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ALIGNING THE COMPASS FOR THE SEC'S RELATIONSHIP WITH ITS PRACTISING BAR

Edward H. Fleischman
Commissioner
Securities and Exchange Commission
Washington, D.C. 20549

The views expressed herein are those of Commissioner Fleischman and do not represent those of the Commission, other Commissioners or the staff.

The subject of counsel responsibility, which concluded this morning's session, is a subject that was close to Ray Garrett's heart. During the time he was Chairman of the SEC, he made nearly a dozen speeches bearing on the role of lawyers, and he had already sired the subcommittee that ultimately matured into the Committee on Counsel Responsibility of the ABA's Section of Corporation, Banking and Business Law. I mean today to address one facet of the subject of counsel responsibility in securities law practice, and also to address a facet of SEC responsibility in the agency's dealings with lawyers.

But allow me a personal note for a moment. My relationship to Ray was one of admiration and respect on my part. I am pleased to think that in some way I earned his respect, since I was included on that original subcommittee and he afforded me several lengthy personal conversations after leaving the SEC. Reviewing his speeches for today, I could just hear his deep voice and his rolling cadences, and I do think that this Institute is a fitting tribute to a very great lawyer and a truly honorable man.

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Let me start with a distinction made in the Code of Professional Responsibility, 1/ and emphasized by Ray and by Al Sommer (his colleague on the Commission at the time), between the role of the lawyer as adviser, whether or not also a stockholder or director or acting in any other capacity, and the role of the lawyer as advocate. I think that distinction must be accompanied by recognition that the advisory role, at least in the securities field, is frequently the precursor of advocacy -- advocacy to opposing parties, to regulatory personnel, and sometimes to those for whom the direct recipients of the lawyer's advice stand as proxies. Even with that qualification, however, it is a distinction that is generally accepted, as reflected in the Ethical Considerations of the CPR.

For example:

> Where the bounds of law are uncertain, the action of a lawyer may depend on whether he is serving as advocate or adviser. . . . While serving as advocate, a lawyer should resolve in favor of his client doubts as to the bounds of the law. In serving a client as adviser, a lawyer in appropriate circumstances should give his professional opinion as to what the ultimate decisions of the courts would likely be as to the

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1/ Model Code of Professional Responsibility (1979).

applicable law. 2/

And again:

> A lawyer as adviser furthers the interest of his client [not only] by giving his professional opinion as to what he believes would likely be the ultimate decision of the courts on the matter at hand [but also] by informing his client of the practical effect of such decision. 3/

And then again:

> A lawyer appearing before an administrative agency, regardless of the nature of the proceeding [i.e., whether as advocate or as at least quasi-adviser] . . . , has the continuing duty to advance the cause of his client within the bounds of the law. 4/

These ECs derive from Canon 7, a Canon that relates to zealousness and, I think, in the context of administrative law practice at any rate, a Canon that reflects the underlying value of the independence of the practicing Bar.

The SEC's response in this area has always reflected the practicalities that face a federal regulatory agency with broad jurisdiction and limited funds, in dealing with a group as diverse as the practicing Bar. Jawboning and coopting has been one approach. In the often-cited Emanuel Fields footnote, the SEC stressed the "peculiarly strategic" and "especially central" position of the practicing lawyer in the investment process and in the enforcement of laws "aimed at keeping that process fair":

> Members of this Commission have pointed out time and time again that the task of enforcing the securities laws rests in overwhelming measure on the bar's shoulders. These were statements of what all who are versed in the practicalities of securities law know to be a truism, i.e., that this Commission with its small staff, limited resources, and onerous tasks is peculiarly dependent on the probity and the diligence of

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2/ Id. EC 7-3.

3/ Id. EC 7-5.

4/ Id. EC 7-15.

> the professionals who practice before it. Very little of a securities lawyer's work is adversary in character. He doesn't work in courtrooms where the pressure of vigilant adversaries and ale[r]t 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 community, and the investing public must take on faith. This is a field where unscrupulous lawyers can inflict irreparable harm on those who rely on the disclosure documents that they produce. Hence we are under a duty to hold our bar to appropriately rigorous standards of professional honor. 5/

A second response on the part of the Commission has been selective prosecution of egregious cases, to make broad law out of bad practice. You will all remember United States v. Benjamin, 6/ where there were outright lies, falsification of stock, and a bad legal opinion. In deciding the appeal in Benjamin, Judge Friendly stated:

> In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar. . . . Congress . . . could not have intended that men holding themselves out as members of these ancient professions should be able to escape criminal liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen or have represented a knowledge they knew they did not possess. 7/

And, of course, a third response by the SEC has been action taken under Rule 2(e), the disbarment rule. This SEC response, I think, is based on an understanding, best articulated in Al

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5/ In re Emanuel Fields, 45 S.E.C. 262, 266 n.20 (1973).

6/ 328 F.2d 854 (2d Cir. 1964), cert. denied, 377 U.S. 953 (1964).

7/ Id. at 863.

Sommer's "Emerging Responsibilities" speech, 8/ that the public will stand for no less than a high standard of professional responsibility in SEC-oriented practice directed at disclosure to the securities markets:

> Society in general, the securities law in particular, is in a period of revolution and usually efforts to hasten the conclusion of a revolution are unavailing. . . . Thus, conduct [which] might have been tolerable in other ages becomes unacceptable in these times. The accountants' conduct clearly comes under new, more urgent, more searching scrutiny. The standards by which directors carry out their responsibilities in publicly-held companies are similarly undergoing critical reexamination. It is not given to any group in society, and certainly not lawyers, to be insulated from these trends. 9/

True, all true. But the value of independence that underlies the Ethical Considerations is of extraordinary importance to our common-law-based American society. And I think preservation of that independence evokes a resistance, an effort not to avoid social change but to preserve a fundamental value without sacrificing Judge Friendly's proper and universally accepted affirmance in Benjamin.

I offer, then, as my rationale for resistance not the importance of confidentiality (which is the traditional ground), but rather the importance of independence. Adapting a bit from The Federalist Papers: In a monarchy, the Bar is an excellent barrier to the despotism of the prince; in a republic, it is a no less excellent barrier to the encroachments and oppressions of the representative body -- and, in the late Twentieth Century, to the encroachments and oppressions of the federal administrative agencies by which the law is applied. 10/ Hamilton was writing about the Judiciary rather than the Bar, but what he wrote seems to me logically to extend to the Bar itself. There is, after all, no more vital "barrier", to use Hamilton's word, than the

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8/ A.A. Sommer, The Emerging Responsibilities of the Securities Lawyer, reprinted in [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶79,631, at 83,686 (Jan. 1974).

9/ Id. at 83,691-2.

10/ See The Federalist No. 78, at 502, 503 (A. Hamilton) (Modern Library ed., introduction dated 1937).

Judiciary coupled with the Bar as officers of the court.

Unlike accountants, whose role is analyzed in the Arthur Young opinion, 11/ it seems to me that lawyers do not assume such a public responsibility as to transcend their relationships with their several clients, nor do lawyers undertake a special ultimate role as "public watchdogs", in the Supreme Court's phrase, 12/ on behalf of creditors and the investing public generally. Congress recognized that professional difference in its ban on licensing by federal agencies, which applies to lawyers but not accountants. 13/

Does this lead me to conclude that lawyers are somehow immune from prosecution by the SEC? Far from it. There is a real distinction between the Bar, which (as I see it) must be independent, and the blackguards and renegades who traduce its principles and smear its reputation. How do I know the blackguards and renegades? Is this to be like pornography, understood by what stimulates my prurient interest? 14/ No. Lawyers are no different from anyone else in our society. The securities laws apply to lawyers just as they do to everyone else. So, generally speaking, any lawyer may be prosecuted for violating the law -- section 5, section 17(a), sections 9(a), 10(b), and 15(c), and the rules thereunder, section 13(d) and sections 14(d) and (e), among others, or for aiding and abetting a violation of those sections and rules, or of sections 13(a) and (b) or section 15(d), or any other provision that is of relevance in a particular case -- and a lawyer should be considered for civil or criminal prosecution in just the same manner as anyone else.

I will modify that proposition in only one respect, which

11/ United States v. Arthur Young & Co., 465 U.S. 805 (1984).

12/ Id. at 818.

13/ Compare 5 U.S.C. §500(b) (1982) (member in good standing of the bar of any state may practice before any federal agency) with id. §500(c) (individual qualified to practice as CPA in any state may practice before IRS). For an accountant's view of the proper role of the CPA, compared to and contrasted with the traditional roles of doctor and lawyer, see C.E. Graese, Honesty and Professional Ethics: Focus on Accounting, in The Ethical Basis of Economic Freedom 197 (I. Hill ed. 1976).

14/ Cf. Jacobellis v. Ohio, 378 U.S. 184, 197 (Stewart, J., concurring).

relates to aiding and abetting. In its August 1975 Statement of Policy, the ABA affirmed that, "if the conduct of a client clearly establishes [my emphasis] his prospective commission of a crime [read: a criminal violation of the securities laws] or the past or prospective perpetration of a fraud in the course of the lawyer's representation," then the lawyer may make disclosure. 15/ "However, the lawyer has neither the obligation nor the right to make disclosure when any reasonable doubt exists concerning the client's obligation of disclosure. . . ." 16/ I do think that, if a lawyer is to be prosecuted for aiding and abetting, or for one of those occasional principal violations that are grounded in participation and are really aiding and abetting matters, and if the lawyer has acted solely as a lawyer, then the element of "clearly establishes" that was articulated by the ABA should be a prerequisite to that portion of the aiding and abetting definition that calls for substantial participation by the defendant -- and you may be assured that that element usually is present in the cases brought to the Commission table. (I understand that my one modification of the general principle has more substance than appears on the surface, because it accepts the Code of Professional Responsibility and its ABA interpretations, or the Model Rules of Professional Conduct, the Code's successor, as the basic standard by which lawyers' professional conduct is to be judged; I think that's implicit in what else I've said, but I don't want you to think it comes without my understanding.)

Now, to say that, in abstract theory, any lawyer may be prosecuted as a principal violator, or as an aider and abettor, still leaves two issues. First, should a particular lawyer be prosecuted on the particular facts? Subject to the "clearly establishes" element that I pointed to a moment ago, this determination should be the same as for any other possible defendant. There is a wide variety of prosecutorial discretion, and, while I can understand some role for discretion at the very margin (going to the notion of an "atmosphere" created by the enforcement authorities -- an atmosphere more (or less) conducive to advancing the client's interests without constant self-protection by the Bar), I don't think there is much of a special issue here for lawyers.

The second issue, however, is more substantial. By what

15/ Statement of Policy Adopted by American Bar Association Regarding Responsibilities and Liabilities of Lawyers in Advising with Respect to the Compliance by Clients with Laws Administered by the Securities and Exchange Commission ¶4 reprinted in 31 Bus. Law. 543, 545 (1975) [hereinafter cited as Statement of Policy].

16/ Id.

procedure -- under what enforcement alternative -- in what kind of proceeding -- should a lawyer be prosecuted? And here I do see a difference. Not as to whether there should be a criminal reference, formal or informal; 17/ again, except at the very margin, where there may be an effect on the notion of "atmosphere" already recited, I don't think a lawyer should get any special treatment as to a possible criminal reference. But should there be an injunctive proceeding 18/ or an administrative proceeding 19/ or a Rule 2(e) proceeding 20/ (just to pick the three alternatives most frequently used)?

Let me pose a hypothetical case. Suppose a lawyer for an issuer engaged in active but yet-unsuccessful merger negotiations blesses a press release stating that "there are no material corporate developments that account for the market activity." If that lawyer is to be prosecuted for his actions as a lawyer, presumably by an SEC angry at him for flouting the Carnation decision, 21/ it seems to me that, given the opinions of the Third 22/ and Seventh 23/ Circuit Courts of Appeal, the client's violation is not clearly established, so I shouldn't think that a prosecution would lie at all. But suppose, by way of an alternative hypothetical, that a lawyer for a 7% discretionary beneficial owner of stock in a public company, an owner that is a broker-dealer, is told by his client of the existence of a

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17/ See, e.g., 17 C.F.R. §§200.19b (third sentence), 200.21(a) (third and fourth sentences), 200.30-4(a)(7) (1986). See also, e.g., id. §§230.122 (second sentence), 240.0-4 (second sentence).

18/ See, e.g., 15 U.S.C. §77t(b) (1982); 78u(d)(1) (Supp. III 1985).

19/ See, e.g., id. §78o(b)(6) (1982); id. §78o(c)(4) (Supp. III 1985).

20/ See 17 C.F.R. §201.2(e) (1986).

21/ In re Carnation Co., SEC Securities Exchange Act Release No. 22,214 (July 8, 1985), 33 SEC Docket (CCH) 874.

22/ See Staffin v. Greenberg, 672 F.2d 1196, 1204-7 (3d Cir. 1982); Greenfield v. Heublein, Inc., 742 F. 2d 751, 756-8 (3d Cir. 1984).

23/ See Flamm v. Eberstadt, [Current] Fed. Sec. L. Rep. (CCH) ¶93,178, at 95,799, 95,804-5 (7th Cir. Mar. 9, 1987).

Boesky-type parking arrangement 24/ with and for the benefit of a third party that is well-financed and is almost ready to lunge for control of a public company, and suppose that the lawyer blesses a filing on Schedule 13G, 25/ pointing out that the filing will not be due until February of the following year. 26/ If that lawyer is prosecuted for his actions as a lawyer (and I hope it's plain that I've tried to set this one up so it's quite easy), then the violation by his client is clearly established and proceeds directly from his advice, and it seems to me that a proceeding should be brought seeking an injunction.

I have repeatedly postulated prosecution for the lawyer's actions as a lawyer. Now suppose that the same lawyer is also an officer or a director of the broker-dealer, so that in effect he is both lawyer and client, or suppose he gives legal advice and also acts as a direct participant in the transaction. I would treat him as a lawyer nevertheless, and give him any benefit that inures to him from his lawyer status as opposed to his principal status. That benefit, if there is any, comes because it is also possible to bring an administrative proceeding against the lawyer, either under section 15(b)(6), as an "associate" of my hypothetical broker-dealer, 27/ or under section 15(c)(4), as a "person who was a cause of the failure to comply due to an act or omission [he] knew or should have known would contribute to the failure to comply." 28/ Such an administrative proceeding may be brought before an ALJ 29/ under section 15(b)(6) or section 15(c)(4), with any appeal addressed back to the very Commission that authorized the proceeding in the first place, 30/ perhaps en route to review of the law in the Court of Appeals. 31/

24/ See SEC Litigation Release No. 11,370 (Mar. 19, 1987), 37 SEC Docket (CCH) 1286.

25/ 17 C.F.R. §240.13d-102 (1986). The conditions to availability of Schedule 13G pertinent to the facts hypothesized are set forth at id. §240.13d-1(b)(1)(i)-(ii)(A).

26/ See id. §240.13d-1(b)(1).

27/ 15 U.S.C. §78o(b)(6) (1982).

28/ Id. §78o(c)(4) (Supp. III 1985) (amending id. §78o(c)(4) (1982)).

29/ 17 C.F.R. §§200.14(a), 201.1, 201.11, 201.16 (1986).

30/ Id. §§201.12, 201.17.

31/ 15 U.S.C. §78y(a)(1) (1982).

I do conclude, on this hypothetical set of facts, that the client's violation is clearly established. But I don't believe that my conclusions can't be wrong -- and, if the matter has the potential to become a question of the application of professional standards to securities law concepts such as "contribute to the failure to comply" 32/ or, more commonly, "omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading", 33/ I don't doubt the SEC could decide a section 15(b)(6) or 15(c)(4) appeal from an ALJ decision, but I feel strongly that the matter ought to be determined by a federal judge in an Article III proceeding. 34/

A fortiori, I don't believe that a Rule 2(e) proceeding should be used to set professional standards. Let me advance two interrelated explanations for this position. One explanation was given best by the Commission itself in its Carter-Johnson opinion:

> If a securities lawyer is to bring his best independent judgment to bear on a disclosure problem, he must have the freedom to make innocent -- or even, in certain cases, careless -- mistakes without fear of legal liability or loss of the ability to practice before the Commission. Concern about his own liability may alter the balance of his judgment in one direction as surely as an unseemly obeisance to the wishes of his client can do so in the other. 35/

The second explanation again comes from the 1975 ABA Statement of Policy:

> Efforts by the government to impose responsibility upon lawyers to assure the quality of their clients' compliance with the law or to compel lawyers to give advice resolving all doubts in favor of regulatory restrictions would evoke serious and far-

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32/ Id. §78o(c)(4) (Supp. III 1985).

33/ 17 C.F.R. §240.10b-5 (1986).

34/ See U.S. Const. art. III, §2, para. 1.

35/ In re Carter and Johnson, SEC Securities Exchange Act Release No. 17,597 (Feb. 28, 1981), 22 SEC Docket (CCH) 292, 316.

> reaching disruption in the role of the lawyer as counselor, which would be detrimental to the public, clients and the legal profession. 36/

Professional malfeasance and professional nonfeasance is undoubtedly a stain on the Bar. Cases under the securities laws rarely have been as egregious as a recent ICC-oriented case in which the opinion of the Court of Appeals for the District of Columbia related that a complaint seeking sanctions against a lawyer had been filed with the appropriate state bar authorities, and that those state proceedings had been dismissed on the ground that the evidence available couldn't support the allegation of misconduct on a "clear and convincing" standard. 37/ It was an egregious case. Perhaps because there seemed nowhere else to look to provide a sanction, Judge Mikva concluded that "[t]here can be little doubt that the [Interstate Commerce] Commission, like any other institution in which lawyers . . . participate, has authority to police the behavior of practitioners appearing before it." 38/

If Judge Mikva meant that lawyers' actions impacting on the processes of the ICC (this having been a quasi-adjudicatory proceeding) are subject to the inherent power, usually but not only identified with a tribunal, of the ICC to safeguard itself and its proceedings, I have no disagreement. But if Judge Mikva meant that lawyers' professional standards (this having been a conflict-of-interests case) are subject to being set and changed and adjudged by a federal regulatory agency, I strongly disagree. And I call Ray Garrett to the stand as my expert witness:

> The use of Rule 2(e) has . . . attraction. In some cases it has clearly seemed like the appropriate remedy with respect to lawyers whose sins have extended to misrepresentations if not outright lies in their dealings with the Commission itself [or, if you would prefer, in their dealings with disclosure matters affecting public

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36/ Statement of Policy, supra note 15, ¶5, reprinted in 31 Bus. Law. at 545.

37/ See Polydoroff v. Interstate Commerce Commission, 773 F.2d 372, 373 (D.C. Cir. 1985).

38/ Id. at 374.

> investors]. But I doubt whether it can ever serve as an appropriate vehicle for enunciating professional guidelines. 39/

To return to the point of my beginning: I am proud to be a lawyer, to be an officer of the court. I believe that the Bar's role as a "barrier" to overreaching by Government is too vital a part of our democratic heritage to concede to any mere agency the power to determine professional standards.

I do not believe that the SEC has that power. I do believe that, if the power exists, it should not be exploited.

39/ R. Garrett, New Directions in Professional Responsibility, reprinted in 29 Bus. Law. 7, 13 (Mar. 1974 Special Issue).