. It is interesting to consider whether the same result would have obtained if the questions presented had been in the context of an SEC subpoena enforcement proceeding.

In the recent case of *SEC v. Csapo*,<sup>209</sup> a subpoena enforcement proceeding, the court held that the SEC could not sequester corporation counsel to stop him from representing an officer of the corporation where the counsel had represented a number of other persons involved in the staff's investigation. The Commission argued there was an opportunity for a substantial possibility of frustration of the Commission's investigatory processes flowing from such representa-

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<sup>208</sup> 238 F. Supp. 575 (S.D.N.Y. 1965).

<sup>209</sup> [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,746 (D.D.C. 1974).



tion. The court declined to consider the constitutionality of the Commission's sequestration rule, although it noted an apparent conflict between the rule and witnesses' right to counsel under the Sixth Amendment, as well as the APA. The court preferred to base its holding on the absence of any evidence of misconduct by corporation counsel.

The SEC's staff position on sequestration was questioned in a different context in the *Merrill Lynch, Pierce, Fenner & Smith, Inc.* administrative proceeding.<sup>210</sup> In that case the Division of Enforcement applied to the Administrative Law Judge for an order to prevent the same firm of attorneys from representing both the broker-dealer corporation named as a respondent and 47 individual respondents who were employees of the corporation. The judge held that notwithstanding the potential conflict of interest between the corporation and the employees, since the corporation's law firm had obtained the informed consent of all respondents to their engagement, such representation could be continued. Although the judge pointed out that the strictures concerning attorneys' conflicts of interest in the canons of legal ethics are placed upon the attorney, he did not challenge the standing of the Division of Enforcement as a non-client to question the propriety of corporation counsel's continued representation. It is submitted that staff attorneys have no such standing. The position taken by the Division of Enforcement assumes the SEC has substantive licensing power over attorneys and may enunciate legal ethics for the securities bar. Not only is this assumption unfounded, but the sequestration rule applies only to investigations. In general, only a party who has a client relationship to an attorney who undertakes to represent conflicting interests may be entitled to object to such representation.<sup>211</sup> Although the government may have some legitimate interest in sequestering lawyers in investigations, the policy reasons which have been used to justify the sequestration rule do not pertain to administrative proceedings.

The staff's argument in the *Merrill Lynch* proceeding that it was trying to protect the rights of the corporation's employees fails to

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<sup>210</sup> [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 79,608, (1973).

<sup>211</sup> See, e.g., *E.F. Hutton & Co. v. Brown*, 305 F. Supp. 371 (S.D. Tex. 1969); *Murchison v. Kirby*, 201 F. Supp. 122 (S.D.N.Y. 1961); *State v. Garaydorobil*, 89 Ariz. 161, 359 P.2d 753 (1961); *Wenzel v. Werch*, 256 Wis. 47, 39 N.W.2d 721 (1949).

show a proper appreciation for the adversarial nature of the proceeding. The employees were respondents against whom the Division was prosecuting disciplinary proceedings. The respondents retained counsel to protect them from their prosecutors, who then attempted to protect the respondents, albeit against their will. To deprive them of the benefits of corporation counsel could have had the punitive effect of making them individually pay the cost of retaining personal counsel. Although the hearing examiner recognized cost as a factor in his decision, he did not make much of it.

Despite older precedents to the effect that the right of counsel is not constitutionally guaranteed in an administrative investigation, the viability of these precedents in the light of subsequent right to counsel cases should at least be questioned.<sup>212</sup> However, even if the rule is constitutional, and not in conflict with the APA, the manner in which the staff has invoked sequestration in investigations of corporations and their officers and directors is very questionable.

The Commission's views on sequestration necessarily rest on the premise that there is a conflict of interest between the corporation which may have violated the securities law and its officers and directors who were the agents of any such violation. This is a variation of the developing (and erroneous) staff view that the corporation is the representative of public investors, which in cases of wrongdoing should be investigating and suing its officers and directors. In cases where the SEC has succeeded in having special counsel appointed to oversee the affairs of a corporation which has egregiously violated the securities laws, counsel to the corporation may indeed play such a role.<sup>213</sup> However, in the case of an ongoing business concern which has fallen under SEC scrutiny, the law should not indulge in the presumption that there is a conflict of interest between the corporation and its officers and directors merely because an agency investigation is initiated. Such a presumption can only be based on the conclusions that the corporation has violated the law, that violations were carried out by the particular officer or

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<sup>212</sup> See, e.g., *Orozco v. Texas*, 394 U.S. 324 (1969); *Miranda v. Arizona*, 384 U.S. 436 (1966); *Escobedo v. Illinois*, 378 U.S. 478 (1964); *Massiah v. United States*, 377 U.S. 201 (1964).

<sup>213</sup> See *SEC v. Westgate California*, SEC Litigation Release No. 6142 (S.D. Cal. 1973); *SEC v. Clinton Oil Co.*, SEC Litigation Release Nos. 5798 and 5715 (D. Kan. 1973).

director also under investigation, and that the conduct in question was not within the scope of such individual's employment. These conclusions are biased and adjudicatory. They should only be made, if established as true, after a hearing with its attendant protections of due process.

Moreover, statements made by corporate officers and directors would ordinarily be admissible in evidence against the corporation.<sup>214</sup> Therefore, because of the corporation's potential civil liability for securities law violations or because of indemnification obligations the corporation has a legitimate interest in having its counsel attend the interrogation of its officers or directors. If such counsel is sequestered, the Division of Enforcement should not be permitted to use as admissions testimony adduced against the corporation in a subsequent trial.<sup>215</sup>

### C. *The Fifth Amendment*

In any investigation where an attorney represents a client involved in serious wrongdoing, the attorney must advise his client to testify or to invoke his privilege against self-incrimination. When this privilege is pleaded, the SEC's ability to gather evidence is obviously frustrated, and such frustration breeds a temptation to take vindictive steps.<sup>216</sup> Moreover, many staff members look askance at attorneys who represent clients who invoke this privilege.

The SEC cannot bar a person from association with a broker-dealer or other regulated entity solely on the ground that such per-

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<sup>214</sup> See RESTATEMENT (SECOND) OF AGENCY §§ 286, 288 (1958); 4 WIGMORE, EVIDENCE § 1078 (Chadbourne Rev. 1972). See also *Slifka v. Johnson*, 161 F.2d 467 (2d Cir. 1947); *Rubin v. General Tire & Rubber Co.*, 18 F.R.D. 51 (S.D.N.Y. 1955).

<sup>215</sup> See *Harper & Row Publishers, Inc. v. Decker*, 423 F.2d 487 (7th Cir. 1970) (per curiam), *aff'd per curiam*, 400 U.S. 348 (1971), *reh. denied*, 401 U.S. 950 (1971); *Singer Corp. v. NLRB*, 63 CCH LAB. CAS. ¶ 11,002 (8th Cir. 1970); cf. *United States v. Hughes*, 413 F.2d 1244 (5th Cir. 1969), *vacated as moot*, 397 U.S. 93 (1970); *City of Philadelphia v. Westinghouse Electric Co.*, 210 F. Supp. 283 (E.D. Pa. 1962).

<sup>216</sup> See *Morrison, The Fifth Amendment*, 3 REV. SEC. REG. No. 6 (1970). It may seem obvious, but without the Fifth Amendment there could have been no ratification of the Constitution including the Commerce Clause in Article I, Section 8 and without the commerce clause there could have been no federal securities laws, no SEC. Perhaps, then, consideration of the defense against self-incrimination as a privilege rather than a right is *per se* misleading.

son had claimed his privilege against self-incrimination. A stock exchange, however, can take disciplinary action against persons subject to their regulation for failure to give testimony to exchange examiners. Such compulsion has been held not to violate the Constitution.<sup>217</sup>

Because the brokerage community and the securities bar are relatively small, the pressures against a witness invoking this privilege under the Fifth Amendment are great. This erosion of the privilege under the basic bill of rights of all citizens has been accelerated by the SEC's efforts to compel attorneys to come forward to the federal government with evidence against clients and former clients. Where the attorney himself is charged with wrongdoing, the SEC has even greater leverage in obtaining information in possible derogation of the privilege against self-incrimination because an attorney is permitted to breach his duty to preserve the confidences and secrets of his client in order to defend himself.<sup>218</sup>

Although a director, officer, employee or stockholder of a corporation may enjoy a Fifth Amendment privilege as an individual, the corporation with which he is associated does not.<sup>219</sup> Further, the extent to which conversations between such persons and the corporation's attorney are protected by the attorney-client privilege is unclear.<sup>220</sup> As a result, the corporation attorney may be placed in an unconscionable position if he is subpoenaed to testify, particularly if his own conduct may be under scrutiny. If he testifies without an appropriate waiver from his client, he may be breaching legal ethics. If he refuses to testify, he may be named as an aider and abettor by the SEC.<sup>221</sup> The grounds upon which he can refuse to testify, at least if his client was a corporation, are less than clear.

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<sup>217</sup> *United States v. Solomon*, CCH FED. SEC. L. REP. ¶ 94,948 (2d Cir. 1975).

<sup>218</sup> *See Meyerhofer v. Empire Fire & Marine Ins. Co.*, 497 F.2d 1190 (2d Cir. 1974), *cert. denied*, \_\_\_ U.S. \_\_\_ (1975).

<sup>219</sup> *See United States v. Guterma*, 272 F.2d 344 (2d Cir. 1959). The holdings in the federal courts on the ability of an attorney to assert the Fifth Amendment on behalf of a client are not uniform. *Compare United States v. Judson*, 322 F.2d 460 (9th Cir. 1963), *with Bouschor v. United States*, 316 F.2d 451 (8th Cir. 1963).

<sup>220</sup> *See Garner v. Wolfenbarger*, 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971); *United States v. Koenig*, [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,414 (S.D.N.Y. 1974); Simon, *The Attorney-Client Privilege as Applied to Corporations*, 65 YALE L.J. 953 (1956).

<sup>221</sup> *See Lipman, The SEC's Reluctant Police Force: A New Role for Lawyers*, 49 N.Y.U.L. REV. 437, 460-62 (1974).

The claim of work product privilege as a shield for protecting a client's constitutional rights was suggested in the case of *In re Terkeltoub*.<sup>222</sup> Whether this claim is available with respect to information obtained by an attorney prior to the time a Formal Order of Investigation is obtained by the SEC's staff is open to question.<sup>223</sup> It is submitted, however, that the existence of the work product privilege in response to a government inquiry should not be contingent upon whether an attorney was retained before or after litigation has been initiated. The privacy of a client's consultations with his attorney and his attorney's deliberations should be an important component of the constitutionally protected right to counsel.<sup>224</sup>

Because the government cannot compel a person to become a witness against himself, in contravention of the Fifth Amendment, either voluntarily or through mechanical eavesdropping devices,<sup>225</sup> it should not be able to circumvent this protection by extracting such testimony from an attorney with whom the witness believed he was free to consult in confidence.

#### D. Discovery

The attorney serving as counsel for corporate or individual targets of an SEC investigation can no longer be content with advice to his client in which he outlines the statutory or regulatory consequences of the investigation in terms of administrative proceedings,<sup>226</sup> civil injunction<sup>227</sup> and possible criminal references.<sup>228</sup> Rather, the attorney in order to inform his client fully must point out that the attorney may himself become a target of the investigation. The prospects for appointment of special counsel to replace the defending attorney must also be analyzed.<sup>229</sup> In those instances where the defense-

<sup>222</sup> 256 F. Supp. 683 (S.D.N.Y. 1966). See notes 282-85 *infra* and accompanying text.

<sup>223</sup> See *Garfinkle v. Arcata National Corp.*, BNA SEC. REG. & L. REP. No. 272, A-15 (S.D.N.Y. 1974).

<sup>224</sup> See *United States v. Colacurcio*, 499 F.2d 1401, 1404 (9th Cir. 1974).

<sup>225</sup> See *In re Terkeltoub*, 256 F. Supp. 683 (S.D.N.Y. 1966).

<sup>226</sup> Securities Act of 1933, 15 U.S.C. § 77h(d), (3) (1970); Securities Exchange Act of 1934, 15 U.S.C. § 780(b) (1970); Investment Company Act of 1940, 15 U.S.C. § 80a-8(e) (1970).

<sup>227</sup> Securities Act of 1933, 15 U.S.C. § 77t (1970); Securities Exchange Act of 1934, 15 U.S.C. § 780(b) (1970); Investment Company Act of 1940, 15 U.S.C. § 80a-8(e) (1970).

<sup>228</sup> Securities Act of 1933, 15 U.S.C. § 77q (1970); Securities Exchange Act of 1934, 15 U.S.C. § 78ff (1970); Investment Company Act of 1940, 15 U.S.C. § 80a-43 (1970).

<sup>229</sup> See note 174 *supra*. See Mathews, *Liabilities of Lawyer Under the Federal Securities*

attorney was also the transaction-attorney, he probably should advise the client that he may be called as a witness and that the staff may inquire as to the client's position on the attorney-client privilege<sup>230</sup> or as to matters within the attorney's work product relating to other civil litigation.<sup>231</sup> In this respect, notwithstanding the position expressed in speeches and in the report of the Advisory Committee on Enforcement Policies and Practices,<sup>232</sup> the SEC investigation and its related rules do not afford counsel full and fair discovery of the SEC enforcement case to obtain information to advise his client.

During an investigation, the power to subpoena information and witnesses is a one-way street. Unlike the SEC staff-attorney who can go forward to obtain information, the defense-attorney is unable to issue subpoenas until and unless an administrative proceeding is commenced or unless the Federal Rules apply in a civil proceeding.<sup>233</sup> Counsel must deduce those areas in which his client faces principal risk from the list of documents requested of his client, or from other persons under investigation whose attorneys will cooperate with him. If the SEC subpoena is a broad list of companies and documents, the defense-attorney is virtually powerless to question relevance or to determine which particular documents or companies are critical. Similarly, during the course of an examination when documents from other sources are shown to a witness, the defense-attorney is powerless to discover where the documents came from or to take depositions as to their reliability. In complex cases, such documents may have a neutral significance, but related testimony can be of great importance. Yet counsel for the defense-attorney has no right to obtain relevant testimony of other witnesses.<sup>234</sup>

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*Laws*, 30 BUS. LAW. 142 (Special Issue: March, 1975).

<sup>230</sup> If the SEC eventually obtains ancillary relief in the form of a majority of new directors, these directors could waive an attorney-client privilege which the previous directors asserted.

<sup>231</sup> *SEC v. National Student Marketing Corp.*, [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,610 (D.D.C. 1974).

<sup>232</sup> Report of the Advisory Committee on Enforcement Policies and Practices, June 1, 1972 [hereinafter cited as Wells Report].

<sup>233</sup> See 17 C.F.R. § 201 (1974); Rules 34 and 45, FED. R. CIV. P.

<sup>234</sup> 17 C.F.R. § 201 (1974). Freedom of Information Act, 5 U.S.C. § 552 (1970); See *Villani v. NYSE*, 348 F. Supp. 1185 (S.D.N.Y. 1972), *modified*, 367 F. Supp. 1124 (S.D.N.Y.), *aff'd*, 489 F.2d 1 (2d Cir. 1973); SEC Securities Act Release No. 5571 (1975).

These disabilities are not cured by examination of the SEC's Formal Order<sup>235</sup> because the typical order recites only that the staff has reported information to the Commission which indicates there may have been violations of certain provisions of the federal securities laws. Moreover, the defense-attorney cannot get the memorandum of the staff which requested the Order of Investigation or any subsequent request for enforcement proceedings.<sup>236</sup> This inadequacy is implicitly recognized by the recommendation of the Wells Report and the partial adoption of its recommendations.<sup>237</sup> Nevertheless, discovery remains limited. Further, under recent practice, presumably designed to restrict the staff from usurping the Commission's authority, the staff-attorney is restricted from discussing settlement with a defense-attorney prior to the bringing of the enforcement action.<sup>238</sup>

The limitations on discovery by private attorneys have been explained only through SEC reaction to requests for information, the use of Rule 5 of the Rules Relating to Investigations, and the SEC defense to production of documents under the Freedom of Information Act.<sup>239</sup> However, the SEC has never been required to articulate or defend the reasons for keeping an investigation private. If the SEC trusted the adversary process as a device to arrive at truthful results, it would consider the adoption of provisions comparable to federal discovery rules during its investigations. In the event the rationale for the secrecy is to protect the parties investigated, the SEC should consider whether a waiver by any witness should allow discovery of the testimony given and documents produced by the witness.<sup>240</sup> If the rationale is that such secrecy relates to a particular type of document or testimony obtained, the SEC should consider the adoption of general discovery rules together with the opportunity for protective orders which would allow the staff to maintain its confidentiality for certain documents.

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<sup>235</sup> 17 C.F.R. § 201.7(a) (1974) (Investigations Rules).

<sup>236</sup> See *SEC v. National Student Marketing Corp.*, [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,610 (D.D.C. 1974).

<sup>237</sup> See Wells Report, *supra* note 232.

<sup>238</sup> See *SEC v. National Student Marketing Corp.*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,011 at 97,529 (D.D.C. 1975).

<sup>239</sup> 17 C.F.R. § 201.5 (1974). See *In re Bader*, Freedom of Information Act Release No. 1 (1975).

<sup>240</sup> See Committee Reports, Government Databanks and Privacy of Individuals (H.R. 16373 and S. 3418), 30 RECORD ASS'N BAR 55, at 97 (1975).

### E. *The Wells Report*

Prior to the crystallization of its enforcement program against attorneys, the SEC authorized a review and evaluation of its enforcement practices.<sup>241</sup> The Advisory Committee on Enforcement Policies and Practices which was appointed on January 27, 1972, conducted a remarkably expeditious review and reported its recommendations on June 1, 1972.<sup>242</sup> The recommendations of the Committee were adopted on only a limited basis.<sup>243</sup>

The most significant impact of the Wells Report is the new procedure which allows the defense-attorney for targets of investigations to submit a memorandum to the Commission, counter to the staff recommendation, as to why his clients have not violated the securities laws.<sup>244</sup> This is permitted in cases where the recommendation of the staff is to file for an injunction or to start an administrative case. In the preparation of this memorandum, the defense-attorney is limited because he is unable to see any staff memoranda, so he must anticipate all charges arising out of the Formal Order or any divergent path which the investigation has taken. In this regard it is imperative that the defense-attorney preparing the memorandum, if he has replaced another attorney, consult with the transaction-attorney. In the investigation, if the staff makes charges relating to professional conduct, the witness-attorney must consider whether to submit his own memorandum. In this regard any witness-attorney must consider whether to ask his client to waive the attorney-client privilege, and whether to retain separate counsel to prepare his statement and argue his cause. In the light of the paucity of standards and the apparent indecision by the SEC as to naming individual attorneys,<sup>245</sup> full partnerships,<sup>246</sup> attorneys primarily involved and attorneys secondarily involved,<sup>247</sup> the task of

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<sup>241</sup> BNA SEC. REG. & L. REP. No. 137, A-5 (February 2, 1972).

<sup>242</sup> See Wells Report, *supra* note 232.

<sup>243</sup> SEC Securities Act Release No. 5310 (1972).

<sup>244</sup> *Id.*

<sup>245</sup> See SEC v. Vesco, [1972-73 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,777 (S.D.N.Y. 1973); SEC v. International Camra-Corder Corp., CCH FED. SEC. L. REP. ¶ 91,666 (S.D.N.Y. 1964).

<sup>246</sup> See SEC v. National Student Marketing Corp., [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,610 (D.D.C. 1974); SEC v. Sitomer, Sitomer & Porges, [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,184 (S.D.N.Y. 1973).

<sup>247</sup> See SEC v. Spectrum, Ltd., 489 F.2d 535 (2d Cir. 1973) (as to defendant Shiffman);



the attorney who must prepare a submission on behalf of a fellow attorney is difficult and his path to defending his client is uncharted.

Implicit in the Wells Report was a recognition of the SEC's argument that it has implied powers over attorneys beyond its express statutory limitations. Without any citations the Report commented:

A major development in the past several years has been the expansion of the Commission's oversight over the activities of lawyers, accountants and other professionals. 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.<sup>248</sup>

The focus of the Advisory Committee, however, dealt with specific enforcement problems and did not approve an incursion into general professional standards. The implications of recent speeches and cases go far beyond the scope of the Advisory Committee's study. Scores of attorneys who practice in areas of corporate responsibility have never been required to consider the SEC position on their qualifications or standards. As a general rule, there are no requirements for knowledge of securities laws for qualification for state bar examinations. Courses in securities laws are not required for initial standing to apply for admission. Consequently, even if there are implied powers for quasi-judicial agencies such as the SEC allowing regulation of conduct by professionals before them, the question of where to draw the lines between initial entry to a profession (which has nothing whatsoever to do with the SEC) standards for subsequent conduct involving a client, and final confrontation in an investigation with the SEC (which has some quasi-judicial control over professional activities at that point) is more difficult than the SEC admits.

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SEC v. Everest Management Corp., SEC Litigation Release No. 5209 (S.D.N.Y. 1971).

<sup>248</sup> Wells Report, *supra* note 232 at 9.

Instead of dealing with the difficult problems as to where or when the SEC should influence the bar, the current policy arises out of the conclusion by the SEC that certain problems in the securities industry are unsolved or increasing. The SEC would then require the professions to solve the industry's problems because of congressional limitations on the SEC. This is akin to a conclusion that because you have something to do with the problem you must help in solving it and, worse still, if you fail to help in solving it, proceedings would be taken against you for violation of your professional duties. The same argument could have been advanced for other problems which the Federal Government for myriad reasons has been unable to solve, whether in the field of energy limitation, international balance of payments, housing programs or ecological decay.<sup>249</sup>

In attempting to extend its authority to the regulation of the securities bar, the SEC is laying itself open to the criticism that its enforcement program against attorneys is merely another weapon in the prosecutor's arsenal. Attorneys who have been sequestered may feel that they are being discriminated against for vigorously defending their clients. Attorneys who have clients who claim the Fifth Amendment and then find themselves targets of a Commission investigation may likewise feel righteously indignant. Attorneys who are named as defendants in an SEC injunction and then find they are unable to discover the basis for the staff's recommendation that they be enjoined may believe that it was to enable the SEC to obtain an adversarial advantage in its case against their client.

The work of the SEC as a regulator of the securities markets, as well as the adversarial system upon which our legal institutions depend, are too important to be undermined by enforcement actions against a professional group the Commission does not license. All persons are constitutionally entitled to be represented by counsel in their dealings with the Government. In the light of these existing protections the Government should not lightly or easily be permitted to deprive anyone of adequate adversary representation by wielding the power to prosecute the vigorous defender.

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<sup>249</sup> See Garrett, *Changing Concepts in Business Ethics*, 30 BUS. LAW. 7 (Special Issue: March, 1975).

## VI. A DOUBLE STANDARD—THE CONDUCT OF STAFF ATTORNEYS VS. THE CONDUCT OF PRIVATE PRACTITIONERS

Another telling argument against the duties which the SEC is preaching to attorneys is that in cases where SEC staff-attorneys have been urged to assume similar duties, the SEC has asserted privilege and resisted responsibility.

### A. *Responsibility for No-Action Letters vs. Responsibility for Opinion Letters.*

As explained earlier in this article,<sup>250</sup> government attorneys are required to observe the same professional ethics as private attorneys. One of the canons fully applicable to the federal lawyer is the stricture to represent a client competently.<sup>251</sup> A lawyer may not seek to limit his individual liability to his client for malpractice. If a lawyer handles the affairs of his clients properly he has no need to do so; if he does not, he should no longer be permitted to perform such work.<sup>252</sup>

In *SEC v. Spectrum, Ltd.*,<sup>253</sup> the Commission urged that the negligent issuance of an opinion letter by an attorney was actionable in an injunctive action instituted by the SEC. Similarly, in *United States v. Koenig*,<sup>254</sup> the Government argued that an attorney was subject to a higher standard of conduct than the lay defendants in a criminal securities case. These views embrace the dual duties which the SEC has attempted to devolve upon attorneys to investigate facts and interpret the law as the SEC would interpret it.<sup>255</sup>

At the same time that the SEC has been developing this high standard of care for the private practitioner, the Commission has refused to assume responsibility for the issuance of legal opinions by SEC staff members. Such opinions are usually rendered by SEC staff-attorneys in response to inquiries from members of the public

<sup>250</sup> See notes 112-24 *supra* and accompanying text.

<sup>251</sup> ABA CODE EC 6-1.

<sup>252</sup> ABA CODE EC 6-6; ABA CODE DR 6-102.

<sup>253</sup> 489 F.2d 535 (2d Cir. 1973).

<sup>254</sup> CCH FED. SEC. L. REP. ¶ 94,765 (S.D.N.Y. 1974).

<sup>255</sup> See 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, 425-26 (1974).

or their attorneys.<sup>256</sup> The advice may take either of two forms: an interpretative letter, which is little different in form or function from a letter of advice from a private attorney, or a "no-action" letter, which is a statement of a policy decision as to whether prosecutorial discretion would be exercised to pursue a possible violation of the securities laws.<sup>257</sup> In its release preliminary to making "no-action" correspondence publicly available, the Commission described "no-action" and interpretative letters as "the expert views of the staff on novel questions of law or on the application of existing principles to novel or unusually complex factual situations."<sup>258</sup>

In *Professional Care Service, Inc.*,<sup>259</sup> the Commission's views with respect to "no-action" letters were enunciated as follows:

. . . the no-action letter process is merely an informal mechanism by which private persons and their counsel may seek either interpretative advice from individuals familiar with the federal securities laws or an indication of the staff's enforcement attitude toward a particular transaction prior to its consummation. The Commission is not bound by these staff responses nor do the staff responses purport to be an official expression of the Commission's views. . . .

. . . The staff responses in no-action letters only purport to represent the views of the officials who give them.<sup>260</sup>

The staff-attorney who gives "no-action" or interpretive advice is acting in two capacities: as a governmental official and as an attorney for the SEC. The cases which have thrown into question the Commission's view that it is not responsible for the opinions of its staff-attorneys have not analyzed whether the nature of any liability sought to be imposed is akin to the liability of a private attorney who renders legal opinions.

In *SEC v. Medical Committee for Human Rights*,<sup>261</sup> a stockholder of Dow Chemical Co. petitioned the court of appeals for review of

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<sup>256</sup> Staff members are permitted to render such advice in an effort to inform and assist the public in complying with the securities laws. 17 C.F.R. § 202.1(d) (1974).

<sup>257</sup> SEC Securities Act Release No. 4924 at 2 (Sept. 20, 1968).

<sup>258</sup> *Id.* at 4. This correspondence was made public in response to the Freedom of Information Act, 5 U.S.C. § 552 (1970).

<sup>259</sup> [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 79,770 (1974).

<sup>260</sup> *Id.* at 84,079-80.

<sup>261</sup> 434 F.2d 659 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972).

an SEC "no-action" letter. The stockholder had submitted to Dow a proposal for inclusion in the company's proxy statement. Dow had written to the SEC requesting staff review of Dow's decision to omit the proposal. The Chief Counsel for the Division of Corporation Finance, by letter to Dow stated that his Division would not recommend any action if the proposal was omitted from Dow's proxy material. The stockholder requested and obtained Commission review of Counsel's opinion, and the opinion was affirmed.

When the stockholder initiated court action, the SEC asserted that its action was not a "reviewable order" under Section 25(a) of the Exchange Act. The court held that such action was reviewable, either in a district court or a court of appeals. It should be noted, however, that reviewability is not tantamount to liability. An SEC attorney is immune from liability for discretionary action taken within the scope of his authority.<sup>262</sup> A federal agency cannot even be held liable for issuing an order which constitutes aiding and abetting a violation of the anti-fraud provisions of the securities law.<sup>263</sup>

The court in the *Medical Committee* case reasoned that there was no difference, insofar as reviewability was concerned, between a "no-action" decision and a decree binding a party to perform or refrain from performing some act. Further, the Commission's procedures were sufficiently formal to make its determination a reviewable order. In part, the court based its opinion upon its finding that the SEC's procedural regulations governing proxy proposals incorporate the basic theory of an adversary encounter between a shareholder and management. However, in a case where relief was sought by a business concern which had requested a staff opinion under the Investment Advisors Act to enjoin threatened enforcement action,

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<sup>262</sup> 15 U.S.C. § 78y(a) (1970). It is noteworthy that the allegation of perjury in the course of his duties by a high SEC official resulted in disciplinary proceedings against him by the state bar to which he belonged, but not the institution of Rule 2(e) proceedings by the SEC. BNA SEC. REG. & L. REP. No. 243, Y-1 (March 5, 1975). See also SEC v. Blatt, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,026 (S.D. Fla. 1975); White v. Jaegerman, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94, 995 (S.D.N.Y. 1975); BNA SEC. REG. & L. REP. No. 295, A-28 (March 26, 1975).

<sup>263</sup> Safeway Portland Employees' Fed. Credit Union v. FDIC, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,899 (9th Cir. 1974). See also Brown v. Commonwealth, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,049 (6th Cir. 1975). The SEC also would be immune from liability for negligently issuing a legal opinion. Kenler v. Canal Nat'l Bank, 489 F.2d 482 (1st Cir. 1973).

the court held that the issuance of a "no-action" letter with Commission approval was reviewable.<sup>264</sup> The decision implicitly recognized the adversarial nature of the staff-attorney's role.

It should be noted that the affirmance of Counsel's opinion by the Commission in the foregoing cases was a departure from normal SEC practice in which the Commission does not review a "no-action" letter. *Kixmiller v. SEC*<sup>265</sup> involved a "no-action" letter issued by the Counsel to the Division of Corporation Finance, concurring in the opinion of the Washington Post Company to exclude a stockholder's proposal from its proxy material. The Commission declined to review the staff's position. The court held that in the absence of such review by the Commission, the "no-action" letter was not reviewable by the court. In the court's opinion, staff members of the Commission have no authority, individually or collectively, to make "orders."

The distinction drawn by the court between the *Medical Committee* and *Kixmiller* cases seems to have been premised on the view that a "no-action" letter is the act of a government official rather than a lawyer's opinion letter. Yet, such letters are opinion letters, and at one time were even so designated by their authors.<sup>266</sup>

In addition to resisting suits directly challenging the correctness of a staff legal opinion, the Commission believes that its letters are not dispositive of the legal issues raised on the applicability of the federal securities laws to a given transaction; that is to say, they may not be relied upon by third parties. This view was recently expressed as follows:

A no-action letter is not binding in a court of law on the question of the liability of an issuer for permitting a sale of its securities without registration under the Securities Act of 1933, nor would a letter stating a no-action position preclude an issuer from maintaining that a sale of its unregistered securities would be in violation of Section 5 of the Securities Act of 1933.<sup>267</sup>

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<sup>264</sup> *Potomac Federal Corp. v. SEC*, [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,704 (D.D.C. 1974), *dismissed on other grounds*, ¶ 94,815 (D.D.C. 1974).

<sup>265</sup> 492 F.2d 641 (D.C. Cir. 1974).

<sup>266</sup> 3 L. LOSS, *SECURITIES REGULATION* 1895 (2d ed. 1961).

<sup>267</sup> *Professional Care Services, Inc.*, [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶

Some courts have accepted such a limited conception of a staff attorney's opinion.<sup>268</sup> Other courts have held that a "no-action" letter may be binding in a court of law.<sup>269</sup>

If, as the Commission has been urging, a private practitioner is liable for an improper opinion letter, a government attorney should be held to a similar standard of professional responsibility. If, as one lawyer claims, and the SEC agrees, a private attorney's opinion is the "pass-key" to an illegal securities transaction,<sup>270</sup> a "no-action" or interpretive letter by a government attorney should be binding on the SEC. In our view, the importance of both types of legal advice has been overemphasized.<sup>271</sup> An attorney who renders an erroneous legal opinion should be held responsible to his client, not to the general public.

#### B. *Executive Privilege vs. Attorney-Client Privilege and the Attorney's Work Product*

As stated earlier in this article, the private attorney has a duty to preserve the confidences of his client, whereas the government attorney has a duty of disclosure insofar as he must assist his client in complying with the Freedom of Information Act.<sup>272</sup> The SEC, however, while attacking the attorney-client privilege of the corporation attorney, has been assiduous in preserving its own secrets.

The nature and scope of the privileges enjoyed by either the corporation or government attorney are unclear because of the clash of public policy considerations involved. The public's interest in free disclosure must be balanced against the client's interest in confidentiality. Pronouncements by SEC Commissioners to the effect that, at least in the disclosure process, attorneys do not act as advo-

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79,770 (1974).

<sup>268</sup> See, e.g., *Kenler v. Canal Nat'l Bank*, 489 F.2d 482 (1st Cir. 1973).

<sup>269</sup> See *Gasarch v. Ormand Industries, Inc.*, 346 F. Supp. 550 (S.D.N.Y. 1972); *Kanton v. U.S. Plastics, Inc.*, 248 F. Supp. 353 (D.N.J. 1965). See 6 L. LOSS, *SECURITIES REGULATION* 4024 (Supp. 1969).

<sup>270</sup> See Sommer, *supra* note 1; Shipman, *The Need for SEC Rules to Govern the Duties and Civil Liabilities of Attorneys Under the Federal Securities Laws*, 34 OHIO ST. L.J. 231 (1973).

<sup>271</sup> Even an erroneous legal opinion by a lower court trial judge imposes no liability for negligence or misinterpretation of law.

<sup>272</sup> 5 U.S.C. § 552 (1970).

cates for corporate clients but have a responsibility to the investing public,<sup>273</sup> have only confounded the issues.

Where legal advice is sought from a private attorney, the communications relating to that advice made in confidence by the client are, at the instance of the client, permanently protected from disclosure by the attorney.<sup>274</sup> Whether communications between a government attorney and officials employed by his agency are protected by the attorney-client privilege is problematic.<sup>275</sup> However, such communications may be protected by executive privilege which "obtains with respect to intra-governmental documents reflecting advisory opinions, recommendations and deliberations comprising part of a process by which government decisions and policies are formulated."<sup>276</sup>

In addition to the attorney-client privilege, a private attorney has the work product privilege with respect to his interviews, statements, memoranda, correspondence, briefs, mental impressions and personal beliefs generated in the preparation of a client's case.<sup>277</sup> A government attorney may also be entitled to claim the work product privilege.<sup>278</sup> The work product privilege of a government attorney would not appear to be more extensive than executive privilege. Both would be limited by the Freedom of Information Act.<sup>279</sup> The work product privilege of a private attorney, however, covers a much broader range of communications than those covered by the attorney-client privilege.

The public policy justification for all the privileges granted to

<sup>273</sup> See, e.g., Garrett, *Professional Responsibility and the Securities Laws*, Address to State Bar of Texas, July 4, 1974.

<sup>274</sup> 8 WIGMORE, EVIDENCE § 2292 (McNaughton rev. 1961).

<sup>275</sup> See Poirer, *The Federal Government Lawyer and Professional Ethics*, 60 A.B.A.J. 1541, 1543 (1974). But see SEC v. National Student Marketing Corp., [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,610 (D.D.C. 1974).

<sup>276</sup> Carl Zeiss Stiftung v. V.E.B. Carl Zeiss, Jena., 40 F.R.D. 318, 324 (D.D.C. 1966).

<sup>277</sup> Hickman v. Taylor, 329 U.S. 495, 511-12 (1947). When the work product privilege attaches to the work of a securities lawyer has been thrown into doubt by Garfinkle v. Arcata National Corp., 272 BNA SEC. REG. & L. REP. A-15 (S.D.N.Y. 1974).

<sup>278</sup> SEC v. National Student Marketing Corp., [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,610 (D.D.C. 1974). See also SEC v. National Student Marketing Corp., CCH FED. SEC. L. REP. ¶ 95,011 (D.D.C. 1975); Simon, *The Attorney-Client Privilege As Applied to Corporations*, 65 YALE L.J. 953, 955 n.9 (1956).

<sup>279</sup> See Nixon v. Sirica, 487 F.2d 700, 715 (D.C. Cir. 1973) (per curiam).



attorneys, including executive privilege,<sup>280</sup> is to promote free and frank discussion between clients and their attorneys.

In order to promote freedom of consultation of legal advisers by clients, the apprehension of compelled disclosure by the legal advisers must be removed; hence the law must prohibit such disclosure except on the client's consent.<sup>281</sup>

An important related justification for the work product privilege accorded a private attorney is to protect persons against improper intrusion by governmental officials into their affairs.

The constitutional underpinnings for the work product privilege were pointed out in the case of *In re Terkeltoub*,<sup>282</sup> in which the Government made an application to compel an attorney to testify before a grand jury concerning a meeting between his client and a third party. The client had been indicted for perjury. It was alleged that the meeting concerned an attempt to persuade the third party to give false testimony at the perjury trial. The court held that the attorney-client privilege was not available because the testimony sought related to a meeting with a third party and because the conversation amounted to or looked toward the commission of a crime.<sup>283</sup> The attorney argued that compelling his testimony would deprive his client of due process under the Fifth Amendment and the effective assistance of counsel under the Sixth Amendment. The court agreed.

Because privacy is so vital to these preparatory efforts, the prosecution is forbidden to eavesdrop or plant agents to hear counsels of the defense. . . .

The ultimate interest to be protected is the privacy and confidentiality of the lawyer's work in preparing the case. It is the violation of that interest that is held offensive to the Constitution in the cases of eavesdropping and spying. The protection would be a thin illusion if the Government could have for

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<sup>280</sup> See *Carl Zeiss Stiftung v. V.E.B. Carl Zeiss, Jena.*, 40 F.R.D. 318, 325 n.17 (D.D.C. 1966) ("uninhibited communication").

<sup>281</sup> 8 WIGMORE, EVIDENCE § 2291 (McNaughton rev. 1961).

<sup>282</sup> 256 F. Supp. 683 (S.D.N.Y. 1966).

<sup>283</sup> *Id.* at 684 n.2.

the asking what it has, in rare lapses, sought by less genteel means.<sup>284</sup>

In *Terkeltoub*, Judge Frankel pointed out that the Government was trying to deprive a private attorney of a privilege that government attorneys are quick to seize:

. . . [N]o lawyer, on any side of any case, would consider it salutary for his client that the opposition knew who was being interviewed and what was being said during such meetings. If vivid illustration were needed, it is supplied every day by the Government's stout resistance to discovery efforts by defendants in criminal cases.<sup>285</sup>

The SEC has put up as stout a resistance as any federal agency in protecting its secrets. In *SEC v. Bausch & Lomb, Inc.*,<sup>286</sup> certain of the defendants were alleged to have conveyed adverse material, non-public information, to other defendants, who sold shares upon such information before the information was made public. The defendants moved for the production of a detailed report and other documents which purported to trace the history and intent of the law on inside information and set forth a series of guidelines for financial analysts, corporate management investors, lawyers and the industry as a whole. The SEC's claim of executive privilege with respect to such documents was sustained.

In *SEC v. National Student Marketing Corp.*,<sup>287</sup> the SEC moved for production of documents by a defendant law firm and attempted to resist a counter-motion for production. The court held that the work product shield applies only to documents prepared in anticipation of litigation, and noted that the point in which the SEC's investigation blossomed into litigation was by no means clear cut. The basic inconsistency in the SEC's position of requesting discovery of the defendants and resisting discovery by them was not noted by the court, which treated the parties as adversaries and ordered mutual production of the documents.

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<sup>284</sup> *Id.* at 685.

<sup>285</sup> *Id.*

<sup>286</sup> [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,825 (S.D.N.Y. 1974).

<sup>287</sup> [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,610 (D.D.C. 1974). *See also* SEC v. National Student Marketing Corp., [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,011 (D.D.C. 1975).

Work product and executive privilege were again successfully asserted by the SEC in *SEC v. Geotek Resources Fund*.<sup>288</sup> The court there stated that the Government has the burden of sustaining a claim of privilege, and must demonstrate that the public interest would be harmed by the disclosure of the information. Nevertheless, the court allowed the SEC to keep its files secret on the rather general rationale that denial of the privilege would complicate and delay law enforcement proceedings. No special showing of detrimental effect on the particular case was required to be made.

In *SEC v. Republic National Life Insurance Co.*,<sup>289</sup> a defendant accounting firm sought by way of counterclaim an order enjoining the SEC from withholding from the accounting firm information concerning their clients, material to the accountant's examination of statutory financial statements. The accounting firm argued that the SEC's only motive in withholding the information was the impermissible one of gaining an adversarial advantage in the litigation. The accountants cited SEC pronouncements that it could not work with accountants in "an adversary atmosphere." The court held that the SEC had administrative discretion to withhold the information sought.

The court relied upon the SEC's regulation implementing the agency's executive privilege, which provides that information or documents obtained pursuant to an investigation by the SEC shall be deemed confidential and may not be released unless such release is authorized by the Commission as not being contrary to the public interest.<sup>290</sup> In general, the Commission does not authorize such release. Although the Freedom of Information Act<sup>291</sup> has opened up the files of the SEC to some extent, there are significant exemptions in the statute which give the Commission substantial claims of executive and work product privilege. Even under the recent liberalizing amendments to the Freedom of Information Act,<sup>292</sup> the SEC may

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<sup>288</sup> [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 95,039 (N.D. Cal. 1975).

<sup>289</sup> [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,852 (S.D.N.Y. 1974).

<sup>290</sup> 17 C.F.R. § 240.0-4; see SEC Minute, [1970-71 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,905.

<sup>291</sup> 5 U.S.C. § 552 (1970).

<sup>292</sup> Pub. L. No. 93-502, § 2(b), 88 Stat. 1561 (Nov. 21, 1974), amending 5 U.S.C. § 552(b)(7) (1970). The purpose of the amendments to the Freedom of Information Act with regard to investigatory files was to "clarify congressional intent disapproving certain court

keep secret inter- or intra-agency memoranda or letters, including the work product of members of the Commission or attorneys prepared in the course of an inspection of the books and records of any person regulated by the Commission or any examination or investigation or related litigation conducted by or on behalf of the Commission. Also, the SEC may keep secret investigatory records compiled for law enforcement purposes to the extent that production of such records would interfere with enforcement proceedings. Investigatory records, for this purpose, include all documents, records, transcripts, correspondence and related memoranda and work product concerning examinations and other investigations and related litigation which pertain to or may disclose possible violations of the securities laws by any person.<sup>293</sup>

The SEC has advocated that because the securities lawyer has a duty to existing and future stockholders, and because the continuous disclosure system of the Exchange Act makes any failure by a public corporation to disclose a material fact a continuing antifraud violation, the corporation attorney has a duty to reveal violations of the antifraud provisions to the SEC and public investors. Further, the attorney-client privilege does not prevent such disclosure.<sup>294</sup> As the *Terkeltoub* case points out, however, the Commission's efforts to lay bare every incipient business fraud which comes to the attention of an attorney would effectively deprive corporations of their right to counsel. Such government intrusion into attorney-client communications is evil not only because of its "chilling impact upon the lawyer's advocacy," but also because of its "invasion of the lawyer's privacy in preparation."<sup>295</sup> An attorney is entitled to such

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interpretations which have tended to expand the scope of agency authority to withhold certain investigatory files compiled for law enforcement purposes." 3 United States Code Congressional and Administrative News, 93d Cong., 2d Sess. 6267 (1974).

<sup>293</sup> SEC Securities Act Release No. 5571 (1975). In *In re Bader*, Freedom of Information Act Release No. 1 (April 3, 1975), the SEC took the position that it need not release investigatory records on the grounds that law enforcement proceedings were in progress or in the contemplation of the SEC. It is too early to assess how the SEC will respond to requests under the new amendments for opening its files. However, the agency's initial reaction has been to criticize the statute and try to keep secret as much of its files as the law will permit. See 302 BNA SEC. REG. & L. REP. A-12 (May 12, 1975).

<sup>294</sup> See Lipman, *The SEC's Reluctant Police Force: A New Role for Lawyers*, 49 N.Y.U.L. REV. 437, 453-68 (1974).

<sup>295</sup> See *United States v. Colacurcio*, 499 F.2d 1401, 1404 (9th Cir. 1974); *United States v. Mitchell*, 372 F. Supp. 1239, 1245 (S.D.N.Y. 1973); accord, *In re Grand Jury Proceedings*, 473 F.2d 840 (8th Cir. 1973).

privacy whether he is working in his office or in court. The Commission is not entitled to say that "very little of a securities lawyer's work is adversary in character"<sup>296</sup> and then regulate the performance of that work, when it is the SEC who is the adversary. If, as we have suggested, a securities lawyer acts as an advocate whether he is confronting the SEC's Division of Corporation Finance or the Division of Enforcement, the attorney's privilege should not be contingent upon if or when the SEC commences an investigation or proceeding. The power to stop order, enjoin or revoke a license based upon a securities transaction is always present. The subtlety and gentility of the Commission's rationalization for inquiring into attorney-client relationships does not make the SEC's enforcement program free from constitutional infirmity.

To make the work product privilege at least as fully applicable to the private securities lawyer as it is to the SEC staff lawyer is particularly important in the context of corporate representation. This is because the boundaries of the attorney-client privilege are unclear. In *Garner v. Wolfenbarger*,<sup>297</sup> the attorney-client privilege was held not to be available in a shareholder derivative suit with respect to prior communications between management and corporate counsel. However, if the SEC or U.S. Attorney attempted to obtain such information, either the attorney-client or work product privilege should be available.<sup>298</sup>

It should be noted that the unavailability of the privilege against self-incrimination for corporations does not deprive them of the attorney-client or work product privileges. Indeed, such privileges should not be denied to corporations

. . . because of their power, wealth, or quasi-public position, since—unlike the privilege against self-incrimination, which they do not enjoy—it is not intended as a shield to the weak, but rather as an encouragement to all, strong and weak alike, to consult freely with counsel.<sup>299</sup>

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<sup>296</sup> *In re Emanuel Fields*, SEC Securities Act Release No. 5404, [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 79,407, 83,174-75 n.20 (1973).

<sup>297</sup> 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971).

<sup>298</sup> See *In re Grand Jury Proceedings*, 473 F.2d 840 (8th Cir. 1973); *Continental Oil Co. v. United States*, 330 F.2d 347 (9th Cir. 1964). *But see United States v. Koenig* [1973-74 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,414 (S.D.N.Y. 1974).

<sup>299</sup> Simon, *The Attorney-Client Privilege as Applied to Corporations*, 65 YALE L.J. 953, 955 (1956).

The loyalty of SEC staff attorneys in seeking to protect the confidentiality of the Commission's files, despite the limited applicability to government lawyers of the duty to preserve the confidences and secrets of a client, is not surprising. As<sup>1</sup> was stated in support of the attorney-client privilege, by a less than ardent defender,

. . . it must be repugnant to any honorable man to feel that the confidences that his relation naturally invites are liable at the opponent's behest to be laid open through his own testimony. He cannot but feel the disagreeable inconsistency of being at the same time the solicitor and the revealer of the secrets of the cause. This double-minded attitude would create an unhealthy moral state in the practitioner. Its concrete impropriety could not be overbalanced by the recollection of its abstract desirability.<sup>300</sup>

In *SEC v. Republic National Life Insurance Co.*, the court strongly admonished the SEC for exercising its discretion to withhold financial information which might have been material to the defendant accounting firm:

Unless the SEC's pronouncements of cooperation with public accountants in the interests of providing full and understandable disclosure to the investing public are to be taken as mere exercises in public relations, the SEC must genuinely indicate that cooperation is indeed a two-way street. Surely the SEC would not choose to have accountants judge it by the precept "do as I do, not as I say."<sup>301</sup>

### C. *Who Represents The Public Interest?*

In an adversary system, neither the prosecuting attorney nor the private practitioner is the sole guardian of the public interest. In an adversary system, a lawyer must vigorously represent the interests of his client within the boundaries of the law. Both the lawyer and his client may realize that their adversary, the SEC, has a statutory command to direct its efforts in rule-making and adjudication toward the public interest and the protection of investors. However, the SEC may on occasion see its interest best served by attempting to increase its jurisdiction by prosecuting novel cases. There is no

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<sup>300</sup> 8 WIGMORE, EVIDENCE § 2291 (McNaughton rev. 1961).

<sup>301</sup> [1974-75 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,852 (S.D.N.Y. 1974).

good reason why the private lawyer should be enlisted in this effort when it may be in the best interest of his client and the public to limit the SEC's jurisdiction.

The relationship of an SEC attorney to the Commission is very similar to the relationship of the private practitioner to the board of directors of a public corporation. There is no more reason why a private practitioner should assume a board of directors is engaging in illegal conduct than government attorneys should assume that members of the Commission are engaging in illegal conduct. The private practitioner, like the government attorney, should be protected from liability if he acts in good faith and reasonably believes that his clients are acting lawfully.

A good argument could be made that regulation of the public securities markets by the SEC has been an abysmal failure because the federal securities laws did not prevent the I.O.S., Equity Funding, Penn-Central or other notorious frauds of the late 1960's. The blame for these frauds, however, should be assigned to avarice and speculation rather than the SEC. But neither should the blame for these frauds be assigned to the securities bar. It would be unwise to expect the securities laws to eliminate fraud for all time because of the national countervailing interest in expanding the free capital markets. If the SEC and its statutes have been unable to rid the world of fraud, private practitioners are unlikely to discover a cure. Moreover, chilling the adversarial nature of the relationship between private and government attorneys would be a cure worse than the disease.

Truth should not be achieved at the expense of liberty.

A bar too tightly regulated, too conformist, too "governmental," is not acceptable to any of us. We speak often of lawyers as "officers of the court" and as "public" people. Yet our basic conception of the office is of one essentially private—private in politico-economic, ideological terms—congruent with a system of private ownership, enterprise, competition, however modified the system has come over time to be. It is not necessary to recount here the contributions of a legal profession thus conceived to the creation and maintenance of a relatively free society. It is necessary to acknowledge those contributions

and to consider squarely whether (or how much) they are endangered by proposed reforms.<sup>302</sup>

The government attorney is a public servant who should be representing the public interest at all times. The public interest goes beyond the parochial concerns of a particular agency. As important as it may be for the SEC to root out fraud, the integrity of the legal system and personal liberty are more important. An attorney cannot adequately represent his clients when he is worried about his own liability. Although an attorney should not be immune from securities law liability merely by reason of his profession, he should not be made derivatively liable for the derelictions of his clients.

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<sup>302</sup> Frankel, *The Search For Truth—An Umpireal View*, 30 RECORD OF N.Y.C.B.A. 14, 34 (1975).



