SEC ENFORCEMENT ACTIONS AGAINST SECURITIES LAWYERS: NEW REMEDIES VS. OLD POLICIES

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I. INTRODUCTION

Why is the Securities Exchange Commission (SEC or Commission)[1] concerned about lawyer discipline? Catching a few unscrupulous practitioners who subvert the SEC's processes by lying to the staff or filing false documents is perhaps the least important reason. The SEC is far more concerned with the misconduct of the securities markets' principal players — the lawyers' clients. By disciplining lawyers for failing to adhere to standards of conduct that, in the SEC's view, are adequate, lawyers will have an incentive to monitor and deter their clients' misconduct. Deterring violations protects the investing public for whose benefit the securities laws were enacted. Lawyers, in the SEC's view, can be required to participate in providing that protection because lawyers owe a responsibility, if not a duty, to the investing public.[2]

The view that a lawyer has a responsibility to the public is undisputed. Subsumed within the concept of belonging to a profession or being a professional is the idea of societal responsibility.[3] Lawyers are

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[1]The SEC or the Commission, as used in some contexts in this article, refers to action taken by the official body. In other contexts, especially when discussing the agency's objectives and views, the term SEC or the Commission is simply used as a shorthand term referring to a model conceived as embodying a concept. References to the bar and the legal profession in this article refer to a model in this sense.

[2]Lewis D. 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, 424 (1974) (noting the Commission's view of the "unique public responsibilities" and commensurate "public standard of care" of the securities lawyer).

[3]WILLIAM M. SULLIVAN, WORK AND INTEGRITY: THE CRISIS AND PROMISE OF PROFESSIONALISM IN AMERICA 2 (1995) (describing the three characteristics typically used to distinguish occupations considered professions as: (1) specialized training in a particular field of knowledge, (2) commitment to public service going beyond the economic welfare of the practitioner, and (3) autonomy of the profession to regulate its own standards of practice); *see also* ANTHONY T. KRONMAN, THE LOST LAWYER: FAILING IDEALS OF THE LEGAL PROFESSION 14-15 (1993) (describing the lawyer-statesman ideal that a lawyer is an individual who cares about the public good); Robert W. Gordon & William H. Simon, *The Redemption of Professionalism?*, *in* LAWYERS' IDEALS/LAWYERS' PRACTICES 230-31 (Robert L. Nelson et al. eds., 1992) (stating that social commitment in the professional ideal makes possible the

responsible to the public even while they owe their primary duty of loyalty to the client. At times the duties to each group will compete for the lawyer's judgment and action. The difficult issues in the context of securities laws are who determines the standards the lawyer must use to make the judgments needed to carry out those competing duties, and who has the authority to discipline lawyers who fail to meet those standards. The legal profession asserts, as do other professions, that the right and responsibility to regulate itself is part of what it means to be a profession.[4]

Regardless of that assertion, the organized bar has done little to establish standards of conduct useful to securities lawyers. The bar has not hesitated, however, to focus its resources on resisting the SEC's attempts to assert authority over setting professional standards. The SEC has been somewhat more successful. Standards of conduct, to the extent they have been articulated, have been adduced from cases brought against lawyers in SEC and private actions.[5] The process of SEC standard setting is not necessarily obvious. Even in actions that result in consent decrees or in a refusal to sanction, the SEC exercises its authority through the kind of conduct it targets and in dicta written about that conduct. Securities lawyers, taking these pronouncements seriously, incorporate them in practice. The lawyers risk incurring reputational and monetary costs if their failure to follow these standards results in the SEC challenging their conduct.[6]

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institutional element of autonomy and compensates for the inability of market forces or government to regulate the occupation). *But see* RICHARD L. ABEL, AMERICAN LAWYERS 14-39 (1989) (describing various economic and sociological theories of the professions that reduce professions to cartels with ethical rhetoric used as mere rationalization of the ideal in order to secure immunity from the market).

[4]*See* ABEL, *supra* note 3, at 37-39 (discussing self-regulation as an essential characteristic of professions).

[5]*See, e.g.*, Lowenfels, *supra* note 2, at 412-38 (describing, as of 1974, the body of law that expanded duties and responsibilities of lawyers under the federal securities laws).

[6]*See* Susan P. Koniak, *The Law Between the Bar and the State*, 70 N.C. L. REV. 1389 (1992). Professor Koniak, in describing how the bar's normative system (ethics) competes and conflicts with the state's normative system (law), argues that courts have shown a weak commitment to creating rules and enforcing those rules in cases involving the law governing lawyers. *Id.* at 1461-78. She further argues that the bar's commitment, on the other hand, is strong in resisting encroachments on its own normative vision of maximizing lawyers' freedom of action. *Id.* at 1478-85.

Professor Koniak's concept of dynamic competition is useful in understanding the interaction between lawyers and the SEC. As Professor Koniak readily admits, the normative systems of state and bar she describes are not monolithic. *Id.* at 1392. Securities lawyers, as a group, almost certainly have a different normative understanding of their ethics from other members of the bar and the SEC has a different normative view of lawyer conduct from other

The SEC's objectives in disciplining lawyers serve one direct and two indirect interrelated purposes. Its direct purpose is to sanction and deter the misconduct of lawyers.[7] Its indirect purposes are (1) to provide an incentive for lawyers to monitor and deter their clients' misconduct,[8] and (2) to provide occasions for the SEC to define standards of professional conduct that assist in the enforcement of the securities laws it administers.[9]

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government agencies. These competing views are not static and each influences the other. In circumstances where the organized bar has been reluctant to set standards for securities lawyers and the courts are weakly committed, the field for standard setting has largely been left to the SEC. Securities lawyers, in turn, have incentives to adopt these standards to protect their human capital gained in specializing in securities laws.

[7]*See infra* Part II.

[8]The Commission has stated its position that lawyers serve as gatekeepers to the market:

> 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. . . . [T]his Commission with its small staff, limited resources, and onerous tasks is peculiarly dependent on the probity and the diligence of 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 alet [sic] 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.

In re Fields , 45 S.E.C. 262, 266 n.20 (1973), *aff'd without opinion*, 495 F.2d 1075 (D.C.C. 1974). *Cf.* John C. Burton, *SEC Enforcement and Professional Accountants: Philosophy, Objectives and Approach*, 28 VAND. L. REV. 19, 20 (1975) (describing SEC enforcement actions against accountants as important because these professionals provide financial information to the investing public); *see generally* Harvey L. Pitt & Karen L. Shapiro, *Securities Regulation by Enforcement: A Look Ahead at the Next Decade*, 7 YALE J. ON REG. 149, 171-75 (1990) (discussing the use of enforcement actions against lawyers and other professionals to control market participants conduct).

[9]*See generally* James R. Doty, *Regulatory Expectations Regarding the Conduct of Attorneys in the Enforcement of Federal Securities Laws: Recent Development and Lessons for the Future*, 48 BUS. LAW. 1543 (1993) (discussing the special professional responsibilities of securities lawyers as defined through the leading SEC cases against lawyers).

For example, the SEC has developed a professional standard that a lawyer, knowing that an officer of a corporation has failed to act on the lawyer's advice as to a securities law violation, has a duty "to go up the line" over senior management's heads to his client's board of directors to try to obtain compliance with the securities laws. *See infra* notes 56-69, 82-85 and accompanying text (discussing the development of the professional standard that a securities lawyer has a duty to go up the line when his/her compliance advice is being ignored by management). The SEC has, in several actions, articulated this standard of conduct as the lawyer's professional responsibility even though a lawyer has yet to be sanctioned for failing

The SEC's direct purpose, sanctioning lawyer misconduct, does not produce opposition from the bar when the conduct is egregious and a court, rather than the Commission, imposes the sanction.[10] The SEC is responsible for the civil enforcement of the securities laws, and lawyers enjoy no special dispensation from sanctions when they violate those laws. Similarly, the SEC's authority to proceed administratively against a lawyer who engages in improper conduct while representing a client before the Commission is not generally questioned.[11] Congress authorized the Commission to make rules to protect the integrity of its processes.

On the other hand, the bar has vigorously and consistently opposed those disciplinary actions viewed as attempts by the SEC to make lawyers into "gatekeepers" to the markets or to define standards of professional responsibility.[12] The objections are based on legal and policy grounds.

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to go up the line.

In fulfilling the SEC's objectives to prevent securities law violations, the standard has merit because even when an officer or senior management chooses to risk the violation, the boards of directors of public companies have little tolerance for facing the litigation consequences of securities law violations. However, unless the violation is obvious and severe, it can present difficult judgment calls for either inside or outside lawyers to second guess senior management and go over their heads. It is easy to say that the dilemma for the lawyer is only in losing his employment, but in fairness, when the violation is in the grey area, the problem of "going to the mat" or "living to fight another day" is a judgment call that can face anyone acting in good faith. After the fact, the call always looks easy. The point is that the lawyer should be permitted to guess wrong or make a mistake without suffering the obloquy of SEC sanctions.

The requirement of "going up the line" with information of illegal acts has even been recently codified with respect to accountants. A public accountant, who in the course of conducting an audit of a public company finds "information indicating that an illegal act" may have occurred, is required to report the information, if necessary, to the board. 15 U.S.C.A. § 78j-1(b)(1)-(3) (1996). If the accountant, after informing the appropriate level of management, concludes that the company has not taken appropriate remedial action in response to the information, the accountant must report to the board of directors. *Id.* § 78j-1(b)(2). The board must in turn notify the Commission of the report, and if it fails to do so, the accountant must send the report to the Commission. *Id.* § 78j-1(b)(3).

[10]*See infra* note 72 and accompanying text (noting that the SEC's declaration, that it would not begin sanction proceedings until a court first declared that a securities violation existed, defused the bar's anger).

[11]In *In re Keating, Muething & Klekamp*, Commissioner Karmel dissented from the Commission's order imposing sanctions on a law firm, arguing that the Commission's use of Rule 2(e) to sanction unethical or incompetent lawyers was an invalid exercise of its power. *In re* Keating, Muething & Klekamp, 47 S.E.C. 95, 109 (1979) (Karmel, SEC Commissioner, dissenting). She conceded the Commission had power to discipline lawyers, but only to the extent necessary to "keep its proceedings orderly and dignified." *Id.* at 111-12.

[12]*See, e.g.*, David B. Wilkins, *Who Should Regulate Lawyers?*, 105 HARV. L. REV. 799, 836 (1992) (positing that the SEC has appeared to engage in "overzealous enforcement" actions

The legal challenges to the SEC's rule-making authority have failed, although a recent appellate court decision raises unresolved issues as to the extent of that authority.[13]

Commentators' policy objections center on their views that the SEC's actions are an unwarranted interference with the lawyer-client relationship and the bar's independence.[14] The battleground between the bar and the SEC has been centered primarily on issues of lawyer-client confidentiality. Commentators argue that the SEC interferes with the lawyer-client relationship to the extent that it attempts to require lawyers to reveal client confidences to prevent client securities law violations.[15] The principle that traditionally justifies a lawyer's duties of loyalty and confidentiality is the need to foster complete and honest communication

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against lawyers in order to encourage lawyers to serve as watchdogs over their clients).

[13]*See infra* text and accompanying notes 109-23 (discussing the decision in Checkosky v. SEC, 23 F.3d 452 (D.C. Cir. 1994) (per curiam)).

[14]*See* ROBERTA S. KARMEL, REGULATION BY PROSECUTION: THE SECURITIES AND EXCHANGE COMMISSION VS. CORPORATE AMERICA 173-83 (1982) (describing the issues surrounding Rule 2(e) actions and arguing that the SEC's discipline of lawyers interferes with the individual's right to counsel); Association of the Bar of the City of New York, *Report by Special Committee on Lawyers' Role in Securities Transactions*, 32 BUS. LAW. 1879 (1977) (describing the work of securities lawyers and setting forth specific guidelines for legal opinions and assisting in preparation of registration statements); Joseph C. Daley & Roberta S. Karmel, *Attorneys' Responsibilities: Adversaries at the Bar of the SEC*, 24 EMORY L.J. 747, 765-66 (1975) (arguing that because SEC and private lawyers are adversaries, the SEC is not the proper agency to discipline lawyers); Robert A. Downing & Richard L. Miller, Jr., *The Distortion and Misuse of Rule 2(e)*, 54 NOTRE DAME LAW 774 (1979) (criticizing SEC's Rule 2(e) proceeding on grounds of a usurpation of authority, or lack of due process afforded the professional); Norman S. Johnson, *The Dynamics of SEC Rule 2(e): A Crisis for the Bar*, 1975 UTAH L. REV. 629, 631-48 (criticizing Rule 2(e) for lack of identifiable standards of care and for attempting to resolve professional responsibility issues by broad references to the importance of lawyer's role); Norman S. 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 (1974) (describing the expansion of the SEC's use of Rule 2(e) and arguing that the independence of the lawyer must be considered); Simon M. Lorne, *The Corporate and Securities Adviser, the Public Interest, and Professional Ethics*, 76 MICH. L. REV. 423, 453-58 (1978) (arguing that SEC claims against lawyers gain significance far beyond the activity cited and that most claims are settled by consent and are overstated); Simon M. Lorne & W. Hardy Callcott, *Administrative Actions Against Lawyers Before the SEC*, 50 BUS. LAW. 1293, 1300-03 (1995) (describing the private securities bar's objections to SEC's actions against securities lawyers); Harold L. Marquis, *An Appraisal of Attorneys' Responsibilities Before Administrative Agencies*, 26 CASE W. RES. L. REV. 285, 287-95 (1976) (questioning the efficacy of using lawyers to monitor clients and outlining disadvantages of SEC regulating lawyer conduct); Francis M. Wheat, *The Impact of SEC Professional Responsibility Standards*, 34 BUS. LAW. 969 (1979) (outlining the SEC's aggressive enforcement actions in the 1970s and the steps taken by the ABA in addressing the issues).

[15]*See, e.g.*, Marquis, *supra* note 14, at 291-92. The author argues that "[t]he primary duty of the securities attorney should remain to his client and not the Commission." *Id.* at 292.

— so the lawyer can learn the facts needed to advise clients effectively on how to comply with the law.[16] Commentators assert that the government's attempt to define the lawyer's duties to the client strikes at the heart of the lawyer-client relationship.[17] "Whistle blowing" rules for the benefit of a particular regulatory scheme serve only to undermine the more important public policy achieved through the lawyer-client relationship built on the duties of confidentiality and loyalty.[18]

Moreover, arguments state that efforts by the SEC to impose obligations on lawyers to ensure their clients comply with the law, or to coerce lawyers to resolve all doubts in favor of regulatory restrictions, interfere with a person's right to counsel, a right protected by common law principles and the Sixth Amendment.[19] Government interference with the independence of the legal profession has important public policy implications that should not be subordinated to the regulatory objectives of an agency. An independent legal profession protects citizens from the abuses of government.[20] That protection is important to preserve the democratic principle of limited government.[21] Professional independence

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[16]Upjohn Co. v. United States, 449 U.S. 383, 389 (1981). In stating the purpose of the evidentiary rule of attorney-client privilege, which is contained within the duty of confidentiality, the Supreme Court stated:

> [The] purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice. The privilege recognizes that sound legal advice or advocacy serves public ends and that such advice or advocacy depends upon the lawyer's being fully informed by the client.

Id.; *see also* Lee A. Pizzimenti, *The Lawyer's Duty to Warn Clients About Limits on Confidentiality*, 39 CATH. U. L. REV. 441, 443-51 (1990) (discussing the different legal and moral rationales given for the confidentiality rule).

[17]*See, e.g.*, Lorne & Callcott, *supra* note 14, at 1303 (noting that even the SEC itself has recognized that because the attorney-client relationship is special, "administrative enforcement proceedings which endanger lawyers' ability to represent their clients adequately present a potential danger that is different in kind from that posed by enforcement proceedings against other types of professionals").

[18]*See, e.g.*, Albert W. Alschuler, *The Preservation of a Client's Confidences: One Value Among Many or a Categorical Imperative?*, 52 U. COLO. L. REV. 349 (1981) (arguing that the lawyer-client relationship of trust is the chief value of the confidentiality principle because it promotes client autonomy and a sense of fair play).

[19]American Bar Association, *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*, 31 BUS. LAW. 543, 545 (1975).

[20]*Id.* at 546-47.

[21]*See* Wilkins, *supra* note 12, at 854-55 (stating that arguments for professional independence based on a conception of the public good fall into two categories: (1) "that an independent legal profession is necessary to maintain the separation of powers . . . [and (2)] that an independent legal profession . . . preserv[es] the rights of citizens in a democracy").

can be lost through government attempts to define lawyers' duties or, to impose upon lawyers duties to the public that would erode a lawyer's duty of loyalty to a client.

Some commentators argue that an agency, such as the SEC, that has prosecutorial functions will intimidate lawyers if that agency has the power to take disciplinary action against vigorous adversaries.[22] That power can chill the lawyer's zealous representation, whether the lawyer is acting as an advisor or an adversary.[23] The potential for abuse is compounded when the SEC's administrative law judges hear disciplinary cases in a forum perceived as biased in favor of the SEC.[24] In administrative actions, the SEC combines judicial authority with prosecutorial authority to enforce and interpret rules and regulations made pursuant to its own legislative authority.[25] Impartiality, or at least the appearance of impartiality, cannot be maintained when all three functions are exercised by one body.

These objections, however, do not address the issue of what action the SEC should take when a lawyer's services are implicated in a violation of the securities laws. The SEC's direct purpose of enforcing the securities laws against lawyers who violate them is often intertwined

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[22]*See* MONROE H. FREEDMAN, LAWYERS' ETHICS IN AN ADVERSARY SYSTEM 21-22 (1975) (arguing that the SEC has intimidated lawyers through regulatory excesses); Monroe H. Freedman, *A Civil Libertarian Looks at Securities Regulation*, 35 OHIO ST. L.J. 280, 285 (1974) (same); Jonathan R. Macey & Geoffrey P. Miller, *Reflections on Professional Responsibility in a Regulatory State*, 63 GEO. WASH. L. REV. 1105, 1110 (1995) (noting Monroe Freedman's analysis and determination that the SEC intimidates lawyers in order to curtail zealous advocacy).

[23]The problem of lawyer intimidation is even more complex than simply fear of SEC enforcement actions. Macey and Miller argue that lawyers who regularly practice before agencies are repeat players whose interests can diverge from their clients' desire or need for zealous advocacy. Macey & Miller, *supra* note 22, at 1110. Lawyers may not exercise enough zealousness because they are fearful of alienating the agency staff or being held in low esteem. *Id.* Lawyers therefore, acting out of rational self-interest, especially when the individual lawyer has devoted considerable human capital in developing a specialized practice, are already intimidated in dealing with the SEC without need of SEC enforcement actions. *Id.*

[24]The bar has criticized the SEC's administrative law courts as being plagued by procedural irregularities that do not offer defendants adequate procedural protections. *E.g.*, American Bar Association Committee on Federal Regulation of Securities, *Report of Task Force on the SEC Administrative Law Judge Process*, 47 BUS. LAW. 1731, 1732-33 (1992). The structure for initiating and conducting the proceedings, the bar argues, is fraught with "perceived and actual unfairness inherent in the Commission's dual prosecutorial and judicial roles." *Id. But see* Lorne & Callcott, *supra* note 14, at 1309-12 (arguing that the SEC's efforts to improve the SEC's administrative proceedings "should have substantially alleviated any possible perception that the [proceedings are] unfair").

[25]*See Report of Task Force on the SEC Administrative Law Judge Process*, *supra* note 24, at 1733 (noting the dual prosecutorial and judicial roles of the SEC).

with the two indirect purposes of deterring client misconduct and setting professional standards. The indirect purposes implicate the broader issues of interference with the lawyer-client relationship and the bar's independence in regulating its members. The bar, however, often finds itself in the uncomfortable position of voicing its objections in the context of specific proceedings that involve intentional or suspicious lawyer wrongdoing. When arguments against interfering in the profession's independence are raised in a context where lawyers have failed, the arguments too often sound self-serving.

The bar's arguments were raised in response to high profile cases brought by the SEC in the late 1970s.[26] These arguments may have influenced a change in SEC policy after an active period of SEC enforcement actions against lawyers produced intense controversy between the bar and the SEC. To diffuse that controversy, the SEC's General Counsel, Edward Greene, in 1982, announced a practice of prosecutorial restraint in bringing administrative actions against lawyers.[27] Administrative disciplinary actions against a lawyer for unprofessional conduct, Greene stated, would be initiated only after a district court had found that the lawyer had violated the securities laws.[28] This requirement of an independent court's determination that a lawyer had committed a securities violation would act as a safeguard against the potential for abuse that concerned many members of the bar. The forum of the district court is impartial and the SEC would have to prove that a lawyer acted with scienter[29] before the SEC could disbar or suspend the lawyer for unprofessional conduct. This policy appeared to strike a satisfactory balance between the concerns of the SEC and the bar.

Recent developments create uncertainty as to whether the Greene policy will be maintained. First, the SEC will find it more difficult to

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[26]*See, e.g.*, Edward F. Greene, *SEC General Counsel's Remarks on Lawyer Disciplinary Proceedings*, 14 Sec. Reg. & L. Rep. (BNA) 168 (Jan. 20, 1982), *available in* LEXIS BNA Library, Sec. Reg. File at *2 (noting the securities bar's criticism to the standard of professional conduct announced *In re* Carter, Exchange Act Release No. 17,597, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847 (Feb. 28, 1981)).

[27]*See infra* text accompanying notes 72-73 (setting forth the policy of prosecutorial restraint).

[28]*See infra* text accompanying note 72.

[29]Scienter, as it applies to the standard of proof of the lawyer's mental state in cases alleging that the lawyer aided and abetted his client's securities fraud," refers to a mental state embracing intent to deceive, manipulate, or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 n.12 (1976). Although the Supreme Court has not ruled on the issue of whether reckless behavior is sufficient to meet the scienter standard, all of the circuits have interpreted "scienter" to include reckless behavior. 8 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 3665-67 n.521 (3d ed. 1989) (marshaling cases from all the circuits).

obtain a district court's determination that a lawyer has violated the securities laws before initiating Rule 102(e) proceedings.[30] Congress's enactment of the Private Securities Litigation Reform Act of 1995[31] arguably imposes a more stringent culpability standard against lawyers.[32] Second, the Securities Law Enforcement Remedies Act of 1990[33] expanded the SEC's administrative enforcement authority with the concomitant use of that authority in administrative actions against lawyers.[34] Although Rule 102(e) proceedings will continue to be available to the SEC, the SEC has incentives to proceed under more efficient and less costly administrative proceedings.

In examining the SEC's incentives to rely more on its new administrative remedies, the dramatic pace of change in the SEC's regulatory landscape should also be considered. The National Securities Markets Improvement Act of 1996[35] creates broad categories of securities transactions that are now exclusively under the regulatory control of the SEC.[36] The states' concurrent regulation of these transactions has been preempted.[37] Other Congressional and SEC initiatives continue to seek efficiencies in raising capital and in the operations of the agency itself. For instance, an SEC advisory committee has recommended implementation of a company registration system that, if adopted, will

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[30]*See infra* notes 47-55 and accompanying text (discussing Rule 102(e)).

[31]Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in scattered sections of 15 U.S.C.) [hereinafter 1995 Reform Act].

[32]*See infra* Part III.B (discussing the implications of the 1995 Reform Act).

[33]Securities Law Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931 (1990) (codified in scattered sections of 15 U.S.C.) [hereinafter the 1990 Remedies Act]. *See infra* Part III.C (discussing the Commission's cease-and-desist authority).

[34]*See infra* Part III.C. (discussing the Commission's cease-and-desist authority).

[35]The National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996) (codified in scattered sections of 15 U.S.C.) [hereinafter 1996 Markets Improvement Act].

[36]The 1996 Markets Improvement Act preempts state registration requirements with respect to four classes of "covered securities": (1) securities issued by investment companies registered with the SEC under the Investment Company Act of 1940; (2) securities listed or to be listed on the recognized stock exchanges; (3) offers and sales to "qualified purchasers" as defined by the SEC and (4) certain transaction exempt under the 1933 Act. *Id.* § 102, at 3418. These transactions include: (1) transactions exempt under §§ 4(1) (i.e., by persons other than an issuer, underwriter or dealer) and 4(2) (i.e., dealer transactions in securities of reporting issuers); (2) transactions exempt under § 4(4) (i.e., brokers' transactions); (3) transactions exempt under § 3(a) except for securities of religious and charitable organizations, securities issued in intrastate offerings, and municipal securities offered in their home state; and (4) private placements pursuant to rules issued under § 4(2) (i.e., transactions exempt under Rule 506 of Regulation D). *Id.* § 102, at 3418-19.

[37]1996 Markets Improvement Act, *supra* note 35, § 103, at 3420-22.

fundamentally change the current transactional registration system.[38] The impact of electronic trading and increased competition from international trading markets will also influence the course that the SEC will take in implementing its regulatory goals.

These developments, which require the SEC to act more efficiently, all point to the conclusion that the SEC is now more likely to rely on its administrative actions to discipline lawyers, thus awakening the issues left dormant since 1982 when the SEC adopted Greene's policy of prosecutorial restraint.

The SEC's increased use of administrative proceedings also results in the articulation of professional standards of conduct without the benefit of a rule-making process. These standards are articulated despite the Commission's official position denying that it defines professional standards for lawyers.[39] The evidence demonstrates that an accretion of actions, even though most are settled by consent decrees, produces a body of standards that are eventually accepted as part of an expanded set of responsibilities of securities lawyers.[40] These standards are not a part of state bar codes or even state common law, but they apply to securities lawyers nonetheless. A breach of duty based on these standards can result in actions for malpractice, third party liability, or sanctions for violation of the securities laws.

Some commentators approve of the SEC's efforts in regulating the bar.[41] Others, however, have opposed those efforts. The SEC, they note, lacks a congressional mandate to regulate lawyers.[42] SEC disciplinary actions, based on unprofessional or negligent conduct, interfere with the legal profession's hegemony in setting its own professional standards and disciplining its members in accordance with

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[38]Report of the Advisory Committee on the Capital Formation and Regulatory Processes, [1996-1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,834, at 88,405 (July 24, 1996) (recommending a company registration system and a voluntary pilot company registration program); *see* John C. Coffee, Jr., *Re-Engineering Corporate Disclosure: The Coming Debate Over Company Registration*, 52 WASH. & LEE L. REV. 1143 (1995) (discussing current trends in the deregulation of the securities market and the complexities surrounding those issues).

[39]*See infra* note 73 (setting forth the Commission's official policy that it does not seek to establish standards of professional conduct).

[40]*See infra* text accompanying notes 187-88.

[41]*See, e.g.*, Lowenfels, *supra* note 2, at 437-38 (stating that the SEC and the court's utilization of "the securities bar as an additional line of protection for the investing public is sound and practical").

[42]*See, e.g.*, Downing & Miller, *supra* note 14, at 774-79, 793-94 (stating that the Commission has misused Rule 2(e) to usurp power that it does not really have with respect to the regulation of accountants specifically and all professions generally).

the various state laws.[43] There are no national standards under which lawyers practice. Not only does the Commission lack the authority and the expertise to set professional standards, but standards adopted by the Commission could conflict with the professional responsibilities imposed by state law. This conflict could force a Hobson's choice on the lawyer.[44]

This article considers how recent developments affect the SEC's authority, its objectives, and its discretion in deciding when and how to bring disciplinary proceedings against lawyers. Following an historical overview of the SEC's enforcement efforts in Part II of this article, Part III analyzes the recent developments in the SEC's remedies against lawyers. These developments will cause the SEC to modify its policy in the way it proceeds against lawyers. The SEC can be expected to rely more on its own administrative proceedings, again bringing the bar's objections to the fore without resolution. The article concludes by proposing an alternative to the exercise of the SEC's growing assumption of authority over the securities bar. It offers, as a starting point for additional thought and development, the idea of establishing an independent and self-regulating national securities lawyers bar.

II. OVERVIEW

This section presents an historical overview of the important SEC enforcement proceedings against lawyers in order to provide a

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[43]In *In re* Fields, 45 S.E.C. 262 (1973), the Commission responded to Field's argument that his right to practice securities law could only be denied by the courts in New York:

> That argument assumes, among other things, that the standards of character and integrity that the New York courts consider adequate or [sic] their purposes ought to be and are necessarily controlling here. This fallacious position overlooks the pecularly [sic] strategic and especially central place of the private practicing lawyer in the investment process and in the enforcement of the body of federal law aimed at keeping that process fair.

Id. at 266 n.20.

[44]*See, e.g.*, Meyerhofer v. Empire Fire & Marine Ins. Co., 497 F.2d 1190, 1192-94 (2d Cir. 1974) (reporting the activities of a lawyer, who unable to compel his clients' disclosures, resigned the engagement and disclosed the client confidences to the SEC). The lawyer's actions in *Meyerhofer* were within one year after *National Student Marketing* in which the SEC argued that lawyers have a duty to disclose to the SEC. Complaint, SEC v. National Student Mktg. Corp., [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,360 (D.D.C. Feb. 3, 1972). *See infra* text accompanying notes 56-61 (analyzing *National Student Marketing*). In the settlement of the shareholder suit following disclosure, the lawyer's former firm paid $625,000 of the $785,000 settlement to settle the breach of confidentiality claim of the former client. Federman v. Empire Fire & Marine Ins. Co., [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,418 (S.D.N.Y. Jan. 19, 1976).

background for the discussion in Part III concerning why the SEC will choose to increase its use of administrative remedies to achieve its objectives in disciplining lawyers. The historical overview demonstrates how the SEC has chosen to pursue its objectives with respect to lawyer discipline through a series of enforcement proceedings rather than through the rule-making process. This practice has permitted the SEC to effectively exercise more authority over lawyers than Congress arguably intended to grant. The SEC can be expected to continue this approach by utilizing its expanded enforcement remedies granted by Congress in 1990.[45]

Before the enactment of the 1990 Remedies Act, the securities laws provided the SEC with only a limited range of remedies against entities and individuals that it does not directly regulate. The SEC had two principal choices in disciplining lawyers: initiate Rule 102(e) administrative proceedings or seek injunctions in federal district court.[46]

Rule 102(e) of the Rules of Practice of the SEC authorizes administrative proceedings to discipline unprofessional conduct of those who practice before the SEC.[47] Pursuant to the Rule, the Commission may suspend or disbar lawyers and other professionals who engage in unethical or improper conduct.[48] Prior to 1971, the type of conduct for which Rule 102(e) actions were brought usually involved egregious conduct analogous to that sanctioned as contempt in a court — such as

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[45]The 1990 Remedies Act, Pub. L. No. 101-429, 104 Stat. 931 (1990) (codified in scattered sections of 15 U.S.C.). *See infra* Part III.C (discussing the Commission's cease-and-desist authority).

[46]In appropriate cases, the SEC can also refer cases to the Justice Department for criminal prosecution. In addition, the SEC can issue reports on investigations pursuant to § 21(a) of the Exchange Act, as it did in the Salomon matter. *See infra* text accompanying notes 82-85 (discussing *In re* Gutfreund, Exchange Act Release No. 34-31,554, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,067, at 83,597 (Dec. 3, 1992)).

[47]The Rule provides:

> The Commission may censure a person or 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 and opportunity for hearing in the matter: (i) [n]ot to possess the requisite qualifications to represent others; or (ii) [t]o be lacking in character or integrity or to have engaged in unethical or improper professional conduct; or (iii) [t]o have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

17 C.F.R. § 201.102(e)(1) (1996). Before the SEC's 1995 revision of its Rules of Practice, the rule was denominated as Rule 2(e). The revision redenominated the provision as Rule 102(e) without any change in its substance. Whether appearing in the text or in cited authority, the terms "Rule 2(e)" and "Rule 102(e)" are synonymous.

[48]*Id.*

intentionally filing false documents or other highly unprofessional conduct.[49] Then, as now, most of these cases were settled by consent decrees.[50]

The Commission's 1970 amendments to Rule 102(e) gave it added authority to suspend or disbar a professional for violation of any of the securities laws, whether or not that violation has been established in a court.[51] Beginning in the early 1970s, the Commission embarked on an aggressive program of enforcement against lawyers, sparking a growing controversy with the bar that persists today.[52] The Commission began asserting a broader range of misconduct as appropriate grounds for Rule 102(e) proceedings. Actions against lawyers were initiated for failure to detect and prevent misleading statements contained in a municipal bond offering circular[53] and for failure of underwriter's counsel to properly perform "due diligence" to prevent misleading statements in an offering.[54]

In disciplining lawyers for failing to perform these tasks, the SEC began to assume authority to answer fundamental professional questions of: (1) whether, in undertaking the task, the lawyer assumes an obligation subjecting him or her to the rules and regulations of the securities laws; (2) if so, what standard of care applies to the securities lawyer's actions; and (3) when the lawyer's actions fall below that standard, what standard of culpability warrants sanctions. The conduct

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[49]*E.g.*, *In re* Germaise & Quinn, Securities Act Release No. 33-5216, 1971 WL 17028, at *1 (SEC) (Dec. 7, 1996) (law partners representing issuer and underwriter without knowledge of the clients and one partner convicted for securities law violation); *In re* Stewart, Release No. 33-4829, 1966 WL 6768, at *1-2 (SEC) (Apr. 29, 1966) (intentional false filings, lawyer enjoined and disbarred by state); *In re* DeWitt, 38 S.E.C. 879 (1959) (allegations of false filings with the SEC and obtaining money from client to bribe SEC officials). *See generally* Harold Marsh, Jr., *Rule 2(e) Proceedings*, 35 BUS. LAW. 987 (1980) (chronicling the history of Rule 2(e) and questioning the constitutional validity of the rule).

[50]*See* Marsh, *supra* note 49, at 989 (noting that the majority of Rule 2(e) proceedings resulted in a consent decree).

[51]Amendment of Rule 2(e) of the Rules of Practice, Securities Act Release No. 5088, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,913, at 80,033 (Sept. 24, 1970).

[52]Only five cases were instituted against lawyers before 1960. Between 1970 and 1980, the SEC brought over 85 cases against lawyers. *In re* Keating, Muething & Klekamp, 47 S.E.C. 95, 112 (1979) (Karmel, SEC Commissioner, dissenting).

[53]*In re* Ferguson, Securities Act Release No. 5523, 5 SEC Docket 37 (Aug. 21, 1974). *But see* SEC v. Haswell, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,156, at 96,373 (W.D. Okla. Oct. 19, 1977), *aff'd*, 654 F.2d 698 (10th Cir. 1981) (Commission losing a similar case in court).

[54]*In re* Feld, Exchange Act Release No. 11,775, 8 SEC Docket 291, 292 (Oct. 30, 1975); *see In re* Loewe, Exchange Act Release No. 11,776, 8 SEC Docket 294, 295 (Oct. 30, 1975) (charging Loewe, counsel for the issuer, with the same charges as Feld, counsel for the underwriter). *See also* Marsh, *supra* note 49, at 990-92 (describing the Commission's actions in both *In re Feld* and *In re Loewe*).

involved in the above actions was qualitatively different from earlier actions against the rogue lawyer who lied or intentionally filed false documents. Here, the core professional activities such as advising clients with respect to disclosure issues, assisting clients with their duty to exercise due diligence, and assisting clients with drafting disclosure statements were implicated. These activities dealt with the judgment, discretion, and standards of lawyering; all issues which had been historically within the traditional bounds of the bar's determination.[55]

The SEC also began to use its injunctive authority to persuade courts to impose standards of care on securities lawyers. In 1972, the Commission created a *cause bellus* within the bar when it sought an injunction in *SEC v. National Student Marketing Corp.*[56] against numerous defendants, including lawyers of two prominent law firms as a result of their representation of their respective clients in a merger transaction.[57] Because one party completed the merger without resoliciting its shareholders for approval in light of new adverse financial information concerning the other party, the SEC alleged that the party's lawyers had aided and abetted their client's violations in failing to take sufficient action to persuade it to delay the merger until the shareholders could be resolicited.[58] The SEC argued that the lawyers had a duty to disclose to the SEC their client's refusal to resolicit the shareholders.[59]

The court refused to accept the SEC's "whistle blowing" theory when it held only that the lawyers had aided and abetted the violation by failing "to take steps to ensure that the information would be disclosed to the shareholders."[60] In concluding the proceedings in 1978, the court

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[55]*See* Daley & Karmel, *supra* note 14, at 753 (noting the historical regulation of the practice of attorneys by their particular court and bar).

[56]Complaint, SEC v. National Student Mktg. Corp., [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,360, at 91,913-2 (D.D.C. Feb. 3, 1972). National Student Marketing's lawyers, White and Case, settled with the SEC by entering into a consent decree. Several opinions in the course of the litigation were reported. *See* SEC v. National Student Mktg. Corp., 457 F. Supp. 682 (D.D.C. 1978); SEC v. National Student Mktg. Corp., 73 F.R.D. 444 (D.D.C. 1977); SEC v. National Student Mktg. Corp., 430 F. Supp. 639 (D.D.C. 1977); SEC v. National Student Mktg. Corp., 402 F. Supp. 641 (D.D.C. 1975); SEC v. National Student Mktg. Corp., 68 F.R.D. 157 (D.D.C. 1975), *aff'd*, 538 F.2d 404 (D.D.C. 1976), *cert. denied*, 429 U.S. 1073 (1977); SEC v. National Student Mktg. Corp., 360 F. Supp. 284 (D.D.C. 1973).

[57]*National Student Mktg.*, 457 F. Supp. at 700-01. At the closing of the merger, the National Student Marketing accountant's comfort letter revealed the necessity to restate revenues, making materially misleading the proxy statement's financial information which had been used to solicit Interstate National Corporation's shareholders' vote to approve the merger.

[58]*Id.* at 700.

[59]*Id.* at 700-01.

[60]*Id.* at 713. The court found that because the lawyers had taken no steps to delay the

found that when a lawyer's client commits a violation of the securities laws, the lawyer has a duty to recognize that violation and has a duty to take sufficient steps to attempt to persuade the client to comply with the securities law.[61] The lawyer's ethical duties to represent a client with competence and to advise the client to comply with the law, had, in a securities context, transformed into a duty under the securities laws. If the lawyer failed in those duties, his failure could also violate the securities laws.

The decision was viewed by the bar as "a substantial departure from traditional standards of care and priorities of duties for securities lawyers."[62] The legal community was concerned, not only that the courts might agree with the SEC that lawyers should be required to "blow the whistle" on their clients, but that the SEC was attempting to regulate the professional responsibility of lawyers.[63]

Three years after the conclusion of *National Student Marketing*, the SEC, turning again to its Rule 102(e) authority, initiated its most prominent administrative proceeding against lawyers. In *In re Carter*,[64] the SEC alleged that the lawyers had failed to take steps which in the SEC's view were required to assure that the lawyers' client adequately disclosed its continuing financial problems.[65]

The administrative law judge (ALJ) found that the lawyers had aided and abetted the company's primary 10(b)-5 violation and had engaged in unethical or improper professional conduct.[65] The Commission reversed the ALJ on the grounds that the lawyers did not have notice of a sufficiently clear rule formulated in the profession's

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closing, "it [was] unnecessary to determine the precise extent of their obligations." *Id.*

[61]*National Student Mktg.*, 457 F. Supp. at 713. The court also stated that the lawyer had "fiduciary responsibilities to [the] . . . shareholders." *Id.* at 714. The opinion, however, does not imply that the lawyer himself must disclose to the shareholders.

[62]Lowenfels, *supra* note 2, at 421.

[63]*See, e.g.*, Panel Discussion, *Advisors to Management: Responsibilities and Liabilities of Auditors and Accounts*, 30 BUS. LAW. 169 (1975) (Special Issue).

[64]Exchange Act Release No. 17,597, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847, at 84,146 (Feb. 28, 1981).

[65]The client, National Telephone Company, a telephone leasing company, had issued numerous press releases and SEC filings which were false and misleading. *Id.* at 84,161-62. The releases in particular had failed to disclose that the company had entered into an agreement with its creditors after it had encountered a liquidity crises. *Id.* The agreement required the company to maintain existing leases until they expired and not to write any new business. *Id.* at 84,161. The agreement was in effect a liquidation plan. The lawyers had repeatedly advised the CEO that he had to make this disclosure and had to correct and revise proposed press statements. *Id.* at 84,162. The CEO, apparently fearing that the revelations would demoralize the employees and make failure more probable, ignored the lawyers' advice. *Id.* at 84,162-63.

[66]*Id.* at 84,165, 84,169.

ethical precepts.[67] At the same time, however, the Commission wrote a lengthy opinion on the steps a lawyer must take when a client is not following disclosure advice.[68] Essentially, the lawyer may be required to go over senior management's heads to the board of directors or to the independent directors to urge compliance.[69] In declining to impose

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[67]*Id.* at 84,173. The Commission was aware that it was setting professional standards of conduct for lawyers. It stated:

> The ethical and professional responsibilities of lawyers who become aware that their client is engaging in violations of the securities laws have not been so firmly and unambiguously established that we believe all practicing lawyers can be held to an awareness of generally recognized norms. We also recognize that the Commission has never articulated or endorsed any such standards. That being the case, we reverse the Administrative Law Judge's findings under subparagraph (ii) of Rule 2(e)(1) with respect to both respondents. Nevertheless, we believe that respondents' conduct raises serious questions about the obligations of securities lawyers, and the Commission is hereby giving notice of its interpretation of "unethical or improper professional conduct" as that term is used in Rule 2(e)(1)(ii).

Id. at 84,170.

[68]*In re* Carter, Exchange Act Release No. 17,597, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847, at 84,146, 84,172 (Feb. 28, 1981).

[69]The Commission delineated the standard the lawyer is to employ at critical junctures in ongoing attempts to get his client to comply with disclosure advice:

> The Commission is of the view that a lawyer engages in "unethical or improper professional conduct" under the following circumstances: When a lawyer with significant responsibilities in the effectuation of a company's compliance with the disclosure requirements of the federal securities laws becomes aware that his client is engaged in a substantial and continuing failure to satisfy those disclosure requirements, his continued participation violates professional standards unless he takes prompt steps to end the client's noncompliance. The Commission has determined that this interpretation will be applicable only to conduct occurring after the date of this opinion.
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> We do not imply that a lawyer is obliged, at the risk of being held to have violated Rule 2(e), to seek to correct every isolated disclosure action or inaction which he believes to be at variance with applicable disclosure standards, although there may be isolated disclosure failures that are so serious that their correction becomes a matter of primary professional concern. It is also clear, however, that a lawyer is not privileged to unthinkingly permit himself to be co-opted into an ongoing fraud and cast as a dupe or a shield for a wrong-doing client.
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> Initially, counseling accurate disclosure is sufficient, even if his advice is not accepted. But there comes a point at which a reasonable lawyer must conclude that his advice is not being followed, or even sought in good faith, and that his client is involved in a continuing course of violating the securities laws. At this critical juncture, the lawyer must take further, more affirmative steps in order to avoid the inference that he has been co-opted, willingly or unwillingly, into the scheme of non-disclosure.
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> The lawyer is in the best position to choose his next step. Resignation is one option, although we recognize that other considerations, including the

sanctions on the lawyers, the Commission avoided both judicial review of the scope of its authority to discipline lawyers and the definition of standards of professional conduct.[70]

The ruling in *In re Carter* escalated the controversy between the bar and the SEC.[71] However, this controversy was defused in 1982 when the SEC's general counsel, Edward Greene, stated that as a general matter, when there was a sufficient nexus between the practice of securities law and a securities law violation, the SEC should not initiate Rule 102(e) proceedings against a lawyer unless an Article III court had first made a determination that the lawyer had violated the securities laws.[72] Since 1982, the Commission's announced policy with respect to disciplining lawyers has been to first obtain a ruling in district court that the lawyer aided and abetted a violation of the federal securities laws before initiating a Rule 102(e) proceeding.[73]

Rule 102(e), however, did not continue to serve as the exclusive administrative venue for disciplinary actions. In 1987, the SEC, relying on the provisions of section 15(c)(4) of the Exchange Act,[74] brought

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> protection of the client against foreseeable prejudice, must be taken into account in the case of withdrawal. A direct approach to the board of directors or one or more individual directors or officers may be appropriate; or he may choose to try to enlist the aid of other members of the firm's management. What is required, in short, is some prompt action that leads to the conclusion that the lawyer is engaged in efforts to correct the underlying problem, rather than having capitulated to the desires of a strong-willed, but misguided client.
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> . . . .
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> 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 thoroughgoing 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 an egregious nature.

Id. at 84,172-73.

[70]The Commission decided other issues in the case, none of which has been challenged in court: (1) Rule 2(e) could be applied against lawyers, (2) the possibility of prosecutorial abuse would not prevent Rule 2(e) being used against lawyers, and (3) the Commission had sufficient expertise to decide whether lawyers had violated professional standards. *Id.* at 84, 147-49.

[71]Greene, *supra* note 26, *available in* LEXIS BNA Library, Sec. Reg. File at *2.

[72]*Id.*

[73]The Commission confirmed this policy in 1988. Securities Act Release No. 6,783, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,248, at 89,244 (July 7, 1988) (stating that the "Commission. . . ha[d] not sought to develop or apply independent standards of professional conduct . . . [or] to conduct *de novo* determinations of the professional obligations of attorneys").

[74]Exchange Act § 15(c)(4), 15 U.S.C. § 78o(c)(4) (1994); Exchange Act § 21C(a), 15

charges in *In re Kern, Jr.*[75] against a prominent lawyer for legal advice given to his client during a takeover battle.[76] The SEC initiated an administrative proceeding against Allied Stores for a violation of the securities laws in failing to promptly disclose steps the company took in attempting to fend off a takeover bid.[77] George Kern, Allied Store's principal outside counsel and an Allied director, was included in the complaint for his role in "causing" the violation.[78]

Naming a lawyer was an unprecedented step which sidestepped the Commission's policy of prosecutorial restraint against lawyers.[79] The ALJ found that Kern had negligently caused his client to violate the securities laws, but discontinued the proceedings against Kern because the judge concluded that the remedy was limited to requiring Kern to effect compliance by Allied, which had long since been taken over.[80] The Commission affirmed the discontinuance of the proceeding on the ground that orders of general future compliance under 15(c)(4) were not authorized.[81] As in *In re Carter*, the SEC announced by implication a substantive standard of conduct by failing to withdraw the ALJ's

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U.S.C. 78u-3(a) (1994).

[75]*In re* Kern, Jr., Exchange Act Admin. Proc. File No. 3-6869, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,342, at 89,580 (Nov. 14, 1988), *aff'd*, Exchange Act Release No. 29,356, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,815, at 82,004 (June 21, 1991). *See also infra* text accompanying notes 161-67 (discussing *In re Kern, Jr.* in light of the Commission's cease-and-desist authority). *See generally* Doty, *supra* note 9, at 1548-53 (discussing the *In re Kern, Jr.* decision).

[76]*In re Kern, Jr.*, Exchange Act Admin. Proc. File No. 3-6869, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,342, at 89,580.

[77]*Id.* Allied failed to disclose that: (1) negotiations were underway with another party which would result in either the sale of a material amount of the company assets or a transaction such as a reorganization or merger, (2) the parties reached an agreement to a merger, and (3) the board of directors agreed to execute the merger. *Id.*

[78]*Id.*

[79]*See* Doty, *supra* note 9, at 1553 (noting that "the Commission had no controlling precedent for its interpretation").

[80]*See In re Kern, Jr.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,342, at 89,595 (stating that "[a]s to the appropriateness of any order of compliance directed against Kern with respect to Allied, the record establishes that Kern no longer has power or authority to require Allied to make any corrective filing and cannot control its future compliance"). The SEC also sought an order against Kern prohibiting any future violations of securities laws, not limited to dealings with Allied. The SEC went forward with this proceeding, despite the objections of Commissioner Fleischman, who asserted that proceedings against lawyers relating to their legal advice to clients should be handled through outside injunctive action, not in an SEC section 15(c)(4) proceeding. *In re Kern, Jr.*, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,815, at 82,005.

[81]*In re Kern, Jr.*, Exchange Act Release No. 29,356, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,815, at 82,008.

findings, while at the same time protecting its decision from review by not imposing a sanction.

In 1992, the Commission used a disciplinary proceeding against a regulated entity to announce standards of professional conduct for inside counsel. The Commission entered a consent order making findings and imposing sanctions against former senior officers of Salomon Inc. for their failure to take appropriate action when they became aware that one of their securities traders was submitting unauthorized customer bids in auctions for U.S. Treasury securities.[82] In connection with the proceedings, the SEC issued a 21(a) report[83] on the inside counsel's duties in the context of his role as the chief legal officer of Salomon Inc.[84] In discussing steps inside counsel of a regulated entity should take when his advice is being ignored, the report stated the SEC's views that inside counsel is required, among other actions, to go up the line to more senior officials.[85] The Commission had announced similar duties required of outside counsel in *In re Carter*.[86]

The SEC's enforcement remedies were substantially expanded in 1991 when Congress granted the agency cease-and-desist authority pursuant to the 1990 Remedies Act.[87] The 1990 Remedies Act authorizes the Commission to issue cease-and-desist orders against any person who violates or "causes" a violation of the securities laws.[88] Under the 1990 Remedies Act, the SEC can also apply to a court to impose civil monetary penalties for violations of the securities laws or cease-and-desist orders.[89] Additionally, the SEC can impose penalties in administrative proceedings against certain securities participants and their "associated" persons.[90] The scope of the authorization permits the SEC, after notice and an opportunity for a hearing, to determine whether a securities violation has occurred.[91] As discussed in Part III of this article, the

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[82]*In re Gutfreund*, Exchange Act Release No. 34-31,554, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,067, at 83,605-09 (Dec. 3, 1992). *See generally* Doty, *supra* note 9, at 1556-61 (discussing the case and its implications with respect to how a lawyer must respond when management fails to follow lawyer's advice).

[83]Section 21(a) authorizes the SEC to investigate possible or potential violations and to publish reports about them. Section 21(a) of the Exchange Act, 15 U.S.C. § 78u(a) (1996).

[84]*In re Gutfreund*, Exchange Act Release No. 34-31,554, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,067, at 83,608.

[85]*Id.* at 83,601-09.

[86]*See supra* notes 64-69 and accompanying text (discussing *In re Carter*).

[87]*See infra* Part III.C (discussing the Commission's cease-and-desist authority).

[88]15 U.S.C. §§ 77h-1, 78u-3 (1994).

[89]*Id.*

[90]*Id.*

[91]*Id.* §§ 77h-1(a), 78u-3(a) (1994).

statute raises important interpretive issues that could expand lawyers' liability through the use of administrative actions.[92]

Four years after Congress granted the SEC cease-and-desist authority, Congress enacted a new statutory provision dealing with actions for secondary liability.[93] The SEC's implied authority to bring secondary liability actions for aiding and abetting the client's violation, such as the one brought in *National Student Marketing*, was replaced with a statutory provision. The statute provides that an individual who knowingly renders substantial assistance to a securities law violator is in violation to the same extent as the individual to whom the assistance is provided.[94] Only one court has thus far interpreted the statute.[95] As discussed in the next section, the SEC faces the uncertainty that the new statutory provision will make court proceedings against lawyers more difficult.[96]

III. PROBLEMS WITH THE OLD ENFORCEMENT REMEDIES; OPPORTUNITIES WITH CEASE-AND-DESIST AUTHORITY

A. *Rule 102(e) Administrative Actions*

The SEC promulgated Rule 102(e), a single rule, under which it disciplines the unprofessional conduct of two different functioning groups, lawyers and accountants. As a result, the Commission has sought to apply the rule flexibly to meet different enforcement objectives with respect to each group. To understand the SEC's objectives, it is necessary to focus on the distinct roles lawyers and accountants play in the securities industry.[97]

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[92]*See infra* Part III.C.

[93]The Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in scattered sections of 15 U.S.C.). *See infra* Part III.B.

[94]15 U.S.C. § 78t(f) (Supp. I 1996).

[95]*See infra* notes 146-47 and accompanying text (discussing SEC v. Fehn, 97 F.3d 1276 (9th Cir. 1996), and its interpretation of the term "knowingly" in the statute).

[96]*See infra* notes 142-49 and accompanying text (discussing the uncertainty surrounding the interpretation of the term "knowingly" in the 1995 Reform Act).

[97]In *In re* American Fin. Co., 40 S.E.C. 1043 (1962), the SEC compared the duties and roles of the securities lawyer and the independent certified public accountant in the disclosure process:

> Though owing a public responsibility, an attorney in acting as the client's advisor, defender, advocate and confidant enters into a personal relationship in which his principal concern is with the interests and rights of his client. The requirement of the Act of certification by an independent accountant, on the other hand, is intended to secure for the benefit of public investors the detached objectivity of a disinterested person. The certifying accountant must be one who is in no way connected with the business or its management and

The independent public accountant's role in the regulatory framework is the more important of the two. Accurate financial disclosure is the centerpiece of the federal securities laws. Securities cannot be registered for sale nor can the continuous reporting requirements be satisfied without the CPA's report on the issuer's financial statements.[98] The SEC has an abiding interest in making sure that accountants are qualified, remain independent, and consistently apply the accounting standards developed by the joint efforts of the SEC and the American Institute of Certified Public Accountants. As an integral part of its indirect regulation of accountants, the SEC interprets those accounting standards to achieve consistent and appropriate application.

The SEC does not have the same overriding statutory interest with respect to the lawyer's function. In issuing securities, for instance, the lawyer's statutory role with respect to the registration process is limited to opining as to the "validity" of the securities when issued.[99] This opinion deals with whether the issuance of the securities has been properly authorized by the board of directors and, if required, by the stockholders or a governmental agency such as a public utilities commission. It does not deal with securities laws issues.[100]

The lawyer's participation in the registration and continuing disclosure process is as an advisor to the primary participants, not as one of the primary participants, such as the accountant, who is required to report on the issuer's financial statements.[101] The securities statutes do not implicate the lawyer's exercise of professional judgment in the way the financial reporting rules and regulations directly implicate the exercise of the accountant's judgment. Moreover, the lawyer does not exercise

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> 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.

Id. at 1049. *See also* T.J. Fiflis, *Current Problems of Accountants' Responsibilities to Third Parties*, 28 VAND. L. REV. 31, 34-42 (1975) (describing public accountants' functions, including the auditing process).

[98]*See* Checkosky v. SEC, 23 F.3d 452, 470-71 (D.C. Cir. 1994) (noting the role of accountants in ensuring the accuracy of financial statements).

[99]Johnson, *The Dynamics of SEC Rule 2(e)*, *supra* note 14, at 629.

[100]In securities transactions not involving a public offering, securities lawyers' opinions frequently deal with securities issues. In addition, securities lawyers give comfort opinions to underwriters. None of these opinions are required by the securities laws, but in practice, transactions would not go forward without them. These opinions are given pursuant to agreements between the parties.

[101]For comprehensive discussions on the role of the securities lawyers, see Johnson, *The Dynamics of SEC Rule 2(e)*, *supra* note 14, at 645-50; Lorne, *supra* note 14, at 464-90; Lorne & Callcott, *supra* note 14, at 1312-26.

judgment pursuant to a set of national standards, against which the SEC can judge the lawyer's performance.

This does not mean the SEC lacks an interest in regulating lawyers' professional conduct. Its predominant interest, however, is, not in monitoring the lawyer's statutory functions, but regulating the lawyer's role of advising clients, including making sure the clients act on such advice — in other words, having the lawyer serve as gatekeeper to the market. Because there are no standards by which to measure the lawyer's judgment in this context, the SEC seeks to supply those standards through the Commission's orders and reports in disciplinary proceedings and in persuading courts to adopt standards in actions brought against lawyers.[102]

This results in a perverse process. In disciplining accountants, the SEC applies standards derived from rules developed from the joint efforts of accountants and the SEC. In disciplining lawyers, the SEC, without consultation, establishes standards for a group of professionals that the SEC has less statutory interest and less expertise in regulating.

From the perspective of using Rule 102(e) for the more limited purpose of protecting the integrity of the Commission's processes, a single rule may suffice. However, the SEC's promulgation of a single disciplinary rule for both lawyers and accountants has the unfortunate effect of lumping the two groups together when the SEC makes policy decisions on what kind of cases it intends to bring under the Rule.[103] The difficulty arises when the single rule is used for the broader and more open ended purpose of disciplining and defining professional conduct.

The SEC has encountered several issues when attempting to meet its expanded objectives; none of which have been satisfactorily resolved. First, is the basic issue of the SEC's authority to promulgate Rule 102(e). The SEC does not have a specific legislative mandate to discipline professionals. Its authority to promulgate Rule 102(e) is based on its general authority to make rules to implement the provisions of the securities laws.[104]

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[102]*See* Johnson, *The Dynamics of SEC Rule 2(e)*, *supra* note 14, at 645-49.

[103]Historical accident and a certain confusion as to functions due to terms used in common with respect to lawyers and accountants, such as "professional" and "client," may explain the genesis of a single disciplinary rule promulgated for both. The result, however, may lead the SEC to regard lawyers and accountants as equivalent candidates for regulation and for monitoring clients.

[104]Section 23(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78w(a)(1) (1994), authorizes the Commission to "make such rules and regulations as may be necessary or appropriate to implement the provisions of this chapter for which [it is] responsible or for the execution of the functions vested in [it] by this chapter." The Commission has similar rule-making authority in each of the other statutes for which it is responsible in administering. *See,*

The courts have upheld the SEC's authority to make rules to protect the integrity of its own processes.[105] Whether that authority is broad enough to include disciplining professionals when they are practicing in their offices has not been directly addressed. The Commission maintains that its authority includes the power to discipline accountants and lawyers for a broad range of unprofessional conduct. However, the SEC's case for disciplining accountants is much stronger than its case for disciplining lawyers, given accountants statutory role. Courts have upheld the SEC's authority only in the context of Rule 102(e) cases brought against accountants.[106]

Even assuming that a broad disciplinary power over professionals is within the SEC's authority, the SEC has not dealt with the issue of what standard of culpability will apply in imposing liability under Rule 102(e). If, for instance, the SEC adopted a negligence standard of culpability, the SEC's authority to discipline could become coextensive with professional bodies' power to discipline for failure to use due care. Although the SEC formally rejects the idea that it seeks to preempt

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e.g., § 19 of the Securities Act of 1933, 15 U.S.C. § 77s(a) (1994); § 20 of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 77sss (1994); § 38 of the Investment Company Act of 1940, 15 U.S.C. § 80a-37(a) (1994); § 211 of the Investment Advisers Act of 1940, 15 U.S.C. § 80-b-11(a) (1994). Section 19(a) of the Securities Act of 1933, 15 U.S.C. § 77sss(a) states: "The Commission shall have the authority from time to time to make, issue, amend, and rescind such rules and regulations . . . as it may deem . . . necessary to carry out the provisions of this [title] . . . ."

The SEC's authority to require lawyers to possess certain qualifications before they can practice before the SEC is limited by the Administrative Practices Act of 1965 (APA), 5 U.S.C. § 500(b) (1994). The statute provides in pertinent part: "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 . . . and is authorized to represent the particular person in whose behalf he acts." *Id.* The APA specifically provides that it does not "authorize or limit the discipline, including disbarment, of individuals who appear in a representative capacity before an agency." *Id.* § 500(d)(2). Thus, to the extent that an agency has authority to discipline lawyers, the APA, in doing away with attorney qualification requirements, does not enlarge or restrict the disciplinary authority of the agency.

[105]Checkosky v. SEC, 23 F.3d 452 (D.C. Cir. 1994) (in case against accountants, holding that promulgation of Rule 2(e) to protect the integrity of SEC's own processes is valid exercise of its general statutory rule-making authority because the rule is "reasonably related" to the purposes of the securities laws); *accord* Davy v. SEC, 792 F.2d 1418 (9th Cir. 1986); Touche Ross & Co. v. SEC, 609 F.2d 570 (2d Cir. 1979). A federal court has yet to address the validity of Rule 2(e) to discipline lawyers.

[106]The Commission has recognized that it does not have comparable statutory authority to regulate lawyers as it has with respect to accountants pursuant to its statutory authority to prescribe the requirements for financial statements filed with the SEC. Securities Act Release No. 6783, 53 Fed. Reg. 26,427, 26,431 (July 13, 1988). *See also Checkosky*, 23 F.3d at 470-71 (Randolph, J., separate opinion) (describing the provisions Congress enacted to regulate financial reporting and the role of accountants in that process).

professional bodies, it nevertheless needs to retain discretion to decide what professional conduct should be subject to discipline. Because negligent conduct can cause just as much harm as intentional conduct, the SEC's objectives include deterring at least some kinds of negligent conduct as well as policing intentional conduct.

If, on the other hand, the SEC adopted a scienter standard for misconduct, the SEC would loose its ability to pursue important objectives in deterring harmful negligent conduct. Moreover, cases against professionals would be more difficult to prosecute and settle. Proof of mental state must usually be established by circumstantial evidence and the evidence, especially in the professional services context, often will not justify a finding of intentional wrongdoing, even when gross negligence can be inferred. The accused professional also has greater incentive to try, rather than settle, cases in which intentional conduct is alleged because of the greater penalties and harm to professional reputation.

The SEC has finessed the culpability standards issue by applying a flexible approach. In pursuing different objectives for each group, the SEC announced a scienter standard for lawyers under Rule 102(e) in its 1981 *In re Carter* decision.[107] In accountant cases, however, the Commission has continued to apply an enhanced negligence standard.[108]

This flexible standard was not challenged in court until 1994, when *Checkosky v. SEC*[109] presented a difficult case in which accountants were sanctioned for negligent conduct without a finding that they had acted in

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[107]Exchange Act Release No. 17,597, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,847, at 84,146, 84,167 (Feb. 28, 1981). In addressing the issue of whether the lawyers had engaged in unethical or improper conduct, the Commission impliedly asserted its position that it had authority to make rules of professional responsibility and to sanction those who failed to observe them. The Commission found that although the conduct was improper, the lawyers should not be sanctioned because "elemental notions of fairness dictate that the Commission should not establish new rules of conduct and impose them retroactively." *Id.* at 84,169.

[108]The Commission does not assert that any violation by an accountant of Generally Accepted Accounting Principles (GAAP) or Generally Accepted Auditing Standards (GAAS) constitutes a violation of Rule 2(e), but it wants to retain discretion to examine all the relevant evidence and assess "whether [an] accountant's conduct was so deficient that a sanction is required to protect the Commission's processes." *In re* Checkosky, Exchange Act Release No. 31,094, [1991-1995 Accounting and Auditing Enforcement Releases Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 73,871, at 63,121, 63,138 (Aug. 26, 1992) (Roberts, C., concurring in part and dissenting in part). *See also Checkosky*, 23 F.3d at 458 (Silberman, J., filing separate opinion) (describing the Commission's opinions in which it articulates conflicting standards of mental states for accountant liability).

[109]23 F.3d 452 (D.C. Cir. 1994) (per curiam).

bad faith.[110] In *Checkosky*, accountants petitioned for review of the Commission's order sanctioning the accountants for incorrectly interpreting complex accounting principles.[111] In the proceedings below, the ALJ had found that the accountants' material violation of Generally Accepted Auditing Standards (GAAS) and Generally Accepted Accounting Principles (GAAP) constituted improper professional conduct under Rule 102(e)(1)(ii).[112] Significantly, the ALJ, without stating what standard applied, held that "proof of scienter or bad faith is not a requirement for the Commission to act pursuant to the rule."[113]

The Commission, with one member dissenting in part, affirmed the ALJ's conclusion, although it stated that the accountants' conduct in this case was reckless.[114] In considering the correct mental standard to apply, the Commission, with little explanation, rejected arguments that the *In re Carter* scienter standard for Rule 102(e) proceedings against lawyers should also be applied to accountants.[115] The Commission noted that the application of the different standards was made on the basis of the different duties between lawyers and accountants and also that the Commission proceedings against lawyers in *In re Carter* were brought under Rule 102(e)(1)(iii) for willful aiding and abetting a violation of the securities laws.[116] Relying on an *unpublished* decision entered six years after *In re Carter*, the Commission reaffirmed its negligence standard for accountant liability.[117]

On appeal, the court remanded, without vacating the Commission's order, "for a more adequate explanation of [the Commission's] interpretation of Rule 102(e)(1)(ii) and its application to this case."[118] The three member appeals court panel agreed on little else. The panel wrote three separate opinions. One member of the panel, Judge Silberman, asserting that it was unclear what standard the Commission had applied, voted to remand without vacating the order so that the

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[110]As discussed *infra*, Judges Reynolds and Randolph found that the Commission had applied a negligence standard while Judge Silberman was not sure of the standard applied. *Id.* at 454 (Silberman, J., filing separate opinion), 467 (Randolph, J., filing separate opinion).

[111]*Id.* at 455 (Silberman, J., filing separate opinion).

[112]*In re Checkosky*, Exchange Act Release No. 31,094, [1991-1995 Accounting and Auditing Enforcement Releases Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 73,871, at 63,121.

[113]*Id.*

[114]*Id.* at 63,121, 63,131.

[115]*Id.* at 63,130.

[116]*In re Checkosky*, Exchange Act Release No. 31,094, [1991-1995 Accounting and Auditing Enforcement Releases Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 73,871, at 63,130.

[117]*Id.*

[118]*Checkosky*, 23 F.3d at 454.

Commission could clarify the standard it had used.[119] Judge Silberman recognized that:

> [t]his is doubtless an important case regarding the SEC's authority to regulate the conduct of professionals practicing before the Commission. . . . I think the Commission should state clearly and without equivocation its decisional standard with respect to "improper professional conduct" under Rule [10]2(e)(1)(ii) and how petitioners' conduct violates that standard. Doing so, of course, would force the Commission to face squarely and forthrightly the legal and practical consequences of its decision.[120]

Judge Randolph declared that the Commission had applied a negligence standard, and he would have vacated the order and remanded because, as he opined, the Commission had acted arbitrarily in violation of the Administrative Procedures Act when it failed to provide a reasoned explanation for departing from the scienter standard announced in *In re Carter*.[121] Judge Reynolds, also finding that the Commission had applied a negligence standard, would have affirmed the Commission's decision.[122] All three members of the panel agreed that there was substantial evidence to support the Commission's finding of a violation and none questioned the SEC's competence to interpret the correct application of accounting standards.[123]

Two and a half years after remand (and almost five years after the Commission's first decision), the Commission affirmed its original decision in *Checkosky*.[124] It again held that the accountants were reckless in their actions, explaining at length the reasons for that conclusion.[125] The Commission determined that violations of Rule 102(e)(1)(ii) for unprofessional conduct do "not mandate a particular mental state."[126] The

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[119] *Id.* (Silberman, J., filing separate opinion).

[120] *Id.* at 465-66.

[121] *Id.* at 467, 483-84 (Randolph, J., filing separate opinion).

[122] *Checkosky*, 23 F.3d at 493-94, 496 (Reynolds, J., filing separate opinion, concurring in part, and dissenting in part from Judge Silberman's and Judge Randolph's opinions).

[123] *Id.* at 456-57, 472-79, 494.

[124] *In re* Checkosky, Exchange Act Release No. 38,183, Accounting and Auditing Enforcement Release No. 871, 1997 SEC LEXIS 137, at *54 (Jan. 21, 1997). Commissioner Johnson dissented, arguing that the appropriate mental standard for Rule 102(e)(1)(ii) was a scienter standard and that the respondents should, in any event, not be disciplined because of the age of the proceeding. *Id.* at *52.

[125] *Id.* at *20-34.

[126] *Id.* at *37. The Commission, in addressing the culpability standard under Rule

Commission's application of a scienter standard for unprofessional conduct under Rule 102(e)(1)(ii) in *In re Carter* was confined to its facts.[127] The Commission observed that not every violation would be sufficient to invoke sanctions under the Rule; only a violation that "threatens the integrity of the Commission's processes in the way that the activities of unqualified or unethical professionals do."[128] The opinion did not attempt to distinguish between a violation that threatens and one that does not threaten the Commission's processes. The Commission's opinion stated, in effect, that not all negligent conduct is actionable, but that when the SEC found actionable conduct, it would inform the errant professional.[129] Thus, the opinion again refused to determine a standard for violations of unprofessional conduct.

Adoption of a negligence standard raises issues with respect to the scope of the SEC's statutory authority and encroachment on the role of the professions' own disciplinary bodies. The SEC is vulnerable to

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102(e), again held that negligence, but not every act of negligence, was the standard for violation of Rule 102(e)(ii). *Id.* at *37, *46. The Commission stated:

> We have explained above why we find Respondents' conduct to be reckless. As noted, however, the Court of Appeals unanimously directed that we generally supply a "more adequate explanation" of our interpretation of Rule 2(e)(1)(ii). The opinions of the panel focus on the mental state required for improper professional conduct.
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> We believe that Rule 2(e)(1)(ii) does not mandate a particular mental state and that negligent actions by a professional may, under certain circumstances, constitute improper professional conduct. Unlike Rule 2(e)(1)(iii), Rule 2(e)(1)(ii) does not require that the conduct be "willful." Nor do we believe that Respondents are correct that the overall structure of the securities laws mandates that scienter is an element of Rule 2(e)(1)(ii).
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> . . . .
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> We wish to make clear, however, that the fact that GAAP and GAAS are professional standards against which we examine the conduct of accountants does not mean that every deviation from GAAP or GAAS is improper professional conduct warranting discipline under Rule 2(e)(1)(ii). Our processes are not necessarily threatened by innocent or even certain careless mistakes. At times, we have found improper professional conduct by accountants who engage in several deviations of GAAS or GAAP, or who deviated from GAAS or GAAP in more than one audit, or with more than one client.
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> . . . .
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> However, isolated failures may be so serious as to warrant discipline.

Id. at *33-44 (footnotes omitted).

[127] *Id.* at *39-41.

[128] *In re Checkosky*, Exchange Act Release No. 38,183, Accounting and Auditing Enforcement Release No. 871, 1997 SEC LEXIS 137, at *43.

[129] *See id.* at *46-47.

arguments from lawyers and accountants that its negligence standard encroaches on the traditional province of state law that Congress did not intend to preempt and that the SEC lacks a legislative mandate for adopting such broad power.[130] Lawyers have an even stronger argument because, unlike accountants, other substantive provisions in the securities laws do not bolster the SEC's authority over lawyers and there are no national professional standards to enforce.

All Rule 102(e) actions since the first *Checkosky* decision have been brought only against accountants.[131] Actions brought against lawyers have only been brought pursuant to the Commission's cease-and-desist authority.[132] No actions against lawyers have been contested.

B. *Injunctive Relief*

In addition to its problems with Rule 102(e), the SEC also must

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[130]The Commission's decision opens to renewed attack, the validity of the Rule on the basis that it is not "reasonably related" to the purposes of the securities laws. *See supra* note 105. In *Checkosky*, Judge Silberman observed:

> If the Commission were to determine that an accountant's negligence is a *per se* violation of Rule 2(e), it would have to consider not only the administrative burden such a position would entail but also whether it would constitute a *de facto* substantive regulation of the profession and thus raise questions as to the legitimacy of Rule 2(e)(1)(ii) — or at least its scope.

Checkosky, 23 F.3d at 459 (Silberman, J., filing separate opinion). *See also Davy*, 792 F.2d at 1422 (reserving to an appropriate case, the issue of the precise reach of Rule 2(e)).

[131]*See, e.g.*, *In re* Baughman, Exchange Act Release No. 37,241, [1996 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 74,299, at 63,264 (May 23, 1996) (accountants "filed with the Commission quarterly, annual, and current reports which contained materially false and misleading financial statements and disclosures"); *In re* Mermelstein, Exchange Act Release No. 37,222, [1996 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 74,298, at 63,257 (May 16, 1996) (accountants failed to follow generally accepted auditing standards and caused client to materially overstate the values in certain patents and property); *In re* Grendi, Exchange Act Release No. 36,313, [1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 74,239, at 63,106 (Sept. 29, 1995) (accountants "knowingly or recklessly participated in a fraudulent accounting scheme . . . through the recording of fictitious, and other improper, accounting entries, prohibiting the proper recording of expenses, and maintaining overvalued assets on the books and records of [their client]"); *In re* Vandenberg, Exchange Act Release No. 36,309, [1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 74, 238, at 63,103 (Sept. 29, 1995) (company's accountant failed to disclose existence of personal check offered to cover devaluation of an investment to the company's independent auditors); *In re* Reich, Exchange Act Release No. 36,246, [1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 74,227, at 63,077 (Sept. 18, 1995) (accountants departure from generally accepted auditing standards); *In re* French, Exchange Act Release No. 36,053, [1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 74,210, at 63,040 (Aug. 3, 1995) (accountants departure from generally accepted auditing standards in failing to plan and supervise audit).

[132]*See infra* Part III.C.

address several substantive issues with respect to its ability to obtain injunctions against lawyers. Courts are not as likely to give the SEC injunctive relief as they once were. They no longer view the issuance of an injunction as "mildly prophylactic" and have become sensitive to the severe collateral consequences of issuing injunctions.[133] The Commission must demonstrate that there exists a reasonable likelihood that the defendants, if not enjoined, will engage in future violations.[134] Under that standard, the SEC faces a high degree of risk that it will not be able to obtain relief, especially when it can produce evidence of only a single violation. Failure to win high profile injunctive cases can have a negative impact on the SEC's regulatory goals.

The SEC also faces uncertainty in deciding whether to bring injunctive actions under the 1995 Reform Act against lawyers as secondary actors who provide substantial assistance to primary violators of the securities laws. Actions for secondary liability usually apply in situations where the lawyer gives securities law advice to his client, but the lawyer does not engage directly in the disclosure process. If the lawyer gives erroneous advice, he is vulnerable to sanctions for substantially assisting his client's violation. A lawyer can also be sued as a primary violator of the securities laws if he is acting directly, such as in issuing a materially misleading opinion.

The 1995 Reform Act authorized the SEC to seek injunctive relief against secondary actors.[135] This secondary liability provision was enacted in response to a 1994 Supreme Court decision, *Central Bank v. First Interstate Bank*,[136] in which the Court determined that the antifraud provision of the Securities Exchange Act of 1934, section 10(b),[137] did not include a private right of action against those who aid and abet the conduct of a primary violator.[138] *Central Bank*'s rationale left in doubt

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[133]For a discussion of the collateral consequences of SEC actions, see Thomas J. André, Jr., *The Collateral Consequences of SEC Injunctive Relief: Mild Prophylactic or Perpetual Hazard?*, 1981 U. ILL. L. REV. 625 (discussing collateral consequences of injunctions, including possible imposition of contempt orders, disclosure requirements in SEC filings, damage to reputation, and various disqualifications of regulated persons under the securities regulations); Marc I. Steinberg, *SEC and Other Permanent Injunctions — Standards for Their Imposition, Modification, and Dissolution*, 66 CORNELL L. REV. 27 (1980) (discussing case standards for imposition of injunctions in view of the consequences of injunction orders).

[134]*See* Steinberg, *supra* note 133, at 28-29 (stating the basic precepts for government injunctions).

[135]Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, § 104, 109 Stat. 737, 757 (1995) (codified at 15 U.S.C. § 78t(f) (Supp. I 1996)).

[136]511 U.S. 164 (1994).

[137]Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j (1994).

[138]*Central Bank*, 511 U.S. at 191.

whether the SEC would be able to continue to bring aiding and abetting actions.[139]

For thirty years before that decision, the lower courts had implied a right of action in favor of the SEC and private litigants to sue lawyers (and others) for aiding and abetting their clients' fraud.[140] The action for secondary liability was the principal remedy for the SEC's injunctive relief against lawyers and the SEC brought some of the most significant aiding and abetting actions against lawyers, such as the one in *National Student Marketing*.[141]

Eighteen months after the *Central Bank* decision, Congress, in passing the 1995 Reform Act, acted to restore to the SEC the ability to sanction secondary actors, including lawyers, who *knowingly* give substantial assistance to primary violators.[142] The statute's limitation in bringing an action only against those who *knowingly* provide substantial assistance creates uncertainty because the meaning of *knowingly* in this context has yet to be judicially defined. Under the implied Rule 10(b)-5 action, the majority of circuits have interpreted the applicable culpability standard of scienter broadly enough to include reckless conduct for primary violations.[143] In some instances, reckless conduct had also been sufficient to hold secondary actors liable under the discarded aiding and abetting action.[144] The Supreme Court has yet to rule on whether reckless conduct is sufficient to meet the scienter standard.[145]

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[139]*Id.* at 199-200 (Stevens, J., dissenting).

[140]*Id.* at 197-98 & n.8 (Stevens, J., dissenting).

[141]For a discussion of SEC v. National Student Marketing Corp., see *supra* text accompanying notes 56-61.

[142]1995 Reform Act, Pub. L. No. 104-67, § 104, 109 Stat. 737, 757 (codified at 15 U.S.C. § 78t(f) (Supp. I 1996)). Section 20(f) of the Exchange Act states:

Prosecution of persons who aid and abet violations:

> For purposes of any action brought by the Commission under paragraph (1) or (3) of Section [21](d) of this title, any person that knowingly provides substantial assistance to another person in violation of a provision of this chapter, or of any rule or regulation issued under this chapter, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.

15 U.S.C. § 78t(f) (Supp. I 1996).

[143]Ann Maxey, *Competing Duties? Securities Lawyers' Liability After* Central Bank, 64 FORDHAM L. REV. 2185, 2196 (1996) (noting that "[t]he majority of the circuits . . . have adopted a recklessness standard for primary violations"); *see* LOSS & SELIGMAN, *supra* note 29, at 3665-67 (listing cases from all of the circuits).

[144]Maxey, *supra* note 143, at 2197 (noting that "[s]ome courts applied a recklessness standard to all 10b-5 claims without distinguishing between primary and aiding and abetting liability").

[145]*See* Maxey, *supra* note 143, at 2196-98 (discussing the courts' interpretation of the

The use of the term *knowingly* in the new statute would appear to preclude the SEC from obtaining injunctions against lawyers based on reckless conduct. Only one decision has thus far addressed the meaning of *knowingly*. In *SEC v. Fehn*,[146] the court, in dicta, did not interpret the *knowingly* standard to include "reckless disregard," stating that the "plain terms" of the statute require a showing of "knowledge."[147] Commentators also conclude that the term *knowingly* will be defined to require the higher standard of "actual knowledge" and will exclude reckless conduct.[148] The conclusion is not certain, however, and the issue is ripe for litigation.[149]

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meaning of scienter in implied actions under Rule 10(b)-5).

[146]97 F.3d 1276, 1284-85 (9th Cir. 1996) (applying new secondary liability provision retrospectively to affirm injunction against lawyer for aiding and abetting 10(b)-5 violation).

[147]*Id.* at 1288 n.11.

[148]John W. Avery, *Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995*, 51 BUS. LAW. 335, 369 (1996) (arguing that by limiting the secondary liability provision to knowing conduct, the Commission does not have authority to pursue the many aiding and abetting actions based on reckless conduct); Lewis D. Lowenfels & Alan R. Bromberg, *A New Standard for Aiders and Abettors Under the Private Securities Litigation Reform Act of 1995*, 52 BUS. LAW. 1, 5-8 (1996) (arguing that the term "knowingly" precludes actions for recklessness, which is consistent with the legislative goals to discourage frivolous litigation); Walter Rieman et al., *The Private Securities Litigation Reform Act of 1995: A User's Guide*, 24 SEC. REG. L.J. 143, 177 (1996) (stating that "the use of the word 'knowingly' seems to support the argument that the SEC may no longer rely on the mere 'recklessness,' as it frequently has, when suing an alleged 'aider and abettor'").

[149]Case authority also supports a definition of "knowing" conduct to include reckless conduct. Decker v. Massy-Feruson, Ltd., 681 F.2d 111, 119 (2d Cir. 1982) (stating in dicta that there is an indication within the Second Circuit that "an aider and abettor's liability can be predicated upon recklessness only where defendant owed a fiduciary duty to the plaintiff"); Huddleston v. Herman & MacLean, 640 F.2d 534, 544-45 (5th Cir. 1981) (concluding that "recklessness can, under certain circumstances, be sufficient to establish scienter for purposes of the cause of action under Rule 10b-5"), *aff'd in part and rev'd in part on other grounds*, 459 U.S. 375 (1983). *See also* ABA Comm. on Ethics and Professional Responsibility, Informal Op. 86-1517 (1986) (addressing the propriety of an attorney complying with a client request to bill the corporation for both corporate and personal legal work where the client is the sole shareholder and the personal work is not identified as such). The opinion states that:

> a lawyer cannot avoid a violation of the rules against assisting a client in conduct the lawyer knows to be illegal or fraudulent by disclaiming "knowledge" of illegality or fraud when the lawyer has, without inquiry, recklessly and consciously disregarded information that plainly suggests that a crime or fraud is involved.

Id. Courts, in construing the terms in the new statute, may reasonably justify a less strict interpretation of knowingly to include reckless conduct because of the need of the SEC to protect the public which can no longer bring private suits against secondary actions. *See* Lowenfels & Bromberg, *supra* note 148, at 8 (claiming that "one might reasonably justify easing the knowledge requirement for a government agency suing as a plaintiff presumably in the public interest").

The distinction between actual knowledge and recklessness can be significant. The SEC's objectives in setting professional standards of competence are better served when it brings actions for negligent or at least reckless conduct.[150] For instance, suppose a lawyer gives erroneous advice to a client that the financial instrument the client proposes to issue does not require registration under section 5 of the 1933 Securities Act. If the lawyer knows that the advice is erroneous, he is liable as a secondary participant and maybe as a primary violator. The case is simple, although it may be difficult to prove the lawyer acted knowingly, unless the lawyer confesses. The case does not particularly implicate standards of professional care because the lawyer, in knowingly counseling a violation of law, has broken a cardinal precept of the profession and thus converted himself *de facto* from the lawyer's role into the status of a primary participant in the wrongdoing.

But if the lawyer's advice is erroneous because the lawyer, acting in good faith, is negligent or even reckless, then standards of conduct of the lawyer acting *qua* lawyer come into play. First, those standards of care and competence have to be defined by reference to other lawyers dealing with the same or similar issues. Which lawyer? Any licensed lawyer, all of whom are permitted to practice securities law? A lawyer regularly practicing securities law, for which there is no special certification or indeed any other defining standard? If it is determined that it is a lawyer practicing securities law, where are the standards defined by securities lawyers? The short answer is there are no announced standards, except those defined in securities cases brought by the SEC and, prior to *Central Bank*, those standards developed in cases brought by private litigants.[151] The setting of standards and the discipline of lawyers acting *qua* lawyer will not be advanced using the new secondary liability statute if actual knowledge is the standard for liability.

The SEC can choose to initiate proceedings against lawyers pursuant to the new secondary liability statute with the hope of obtaining a court ruling to the effect that "knowing" conduct includes recklessness. The SEC may instead choose to argue to courts that lawyers' misconduct should be characterized as a primary violation under the less demanding scienter standard, which, until the Supreme Court states otherwise, includes reckless conduct.

Initiating actions against lawyers for knowingly giving substantial assistance may not further SEC objectives as well as initiating actions

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[150]See, for example, the discussion of *In re* Candie's, Inc., Exchange Act Release No. 36,865, 61 S.E.C. Docket 0938 (Feb. 21, 1996).

[151]*See* discussion *supra* Parts III.A-B.

against lawyers for violations of primary conduct. The SEC has always viewed private litigation as an important adjunct to the SEC's enforcement powers.[152] The SEC should therefore be expected to help private litigants develop theories of primary liability. The 1995 Reform Act did not restore private actions for aiding and abetting.[153] Private litigants can proceed against lawyers only as primary violators.[154] Because the extensive case law on securities fraud has often defined the same kind of lawyer conduct as either a primary or secondary violation, private litigants will now sue lawyers on theories of primary violations.[155] To the extent that SEC actions can assist private litigants in establishing theories that lawyers can be sued as primary violators, the SEC has an incentive to help channel the law in that direction.

Given the difficulties with Rule 102(e) and the uncertainty of injunctive actions against lawyers for secondary liability, the Greene solution no longer meets the SEC's objectives. These difficulties will encourage the SEC to adopt a different policy from the one encompassed by the Greene solution — that is, limiting Rule 102(e) actions when professional responsibilities are at issue only to those cases where an Article III court has found that the lawyer committed a securities violation. The SEC can avoid some of these difficult issues by using a flexible alternative — its cease-and-desist authority.

C. *Cease-and-Desist Authority*

The 1990 Remedies Act significantly expands the Commission's enforcement authority by permitting the Commission, through administrative proceedings, to determine that a person is violating, has violated or is about to violate any provision of the federal securities laws, rules, or regulations.[156] Prior to the Act, only a federal court could make

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[152]*See* Central Bank v. First Interstate Bank, 511 U.S. 164, 199 (1994)(Stevens, J., dissenting) (noting that "[t]he agency charged with primary responsibility for enforcing the securities laws . . . urges retention of the private right to sue aiders and abettors").

[153]Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in scattered sections of 15 U.S.C.).

[154]*Central Bank*, 511 U.S. at 191.

[155]For a discussion of the theories private litigants can use to sue lawyers as primary violators, see generally Maxey, *supra* note 143, at 2198-202.

[156]*See generally* Ralph C. Ferrara et al., *Hardball! The SEC's New Arsenal of Enforcement Weapons*, 47 BUS. LAW. 33, 42-67 (1991) (analyzing the 1990 Remedies Act's civil penalty provisions and cease-and-desist authority); Bruce A. Hiler & Neil K. Gilman, *The SEC's Use of its Cease-and-Desist Authority: A Survey*, 23 SEC. REG. L.J. 235 (1996) (discussing proceedings and interpretive issues); William R. McLucas et al., *SEC Enforcement: A Look at the Current Program and Some Thoughts About the 1990's*, 46 BUS. LAW. 797, 826-

those decisions. Now, if the Commission finds a violation, it may issue an order requiring that person to cease and desist from committing the violation or future violation.[157]

The Commission may also issue an order directing any person "that is, was, or would be a cause of the violation due to an act or omission that the person knew or should have known would contribute to the violation" to "cease and desist from committing or causing such violation and any future violation."[158]

These enforcement powers appear to be tailor-made for those persons, like lawyers, who commit single violations and are not directly regulated by the SEC. In its report on the Remedies Act, the House Committee on Energy and Commerce stated that "[t]he legislation is designed to enable the Commission to maintain an aggressive and comprehensive program to enforce the federal securities laws."[159] The report viewed the enforcement powers as a flexible remedy operating similar to an injunction, and providing the Commission with an alternative to injunction actions that may be used against persons "who commit isolated infractions and present a lesser threat to investors."[160]

The Commission has authority under the Remedies Act to issue cease-and-desist orders against any person who *causes* a violation with an act or omission that the person *knew or should have known* would *contribute* to the violation.[161] The text of this provision confers broad discretionary powers on the SEC to determine what mental culpability is required and what conduct is sufficient to satisfy the nexus between the "causing" conduct and the underlying violation. The Commission takes the position that the "knew or should have known" language is satisfied by a finding of negligence.[162] The word "contribute" gives the SEC the

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38 (1991) (examining personal views of prominent SEC officials on the interpretive issues of the 1990 Remedies Act).

[157]Securities Act § 8A, 15 U.S.C. § 77h-1 (1996); Exchange Act § 21C, 15 U.S.C. § 78u-3 (1996); Investment Company Act § 9(f), 15 U.S.C. § 80-a9(f) (1996); Investment Advisors Act § 203(k), 15 U.S.C. § 80b-3(k) (1996).

[158]Securities Act § 8A, 15 U.S.C. § 77h-1 (1996); Exchange Act § 21C, 15 U.S.C. § 78u-3 (1996); Investment Company Act § 9(f), 15 U.S.C. § 80-a9(f) (1996); Investment Advisors Act § 203(k), 15 U.S.C. § 80b-3(k) (1996).

[159]H.R. Rep. No. 616, 101st Cong., 2d Sess. 14 (1990).

[160]*Id.* at 23-24.

[161]*See, e.g.*, Securities Law Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, § 102, 104 Stat. 931, 933-34 (1990) (amending the Securities Act of 1933 to establish cease-and-desist authority within the Commission); *see supra* note 157 (citing the codification of the cease-and-desist authority in the various Securities Acts).

[162]*See infra* notes 163-68 and accompanying text (discussing the application of a negligence standard in *In re Kern, Jr.*).

widest possible margin to argue that whatever the person did was sufficient to contribute to the cause of the violation. In other words, the causation need not be proximate but can be satisfied merely by a showing that "but for" the conduct, the violation would not have occurred. The SEC's ALJs have also taken the position that once "cause" is established, the SEC need not make any further showing to obtain a cease-and-desist order.

The SEC's willingness to construe the language broadly is illustrated by the facts of *In re Kern, Jr.*, brought pursuant to section 15(c)(4), from which the provision of the 1990 Remedies Act appears to be derived. The SEC charged Kern with causing Allied Stores' failure to comply with timely disclosure in a takeover battle.[163] The ALJ, in finding that Kern's decision not to file an amendment to Allied's Schedule 14D-9 was erroneous, relied heavily on the finding that Kern, as Allied's director and outside counsel, had discretionary authority over decisions as to when the filings should be made.[164] On that basis, the ALJ concluded, Kern became an agent causing Allied to act, and thus was a cause of Allied's failure to act because Kern "knew or should have known" that the failure to file timely would contribute to Allied's failure to comply.[165]

Kern argued that he should not be held liable under the provision unless his conduct was egregious enough to be held liable in a Rule 102(e) proceeding — that is, unless there was a finding that he had aided and abetted, with scienter, his client's violation.[166] The ALJ nonetheless applied a negligence standard in finding that Kern caused Allied to commit the violation.[167]

Commentators have cautioned the SEC to limit its broad discretion when proceeding against lawyers under its cease-and-desist authority to the standards the Commission has historically used in imposing Rule 102(e) sanctions against lawyers for improper professional conduct — either violations of well-established professional standards or willful

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[163]*In re* Kern, Jr., Exchange Act Admin. Proc. File No. 3-6869, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,342, at 89,580-88 (Nov. 14, 1988), *aff'd*, Exchange Act Release No. 29,356, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,815, at 82,004 (June 21, 1991). *See supra* text accompanying notes 75-81 (discussing *In re Kern, Jr.*).

[164]*In re Kern, Jr.*, Exchange Act Admin. Proc. File No. 3-6869, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,342, at 89,592.

[165]*Id.* at 89,592-93.

[166]*Id.* at 89,591-92.

[167]The judge discontinued the proceedings after determining that the Commission's authority to issue an order of future compliance was limited to requiring Kern to take action to effect compliance by Allied, which had long since been taken over. *Id.* at 89,595.

misconduct.[168] The language of the statute, however, does not require a higher culpability standard than negligence and, therefore, the applicable standard can be defined in the Commission's discretion. The Commission will be tempted to vary the standard according to the individual case, which would bring the discussion full circle to the problem in using variable standards in Rule 102(e) proceedings. At a minimum those standards should be fully articulated by the Commission to afford fairness to lawyers, accountants and others who must meet them.

The full Commission has only considered the cease-and-desist language in the *In the Kern, Jr.* decision and in that decision it refused

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[168]*See* Lorne & Callcott, *supra* note 14. During his tenure as general counsel to the SEC, Simon Lorne stated his personal views in an article setting forth a suggested approach that the SEC should observe in initiating cease-and-desist proceedings against lawyers. *Id.* at 1316-27. First, the article reaffirmed the principle laid out by Greene that Rule 102(e) proceedings should not be brought unless a court of competent jurisdiction had made a prior determination that the lawyer had violated the securities laws. *Id.* at 1316. The article argued that this same policy should also apply when a cease-and-desist proceeding was the equivalent to a Rule 102(e) proceeding, such as when the SEC sought an order that the respondent should cease practicing before the SEC. *Id.* at 1316-17.

Next, the article described the kind of lawyer conduct in which the SEC could choose to proceed administratively or injunctively against lawyers. This category included lawyers acting in a nonlegal capacity, such as those who had an economic interest in the transaction other than relatively customary billing arrangements. *Id.* at 1317-18. Also included were lawyers who knowingly or recklessly issued misleading legal opinions to third parties which would result in a primary violation of the anti-fraud provisions. *Id.* at 1318. *See, e.g., In re* Peden, Exchange Act Release No. 35,045, 58 S.E.C. Docket (CCH) 425 (Dec. 2, 1994) (SEC proceedings against tax lawyer in which SEC alleged that tax opinion falsely described use of proceeds in municipal bond transaction and falsely described tax consequences). In addition, the category would include lawyers who participated in their clients' wrongdoing with actual knowledge, willful blindness, or other "high-scienter" conduct. Lawyers who may have acted recklessly would be excluded from this category. Lorne & Callcott, *supra* note 14, at 1319. In other words, where there is fairly clear evidence that the lawyer was not acting *qua* lawyer because he was too deeply or consciously involved in the wrongdoing, the SEC could proceed administratively or injunctively without concern that the action implicated the lawyer's professional role. The article argued that the culpability standard for a cease-and-desist order should be higher than a negligence standard. *Id.* at 1322.

The article carved out from administrative proceedings cases presenting unsettled issues of professional conduct or extension of existing law regarding liabilities of lawyers. *Id.* at 1323. These cases, the article argued, should be brought only in federal court. *Id.* This category would include the conduct of lawyering most intimately associated with the lawyer-client relationship, such as liability for drafting documents, for editing or reviewing documents, for giving erroneous advice, for silence or inaction after the lawyer learns of the client's securities fraud and liability based on the lawyer's *negligent* conduct. *Id.* at 1323-26. The procedure of bringing these actions in federal court would, in Lorne's view, "eliminate any potential criticism that the SEC is attempting to use its administrative process to regulate the professional conduct of lawyers." *Id.* at 1323.

to comment on or withdraw the ALJ's application of a negligence standard.[169]

Cease-and-desist consent orders entered against lawyers do not establish that the SEC will use the same restraint it used in evaluating lawyer conduct in Rule 102(e) proceedings. Two cases appear to fit the traditional mold of the SEC proceeding against lawyers for breaches of well-established professional conduct. In *In re Feldman*,[170] the SEC obtained a consent cease-and-desist order under section 8A of the Securities Act against a lawyer who rendered an opinion to a foreign bank that the sale of the bank's foreign exchange bearer certificates (FEBCs) in the U.S. did not require registration.[171] The SEC charged that neither the lawyer nor any member of his firm had "any background in the practice of law relating to the offer and sale of securities."[172] Furthermore, the SEC charged that Feldman failed to consult anyone experienced in securities-related matters and that he had received notice from the Commission's staff that the FEBCs would have to be registered.[173]

The second case, *In re Fillmore*,[174] involved a lawyer who was determined to have knowingly or recklessly facilitated a plan for an acquiring company to manipulate cash used to purchase another company in violation of the terms of the purchase agreement.[175] The acquiring company's manipulation was then concealed in preparing and filing false statements with the SEC to report the transaction.[176] The lawyer, in acting as closing agent for the transaction, used the law firm's trust account and directed the transfer of money in accordance with his client's directions, which resulted in a material misrepresentation to the shareholders.[177]

Without distinguishing between committing a violation and causing one, the SEC found that the lawyer either committed or caused a violation of the antifraud provisions of the securities laws in violation of the terms of his client's purchase agreement.[178] The order applied a

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[169] *In re Kern, Jr.*, Exchange Act Release No. 29,356, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,815, at 82,008.

[170] Release No. 33-7014, 1993 WL 370958, at *1 (SEC Sept. 20, 1993).

[171] *Id.* at *2.

[172] *Id.*

[173] *Id.* at *4.

[174] Release No. 34-36259, 1995 WL 560221 (Sept. 21, 1995).

[175] *Id.* at *2.

[176] *Id.*

[177] *Id.*

[178] *In re* Fillmore, Release No. 34-36259, 1995 WL 560221 (Sept. 21,1995).

scienter standard of "knowing or reckless" behavior appropriate to an aiding and abetting claim.[179] This is the kind of case the SEC could have brought as an injunctive proceeding under the now discarded aiding and abetting action. The consent order was issued in the interregnum between the 1994 *Central Bank* decision and the enactment of the secondary liability statute in the Reform Act of 1995, when the SEC's authority to seek injunctions for secondary liability was in doubt.

Two later consent decrees raise the issue of whether the SEC has created a new cause of action in targeting negligent conduct of lawyers. In *In re Goodman*,[180] the lawyer was determined to have caused his client to violate the antifraud provisions when the lawyer participated in the drafting of his client's misleading offering circular to sell municipal bonds.[181] The language of the consent order tracked the language of the cease-and-desist authority in applying a "known or should have known" culpability standard. The lawyer's negligence in failing to discover his client's misrepresentations was deemed to have caused his client's violation even though the lawyer was not the author of the misleading disclosure document.[182] Sanctioning a lawyer for negligence in assisting in the drafting of misleading documents could result in the lawyer guaranteeing the accuracy of his client's representations. Alternatively, if the lawyer is allowed to rebut the claim of negligence, the lawyer must be able to prove he exercised due diligence. His problem is that there are no standards of due diligence on which he can rely *ex ante* to avoid the risk of sanction.

The SEC's consent order in *In re Candie's, Inc.*[183] also stated a

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[179]*See id.* (holding that because of his participation in the transaction, the lawyer "either knew or was reckless in not knowing that the series of transactions conducted through the use of the trust account represents a scheme to defraud . . . [h]ence, he acted with scienter"). The lawyer may have acted with scienter in this case, but another lawyer under similar circumstances could have been duped into acting as an unwitting agent for a transfer of funds through his law firm's trust account. In hindsight, his or her conduct may not appear innocent or even negligent in the harsh glare of the client's wrongdoing. The lesson for a professional standard here is that when a firm's trust account is used for a transaction, the lawyer has a duty to investigate, know the terms of the transaction and to monitor the client to make sure the terms are complied with. Failure to monitor the client's transaction if it involves a security could subject the lawyer to sanctions by the SEC and perhaps liability to a third party.

[180]Exchange Act Release No. 36,591, 60 S.E.C. Docket 2690 (Dec. 14, 1995).

[181]*Id.* at 2698-99.

[182]*Id.* Perhaps there is more to this case than meets the eye. The lawyer may actually have known of the misrepresentations but may have preferred to have a negligence standard applied so that his malpractice insurance would be available for the buyers of the bonds. His insurance policy probably excluded coverage for intentional conduct. If these kind of strategic considerations drive the outcome in these cases, the application of a negligent culpability standard could become common.

negligence standard that failed to distinguish between conduct that resulted in a violation and that which caused one. In this case, the cease-and-desist order was directed to the law firm itself, two clients of the law firm, and a broker-dealer who arranged sales of stock with foreign purchasers.[184] In four separate transactions, the respondents sold unregistered stock to foreign purchasers in reliance on the safe-harbor provisions of Regulation S.[185]

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[183]Exchange Act Release No. 36,865, 61 S.E.C. Docket 0938 (Feb. 21, 1996).

[184]*Id.* at 0939-40.

[185]*Id.* at 0941 n.2. In the first transaction, the law firm received stock from the issuer, Candie's, as compensation for legal fees. *Id.* at 0940. The broker-dealer, Mazzeo, arranged a sale of that stock to foreign purchasers who were represented by counsel in London. *Id.* at 0940-41. The law firm received an unsecured, unconditional promissory note for the stock. Mazzeo transferred the stock to the purchasers' account at the broker-dealer and shortly after the expiration of the 40-day restricted period of Regulation S, Mazzeo sold the stock in the United States, which provided proceeds to pay the promissory note. *Id.*

Each of the other three transactions was carried out in approximately the same way. The second transaction was the sale of Candie's stock for the issuer's own account. *Id.* at 0941. The law firm arranged for the sale and issued an opinion to the Candie's transfer agent that the stock need not be registered because it was being sold in reliance on Regulation S. *Id.* The third sale was for stock the law firm had received from Candie's as compensation for having arranged the Candie's offering. *Id.* at 0942. The fourth sale was the sale of another issuer's stock for its own account. *Id.*

Although acknowledging that the sales were in technical compliance with the nonexclusive safe harbors of Regulation S, the SEC held that the sales were part of a plan or scheme to evade the registration provisions. *Id.* at 0944. The SEC concluded the incidence of ownership of the securities never left the U.S. market. *Id.* at 0944. The SEC found the following facts significant: (1) the stock was sold to

> an unknown foreign entity in exchange for a short-term, unsecured promissory note, [(2)] . . . the only liquid market for the securities was in the United States, and a large block of securities was sold at a substantial discount to the market price[,] [(3)] [t]he stock certificates were delivered to the foreign purchasers before the issuer received payment on the notes, and [(4)] the foreign purchasers paid off their promissory notes by selling the stock back into the U.S. market just after the expiration of Regulation S's 40-day restriction period.

Id. at 0944. The order also noted, without explanation, that there did not appear to be meaningful recourse against the purchasers if they had defaulted on the promissory note because the purchasers were off-shore. *Id.*

The consent order did not state what the law firm knew or when it knew it. Only the broker-dealer was found to have willfully violated the registration requirements. *Id.* Giving the lawyers the benefit of a doubt, the broker-dealer could have easily set up a foreign accommodation purchaser for the stock with a plan to sell the stock back into the United States without the lawyers knowing anything about it. Lawyers are ethically required to deal with a represented person's lawyer so the lawyer in this case would be expected to deal only with the foreign entity's lawyer in London. The fact that the stock was sold at a deep discount appears appropriate if the purchaser is taking the market risk of not having a liquid market abroad. The law firm received the usual representations from the purchaser that it would not sell the stock

The result appears unduly harsh, if the lawyers were merely negligent in interpreting the Regulation S rules, when the transactions were technically correct, as the SEC conceded.

Since the standards were not sufficiently clear, and in this case they appear not to have been, the lawyers were sanctioned for conduct that was not based on well established standards of interpretation of Regulation S. The sanctions against the lawyers could also be explained on the basis that the lawyers sold stock for their own account in two of the transactions.[186] They were therefore acting as principals as well as lawyers. If this were the basis for the order, the order did not indicate that the lawyers were being disciplined as principals.

These consent cases, together with *In re Kern, Jr.*, offer evidence that the SEC is using its administrative procedures to discipline lawyers without addressing the standards as to when discipline will be imposed. Moreover, the importance of consent orders in establishing professional standards should not be underestimated. For example, the ALJ in *In re Kern, Jr.* found that George Kern caused a violation because the lawyer had failed to follow the SEC's interpretation of the law as set forth in a prior consent order involving *In re Revlon.*[187] The SEC, the courts, and practitioners rely on consent orders to establish standards of conduct.

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without registration or an exemption. Any sale to a foreign purchaser would entail a significant risk not to collect on a debt because of the difficulty of suing someone abroad. What more must the lawyer do under these circumstances to assure that this is not a scheme to evade the securities laws? Is she or he required to independently verify the purchaser's credit worthiness or ferret out a possible scheme in every transaction his client conducts? The cost of this kind of due diligence would make prohibitive a lawyer's involvement in a fairly routine transaction.

The red flag in this scenario is the business risk taken by the sellers in accepting an unsecured promissory note from a purchaser whose credit worthiness is not known. This is a business risk that a client should be able to accept or reject without the lawyer having to suspect his client of wrongdoing. The lawyers in this case were also sellers of stock to the foreign purchasers and presumably, as prudent business persons, they inquired as to the purchaser's credit worthiness. They were not free to ignore information they had learned (or had not learned) in their capacity as principals when they assumed their duties as their clients' securities lawyers and issued an opinion on Regulation S. If the broker had assured the lawyers not to worry about the purchasers' credit worthiness, that is when the lawyers needed to start worrying. If the lawyers had not themselves sold stock in this case, the sanctions against them would be difficult to justify under the facts presented in the order, unless the SEC was imposing a new stringent standard of due diligence.

[186] *See id.* at 0940-42.

[187] *In re* Kern, Jr., Exchange Act Admin. Proc. File No. 3-6869, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,342, at 89,530, 89,593 (Nov. 14, 1988) (citing *In re* Revlon, Inc., Exchange Act Release No. 23,320, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,006, at 88,142 (June 16, 1986)); *see also In re* Prudential-Bache Sec., Exchange Act Release No. 34-22,755, 34 S.E.C. Docket 1456 (Jan. 2, 1986) (relying on legal standards set forth in prior consent orders).

Over time these decisions take on authoritative weight even though the practice bypasses the notice and hearing requirements of the Administrative Practices Act for agency rule making.[188]

The SEC's cease-and-desist authority creates an opportunity for the SEC to make new substantive law by sanctioning negligent conduct, without having to deal with the interpretive limits that have grown up around Rule 102(e). The SEC has an opportunity to write on a clean slate. Even though commentators have urged the SEC to use restraint, the SEC's history has shown that the SEC has sought to enlarge its authority, not restrain it. If the Commission continues on a course of expanded interpretation of its new authority, all the objections the bar has levied at the SEC will be rekindled.

In a recent speech, Commissioner Norman Johnson addressed the bar's concerns surrounding the SEC's use of its cease-and-desist authority against lawyers.[189] Commissioner Johnson stated a preference for continuing the Greene policy with Rule 102(e) proceedings.[190] But he recognized that the SEC may not have "the luxury of confining itself to the federal courts" because "the remarkable growth in our capital markets has stretched the agency's capabilities to the limits."[191] The Commissioner would limit the cease-and-desist remedy "to those situations where the attorney's conduct was so egregious that he could properly be deemed a principal actor."[192] He acknowledged, however, that "the culpability level of the causing standard is an open question" because the Commission has not ruled on it even though several ALJs have relied on a negligent standard.[193] His view was that the "Commission should maintain its position, as set forth in *In re Carter*, . . . not to penalize good faith though negligent conduct — the instance where the lawyer commits an innocent mistake, or is used to perpetrate a fraud despite using best efforts to ascertain the truth."[194]

The SEC will, however, find it difficult to justify imposition of a

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[188]Lorne, *supra* note 14, at 454-55 (stating that the SEC's consent orders indirectly establish standards of conduct and presenting a "clear danger that ethical standards will be developed [in] a haphazard" way); Pitt & Shapiro, *supra* note 8, at 265-71 (describing the SEC's ALJ practice of bootstrapping into future cases, propositions of law negotiated in a consent order over which the staff exercises great control).

[189]Norman S. Johnson, *Suits Against Lawyers*, Speech given to the Federal Securities Law Committee of the American Bar Association, 1996 WL 786178 (Nov. 8, 1996).

[190]*Id.* at *4.

[191]*Id.*

[192]*Id.* at *5.

[193]Johnson, *supra* note 189, at *2.

[194]*Id.* at *5.

stricter scienter standard for the less drastic cease-and-desist remedy when it has (since Commissioner Johnson's speech) decided *Checkosky*, in which it again affirmed an enhanced negligent standard as sufficient to justify professional disbarment or suspension.[195] It remains to be seen whether the SEC will exercise its discretion to discipline lawyers for negligent conduct. The potential for exercising excessive or unrestrained authority is inherent in the cease-and-desist remedy even though Congress has not granted the SEC statutory authority to discipline negligent lawyer conduct. The danger, of course, in the use of these flexible standards, is that lawyers will have to rely on the political shifts in the SEC rather than the rule of law.

IV. TIME FOR A SPECIALIZED BAR?

Arguments in favor of professional independence ring with a certain bravado in light of the bar's failure to develop and enforce professional guidelines for transactional lawyering, in general, and securities lawyering in particular. The SEC will continue to justify its assumption of authority to discipline securities lawyers and set standards if the profession continues to demonstrate its ineffectiveness in dealing with issues of lawyer discipline, lawyer competence, and professional standards.[196] An effective bar, on the other hand, would deny the SEC's justification for assuming authority when it lacks a legislative mandate. The SEC would then not be able to use a lawyer compliance justification on which to bootstrap its more important objective in using the bar to serve a gatekeeping function.

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[195]*See supra* note 124 and accompanying text (discussing *Checkosky*).

[196]Professor Schneyer, in writing about the regulation of banking lawyers after the Savings and Loan crises, explains that the procedural and remedial limitations of the state disciplinary process and the structural limitations of ethics codes make the bar's traditional self-regulation irrelevant in disciplining banking lawyers. He convincingly argues that the private bar, through its major law firms, its malpractice insurers, and the American Bar Association, will partner with banking agencies to form a regulatory regime of "bar corporatism" to regulate banking practice. Ted Schneyer, *From Self-Regulation to Bar Corporatism: What the S&L Crises Means for the Regulation of Lawyers*, 35 S. TEX. L. REV. 639, 671-76 (1994). The limitations of the bar's traditional self-regulation and inadequate ethics codes are equally applicable to securities practice. This kind of regulatory regime between banking agencies and the ABA may also be the model that will develop in securities law practice between the SEC and the ABA. However, there are some differences between banking and securities practices that suggest limitations on the "bar corporatism" model for securities practice. These differences include the specificity to which banks are regulated in comparison to the regulation of public companies, the broader spectrum of lawyers who practice securities law as compared with banking lawyers, and the bar's and the SEC's long history which influences the interaction between the two.

Whether the bar has the will or the means to achieve sufficient change to forestall increased SEC regulation is a significant open question. Securities lawyers have not addressed these issues in a systematic fashion. Several reasons explain their apparent lack of will to challenge the status quo.

First, regardless of the rhetoric over concerns of ethics and competence, it is doubtful that the corporate bar perceives the need to change. The elite members of the corporate bar, who exercise the profession's power in this area, have been and continue to be hugely successful.[197] The leaders of the corporate bar are highly competent practitioners of securities law who continue to train new lawyers to practice competently. Anecdotal evidence suggests that most securities lawyers believe they attempt to balance their representation of clients with the lawyer's views of regulatory objectives and public policy. These lawyers counsel clients not just on the legality of their conduct, but also on taking a principled path — a path that can usually be justified to clients on the basis of good business judgment as well as following socially beneficial value systems. These lawyers justify maintaining the status quo because they believe, even if their efforts are not recognized by the public or their academic detractors, that they act with a high degree of professionalism.

A further disincentive to change is that the elite corporate bar exercises informal influence over the SEC — a fact that often dissuades the SEC from going too far. The SEC's general counsel and commissioners often come from and go back into the corporate bar's ranks.[198] Therefore, the corporate bar's relationship with and exercise of influence on the SEC is most likely to be currently satisfactory despite the bar's occasional grousing over a particular decision.

If the corporate bar finds the need to initiate significant change, that need will likely arise from a reaction to unanticipated events. Several trends are potential candidates to produce those events. One of

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[197]*See id.* at 641 (noting that "[e]ven in jurisdictions in which large-firm, corporate practice is prominent, proceedings against large-firm lawyers are still rare").

[198]For example, former SEC General Counsel Simon Lorne went to the SEC from private practice and left the SEC in 1996 to become general counsel to Salomon Inc. While serving as SEC General Counsel, Lorne expressed his personal views that the SEC does not have a statutory mandate nor expertise to decide lawyers' improper professional conduct except when there has been a prior finding that the lawyer has committed a securities violation. Lorne & Callcott, *supra* note 14, at 1293, 1330. Present SEC Commissioner Norman S. Johnson, in 1975, criticized Rule 2(e) for its lack of identifiable standards of care and questioned the wisdom of leaving to the SEC's discretion, decisions as to which cases to bring against lawyers. Johnson, *The Dynamics of SEC Rule 2(e)*, *supra* note 14, at 657.

the most important trends is the huge increase in the numbers of lawyers and the resulting stratification of lawyers.[199] The practice of law has always been stratified, but the practice of securities laws has, until the last few years, remained primarily in the realm of the few who shared common practice and ethical constructs. The numbers and diversity of lawyers and the increased amount of competition has helped break down commonly shared agreements on practice and ethical constructs.[200] That trend is likely to continue. This stratification among lawyers will be exacerbated as the types of securities practice become even more differentiated into state transactions, national transactions, and transnational transactions.

Of course, the bar's experience is not isolated. It is but a small part of the larger phenomenon of increasing specialization of work and fragmentation of ethical and social constructs in American society.[201] Whatever the causes of this phenomenon, society must eventually react to the problems emerging from these changes. The issue of lawyer regulation is an example. The bar cannot maintain the fiction that it regulates its own.[202] If the bar is unable or unwilling to regulate its own members, then the SEC (and other agencies, and federal and state governments) will increasingly step into the vacuum.

The SEC will continue to make rules, often in the context of dealing with the conduct of lawyers who are not under the control or influence of the elite bar. These rules will basically define the standards of "competence" in the practice of securities law.[203] To the extent that the lawyer's conduct and judgment is circumscribed by specific standards, the lawyer's opportunity to exercise discretion, judgment, independence, and creativity is diminished. Those opportunities are presumably the stuff of lawyering skills that add value to transactions. For the same reason, however, lawyers are as likely to resist establishing specific standards for themselves as they are in resisting the efforts of the SEC in establishing those standards.

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[199]KERMIT L. HALL, THE MAGIC MIRROR: LAW IN AMERICAN HISTORY 288 (1989) (noting that in 1960 there were 286,000 lawyers in the United States; in 1987 there were 690,000). By 1996, there were approximately 900,000 lawyers in the United States.

[200]*Id.* at 288-89.

[201]*Id.*

[202]*See* MARY ANN GLENDON, A NATION UNDER LAWYERS: HOW THE CRISIS IN THE LEGAL PROFESSION IS TRANSFORMING AMERICAN SOCIETY 60-84 (1994).

[203]*See supra* text accompanying note 187 (noting that the ALJ, in *In re Kern, Jr.*, relied on his interpretation of the law as set forth in a prior consent order, when imposing on George Kern a standard for acting with professional competence in dealing with matters under those circumstances).

At some point, however, securities lawyers should perceive that it is in their interest to make a serious effort to set and enforce their own standards in an attempt to avoid increased governmental regulation. The bar, including the corporate bar, is losing or has lost control over regulation of its members and has failed to define professional standards.[204] The recent literature draws a dismal picture of the state of the profession.[205] Transactional lawyering in particular may inevitably be evolving into a business of providing expertise without serving the larger societal purposes of the profession, such as counseling the client or standing between the client and powers of government.

If the practice of law is becoming only a business, then the morals of the marketplace, with its attendant regulation, should prevail.[206] There is no advantage to lawyers competing with one hand tied behind their backs. And there is no reason for the SEC to treat them differently from other market players. Lawyers should pursue the business of providing expert legal advice with regard to a complex regulatory scheme and act as instrumentalities of their clients. Their conduct in participating in the securities market should have no special exemption from the same regulatory scrutiny applied to those players who seek lawyers' advice. As a matter of rational policy, lawyers' conduct should be even more carefully scrutinized. After all, if lawyers' specialized knowledge makes them gatekeepers to the markets, the SEC's policies in spending disproportional resources in supervising those who guard the gate are both rational and efficient.[207]

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[204]*See* Robert L. Nelson, *The Futures of American Lawyers: A Demographic Profile of a Changing Profession in a Changing Society*, 44 CASE W. RES. L. REV. 345 (1994).

[205]*See generally, e.g.*, ABEL, *supra* note 3; GLENDON, *supra* note 202; KRONMAN, supra note 3; SOL M. LINOWITZ & MARTIN MAYER, THE BETRAYED PROFESSION: LAWYERING AT THE END OF THE TWENTIETH CENTURY (1994); Nelson, *supra* note 204.

[205]Russell G. Pearce, *The Professional Paradigm Shift: Why Discarding Professional Idealogy Will Improve the Conduct and Reputation of the Bar*, 70 N.Y.U. L. REV. 1229 (1995) (tracing the history of law practice from a profession to a business). Pearce predicts the end of the "professional paradigm" and a shift to an emerging "business paradigm." *Id.* at 1263-76. He suggests a middle ground between a pure market approach and the maintenance of the status quo. This "middle range" would continue bar membership as a "credential," but would permit nonlawyers to practice law. *Id.* He would substitute market and government regulation for self-regulation. *Id.* The difficulty in the concept of abandoning lawyering as a profession at this time is that there is simply not enough known about what and where the profession is and what the implications of delicensing are. Questions as fundamental as who, if anyone, could exercise attorney-client privilege have yet to be addressed. The devil is in the details.

[207]*See* Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 75 n.67 (1986) (discussing the economies of scale that can be achieved when a gatekeeper enforcement strategy is superimposed on ongoing enforcement efforts against primary wrongdoers).

If discipline of securities lawyers is left to government regulators, the resulting regulatory regime should work about as well as the discipline of other market participants. Most lawyers, as well as other market participants, will continue to play by the rules. As repeat players in the securities markets, they have market incentives not to break the rules so they can continue to sell their services. The SEC will continue to discipline those few who are not honest and get caught. Regulation will simply provide incentives to lawyers, as it does others, to conform their conduct to a minimum set of rules and to believe that is all that is required of them. Those in the law business will have the same attitudes about regulation as those in other businesses.

The states' experiments with professional ethics rule-making demonstrate how lawyers are likely to react to increased regulation. Lawyers believe, and in fact are taught, that to become and act as a professional, they need only adhere to a set of rules defining minimum standards as set forth in their states' code of professional conduct. The minimum standards are justified because they allow the lawyer to exercise independent judgment in the context of each situation. The profession's decline as a profession has taken place in spite of increased attention to rules and in spite of increased resources used to enforce them.[208]

Can securities lawyers choose a different course? They can at least examine some alternatives. One alternative would be for the ABA to undertake an initiative similar to the Legal Opinion Accord that grew out of the Silverardo Conference.[209] The Conference sought to establish "a national consensus as to the purpose, format and coverage of a third-party legal opinion, the precise meaning of its language and the recognition of certain guidelines for its negotiation."[210] In producing the Accord, the bar was able to write guidelines for opinion practice drawn from custom and practice.[211] From the 1950's opinion practice consisting largely of the lore of the New York bar, opinion practice evolved into a national consensus.[212] A similar undertaking could produce useful guidelines or

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[208]*See* Howard A. Matalon, Note, *The Civil Indigent's Last Choice for Meaningful Access to the Federal Courts: The Inherent Power to Mandate Pro Bono Publico*, 71 B.U. L. REV. 545, 572 (1991) (noting that "[d]espite claims by the drafters that the Model Code and Rules were designed to avoid . . . ethical problems, the system continues to frustrate lawyers in need of ethical guidance).

[209]American Bar Association's Committee on Legal Opinions, *Third-Party Legal Opinion Report, Including the Legal Opinion Accord, of the Section of Business Law, American Bar Association*, 47 BUS. LAW. 167 (1991).

[210]*Id.* at 169.

[211]*Id.* at 224-32.

[212]Arthur N. Field, *Book Review of Fitzgibbon and Glazer on Legal Opinions*, 48 BUS.

standards with respect to securities practice.

A more ambitious approach would be to consider forming an independent securities bar. In the first instance, everyone will consider this a bad idea. The corporate bar working through the ABA will not want the ABA's political strength to be further dissipated. It will not want to relinquish the usefulness of the vague and therefore discretionary characteristics of the Model Rules of Professional Responsibility. State bars will not want to surrender their power to discipline or permit creation of a federal bar that threatens peculiar state practice. The ideal of the lawyer as general practitioner is also threatened. On the other hand, those who believe that lawyering as a profession is dead or dying, will find futile the attempt for the securities bar to remain independent through establishing yet another self-regulating organization.

The idea should not be dismissed out of hand, however, without exploring some of the ways in which it could benefit lawyers and society. A securities bar would allow the formulation of professional standards in a deliberative fashion, bringing the lore of securities practice into the open and serving to educate and inform lawyers' judgments. It could serve to teach new generations of lawyers who want to practice securities law and it could provide an effective alternative to agency discipline.

Even though an independent securities bar should have authority to exercise disciplinary power, that authority alone would not be expected to produce the desired normative behavior. Lessons from state bar disciplinary groups teach that the power to discipline is not used effectively.[213] Effective discipline and desired behavior is brought about in groups small and cohesive enough to form a community — the kind of community where the members know each other, work together, have common professional interests to bind together, identify with each other, and feel guilt and loose face if they let others down. The community does not necessarily have to be geographically bound, but it does have to rely on concepts for creating community for the era in which we live.

The SEC's authority to discipline lawyers is not the only reason to form an independent securities bar. Other issues weigh in favor of a unified securities bar, but each needs to be examined in detail. Examples of some of the practical issues must suffice at this juncture. Community of interest among securities lawyers is likely to increase as securities regulation coalesces into a single federal and international regulatory

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LAW. 1259, 1260 (1993).

[213] *See* Michael P. Cox, *Regulation of Attorneys Practicing Before Federal Agencies*, 34 CASE W. RES. L. REV. 173, 180 n.25 (1984) (noting a survey which " suggest[ed] that state disciplinary systems may not effectively regulate attorneys practicing before federal agencies").

scheme. The states will continue to exercise a disciplinary role in securities transactions, primarily through prosecuting fraud, but the states' regulatory role should continue to diminish. Market forces are bound to shape the transactional aspects of securities practice in the national and international arena into uniformity because that decreases the costs of financial transactions. At the same time the rapid change in SEC practice needs to be examined and the new rules addressed so that standards of competency can be defined. Uniformity of professional ethics standards in the securities arena can be more usefully defined in context to address these rapid changes. Uniformity of standards would also deal with the need to move away from the complexity and confusion of conflicting multiple jurisdictional rules.

The structure of a national securities bar could be based on the model of medical specialization without the need for state or federal legislation. For instance, state laws permit any licensed physician to perform any medical procedure,[214] but in practice, general practitioners do not perform cardiovascular surgery. If not constrained by their own judgment, their inability to obtain malpractice insurance and hospital privileges prevent general practitioners from operating. Education of consumers as to the value in having a specialist perform a procedure also contributes to market and self-regulation. The market forces of malpractice insurance and market participants' confidence in the specialized securities practice could also provide a structure for self-regulation.

Why would the corporate bar organize in a way that would permit even more lawyers to be trained to compete? For the same reasons, perhaps, that the corporate bar found it useful to establish national consensus with respect to legal opinions. The transaction costs involved in providing legal opinions were too high, the potential liability of issuing the opinions became too great, and lawyers were making a mess of them with parochial determinations of the meaning of the opinions.

More importantly, however, if the profession is worth saving as a profession, the bar must take responsibility for training practitioners competently. Maintaining the occupation of law as a profession falls squarely on the shoulders of the bar's leaders. If history offers any guidance in this issue, lawyers have had the privilege to serve a unique role in American society.[215] Lawyers have been given powers to protect

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[214]*See* PA. STAT. ANN. tit. 63, ch. 12, § 422.29(a) (1996) ("[a] license without restriction empowers the licensee to practice medicine and surgery without any restriction or limitation").

[215]*See* Philip S. Stamatakos, Note, *The Bar in America: The Role of Elitism in a*

individuals from abuse by society's government. For instance, they have been entrusted with the power not to reveal a client's confidence, a privilege belonging to no other citizen. Lawyers' powers can also be abused. The profession itself must prevent that abuse and train its own or it will rightfully loose its independence. The profession is receiving failing grades in that effort.[216] In the long run, if lawyers abuse their powers, society will curtail those powers by using tools such as increased governmental oversight. That is the model government now uses to regulate business, and if law is not a profession, it is a business.

This is not, however, an apologia for the profession. Lawyering as a profession is in decline. It may go the way of the guild systems of the middle ages — and for the same reasons.[217] Lawyers may not be able to alter that outcome, but reinventing the profession through manageable groups of lawyers is an idea worth considering.

Liberal Democracy, 26 U. MICH. J.L. REFORM 853, 855 (1993) (noting the special position of lawyers in American society).

[216]KRONMAN, *supra* note 3.

[217]Posner is the latest commentator to compare the legal profession to guilds. RICHARD A. POSNER, OVERCOMING LAW 33-70 (1995). He predicts: "Something like the evolution of the textile industry from guild production to mass production, and the concomitant decline of artisanality, is occurring today in the market for legal services." *Id.* at 47. That may be good economic theory for the industrial age, but no one knows if it will be valid in the information age. A case could be made for a revival of some kinds of lawyering in the information age as the traditional legal skills of communication and negotiation become even more important in the revaluing of human capital.