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SOME OBSERVATIONS ON THE INDEPENDENCE OF LAWYERS*

Paul Gonson[†]

Professor Langevoort and I go back some fifteen years or more when we worked together on the staff of the Securities and Exchange Commission ("SEC"). A young lawyer with a keen intellect, Professor Langevoort played an important role in fashioning the development of insider trading doctrine at the SEC and in the courts. As an academic, he has written and spoken well on this topic, as well as on other topics. I have followed his career with admiration. Recently, he, together with other well-known lawyers and academics in securities law, filed a friend of the court brief with the United States Supreme Court supporting the government's position in a very important insider trading case that will be argued next Wednesday.¹

I would first like to say a few words about questions of independence of lawyers in institutions other than law firms and companies, and I focus on the SEC and law schools. While

* ©1997 Paul Gonson. All Rights Reserved. This paper was prepared by Paul Gonson on February 17, 1998, for inclusion in an issue of the *Brooklyn Law Review* to contain the address of Prof. Langevoort on April 10, 1997 and comments of three commentators (The Pomerantz Lecture). Mr. Gonson was one of those commentators, and this paper is based on an edited version of an audiotape of Mr. Gonson's remarks, which were delivered from notes.

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¹ Subsequently, the Supreme Court ruled in favor of the government, upholding the validity of the misappropriation theory of insider trading under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5 promulgated thereunder, and the validity of SEC Rule 14e-3 under the Exchange Act, concerning insider trading in tender offers. *U.S. v. O'Hagen*, 117 S. Ct. 2199 (1997).

my day job is that of a lawyer at the SEC, for many years I have taught law as an adjunct professor at Georgetown University Law Center in Washington, D.C. I come in one evening a week and enjoy the interaction with the students and the discipline it imposes on me to stay current in my field.

Law schools and the SEC operate in environments and have cultures that bear importantly on how would-be lawyers and younger lawyers will act with respect to independence. In this context, I do not mean independence in the way auditors must be independent by, for example, not owning stock in their client. I am talking about independence of judgment, as Professor Langevoort has eloquently spoken about it.

All law schools have cultures and, whatever they are, they transmit them to the students. Some years ago, I attended a Georgetown faculty retreat and listened to strong views on all sides about critical legal studies and the writings of Professor Duncan Kennedy of Harvard Law School. The Georgetown faculty was acknowledging that the law school was an acculturating experience for students and were debating how to intentionally focus that experience. I taught a seminar on professional responsibility in corporate and securities practice in the graduate division at Georgetown. In addition to teaching the rules, I saw my role as imbuing my students with the idea they should aspire to high standards of personal integrity and ethical conduct in their law practices. Sometimes I thought that the students took my course just to find out how to keep out of trouble. Still, I felt it important to try to transmit a culture of high standards.

I am very proud of the SEC's culture concerning independence of lawyers and the integrity of the staff generally. A few years ago, Lloyd Cutler, a prominent Washington, D.C. lawyer, was counsel to President Clinton. In that capacity, he gave the keynote address to a national convention sponsored by the U.S. Office of Government Ethics. The audience was several hundred ethics officials from government departments and agencies. During the course of his remarks, he referred to the SEC. He said, "You never hear of taking an SEC lawyer to lunch." He observed that the tradition of integrity in that agency was so ingrained that the SEC could be counted on to do the right thing without having to have a written code. The SEC does have a code of conduct in

common with other agencies. But his point was, of course, that what the culture ingrains is more important than what a code requires. I was in that audience and was very proud of my agency.

Recently, the Inspector General at the SEC conducted a study of the SEC's integrity program. He submitted an audit report based on interviews conducted in workshops in which over 200 staff at all levels participated in headquarters and in the field offices. The report states:

Perhaps the most noteworthy finding was that, with almost no exceptions, the participants also indicated that they felt a personal sense of responsibility for maintaining the integrity of the Commission. Most of the participants also indicated that they felt a strong sense of an ethical tradition at the Commission and that the staff live up to the Commission's integrity expectations.²

How does that ethical tradition get transmitted in the SEC to a staff that is constantly turning over? Let me give you a personal example. I was told not to tell war stories. This is not a war story; it is an example.

Many years ago, as a young lawyer at the SEC, I attended a meeting of the Commission. You can visualize this: There is a big round table in a large room with many chairs around it. The five presidentially-appointed Commissioners, who collectively constitute the head of the agency, sit at one side of the table. They have an agenda of matters to be considered at that meeting, much like a judge has a docket of matters at a motion calendar. As the Chairman calls the next agenda item, the relevant staff come forward and sit at the other side of the table. Usually an active discussion takes place.

My matter was a minor one. Someone had made a Freedom of Information Act ("FOIA") request for some documents. Under the FOIA, any person can obtain documents from a federal agency unless an exemption is available which permits the agency to withhold them. At the SEC, some of the

² Audit Report No. 250, Office of Inspector General, Securities and Exchange Commission, *Exchange Excellence: The Commission's Culture & Tradition of Staff Conduct* 1 (January 22, 1997). The Report states: "Over 200 SEC staff and managers participated in one of sixteen structured workshops. Workshops were grouped with respect to where participants worked (e.g., headquarters versus regions) and their role (e.g., professional versus support versus management.)" *Id.* at 2.

exemptions used to withhold documents, for example, relate to ongoing nonpublic law enforcement investigations, trade secret information obtained from companies, and sensitive financial information from financial institutions. But, in this FOIA matter at the Commission table, there was no exemption so far as the staff could see, and thus no basis upon which the agency could deny the request, and we said so.

It was clear to the staff that some of the Commissioners did not want the documents given out because they were embarrassing. My boss made a policy argument to the Commissioners. Suppose, he said, a brokerage firm regulated by the SEC had this attitude. They didn't like an SEC rule, so they decided they would not comply with it. He said that the SEC wants to foster a culture in the securities industry of compliance with the law; so we, no less, as the government, must comply with the law.

Well, one of the Commissioners still was not moved. He said, do not give him the documents. If he sues us, and the court says give them to him, then we will give them to him.

My boss responded that there was no valid basis to deny the requestor the documents, nor was there a valid basis to defend against an FOIA lawsuit. He pointed out that a lawyer may not make an argument or assert a defense in court unless there is an arguable basis for it, and here, none existed.

When asked by the Commission what his position would be if he were directed to withhold the documents, he replied that he hoped that he would not be put in that position, but if he were, he would resign.

Goodness! Shocks and tremors in that room.

To its credit, the Commission authorized the release of the documents.

Later, we went back to my boss's office and talked about this event, important in my life, as I suppose it was in his. We asked him, weren't you scared? He said that, yes, he was, a little, but he had faith the matter would come out the way it did. He also said that he is paid to give his best advice, not to tell the agency heads merely what they want to hear. If he is off base too many times, then he should be fired, or resign. But he prospered in the agency and eventually retired as a highly regarded senior lawyer.

You can guess how many times over the years I have told that story to young lawyers, and to new Commissioners. And on the rare occasion when a comparable issue arises, I tell the story at a Commission meeting. You know how we lawyers like precedent. So I say, this is the way we do it at the SEC. And everyone agrees.

That same boss had a policy of letting lawyers disagree with the Office of General Counsel's recommendations to the Commission in a written memorandum or even at an oral presentation at the Commission table. But he wanted those disagreements reserved for the really important issues.

One day I went to a Commission meeting and orally disagreed with him, and he later yelled at me. I was surprised. Didn't you say that was OK?, I asked. He replied that he was not yelling at me because I took a position different from his. He was yelling at me for my bad judgment in doing so. I asked, aren't you giving with one hand and taking away with the other?

I thought about it later and decided he was right. He gave permission for junior staff lawyers to think and act with independence. But one cannot scream all day long. One has to pick and choose those few matters that are really important.

At the SEC we are also concerned with the conduct of lawyers who appear and practice before us when that conduct can adversely affect the integrity of our own processes. While we expect zealous representation, we also hope lawyers will exercise a degree of independent judgment. Lawyers like to tell us at the SEC that we overestimate their ability to persuade their clients. Well, we like to tell them that they underestimate the clout they have with their clients.

In *In re William R. Carter and Charles J. Johnson* over fifteen years ago, the SEC spoke to the independence of lawyers in a difficult situation with their client.³ That case involved a company named National Telephone, and illustrates Professor Langevoort's observations that some persons in management are eternally optimistic and exercise business judgment not always consonant with their disclosure obligations under the federal securities laws. National

³ *In re William R. Carter and Charles J. Johnson, Jr.*, [1981-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,827 (SEC Feb. 28, 1981).

Telephone Company was in the telephone leasing business and doing well. But the more leases they wrote, the more funds they needed in order to buy those telephones, yet funds would not be internally generated until the lease payments were made. The company was not able to secure adequate financing either from a public offering or from lenders.

At some point, the company had to disclose that their lenders had cut off their credit and no new leases could be written. But the president of the company believed that the situation would get better and if this funding crisis were disclosed publicly, all the salesman would leave. The company's outside lawyers strongly advised disclosure, but the company refused, and adequate disclosure was not made.

When the SEC discovered this, it brought law enforcement proceedings against the company and its president. It also brought an administrative disciplinary proceeding against the company's lawyers. When lawyers find themselves with a strong willed client who is not taking their advice and not making proper disclosure, some lawyers will say that is the time to resign. In the course of its opinion, the SEC emphasized that lawyers should stay with such a hard nosed client and consider resignation only as a last option. The Commission said:

Some have argued that resignation is the only permissible course when a client chooses not to comply with disclosure advice. We do not agree. Premature resignation serves neither the end of an effective lawyer-client relationship nor, in most cases, the effective administration of the securities law. The lawyer's continued interaction with his client will ordinarily hold the greatest promise of corrective action. So long as a lawyer is acting in good faith, and exerting reasonable efforts to prevent violations of the law by his client, his professional obligations have been met. In general, the best result is that which promotes the continued, strong-minded and independent participation by the lawyer.⁴

⁴ *Id.* ¶ 84,172-73. The commission went on to say:

We recognize, however, that the "best result" is not always obtainable, and that there may occur situations where the lawyer must conclude that the misconduct is so extreme or irretrievable, or the involvement of his client's management and board of directors in the misconduct is so through-going and pervasive that any action short of resignation would be futile. We would anticipate that cases where a lawyer has no choice but to resign would be rare and of egregious nature.

Id. ¶ 84,173 (footnote omitted).

Another factor bearing on the independence of lawyers, alluded to by previous commentators, is that lawyers play different roles. A case on point is *SEC v. Fehn*, decided by the United States Court of Appeals for the Ninth Circuit, where the court was critical of the two different roles of the lawyer involved.⁵

In that case, the SEC sued a securities lawyer with over twenty-five years experience and obtained an injunction against him for a violation of the antifraud provisions, which the Ninth Circuit affirmed. Mr. Fehn's role at the start was that of a defense lawyer, but he got in trouble as a disclosure lawyer. He had been retained to represent a company and its president in connection with a formal SEC investigation of the company's initial public offering. During the course of the investigation, Mr. Fehn oversaw the preparation of three Form 10-Qs that were filed with the SEC. The president refused to make certain disclosures of matters concerning him that were a subject of the SEC investigation, and Mr. Fehn omitted them from the Form 10-Qs. Mr. Fehn later testified that he told the president that disclosure was required, but that disclosure could impair the ability of the president to assert his privilege against self-incrimination with respect to these earlier violations. The SEC sued Mr. Fehn for aiding and abetting the company's false filings. The district court and the court of appeals rejected Mr. Fehn's Fifth Amendment argument on the merits.

In its opinion, the Ninth Circuit spoke to the role of disclosure counsel:

We observe, furthermore, that effective regulation of the issuance and trading of securities depends, fundamentally, on securities lawyers such as Fehn properly advising their clients of the disclosure requirements and other relevant provisions of the securities regulations. Securities regulation in this country is premised on open disclosure, and it is therefore incumbent upon practitioners like Fehn to be highly familiar with the disclosure requirements and to insist that their clients comply with them.⁶

⁵ *SEC v. Fehn*, 97 F.3d 1276 (9th Cir. 1996), *cert. denied*, 118 S. Ct. 59 (1997).

⁶ *Id.* at 1293.

The Court discussed the potential for difficulty when a lawyer simultaneously acts as defense and disclosure counsel for a public company:

We acknowledge the inherent tension between representing a client in criminal or civil litigation—which entails professional obligations such as the duty of confidentiality and the need to advise clients of their privilege against self-incrimination—and counseling a client in connection with regulatory compliance

This dilemma is especially pronounced in cases where, as here, a lawyer attempts to represent a client in an SEC investigation of previous disclosure violations and, at the same time, attempts to advise that same client as to ongoing disclosure requirements We express no opinion as to whether Fehn's representation of Wheeler and CTI in connection with the SEC compliance was "compatible" with counseling these same parties about with SEC disclosure requirements. What is clear, however, is that the SEC disclosure requirements mandated disclosure of Wheeler's role as CTI's promoter and of the contingent liabilities stemming from CTI's and Wheeler's earlier securities law violations. In failing to make the Form 10-Qs comply with these disclosure requirements, Fehn 'substantially assist[ed]' in the primary disclosure violations.⁷

Independence of the lawyer is made more difficult by the at-will employment doctrine. Generally, that doctrine says that in absence of a specific agreement to the contrary, employment may be terminated at the will of the employer for any reason or for no reason at all. The corporate lawyer faced with client misconduct must navigate between difficult ethical obligations including not counselling a client to violate the law nor assisting the client in conduct known to the lawyer to be criminal or fraudulent, while exercising independent legal judgment. She must also be concerned about being called to task by bar disciplinary authorities concerned with preservation of client confidences as well as with government watchers like the SEC and federal bank regulators who may want to know about her client's misconduct. If she does the right thing, she must worry about being fired and becoming a pariah in her industry and in the bar. And does she have a wrongful termination claim in

⁷ *Id.* at 1293-95.

tort? In most jurisdictions, the answer is probably not because the notion that the client can select its own lawyer, even corporations when they are dissatisfied with their in-house lawyers, is so fundamental.

When a client determines to follow a course of improper or illegal conduct, despite the lawyer's advice to the contrary, the lawyer must possess a rigid backbone to stand up to that client.

Professor Langevoort's paper is an important work in helping corporate and securities lawyers understand the forces that play on their perception of their independence. I am flattered and feel privileged, having been called upon to make these comments.

