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POLICEMAN, CONSCIENCE OR CONFIDANT: THOUGHTS ON THE APPROPRIATE RESPONSE OF A SECURITIES ATTORNEY WHO SUSPECTS CLIENT VIOLATIONS OF THE FEDERAL SECURITIES LAWS

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INTRODUCTION

In recent years, the legal profession has been the target of a plethora of criticism for remaining oblivious to all but its clients' interests. No area of the bar has been the recipient of greater attack than has the securities bar. This paper examines one aspect of the debate: the obligations of a securities attorney who believes that his client's activities are violating the federal securities laws. 1

There are two settings in which client violations of the federal securities laws may arise. In the first, the client may be directly engaged in a transaction which violates the securities laws, \( \text{e.g., an unregistered sale of securities which does not qualify for an exemption} \) from registration; a purchase or sale of


1 In order to confine my inquiry to manageable dimensions I have purposely excluded from consideration a related topic that I believe is best dealt with separately: the authority of the Securities and Exchange Commission (SEC) to promulgate a standard of conduct for attorneys confronted with the problem dealt with herein. This issue has been the subject of a great deal of attention in its own right but analysis of it is not necessary for present purposes.


3 The 1933 Act requires registration of all sales of securities under § 5 but major exemptions from § 5 are provided by: § 4(2) (transactions not involving a public offering); § 4(6) (transaction involving certain sophisticated investors); § 4(1) (transactions engaged in by those other than issuers, underwriters and dealers); § 4(3) (some dealers' transactions); § 3(b) (partial exemption for relatively small sales); and § 3(a)(11) (intrastate offerings). Other exemptions of transactions and securities need not be considered here.
securities on the basis of false or misleading representations;\(^4\) or a securities transaction based on undisclosed inside information.\(^5\) In the second setting, the client may have violated some statute or common law doctrine unrelated to the securities area, which violation gave rise to a material, contingent liability and may contemplate violation of the securities laws by failing to make full disclosure of such material contingent liability in the financial statements included in the periodic filings required by the Securities and Exchange Commission (SEC).\(^6\)

The securities lawyer who feels that his client may be involved in a violation of the securities laws has, essentially, four options.\(^7\) He may do nothing; he can simply remain silent and not investigate the client’s behavior or protest to anyone with authority to modify the client’s conduct. He may investigate,

\(^4\) Several provisions of both the 1933 and 1934 Acts prohibit false representations as well as incomplete representations which fail to state a material fact and are thus misleading. Such provisions include § 11 of the 1933 Act (pertaining only to 1933 Act registration statements); § 12(2) of the 1934 Act (general prohibition of fraud in connection with securities transactions); § 17 of the 1933 Act (general antifraud provision) and § 10(b) of the 1934 Act along with SEC Rule 10b-5, 17 C.F.R. § 240-10b-5 (1981) [hereinafter cited as Rule 10b-5] (general antifraud provision). Misrepresentations in proxy materials given to shareholders are also prohibited by § 14(a) of the 1934 Act and SEC Rule 14a-9, 17 C.F.R. § 240.14a-9 (1981).

\(^5\) Numerous cases establish that this is a violation of Rule 10b-5. See SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969). See generally BRUDNEY AND CHIRELSTEIN, CORPORATE FINANCE, at 1010-40, (2d ed. 1979) [hereinafter cited as BRUDNEY].

\(^6\) Publicly held corporations, as defined in §§ 12(a) and (g) of the 1934 Act, are required by §§ 12(a), (g) and 13(a) of the 1934 Act to file annual reports pertaining inter alia to the corporation’s current financial status with the SEC as well as make analogous quarterly reports and promptly report to the SEC many extraordinary events. These reports are referred to as the 10-K, 10-Q and 8-K reports respectively. Since the reports must include a balance sheet which reflects all material contingent liabilities, failure to disclose a material contingent liability attributable to a past violation constitutes a separate violation. See infra notes 78-82 and accompanying text. Moreover, Rule 10b-5 requires all reporting companies to disclose material developments regarding their operations even if they are not engaged in trading activities. BRUDNEY, supra note 5, at 1066-78. Of course, the filing of a periodic report that is false or misleading in any other way constitutes an independent violation.

\(^7\) The lawyer obviously cannot affirmatively assist the client in the violation, e.g., by acceding to the client’s request that the lawyer draft a false document. “Of course, the lawyer, like everyone else, has always been liable under the federal securities laws where he engaged in active fraud.” Note, The Duties and Obligations of the Securities Lawyer: The Beginning of a New Standard for the Legal Profession?, 1975 DUKE L.J. 121, 127. This conclusion may not be applicable to a situation in which the client’s violation consists of failing to disclose the contingent liability attributable to a past transgression in current SEC filings. There is authority for the proposition that the attorney can participate in the preparation of such disclosure documents even though he is aware of the omission of the contingent liability. See infra note 186.
and if he determines that the client has violated or intends to
violate the law he may prevail on those with authority to refrain
from the objectionable activity. If he does not attempt or suc-
cceed in pursuing the latter course of action he may resign the
representation. Finally, after pursuing or without pursuing the
above steps, he may disclose his suspicions to the SEC or the af-
fected parties.8 It is the question of whether the lawyer should
be required to disclose suspected violations to the SEC or to po-
tential victims of his client's scheme that has triggered the most
controversy. The remainder of this article is devoted to an anal-
ysis of existing authority and a consideration of the course of
action advocated by this author for attorneys who find them-
theselves caught between loyalties to their client and responsibili-
ties to the public.

EXISTING AUTHORITY

The SEC View

The SEC's view is best understood by analyzing the two
principal proceedings brought against attorneys who allegedly
violated the SEC's standard of conduct.

National Student Marketing Corporation

SEC v. National Student Marketing Corporation9 was an in-
junctive action brought by the SEC against National Student
Marketing Corporation (NSMC), several of its executives, its
certified public accountants and the attorneys and law firms in-
volved in a merger between NSMC and Interstate National Cor-
poration (Interstate).10 Under the terms of the merger the
managements of both corporations submitted proxy materials to
their respective shareholders for approval. The NSMC materi-
als included financial statements showing a profit in the previ-
ous nine-month period. Shareholder approval was obtained, a
date was set for the closing and the merger was publicized. Ac-

8. As a practical matter disclosure to either the SEC or affected parties
will produce the same consequences. Such disclosure will trigger an SEC
investigation as well as induce the victims of the wrong to pursue their own
legal remedies. Notification to the SEC will probably also have the effect of
alerting potentially aggrieved investors.

follows is derived from the final opinion of District Judge Parker in SEC v.
National Student Mktg. Corp. It represents the disposition at the trial level
of the action against the only law firm defendant that did not enter a settle-
ment agreement with the SEC prior to trial.

10. The action was brought against the newly merged corporation. Thus, reference to action taken by the SEC against NSMC, refers to action
taken against NSMC and former Interstate personnel.
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According to the merger agreement, each party was to receive from the accountant of the other a "comfort letter" indicating, in essence, the accountants' belief that the financial statements in the proxies were prepared in accordance with generally accepted accounting principles, fairly presented the financial status of the particular company and had not been materially affected by changes occurring subsequent to their date.

The attorneys for Interstate did not receive the comfort letter from NSMC's accountants by the date set for the closing. When NSMC's attorney contacted the NSMC accountants, he was informed that certain adjustments in their income statement were required. The proposed adjustments converted the sizeable profit indicated on the income statement to a small loss. The income statement given the shareholders was, therefore, erroneous even though the adjustments did not affect the full year results which still showed a sizeable profit.

Interstate executives and attorneys considered waiving the comfort letter and proceeding with the closing as planned in order to avoid any adverse effect which a date change could have on the stock price of either company. The Interstate contingent proceeded with the closing. The attorneys for both parties issued opinion letters providing that "Interstate (NSMC) had taken all actions and procedures required of it by law and that all transactions in connection with the merger had been duly and validly taken, to the best knowledge of counsel, in full compliance with applicable law." After the closing, the NSMC accountant informed the NSMC attorney that, in his view, the adjustments in the income statement required resolicitation of the shareholders. Interstate rejected the idea.

Subsequently, public questioning of NSMC's financial soundness caused a collapse in the price of NSMC stock. The SEC investigated and sought to enjoin all parties, attorneys and accountants from violating the antifraud provisions of the securities laws. The SEC's view of the lawyers' obligation in this situation was indicated in its complaint.

As part of the fraudulent scheme [the attorneys for both parties] . . . failed to insist that the financial statements be revised and shareholders be resolicited, and failing that, to cease representing their respective clients and, under the circumstances, notify the

11. Id. at 690. Whether this opinion referred to substantive legality or mere compliance with applicable procedures, e.g., board and shareholder approval, etc., was never definitively resolved. The court also found that the Interstate representatives were concerned about the possibility of shareholder lawsuits in the event that the merger was abandoned since the terms appeared to be very favorable to the Interstate shareholders.

12. The principals and attorneys decided against undoing the merger because of the possible effect of such a move on the price of the NSMC stock received in consideration of the merger. See infra note 51.
plaintiff Commission concerning the misleading nature of the nine month financial statements.\footnote{13} The SEC argued that the lawyers had a duty to postpone the merger until the shareholders could be resolicited with adjusted financials and that this duty included disclosure, to the SEC and/or the shareholders, of the clients' refusal to resolicit. Breach of that duty was viewed as aiding and abetting the client's violations of the antifraud provisions.\footnote{14}

The NSMC proceeding evinced the SEC's intention to expand the obligation of the securities practitioner, in a nonlitigation setting, from mere allegiance to his client to an \textit{affirmative obligation to the public} as well.\footnote{15} Then Commissioner A.A. Sommer, Jr. likened the role of the securities lawyer in the nonlitigation setting to that of a certified public accountant.\footnote{16} This


\footnote{14. One commentator, writing soon after the filing of the complaint, summarized his view of the implications of the SEC position as follows: The crux of the Commission's proposition is that a lawyer who prepares disclosure documents on behalf of a public company really has two clients: the company, including both directors and shareholders, and the trading markets. When the interests of these clients conflict, the lawyer is obligated to favor the faceless mass of potential securities buyers over the company which is in fact his employer. Lipman, \textit{The SEC's Reluctant Policy Force: A New Role for Lawyers}, 49 N.Y.U. L. Rev. 437 at 440-41 (1974) [hereinafter cited as Lipman].}

\footnote{15. Although the Commissioner's sentiments were expressed in informal speeches, experienced practitioners in the field generally concede that such public statements are often indicative of Commission policy. \textit{Id.} at 472-73. Former SEC Commissioner Irving Pollack advised the bar that "[t]he client [of a securities attorney] is the corporation and, in the case of a publicly held corporation in today's environment, that means the corporation and the public because of the ever changing composition of the corporations' stockholders." Landau, \textit{Problems of Professional Responsibility}, 6 INST. ON SEC. REG. (PLI) 191, 216 (1975).}

\footnote{16. I would suggest, that in securities matters (other than those where advocacy is clearly proper), the attorney will have to function in a manner more akin to that of the auditor than to that of the advocate. It means he will have to be acutely cognizant of his responsibility to the public who engage in securities transactions that would never have come about were it not for his professional presence. It means he will have to adopt the healthy scepticism toward the representations of management which a good auditor must adopt. It means he will have to do the same thing the auditor does when confronted with an intransigent client—resign. Sommer, \textit{The Emerging Responsibilities of the Securities Lawyer}, [1973-74 Transfer Binder] FED. SEC. L. REP. (CCH) \S 79,631. It is interesting to note that former Commissioner Sommer did not explicitly call for disclosure of the misrepresentation to the SEC. It should also be noted that as indicated by the Sommer speech, as well as other authority, the SEC wishes to confine the scope of the lawyer's duty to affirmatively intervene to protect the public from fraud to situations in which he is functioning exclusively as an adviser as opposed to an advocate in litigation. See Gruenbaum, \textit{Corporate/Securities Lawyers: Disclosure},
view substantially departs from the traditional view of the lawyer as his client's confidant, obligated to maintain strict confidentiality with respect to information imparted to him by the client.  

According to the SEC complaint, the lawyers' duty of disclosure attached after consummation of the merger, i.e., after the violation occurred. Thus, the SEC indicated that, in addition to disclosure of intended violations, the lawyer must disclose the client's past securities violations. The imposition of a duty to report past misconduct is generally considered to be a greater departure from the traditional obligation of the lawyer than is the imposition of a duty to report future misconduct. Its settlement with one of the defendant law firms in this case reflected the SEC's insistence that a lawyer must occasionally "turn in" his client (even with respect to a past violation) and always has an affirmative obligation to attempt to prevent the consummation of fraudulent transactions.

In relevant part, the agreement between the law firm of White & Case and the SEC provided that:

1) the firm will refuse to issue any opinion letter in connection with any issuance of securities to the public where it has knowledge that its client has made any material misrepresentation in connection with the transaction and has not taken appropriate corrective action, and

2) where the firm becomes aware that in connection with any transaction involving the issuance of securities to the public by its client, the client has made any material misrepresentations, the firm will "advise the client of the client's disclosure obligations under the Federal Securities laws and if the client does not take appropriate action to comply with such obligations, the responsible partner will consider with at least two other partners of the firm the need for the firm to withdraw from employment or take other appropriate action."

Presumably, the italicized portion refers to public disclosure of the violation where the client has refused to rectify it. In its settlement with one defendant law firm in this case, the SEC was adamant in its insistence that a lawyer has a duty to "turn in"

Responsibility, Liability to Investors, and National Student Mktg. Corp., 54 Notre Dame Law. 795, 800, (1979) [hereinafter cited as Gruenbaum].


his client (even with respect to a past violation) and always has
an affirmative obligation to attempt to prevent the consumma-
tion of fraudulent transactions on the part of the client.

In re Carter and Johnson

An indication of the standard prescribed by the SEC (and
possible departures from its NSMC position) is provided by
analysis of In re Carter and Johnson\textsuperscript{21} in which the obligation of
counsel to control his client was a major issue. In re Carter was
disciplinary proceeding brought by the Commission against
two attorneys accused of primary violations of the securities
laws and of aiding and abetting the violations of their client,\textsuperscript{22}

\begin{footnotesize}
\textsuperscript{21} [1981 Transfer Binder] \textit{Fed. Sec. L. Rep.} (CCH) \textsuperscript{p} 82,847, p. 84,145
(Feb. 28, 1981). The textual discussion focuses on the opinion of the Securi-
ties and Exchange Commission in In re Carter and Johnson. In re Carter
came before the Commission on appeal from an administrative hearing in
which the attorney-defendants were found, by the administrative law judge
(ALJ), to have violated the SEC's ethical standards. The opinion of the In
re Carter proceeding at the administrative level appears at [1979 Transfer
Binder] \textit{Fed. Sec. L. Rep.} (CCH) \textsuperscript{p} 82,175, p. 82,165 (March 7, 1979).

22. The proceeding was brought under 17 C.F.R. \textsection 201.2(e) (1981). The
relevant portions of the Rule are set forth below:

(e) \textit{Suspension and disbarment.} (1) The Commission may deny,
temporarily or permanently, the privilege of appearing or practicing
before it in any way to any person who is found by the Commission
after notice of and opportunity for hearing in the matter (i) not to pos-
sess the requisite qualifications to represent others, or (ii) to be lack-
ing in character or integrity or to have engaged in unethical or improper
professional conduct, or (iii) to have willfully violated, or willfully
aided and abetted the violation of any provision of the Federal securi-
ties laws (15 U.S.C. \textsection 77a--80b-20), or the rules and regulations
thereunder.

(2) [provides for suspension from SEC practice of anyone sus-
pended or disbarred by state authorities or convicted of a crime involving
moral turpitude]

(3)(i) The Commission, with due regard to the public interest and
without preliminary hearing, may by order temporarily suspend from
appearing or practicing before it any attorney, accountant, engineer or
other professional or expert who, on or after July 1, 1971 has been by
name:

(a) Permanently enjoined by any court of competent jurisdic-
tion by reason of his misconduct in an action brought by the Com-
mission from violation or aiding and abetting the violation of any
provision of the Federal securities laws (15 U.S.C. \textsection 77a--80b-20) or of the
rules and regulations thereunder; or

(b) Found by any court of competent jurisdiction in an ac-
tion brought by the Commission to which he is a party or found by
this Commission in any administration proceeding to which he is a
party to have violated or aided and abetted the violation of any provi-
sion of the Federal securities laws (15 U.S.C. \textsection 77a--80b-20) or of the
rules and regulations thereunder (unless the violation was found not
to have been willful).
\end{footnotesize}
There is substantial disagreement concerning the authority of the SEC to
regulate the practice of law by promulgating this rule. \textit{See generally State-
National Telephone Company (NTC), which was disseminating misleading financial information to its shareholders and the general public.

Some of the misleading information was contained in an annual report which was included in a proxy solicitation by NTC which asked for approval to transfer certain assets to a newly created subsidiary in order to obtain bank financing. Despite approval of the transfer and the financing plan, NTC remained in serious financial trouble. Nevertheless, several very optimistic press releases were issued, apparently without the knowledge of the directors. Soon thereafter, the attorneys suggested to management that it communicate with the shareholders and the general public regarding the financial problems. This advice was disregarded.

About a month later, the firm was forced to enter an agreement with several bank creditors under which additional funds would be advanced. Under a critical provision, however, if a default should occur within seven months, the firm would be required to implement a "lease maintenance plan" (LMP) forcing a drastic curtailment of NTC's operations. When the agreement was closed, NTC published a press release prepared by an NTC attorney announcing the closing of the loan agreement. It did not, however, refer to the LMP, the likelihood of its implementation, or how the LMP might affect the future of the company. Three days later, without consulting its attorneys, NTC sent a very optimistic letter to its shareholders. The attorneys considered advising corrective action but decided that certain earlier communications would offset any misleading impression left by the letter.

About two weeks later, NTC attorneys prepared and filed a form 8-K \(^{24}\) with the SEC. Execution of the bank credit agreement was mentioned, but again, no reference to the LMP was included because of management's belief that such disclosure would adversely affect employee morale. About two months later, the banks advised the attorneys that disclosure and implementation of the LMP would be necessary. The attorneys questioned NTC management and were left with the impression that resort to the LMP would not be necessary. About two weeks later, however, it became clear to the attorneys that the banks

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\(^{23}\) Presumably in accordance with the company's obligation under Rule 10b-5.

\(^{24}\) See supra note 6.
were right; default was imminent and implementation would, in fact, be necessary.

Though advised of the necessity of disclosure, NTC's chief executive officer disregarded his attorney's instructions on the ground that an attempt was being made to negotiate a waiver of NTC's obligation. No mention of the situation was made to the directors or anyone else. One month later, when the directors were initially apprised of the seriousness of the situation, disclosure was made and the chief executive officer was forced to resign.

The SEC alleged that the attorneys' conduct violated Rule 2(e) of the Securities Exchange Act in the following respects: (1) direct participation in the preparation of a misleading press release and a misleading 8-K; (2) failure to take any corrective action; (3) failure "to communicate with the board of directors of National or to ensure that required disclosures were made in filings with the Commission and otherwise, despite the optimistic information about the company then extant in the marketplace"; (4) assisting management in disseminating misleading information; (5) failing to ensure that required disclosures were made or to communicate with National's board of directors concerning management's failure to make such disclosures.

The conduct alleged was "aiding and abetting" the client's primary securities violations. It was summarily claimed that the lawyers, "(a) do not possess the requisite qualifications to appear and practice before the Commission in the representation of others; and (b) are lacking in character and integrity and have engaged in unethical and improper professional conduct."

The SEC discounted the aiding and abetting allegations against the lawyers on the ground that frequent caveats to disclose, by the attorneys to NTC management, negated the intent element of the aiding and abetting offense. The allegations of unprofessional conduct were also dismissed because of the lack of a clearly defined standard of conduct for attorneys con-

27. Id. at p. 82,180.
28. "Although it is a close judgment, after careful review, we conclude that the available evidence is insufficient to establish that either respondent acted with sufficient knowledge and awareness or recklessness to satisfy the test for willful aiding and abetting liability." In re Carter and Johnson, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,947, pp. 84,145, 84,167 (Feb. 28, 1981).
29. Id. ¶ 82,947 at p. 84,170.
fronted with a corporate client's refusal to comply with disclosure requirements. However, the SEC went on to specify the standard of conduct to which it would henceforth hold attorneys practicing before it.\(^{30}\)

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.\(^{31}\)

The SEC explained that it would not require lawyers to take corrective action in "every isolated disclosure action or inaction [believed] . . . to be at variance with applicable disclosure standards."\(^{32}\) "[C]ounseling accurate disclosure is sufficient" until it becomes apparent that "[such] advice is not being followed, or even sought in good faith, and that [the] client is involved in a continuing course of violating the securities laws."\(^{33}\) At this point, "further, more affirmative steps" are required.\(^{34}\)

Resignation in a manner which avoids "foreseeable prejudice to the client" is deemed to be one such step.\(^{35}\) The SEC recognized that less drastic steps such as approaching members of management or directors not involved in the unlawful activity might be sufficient.\(^{36}\) Although not prescribing resignation as the sole alternative\(^{37}\) for a lawyer faced with his client's direct refusal to obey the securities laws, the SEC declared that under some circumstances, \textit{e.g.}, where the client's misconduct is so

\(^{30}\) Note, however, that the SEC has solicited public comments as to whether this standard should be expanded or modified. S.A. Rel. No. 33-6344 (CCH) ¶ 83,026 (1981).

\(^{31}\) \textit{In re} Carter and Johnson, [1981 Transfer Binder] \textit{Fed. Sec. L. Rep.} (CCH) at (CCH) ¶ 82,847 at p. 84,172.

\(^{32}\) \textit{Id.} The Commission went on to say that:

\(^{33}\) \textit{Id.}

\(^{34}\) \textit{Id.}

\(^{35}\) \textit{Id.}

\(^{36}\) "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." \textit{Id.}

\(^{37}\) "Premature resignation serves neither the end of an effective lawyer-client relationship nor, in most cases, the effective administration of the securities laws. The lawyer's continued interaction with his client will ordinarily hold the greatest promise of corrective action." \textit{Id.}
egregious or the involvement of the client's management and directors so pervasive, resignation would be required.\textsuperscript{38}

Of possibly greater import than the SEC's pronouncement of a standard of conduct is an issue raised in a footnote: the issue whether securities counsel must disclose his client's illegal intentions to regulatory authorities or affected third parties.

This case does not involve, nor do we here deal with, the additional question of when a lawyer, aware of his client's intention to commit fraud or an illegal act, has a professional duty to disclose that fact either publicly or to an affected third party. Our interpretation today does not require such action at any point, although other existing standards of professional conduct might be so interpreted. \textit{See, e.g., ABA D.R. 7-102(B).}\textsuperscript{39}

The footnote quoted above appears to indicate that if the corporate attorney has a duty of disclosure to third parties, it attaches only after the fact of the client's violation, \textit{i.e.}, the lawyer has no obligation to disclose his client's intent to violate the securities laws.

The pronouncement set forth above constitutes the standard to which the SEC \textit{presently} intends to hold attorneys practicing before it. However, in view of the SEC's solicitation of comments regarding such standard\textsuperscript{40} and the pendency of the American Bar Association's effort to revise the Code of Professional Responsibility, discussed later, significant alterations in this standard are a distinct possibility.

\textit{Judicial Consideration of the Issue}

The courts have also grappled with the issue of counsel's responsibility but have failed to provide a cohesive theory. An examination of the courts' treatment of this issue, beginning with \textit{NSMC} and continuing with other cases discussed in this section, involving identical or related issues, reveals the lack of a judicial consensus as to the proper scope of responsibility for the securities practitioner.

\textsuperscript{38} 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.

\textit{Id.} ¶ 82,847 at p. 84,173.

\textsuperscript{39} \textit{Id.} ¶ 82,847 at p. 84,173 n.78.

\textsuperscript{40} \textit{See supra} note 32.
The allegations levelled against the attorneys in NSMC principally involved charges of “aiding and abetting” primary violations. As defined by the court, the elements of that offense are: (1) a primary violation by another person; (2) a “general awareness” on the part of the aider and abettor that his role is part of an overall improper activity; (3) knowledge and substantial assistance of the violation by the aider and abettor.

Applied to the facts of the NSMC case, consummation of the merger when the principals were aware of the misleading nature of the financial statements contained in the proxy solicitations constituted a primary violation by the principals. Having established the first element, the court examined the three instances of alleged attorney misconduct to determine whether the two remaining elements of the cause of action had been satisfied. The three allegations considered were: (1) the failure of the attorneys to take any action to interfere with the consummation of the merger after they became aware that shareholder approval had been obtained on the basis of misleading financials; (2) the issuance of the opinion letter in spite of the attorneys' knowledge of the misleading financials; (3) the failure of the attorneys, after the merger was consummated, to withdraw their opinion and disclose the falsehood to the SEC or Interstate shareholders. The court held that the failure to interfere with the merger closing constituted aiding and abetting of the primary violation, but determined that the second and third allegations did not constitute substantial assistance of the violations.

With respect to the failure to interfere with the closing, the court found the issue to be whether silence or inaction should be considered substantial assistance. The court concluded that silence would be considered substantial assistance if the alleged aider and abettor had a duty to speak. A duty was found to exist in the instant case due to the presence of three conditions: (1) “the obvious materiality of the information”; (2) the fact that the attorneys were “learned in securities law”; (3) the re-

42. Id.
43. Id. at 709-12.
44. Id. at 712. The SEC also included an allegation of aiding and abetting in connection with the sale of a large block of the NSMC stock received in the merger by the Interstate shareholders. Since this issue does not appear to involve the issue of the lawyer’s obligation to affirmatively intercede to prevent or disclose his client’s securities violations, it will not be discussed.
sponsibility of the attorneys to their corporate client.\(^\text{45}\)

Although the court found that the lawyers' conduct fell short of legal standards, it did not feel compelled to specify those standards since defendants had been wholly remiss in fulfilling their obligations.\(^\text{46}\) A minimum, but not necessarily sufficient, requirement was articulated. "[A]t the very least [the attorneys] were required to speak out at the closing concerning the obvious materiality of the information and the concomitant requirement that the merger not be closed until the adjustments were disclosed and approval of the merger was again obtained from the Interstate shareholders."\(^\text{47}\) The opinion seems to impose an obligation on corporate counsel to take substantial steps to bring management securities law violations to the attention of shareholders. The court somewhat inconsistently contended, however, that "imposition of such a duty will not require lawyers to go beyond their accepted role in securities transactions."\(^\text{48}\) Thus, it is unclear whether the court views the correct scope of the attorney's obligation as including only a duty to persuade those responsible for the fraud to refrain from such conduct, or whether it would require the lawyer to apprise shareholders of the situation.

The court rejected the SEC's contention that the lawyers had a duty to "undo" the merger after its consummation by, \textit{inter alia}, withdrawing their opinion letter, demanding resolicitation of the shareholders, and disclosing the violation to

\(^{45}\) \textit{Id.} at 713. Of course, the last factor seems to beg the question since the issue in dispute is whether the lawyer's duty to his corporate client extends to disclosure of management wrongdoing.

\(^{46}\) In view of the obvious materiality of the information, especially to attorneys learned in securities law, the attorneys' responsibilities to their corporate client required them to take steps to ensure that the information would be disclosed to the shareholders. However, it is unnecessary to determine the precise extent of their obligations here, since it is undisputed that they took no steps whatsoever to delay the closing pending disclosure to and resolicitation of the Interstate shareholders.

\(^{47}\) \textit{Id.}

\(^{48}\) \textit{Id.} If the court views the correct scope of the attorney's obligations as including only a duty to try to persuade those responsible for the fraud to refrain from such conduct, then it is entirely correct. However, the above quoted language suggests that the court sees the lawyer as having an obligation to go beyond internal action and possibly make disclosures to the shareholders himself. The imposition of such a duty does seem to be an expansion of the lawyers obligation. Even Judge Parker declared that, "The filing of the complaint in this proceeding generated significant interest and an almost overwhelming amount of comment within the legal profession on the scope of a securities lawyer's obligations to his client and to the investing public." \textit{Id.} at 714. If the positions taken by the SEC in the complaint were fully consistent with the accepted notion of the lawyer's duty it seems doubtful that such a vociferous response would have been elicited.
 Interstate shareholders and/or the SEC. It was decided that since these alleged breaches of duty occurred after the primary violation, they did not constitute substantial assistance of the primary violation. It seems anomalous, however, to require attorneys to ensure disclosure of management's intention to commit securities violations to shareholders before they occur but not to require any action after they occur even though such disclosure might still prevent injury. Indeed, in the instant case, the lawyers could not be sure that the violations would occur until literally minutes before the closing since the Interstate executives and attorneys had contemplated delaying or abandoning the transactions.

The court's response to the SEC's contention that the lawyers aided and abetted the violation by issuing the opinion letter does little to clarify its position. The court noted that even if the opinion was false, the SEC still had to establish that it substantially assisted the violation. The court found that the opinion did not constitute substantial assistance because it was but one step in the merger process which entails numerous formalities only a few of which are covered by the securities laws. Furthermore, the opinion was provided for NSMC which was already aware of the adjustments in the comfort letter.

The criterion

49. Id. at 714-15. This analysis seems difficult to reconcile with the recognition of a duty to the shareholders to delay the closing of the merger pending resolicitation with adjusted financials since notification of the shareholders or SEC immediately after the deal was closed would have allowed an injunctive action to be brought to undo the merger before the operations of the two companies were integrated. Thus, while the attorneys' failure to disclose the violations after the deal was closed may not have constituted substantial assistance of the violations themselves, it does seem that their silence could be said to have contributed to the success of the fraudulent scheme.

One hint at a possible reconciliation of the court's positions is provided by its very cryptic discussion of the obligation of the lawyers to report management's continuing violation—apparently its failure to disclose the original violation during the time that trading in NSMC shares was occurring. The court indicated that it would not address any question of the lawyers' obligation to disclose the continuing violation during this case because the SEC had not raised such a claim in timely fashion. The fact that the court mentioned the point at all suggests that it might be willing to impose liability on a similar theory in a future case where the argument is properly raised. This would impose some sort of post-violation duty on the attorney.

50. One account of the events that occurred on the day of the closing indicated that the Interstate contingent did not decide to proceed with the transaction until 3:30 p.m. and that the documents were filed at the appropriate office at 3:46 p.m. J. Gouden, THE MILLION DOLLAR LAWYERS, 168 (1978). Thus, the attorneys had, at most, 16 minutes in which to take action to interfere with the closing since no duty to take such action would attach until the client actually decided to proceed with the closing.

51. SEC v. National Student Mktg. Corp., 457 F. Supp. at 714. The court distinguished this type of opinion from an opinion which "addresses a specific issue and is undeniably relied on in completing the transaction." Id.
for substantial assistance may be a simple "but for" test; e.g., the lawyer must not issue the opinion if the transaction could not proceed without it, or if the substance of the opinion is intimately related to the particulars of the violation.52

About the only general conclusion to be drawn from the court's opinion is that the lawyer has a duty to at least protest to his client when he is apprised of the client's intention to violate the securities laws. Beyond this, it is impossible to determine what duty the NSMC court would impose when his protestations are ignored.

Other Cases

Other court cases dealing with this issue have been handled in a variety of ways. In Meyerhofer v. Empire Fire & Marine Insurance Co.,53 an attorney who had worked on a registration statement for a stock issue became convinced that the document was materially misleading. He protested to senior members of his firm, but to no avail. The attorney then resigned from the firm and gave an affidavit containing his suspicions to the SEC. When a private suit arising from the alleged falsehood was brought against the attorney, his former law firm, and the issuer, the attorney provided a copy of his SEC affidavit to the plaintiff's counsel in an effort to persuade counsel to drop him from the list of defendants. He was dropped and the remaining defendants moved to disqualify plaintiff's counsel as well as the attorney who gave them the SEC affidavit on the ground that confidential information pertaining to defendants had been imparted to the plaintiff's attorney. The district court granted the motion to disqualify, but the court of appeals reversed the order

This analysis leaves unanswered what may be the most important question: Is counsel required to refrain from issuing an opinion that is entirely correct when he is aware of a management securities violation relating to the transaction for which the opinion is requested but that does not concern the substance of the opinion? The court's apparent response to this question is that even a valid opinion is forbidden if it substantially assists the violation. However, this response begs the question of how close the relationship between the opinion and the transaction must be.

52. The SEC brought a proceeding that was partially addressed to this issue. SEC v. Haswell, [1979-80 Transfer Binder] FED. SEC. L REP. (CCH) ¶ 97,156 (W.D. Okla. Oct. 19, 1977). The SEC brought an injunction action against a bond attorney for inter alia issuing opinions relating to the legality of the issuance of certain bonds when there were material misrepresentations in the offering circulars used in the bond issue which the attorney had reason to know of. The validity of the opinions was apparently not in issue. The court found that the attorney did not have reason to know of the violations when he delivered his opinions. However, the court did indicate that if the attorney did have reason to believe that there was fraud involved it would have been unlawful for him to deliver the opinions. Id.

53. 497 F.2d 1190 (2d Cir. 1974), cert. denied, 419 U.S. 998.
as it applied to plaintiff's counsel. The court of appeals relied upon a provision of the Code of Professional Responsibility, DR 4-101(c)(4), which permits an attorney to reveal client confidences to the extent necessary to defend himself against an accusation of wrongful conduct.

It seems astounding that the court never considered whether the original disclosures made to the SEC by the attorney were either permitted or required.54 Once a lawsuit has actually been brought against a lawyer, it could hardly be thought unreasonable that the court give effect to the cited DR. Here, however, the attorney went to the SEC well before suit was brought against anyone connected with the transaction. The propriety of this disclosure, in terms of the attorney client relationship, was not addressed. Moreover, assuming that disclosure was permitted, the issue whether it was required was left open.

Black & Co. v. Nova-Tech, Inc.55 takes a more positive stand in imposing potential liability on a lawyer for his client's securities law violations. In Black, an attorney, one of several defendants in a suit brought under the Oregon Blue Sky Law,56 asked the court to dismiss the charges against him because he did not, and could not reasonably have known about his client's violation of such Blue Sky Law. The court denied the motion on the ground that the attorney's efforts had been indispensable to completion of the violative transaction. Thus, according to Black, if a lawyer did any work on a securities transaction that would not have been consummated but for his efforts, the lawyer could be liable for his client's violations of the Oregon statute even if the lawyer did not and could not reasonably know of the violations.57 Although lack of a reasonable opportunity to learn of the violation would be considered a factor in deciding the issue of liability, it would not be dispositive.58 The court may, therefore, be applying a rule of absolute liability for client violations to lawyers, an unprecedented approach.59 The opin-

54. The court of appeals opinion does not indicate if defendants argued this point at any stage of the litigation. In view of the fact that this proceeding was decided more than two years after the NSMC proceeding was brought, the lack of discussion of this issue seems startling.
56. OR. REV. STAT. §§ 59.005--59.115(3) (1953).
58. Id.
59. Furthermore, the "but for" standard applied by the court seems to call for an indiscriminate application of the Oregon statute. For example, it would, if applied literally, allow for suits against the manufacturer of the paper on which a falsified registration statement was printed. The Oregon Supreme Court indicated that the literal language of the Black case did not
ion points up the lengths to which some judges would go to impose responsibility on the securities lawyer for his client's misconduct.

Another group of decisions deals with the application and refinement of a negligence standard to cases in which written materials prepared by the corporate attorney turn out to be erroneous or misleading. In SEC v. Spectrum, Ltd., the attorney-defendant issued an opinion that a sale of securities was exempt from registration. This opinion was erroneous. When the SEC brought an injunctive action against the attorney and his client, the attorney argued that he was ignorant of the facts which caused the opinion to be misleading. The court of appeals rejected this defense since the lawyer's ignorance was the result of his own negligence. The court reasoned that the lawyer's role in administration of the securities laws was important enough, and the public's interest in being able to rely on a lawyer's opinion great enough, to justify holding the lawyer to a duty of reasonable care. The Spectrum court's reasoning could easily apply to most securities transactions in which the lawyer plays an important role. Indeed, the rule of Spectrum has been said to represent the law of Oregon. Adams v. American W. Sec., Inc., 265 Or. 514, 510 P.2d 838 (1973) (lawyer not liable in the absence of knowledge of a client's violation). The case has been described as "abberational" elsewhere. Jenkins, Attorney Liability Under the Federal Securities Laws: The Evolving Standard, 2 J. CORP. L. 505, 533 n.224 (1970) [hereinafter cited as Jenkins].

60. Indeed, an effort to apply a negligence standard to an accountant who failed to discover a client's fraud has already been made and rejected in the U.S. Supreme Court in a private damage suit under Rule 10b-5. Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (proof of defendant's scienter, i.e., intent to defraud, necessary to private damage suit under Rule 10b-5). This case did not deal with the culpability required to be established in an SEC administrative proceeding. Cf. Tager v. SEC, 344 F.2d 5 (2d Cir. 1965), or a Rule 10b-5 injunction suit or a private damage suit under the other antifraud provisions.

61. 489 F.2d 535 (2d Cir. 1973).

62. Id. at 542. The groundwork for the Spectrum approach was laid in an earlier case, Escott v. Barchris Constr. Corp., 263 F. Supp. 643 (S.D.N.Y. 1968), in which it was held at the least that an attorney serving as a director of a corporation which is filing a registration statement is obligated to make some investigation into the accuracy of the statements contained therein. Some commentators have argued that the Barchris holding is equally applicable to a lawyer serving exclusively as a lawyer, i.e., not as a director when he assists in the preparation of a registration statement. E.g., Jenkins, supra note 59. See generally Frank, A Higher Duty: A New Look at the Ethics of the Corporate Lawyer, 26 CLEV. ST. L. REV. 337, 345-49 (1977) (arguing that Barchris and Spectrum were among the first cases to directly raise the issue of the securities lawyer's responsibility to the public). The same proposition was espoused in a virtually contemporaneous case, SEC v. Frank, 388 F.2d 486 (2d Cir. 1968), which explicitly rejected the proposition that a securities lawyer drafting offering documents is merely a scrivener for his client who bears no responsibility for the accuracy of the statements contained in the document.
be that: "[A] lawyer whose negligence permits a fraudulent scheme to succeed is susceptible to an injunctive action brought by the SEC."\(^{63}\)

The *Spectrum* negligence standard was refined to some extent in *SEC v. Management Dynamics, Inc.*\(^ {64}\) In *Management Dynamics*, the court held that the *Spectrum* standard required analysis of the foreseeability of the role of the alleged aider and abettor in the illegal scheme. A finding that the alleged aider and abettor should have been aware that his efforts were being used to effect an illegal scheme was explicitly required.\(^ {65}\)

Also worthy of comment is *State v. Rogers*,\(^ {66}\) a disciplinary proceeding brought against a securities attorney. The attorney, although found to have been aware of his client's violation of the Wisconsin Blue Sky Law,\(^ {67}\) took no action of any kind, either to directly assist the violation or to prevent its commission. The court declared that the attorney had a duty to "protest effectively" to his client and to inform the buyer of the securities of the fraud.\(^ {68}\)

It appears that the courts and the SEC agree on at least two propositions. First, that disclosure of a client's past violations is permitted, and, second, that upon learning of the client's intent to pursue an illegal cause of action, the lawyer must, at a minimum, admonish his client to refrain from the action. Beyond this, the courts and SEC diverge.

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64. 515 F.2d 801 (2d Cir. 1975).
65. *Id.* at 811 (emphasis added). Although this case involved an allegation of aiding and abetting, against a broker-dealer, there is no indication in the opinion that lawyers (or anyone else) would be held to any different standard.
66. 226 Wis. 39, 275 N.W. 910 (1937).
67. *Wis. Stat.* §§ 189.23(2)(b), (f), (g) (1929) (*repealed by* L. 1969, ch. 71, § 1).
68. The scope of the court's holding that the lawyer had a duty to disclose the fraud to the victim is open to question since in this case the lawyer represented both the buyer and the issuer of the securities in connection with the same transaction.
THE APPROACH OF THE BAR

The Bar has grappled with the subject of attorney responsibility but has not succeeded in formulating a workable solution. The following section of this article examines the treatment of the problem by three of the most authoritative sources: the ABA Model Code of Professional Responsibility (CPR); the recently promulgated draft of the Model Rules of Professional Conduct prepared by an ABA standing committee; and the proposal of the Georgetown University Institute for Public Representation.

The Code of Professional Responsibility

Before delving into the specifics of the CPR, it is necessary to make two observations. First, it is important to realize that although the ABA has promulgated only one version of the CPR, the individual state bar associations have not all adopted an identical version. Accordingly, representation of a client with operations in many states requires an attorney, at the outset, to decide which state CPR applies. Additionally, the lawyer must ascertain the SEC's standard of conduct. If the CPR holds lawyers to a different standard than does the SEC, the attorney

69. MODEL CODE OF PROFESSIONAL RESPONSIBILITY (1979) [hereinafter cited as MODEL CODE or CPR]. The Code of Professional Responsibility (CPR) appears to be an attempt to provide concrete answers to the ethical problems commonly confronted by lawyers. However, at least in the area considered here, the document appears to have fallen short of the mark. The relevant provisions have been described as "even for legal writers, an extraordinary achievement in murky cross-references and double negatives." Solomon, The Corporate Lawyer's Dilemma, FORTUNE, Oct. 23, 1978, 138-39.

70. "Although the vast majority of the states generally follow the ABA Model Code, there is inconsistency with respect to the rule regarding the lawyer's responsibility on discovery of a client's fraud committed during the course of the representation." Kramer, Clients' Frauds and Their Lawyers' Obligations: A Study in Professional Irresponsibility, 67 GEO. L.J. 991, 994-95 (1979). In fact, an important amendment adopted by the ABA in 1974 has been adopted by only two of the six states which contain about half the lawyers in the United States. Id. at 995. See infra note 87.

71. In In re Carter and Johnson, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,175, p. 82,165 (ALJ March 7, 1979), the ALJ opinion explicitly relied on the CPR in determining what standard the attorney is held to in SEC practice. Id. ¶ 82,175 at p. 82,181. The opinion also stated that, "counsel interested in determining the standards appropriate to his conduct before the Commission should make reference to the ABA Code, particularly EC 5-18 and DR's 1-102(A)(4) and 7-102(A)(7)." Id. However, in an earlier proceeding, In re Emanuel Fields, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,407, p. 83,172 (June 18, 1973), aff'd without opinion, 495 F.2d 1085 (D.C. Cir. 1974), a Rule 2(e) attorney disciplinary proceeding, the SEC declared that it did not deem state bar association standards of conduct to be binding on it. The point is not a minor one since professional discipline can result from a violation of the CPR.
may be faced with a Hobson's choice; he is bound to violate one of the two standards.\textsuperscript{72}

The first CPR provision relevant to the responsibilities of the securities practitioner is Canon 4 which concerns the preservation of client confidences and secrets. The substance of this provision is contained in the Disciplinary Rules (DR's) and Ethical Considerations (EC's) promulgated under it.\textsuperscript{73} "Confidence" refers to information protected by the attorney-client privilege under applicable state law, and "secret" refers to other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or detrimental to the client.\textsuperscript{74} DR 4-101(B) contains the disclosure prohibition itself: "Except when permitted under DR 4-101(C), a lawyer shall not knowingly: (1) reveal a confidence or secret of his client; (2) use a confidence or secret of his client to the disadvantage of the client; (3) use a confidence or secret of his client for the advantage of himself or of a third person unless the client consents after full disclosure." Information pertaining to client securities violations is obviously encompassed in the term confidences and secrets since its disclosure would be embarrassing and detrimental to the client. Optional exceptions to the rule of confidentiality are contained in DR 4-101(C):

A lawyer may reveal . . . (2) Confidences or secrets when permitted under Disciplinary rules or required by law or court order. (3) The intention of his client to commit a crime and the information necessary to prevent the crime. (4) Confidences or secrets necessary to establish or collect his fee or to defend himself . . . against an accusation of wrongful conduct.

In applying this provision to the problem faced by the securities attorney, two important questions arise. First, where the attorney represents a corporation, as he quite often does in the securities context, who is the "client" that is entitled to claim the benefits of the rule? Second, what constitutes a "crime" for purposes of triggering the exception provided for in DR 4-101(C)(3)?

A major controversy rages over resolution of the first question. The corporate attorney's client might rationally be any or all of the following: the corporate entity, management, the board of directors, the existing shareholders, future shareholder-

\textsuperscript{72} See infra note 83 and accompanying text.

\textsuperscript{73} Disciplinary Rules are at least nominally intended to establish a minimum standard of conduct while Ethical Considerations are nominally intended to specify optimal patterns of conduct. As a practical matter the distinction between the two has become quite blurred.

\textsuperscript{74} MODEL CODE, supra note 69, at DR 4-101(A).
ers, the employees or the public securities markets. Identifying the client is crucial because if the client is perceived to be the market, DR 4-101(B) imposes no real duty of confidentiality on the lawyer since any disclosure of securities violations would be to his own client, the market. If the shareholders are the client, the attorney's conduct is apparently governed by DR 4-101(B)(2) which prohibits disclosures which would disadvantage the client. Consideration of the effect of a given disclosure on the issuer's stock price would appear to be required. In most cases, however, it would be unrealistic to expect the attorney to predict the market's reaction. Arguably, if the shareholders are treated as the client, the lawyer is free to make any disclosures to them that he wishes since the disclosures are to his own client. The flaw in this argument becomes apparent, however, when one considers the practical impossibility of limiting any disclosure made to the shareholders of a publicly held corporation to just shareholders. If the client is considered to be corporate management the problem is simpler; the lawyer cannot disclose anything confided to him by management.

The question of what constitutes a crime for purposes of DR 4-101(C)(3) is almost as difficult as the preceding question. In most contexts, there is no great problem in determining if a proposed action constitutes a crime. In the securities field, how-

75. The only CPR provision addressed to this issue, EC 5-18, provides little practical assistance: "A lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative or other person connected with the entity." This standard does not assist the lawyer in determining whether information imparted to him by a corporate official is to be considered to have been imparted to him by the entity. Even the SEC is not speaking with a unified voice in response to this question. Former Commissioner Pollack felt that the securities attorney's client should be considered to be the public markets. Landau, Problems of Professional Responsibility, 6 INST. ON SEC. REG. (PLI) 181, 216 (1975). But former Enforcement Division Chief Stanley Sporkin apparently felt that the question is still open: "[T]here is a distinction between the interest of any one individual and the corporate interest. There is a large debate going on in the corporate community and the legal community as to who is the client. That is one of the big issues—who is the client?" What the SEC Expects from Corporation Lawyers, FORTUNE, Oct. 23, 1978, at 143-46. Another commentator has suggested that he does not agree with the view that the lawyer represents the public market or future shareholders but feels that the lawyer represents "the company". Lipman, supra note 14, at 499. The ALJ opinion in In re Carter indicates that "the consensus in articles on the subject indicates the client to be the corporation and its board of directors." In re Carter and Johnson [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,175 at p. 82,181.

76. For instance, a disclosure which has a short run adverse effect on stock price may be of long run benefit to the corporation if it assists in driving out corrupt or incompetent management.
ever, a thin line distinguishes a civil violation from conduct which triggers criminal sanctions.

The Securities Acts of 1933 and 1934\textsuperscript{77} describe criminal conduct as any willful violation of the substantive provisions of the statutes.\textsuperscript{78} Violations of the securities laws or any other action that gives rise to material civil liability must be reported to the SEC in periodic or extraordinary reports.\textsuperscript{79} Under the 1934 Act’s continuous disclosure provisions, failure to report such actions may result in criminal liability.\textsuperscript{80} If the corporation is aware of a past violation that gave rise to potential material civil liability, but decides not to disclose it in current SEC filings, the corporation apparently intends to commit a crime. As a result, an attorney’s awareness of the corporate client’s intention not to disclose the past civil wrong, triggers the permissive disclosure clause of DR 4-101(C)(3).\textsuperscript{81} This result follows despite the apparent intention of the draftsmen of the provision to prevent disclosure of past crimes.\textsuperscript{82}

An additional consideration is the potential for conflict between DR 4-101 and SEC disclosure standards. DR 4-101 permits the disclosure of a client’s intent to commit a crime while prohibiting disclosure of a client’s past crime. Should the SEC require attorneys to disclose their corporate client’s past securities violations, as in \textit{National Student Marketing Corp.}, a conflict with DR 4-101 would result. While DR 4-101 prohibits disclosure of past crimes, the SEC would compel disclosure; and, while DR 4-101 permitted only the disclosure of the client’s intent to commit a crime, the SEC would compel disclosure of a client’s intent to commit a violation of a civil nature.\textsuperscript{83}

A possible means of averting this conflict comes from DR 4-101(C)(2). That DR provides for an exception to the rule of confidentiality where disclosure is required by other DRs, by law, or court order. Under this provision, the SEC disclosure standard could be treated as a disclosure required by law, thus avoiding a conflict with DR 4-101.

\textsuperscript{77} See supra note 2.
\textsuperscript{78} 1933 Act, supra note 2, at § 24; 1934 Act, supra note 2, at § 32(a).
\textsuperscript{79} See supra note 6.
\textsuperscript{80} Id.
\textsuperscript{81} Hoffman, supra note 19, at 1411-12.
\textsuperscript{82} See \textit{MODEL CODE}, supra note 69, at DR 4-101(A) (B) and (C)(3).
\textsuperscript{83} I am aware of no authority that provides any indication of whether the SEC recognizes any distinction between criminal and civil violations or between past and future violations. However at least one commentator has suggested that there is a potential conflict between the SEC and CPR positions: “[A] lawyer will often be able to escape SEC prosecution only by disclosing securities violations which the Code requires him to keep confidential.” Lipman, supra note 14, at 462.
The CPR provisions elaborating upon Canon 7 are also relevant to any consideration of attorney responsibility. DR 7-102 states in part that:

(B) A lawyer who receives information clearly establishing that:

(1) His client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal, except when the information is protected as a privileged communication.84

It is important to realize, initially, that the final clause, "except when . . . privileged," drastically affects the applicability of the provision.

"Privileged communications," here, means anything which constitutes a confidence or secret under DR 4-101.85 Since DR 4-101 imposes a duty of confidentiality with respect to confidences and secrets,86 the effect of the final clause is to limit the duty of disclosure to information given the lawyer by someone other than the client. The practical effect of this clause is to virtually annihilate whatever duty is imposed by the balance of the provision.87

DR 7-102(B)(1) also raises a definitional problem: what constitutes "fraud" for purposes of triggering the duty of disclosure? The problem arises because the securities laws go beyond the common law definition of fraud which normally includes some requirement of "scienter," i.e., intent to deceive. Under the securities laws, it is often sufficient for the plaintiff to establish merely the existence of a material misstatement or omission without proving the culpability of the defendant.88 The ABA Ethics Committee has declared that "fraud" under DR 7-102(B)(1) means "active fraud with a requirement of scienter or

84. Model Code, supra note 69, at DR 7-102(B)(1).
85. ABA Ethics Committee Formal Opinion 341, 61 A.B.A. J. 1543 (1975) [hereinafter cited as Opinion 341]. It must be emphasized that "privileged" is used here to refer to far more than what is protected by the attorney-client privilege recognized in the law of evidence.
86. Model Code, supra note 69, at DR 4-101(B).
87. Note, Client Fraud and the Lawyer—An Ethical Analysis, 62 Minn. L. Rev. 89, 110 (1977). The limiting clause was added to the official version of the DR by amendment in 1974 but many states have not adopted the amendment. Kramer, Client Frauds and Their Lawyers' Obligations, 67 Geo. L.J. 991, 994-95. This article indicates that of the six states which contain about half the lawyers in the U.S., only New York and Illinois have adopted the amended version of the DR as modified by Opinion 341.
88. But see Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976). The question of whether this holding applies to SEC injunctive suits was expressly left open. See also §§ 11, 12(2) of the 1933 Act which under some very limited circumstances allow the defendant an affirmative defense of lack of scienter.
intent to deceive." 89

How the ABA's definition of fraud affects the obligation of a securities lawyer is unclear. If the lawyer suspects that the course of conduct being pursued by the client is unlawful and he communicates his suspicion to the client, who refuses to modify its plans, then it is at least arguable that active fraud is established. However, if the client's refusal to alter its plans is based on a good faith belief that its actions will not violate the law, it is questionable whether disregard of the lawyer's admonition should be sufficient to justify a finding of intent to defraud.

A third provision under DR 7-102 (B) (1) requires that the client's fraud be "clearly established" before the duty to disclose is enforced. 90 "Clearly established," under the DR, does not require objectively conclusive proof of fraud. However, the lawyer must be virtually certain that the securities laws have been violated before the disclosure duty is triggered. The lawyer is not required to act if he merely suspects or thinks it probable that the client has committed a fraud. 91

In the securities area it is extraordinarily difficult to apply the "clearly established" standard without depriving the rule of significance. For example, a misstatement or omission must be "material," i.e., relevant to the analysis of a "reasonable investor" 92 in order to constitute a securities violation. But obviously, counsel could often plausibly argue that even a clear falsehood was not material and, therefore, that fraud has not been clearly established. Furthermore, accounting standards allow enormous flexibility in the presentation of financial data. Thus, many apparent falsehoods in financial statements could con-

89. Opinion 341, supra note 84.

90. Since the rule imposes two duties on the attorneys (attempting to persuade the client to rectify the fraud and disclosing the fraud to the victim if the client will not do so) one wonders if the same degree of certainty is required of the lawyer before both duties attach. It would seem logical to require the lawyer to discuss the client's conduct with the client on somewhat less evidence of fraud than would be necessary to justify disclosure. In any event, there is nothing to prohibit the lawyer from discussing his suspicions with the client under any circumstances and good sense would seem to dictate that the lawyer should confer with the client regarding the possibility and implications of securities violations when the lawyer has good reason to believe that a violation has occurred or is imminent.

91. Note, Client Fraud and the Lawyer—An Ethical Analysis, 62 MINN. L. REV. 89, 107 (1977). In a Statement of Position approved by the ABA House of Delegates it is claimed that the lawyer has "neither the obligation nor the right to make disclosure when any reasonable doubt exists concerning the client's obligation of disclosure." Report of the ABA House of Delegates by the Section of Corporation, Banking and Business Law, 31 BUS. LAW. 543, 545 (1975).

ceivably have some justification in generally accepted account-
ing principles.

Even if the lawyer is not permitted or required to disclose
the client's securities violations, he may have the option or the
duty to terminate the representation. The CPR addresses this
issue in several provisions. EC 7-8 permits the lawyer to resign
where the "client in a non-adjudicatory matter insists upon a
course of conduct that is contrary to the judgment and advice of
the lawyer but not prohibited by Disciplinary Rules. . . ." Withdrawal is required by DR 2-110(B)(2) where "[the lawyer] knows or it is obvious that his continued employment will result
in violation of a Disciplinary Rule."93 Thus it is clear that when
a client involves itself in a securities violation, contrary to the
lawyer's advice, the lawyer is at the very least permitted by the
CPR to resign.94

In summary, it is apparent that the CPR is basically anti-
disclosure. A Statement of Policy adopted by the ABA House of
Delegates makes this point quite explicit: "We do not believe
that the policy of disclosure as embodied in the SEC laws war-
rants an exception to the basic confidentiality of the attorney-
client relationship. Such exceptions have to date been carefully
reserved by the CPR for far more critical and limited situations.95

Short of disclosure, the CPR permits and may require the
lawyer to make some inquiry of his client where it appears pos-
sible or probable that the client has violated or intends to violate
the securities laws. Obviously the inquiry should first seek to
determine if a violation has occurred or will occur. Where it ap-
pears that the client's conduct constitutes a violation, the lawyer
is required by DR 7-102(B) (1) to prevail on the client to disclose
and rectify the violation itself. If it becomes apparent that the
client's conduct is unlawful96 and there is time to avoid

93. There are other circumstances such as a nonpayment of fees and
bad faith prosecution of claims in which the lawyer is permitted or required
to resign. See Model Code, supra note 69, at DR 2-110(C) (1) (a), (f).
94. In most cases the lawyer's self interest would dictate that he resign
the representation (or at least cease handling securities matters for the cli-
ent) simply to avoid personal entanglement in any litigation arising from
the client's conduct.
95. Statement of Policy Adopted by ABA Regarding Responsibilities
and Liabilities of Lawyers in Advising with Respect to the Compliance by
Clients with Laws Administered by the Securities and Exchange Commis-
96. Model Code, supra note 69, at DR 2-110(A) (2) prevents the lawyer
from withdrawing:
In any event, . . . until he has taken reasonable steps to avoid foresee-
able prejudice to the rights of his client, . . . including giving due notice
to his client, allowing time for the employment of other counsel, deliv-
prejudice to the client's interest, the CPR probably requires the lawyer to resign. Where sufficient time is not available to engage substitute counsel, turn over books and records, etc., the CPR prohibits the lawyer from resigning without the client's consent.

The Proposed Model Rules Of Professional Conduct

Because of gaps and ambiguities in the existing CPR, the ABA's Commission on Evaluation of Professional Standards has been engaged in an effort to produce a new, more useful code of responsibility. What follows is an analysis of the options and obligations faced by the securities lawyer under the Final Draft of the Model Rules of Professional Conduct (Model Rules). Although the Model Rules have not yet been voted upon by the ABA, they are worthy of consideration here as representative of the views of some of the leading authorities in the field.

One general observation that has been made about the implications of the proposed Model Rules for the practitioner's conduct is that "[c]ompleted crimes and frauds may not be disclosed under the model rules, with one narrow exception—when the lawyer's services [are] used to consummate the unlawful conduct." It is unclear whether conduct that would be a completed offense but for the operation of the 1934 Act's continuous disclosure system, described earlier, is considered a complete crime or fraud under the Model Rules.

97. A problem arising from a decision to withdraw is whether the reasons for withdrawal must be communicated to the client's new counsel. There seems to be no clear consensus on this issue. See Leiman, Responsibility to Report Securities Law Violations, 6 INST. ON SEC. REG. (PLI) 265, 278 (1975) [hereinafter cited as Leiman].

98. MODEL RULES OF PROFESSIONAL CONDUCT (Final Draft, 1980) [hereinafter cited as MODEL RULES].

99. The Model Rules will be considered by the ABA House of Delegates at its August, 1982 meeting. The format for the Model Rules was voted on at the ABA's mid-year meeting in January, 1982. The format selected is that which was used by the ABA Commission on Evaluation of Professional Standards in its Final Draft of the Model Rules. 67 A.B.A.J. (pull-out section) (1981).

The Model Rules specifically address the special duties imposed on advisers of corporations in Rule 1.13. This provision seeks to clarify the identity of the "client" in the corporate context. While Rule 1.13(a) reiterates the message of EC 5-18, that a corporate attorney represents the organization as opposed to its shareholders, officers, directors, etc., Rule 1.13(b) also provides procedures and considerations for the lawyer to refer to where the lawyer knows that a violation of the securities laws has or will occur. The lawyer is instructed to "proceed as is reasonably necessary in the best interest of the organization."

The factors that the lawyer must consider when selecting his course of action include: "the seriousness of the violation and its consequences, the scope and nature of the lawyer's representation, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters and any other relevant considerations."

The course of action chosen should be designed to minimize both disruption of the organization and the risk of leaking information. Possible steps to be taken to effectuate this command include:

1. asking reconsideration of the matter;
2. advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization; and
3. referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law.

If the lawyer is unsuccessful in his attempt to persuade the organization's highest authority to abandon the action (or refusal to act) in question and the action or inaction is "clearly a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization," the lawyer is permitted by Rule 1.13(c) to take further action believed to be in the organization's best interest. This authorization may encompass disclosure of information pertaining to the representation to persons outside the organization only if the lawyer reasonably believes that: "(1) the highest authority in the organization has acted to further the personal or financial interests of members of that authority which are in

101. Model Rules, supra note 98, at Rule 1.13(b).
102. Id.
103. Id.
104. Id.
105. Id.
106. Id. at Rule 1.13(c).
conflict with the interests of the organization; and (2) revealing the information is necessary in the best interest of the organization.\(^\text{107}\)

What is interesting about this provision is the constant admonition that any action taken be in the "best interest of the organization."\(^\text{108}\) Apparently, the lawyer has no independent obligation under this provision to prevent the organization from harming third parties. A provision explicitly releasing the lawyer from a duty to third persons was included in a prior draft of the Model Rules.\(^\text{109}\) Although that provision was omitted from the final draft, its spirit appears to have survived. Thus, if the lawyer is aware of a securities violation but feels that it is likely to go undiscovered unless he discloses it, the correct response may be for him not to disclose it. Disclosure would be contrary to the interests of the only entity whose interest he is to consider, viz., the corporation.\(^\text{110}\) A comparable provision in a preliminary draft was the subject of substantial criticism by former SEC Chairman Williams who expressed the view that wrongful activity, which may not seem to affect the client when it occurs, often has a serious, unforeseen impact on the corporation at a later date.\(^\text{111}\)

With respect to the particular actions encompassed by Rule 1.13, the commentary to that Rule stresses that the lawyer must not attempt to impinge on the client's authority to make final decisions regarding matters of business policy.\(^\text{112}\) Any duty to oppose the decisions of the client attaches only where the lawyer has good reason to question the legality of corporate activity. The lawyer's obligation to go over the head of the corporate official involved in the questionable activity depends on the severity of the consequences likely to ensue from the activity. 'Clear justification' must exist for going over the head of the person responsible for such activity.\(^\text{113}\) The more serious the potential wrongdoing, the higher in the corporate hierarchy the attorney should go.

\(^{107}\) Id.
\(^{108}\) Id.
\(^{109}\) "The lawyer's duty does not extend to third persons who may be injured by wrongful acts of the organization." Model Rules of Professional Conduct Rule 1.13 comment (Discussion Draft 1980).
\(^{110}\) The view that, in this context, the lawyer has no duty whatsoever to the public markets seems rather surprising given the pressure placed on the bar to recognize such a duty. Of course, the provision may also instruct the lawyer to consider the long run benefit to the organization of exposing corrupt management.
\(^{111}\) Fed. Sec. L. Rep. (CCH) \$ 82,318, p. 82,374 (Oct. 4, 1979).
\(^{112}\) Model Rules, supra note 98, at Rule 1.13 comment.
\(^{113}\) Id.
If referral to the client's governing body does not successfully resolve the matter, the commentary instructs the lawyer to attempt to take remedial action without disclosing client confidences, e.g., by consulting the shareholders if a close corporation is involved. If such action cannot be taken, the commentary indicates that the lawyer may take other action which entails disclosure of the wrongdoing to persons outside the organization under the circumstances specified in Rules 1.13(c)(1) and 1.13(c)(2).

Finally, this provision apparently does not apply to past wrongs since the lawyer's duty to take steps to prevent the wrong is triggered by a finding that the organization's officer, employee, etc. "is engaged in [or] intends . . . a violation of law. . . ." This seems to perpetuate the distinction made in the existing CPR between past and future wrongs. Thus, a past wrong which generated a material contingent liability which the client does not intend to disclose in future SEC filings apparently triggers the lawyer's duty under this section of the Model Rules.

The proposed Model Rules also contain a general provision pertaining to attorney-client confidentiality. This provision seems an attempt to improve upon the present CPR by clarifying the scope of the obligation of confidentiality when that obligation is superseded by other obligations. Rule 1.6(a) of the Model Rules prohibits disclosures of information pertaining to the representation of a client without the client's consent. Rule 1.6(b) permits disclosure of the information covered by Rule 1.6(a) to the extent the lawyer believes necessary:

(2) to prevent the client from committing a criminal or fraudulent act that the lawyer believes is likely to result in death or substantial bodily harm, or substantial injury to the financial interest or property of another;

(3) to rectify the consequences of a client's criminal or fraudulent act in the commission of which the lawyer's services had been used;

. . . .

(5) to comply with the rules of professional conduct or other law.115

It is important to realize that in the previous draft of the Model Rules, the counterparts of Rules 1.6(b)(2) and 1.6(b)(5) were mandatory.116 Thus, the draftsmen seem to favor the interests of the client over the interests of third parties, even where the

114. MODEL RULES, supra note 98, at Rule 1.13(b).
115. Id. at Rule 1.6(b).
116. MODEL RULES OF PROFESSIONAL CONDUCT Rules 1.6(b)(2) & (b)(5) (Discussion Draft, 1979).
physical safety of the third party is at stake.\textsuperscript{117}

Two observations about Rule 1.6 are salient to the present analysis. First, there is an apparent inconsistency between Rules 1.6 and 1.13. The latter does not authorize disclosure of client information except if doing so is in the best interest of the organization, while Rules 1.6(2) and (3) permit disclosure where it is in the interest of those affected by the client's action. Obviously, there can be many situations in which the two interests conflict. The commentary to Rule 1.6 recognizes that Rule 1.13 should be examined in conjunction with Rule 1.6 but does not clearly indicate which prevails when they conflict.\textsuperscript{118} Similarly, the commentary to Rule 1.13 merely recognizes the potential interplay between Rules 1.13 and 1.6 but does not indicate whether the lawyer's duty to his organizational client is of greater or lesser importance than his right to warn third parties affected by the client's unlawful activity.\textsuperscript{119} It would seem that Rule 1.13 supersedes Rule 1.6 whenever the two conflict since this interpretation lends credence to the specific attempt of the draftsmen to deal with the issue of the duty of advisers of organizations.

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{117} It is arguable that the lawyer should have a professional obligation to make a disclosure in order to prevent homicide or serious bodily injury which the lawyer knows is intended by a client. However, it is very difficult for a lawyer to "know" when such a heinous purpose will actually be carried out, for the client may have a change of mind. To require disclosure when the client intends such an act, at risk of disciplinary liability in the assessment of the client's purpose turns out to be wrong, would be to impose a penal risk that might interfere with the lawyer's resolution of an inherently difficult moral dilemma.\textsuperscript{118}
\item \textsuperscript{118} See Rules 1.13, 2.2, 2.3, 3.3 & 4.1. In addition to these provisions, a lawyer may be obligated or permitted by other provisions of law to give information about a client. Whether another provision of law supersedes Rule 1.6 is a matter of interpretation beyond the scope of these Rules, but a presumption should exist against such a supersession.\textsuperscript{119}
\item \textsuperscript{119} In particular, the responsibility to act for the best interest of the organization under this Rule exists independently of the authority to prevent legally wrongful conduct under Rule 1.6 or 3.3, the responsibilities to the client under Rules 1.8 and 1.16 and the responsibilities of the lawyer under Rule 4.1. If the lawyer's services are being used by an organization to further a crime or fraud by the organization, Rule 1.2(d) can be applicable. In connection with complying with Rule 1.2(d), 3.3, or 4.1 or exercising the discretion conferred by Rule 1.6(b), a lawyer for an organization may be in doubt whether the conduct will actually be carried out and whether higher authority in the organization approves. To guide his conduct under Rule 1.2(d), 3.3 or 4.1 or Rule 1.6(b), the lawyer ordinarily should make inquiry within the organization as indicated in Rule 1.13(b).\textsuperscript{118}
\end{itemize}
\end{footnotesize}
Second, Rule 1.6 could apply in situations that are relevant for present purposes where Rule 1.13 is entirely inapplicable. One situation might be where the lawyer’s client is an individual investor who proposes an unregistered sale of a block of securities that constitute “control shares.” Another situation would involve an individual investor who proposes to trade on undisclosed, material information.

A third observation is that Rule 1.6 represents a substantial improvement over the existing CPR since it largely eliminates the unmanageable distinctions drawn between crimes and frauds and between past and future activities. Since both Rule 1.6(b)(2) and Rule 1.6(b)(3) apply to disclosures regarding criminal or fraudulent acts of the client, and since Rule 1.6(b)(2) refers to prevention of such acts and Rule 1.6(b)(3) refers to rectification of the consequences of such acts, it is no longer necessary to determine whether the client’s act involved a fraud or a crime or whether it has occurred or will occur. However, uncertainty remains as to the applicability of this provision in the securities area.

A violation of the securities laws often does not require the defendant to act with any particular state of mind, but “fraud” or “fraudulent conduct” under the Model Rules includes only “conduct having a purpose to deceive and not merely negligent misrepresentation or failure to apprise another of relevant information.”121 Query, whether a client’s failure to correct a material misstatement or omission which was not originally the product of deceptive intent, is within the Model Rule’s definition of fraud.

The commentary associated with Rule 1.6 tells us two things. First, it states the overall policy judgment underlying the provision:

A rule governing disclosure of threatened harm thus involves balancing the interests of one group of potential victims against those of another. On the assumption that lawyers generally fulfill their duty to advise against the commission of deliberately wrongful acts, the public is better protected if full disclosure by the client is encouraged than if it is inhibited.122

Clearly, Rule 1.6 opposes disclosure except in very serious cases and, even then, disclosure is merely permissive. Secondly, the commentary specifies the facts that should be considered by the attorney in deciding what to do when disclosure of client wrongdoing is permitted. The lawyer is instructed to consider, “[his]
knowledge about and relationship to the conduct in question, and the seriousness of that conduct." 123

Closely related to the lawyer's right to reveal certain of his client's wrongful acts is his duty to avoid assisting the client in such acts. The proposed Model Rules specifically impose such a duty. Rule 1.2(d) provides that:

A lawyer shall not counsel or assist a client in conduct that the lawyer knows or reasonably should know is criminal or fraudulent, or in the preparation of a written instrument containing terms the lawyer knows or reasonably should know are legally prohibited, but a lawyer may counsel or assist a client in a good faith effort to determine the validity, scope, meaning or application of the law. 124

This provision comes into play where the lawyer discovers during the course of his representation that the client's conduct, with respect to a particular transaction, is criminal or fraudulent. 125 The commentary makes clear that this provision requires the lawyer to withdraw from the representation if his continued involvement assists the client's unlawful activity.

However, the lawyer's obligation may go beyond mere resignation to actual disclosure of the client's activity. The commentary associated with Rule 1.6 indicates that Rule 1.2(d) requires disclosure where silence constitutes assisting the client in his unlawful activity. 126

The commentary to Rule 1.2(d) elaborates upon the proposition by noting that steps beyond resignation (of which the most likely is public disclosure) may be required if "the lawyer knows that despite the withdrawal the client is continuing in conduct that is criminal or fraudulent, and is making use of the fact that the lawyer had been involved in the matter." 127 Although the commentary states that action beyond resignation may be required, the context of the statement indicates that "may" should be read as "shall" because the next sentence states that "[i]n other situations not involving such assistance, the lawyer has discretion to make disclosure of otherwise confidential information in accordance with Rule 1.6(b)." 128

In the securities context, the disclosure obligation imposed by Rule 1.2(d) would seem to attach, inter alia, in situations where the lawyer has given an opinion that was necessary for the consummation of the client's unlawful transaction, even if

123. Id.
124. Id. at Rule 1.2(d).
125. As in the case of Rule 1.6 there is a question as to how the "fraudulent" language would apply in the securities context.
126. MODEL RULES, supra note 98, at Rule 1.6 comment.
127. Id. at Rule 1.2 comment.
128. Id.
the opinion itself is still valid. Of course, any disclosure obligation imposed by Rule 1.2(d) would attach only where the lawyer learns or should learn of the client's unlawful activity at a time when the consequences of such activity can be prevented.

The command of Rule 1.2(d) and the associated commentary is supplemented and explained by Rule 4.1(b)(2): In the course of representing a client a lawyer shall not:

(b) knowingly fail to disclose a fact to a third person when:

(2) disclosure is necessary to prevent assisting a criminal or fraudulent act, as required by Rule 1.2(d).\(^\text{129}\)

The commentary pertaining to this provision indicates that it comes into play only when the lawyer becomes aware that the client's unlawful activity has rendered a prior statement by the lawyer untrue.\(^\text{130}\)

However, statements made by the chairman of the ABA Committee that produced the Model Rules suggest that the duty imposed by Rule 4.1 is a more general one. In particular, and of special relevance to the securities practitioner, it is suggested that the duty attaches during negotiation of a business transaction whenever disclosure is necessary to avoid assistance of the client's crime or fraud.\(^\text{131}\) It is, furthermore, suggested by the same commentator, that the NSMC case prompted articulation of the duties imposed by Rule 4.1. Significantly, the above comments indicate that Rule 4.1 imposes a disclosure obligation upon the lawyer whenever disclosure is necessary to avoid assistance of the client's crime or fraud and not merely when the validity of the lawyer's own statement is jeopardized by the client's actions.\(^\text{132}\)

\(^{129}\) *Id.* at Rule 4.1(b)(2).

\(^{130}\) This Rule governs representations by a lawyer. A related but distinct duty exists under Rule 1.2(d), which forbids a lawyer to assist a client in conduct that is criminal or fraudulent. The critical elements under Rule 1.2(d) are the nature of the client's purpose, whether the lawyer knew of the purpose and whether the lawyer assisted in carrying it out. In contrast, the critical elements under this Rule are the making of a statement by the lawyer and the lawyer's knowledge that the statement is false. *Id.* at Rule 4.1 comment.

\(^{131}\) Under the model rules, therefore, a lawyer is under a duty to disclose not fraud in general, as D.R. 7-102(B) would require, but those facts necessary to avoid assisting an ongoing or prospective criminal or fraudulent transaction. This duty may become operative in a business transaction, for example, during negotiations (Rule 4.1) . . .


\(^{132}\) Rule 4.1 furthermore requires disclosure only when it is "necessary to prevent" assisting a criminal or fraudulent act. Thus, in some
The attorney also confronts the decision of whether he should withdraw from representation of the client who is involved in a securities violation. Of course as indicated earlier, Rule 1.2(d) sometimes requires resignation. Assuming, however, that Rule 1.2(d) does not compel resignation, a lawyer is permitted to withdraw by Rule 1.16(b) if “withdrawal can be accomplished without material adverse effect on the interests of the client, or if: . . . the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent. . . .” The commentary makes clear that these conditions are in the alternative, i.e., if the client engages in illegal activity the lawyer is free to resign even if doing so results in material prejudice to the client. This formulation eliminates the ambiguity of the existing CPR. At least one question, however, remains: does “persists in a course of action . . . that the lawyer reasonably believes is criminal or fraudulent” trigger the withdrawal option only after illegal conduct has occurred or is the lawyer free to resign when he becomes aware of the client's intention to pursue an illegal course of conduct?

In summary, it appears that the Model Rules have the following implications for the securities practitioner:

1) he must prevail upon the individual who appears to be responsible for the unlawful activity in the first instance in an effort to dissuade him from committing the violation;

2) he must refuse to provide any legal services that appear likely to contribute to the success of the unlawful scheme;

3) he must refer the matter upward if attempts to resolve it with the source are unsuccessful;

4) he must resign the representation if the client refuses to discontinue the unlawful activity and his continued involvement assists the client in such activity;

5) after he resigns he must disclose the client's wrongdoing if the client is making use of his prior involvement to continue the unlawful activity;

cases, withdrawal may suffice to prevent that assistance. Perhaps illustrative is Securities and Exchange Commission v. National Student Marketing Corporation, 457 F. Supp. 682 (D.D.C. 1978). The operative terms of Rule 4.1 also indicate that, in a corporate context, outside disclosure will not be “necessary” if there is an opportunity to intercept the conduct within the corporate hierarchy.

Id.

133. See supra notes 124-25 and accompanying text.
134. Id. at Rule 1.16(b)(1).
135. Id. at Rule 1.16 comment.
136. Id. at Rule 1.16(b)(1).
whether or not he resigns, he may disclose the client's (or former client's) wrongdoing if the criteria contained in Rules 1.6(b)(2), (3) or (5) or 1.13(c)(1) and (2) are satisfied.

Proposal of the Institute for Public Representation

The final source of authority to be dealt with in this section of the paper is the proposal of the Institute for Public Representation at Georgetown University for an amendment to SEC Rule 2(e). The proposed amendment, which applies to all reporting companies, requires the company to include in its Form 10-

137. 17 C.F.R. § 201.2(e) (1981). The Institute actually made 2 proposals to the SEC, one of which would impose an obligation of disclosure on attorneys, was not promulgated for public comment by the SEC. What follows are the relevant provisions of the proposal that was published for public comment by the SEC.

The full text of the relevant provisions of the proposal appears below:

1. Every corporation required to file reports with the Securities and Exchange Commission ("reporting corporation") shall include in its Form 10-K and in its annual report to shareholders a certificate stating that:

   (A) Its board of directors has instructed each attorney employed or retained by the corporation to report promptly to the board either directly or through the audit committee or some other committee of the board with a similar ratio of independent directors, any corporate activities discovered by the attorney through reasonable diligence during the course of representation which, in the attorney's opinion, violate or probably violate any law administered or enforced by the SEC or any other law, where such violations or probable violations

   (i) could result in material financial liability to the corporation;

   (ii) call into question the quality and integrity of management in connection with corporate activity; or

   (iii) are part of a pattern or practice of recurring activity;

   (B) All attorneys have indicated their compliance with the board's instructions either by reporting such violations or probable violations, or by reporting, at least annually, that no such violations or probable violations have come to their attention;

   (C) The full board of directors has considered each attorney's report and has taken all actions determined to be appropriate;

   (D) Information regarding such violations or probable violations has been conveyed to the independent auditors if, in the opinion of the board, the violations or probable violations are material . . . .

3. When a reporting corporation's general counsel or any attorney retained in connection with matters pertaining to the laws administered or enforced by the Commission resigns or is dismissed the corporation shall file with the Commission Form 8-K, describing the circumstances of the resignation or dismissal. Prior to submission of the Form 8-K to the Commission the corporation shall provide the resigning or dismissed attorney with an opportunity to comment on the accuracy and completeness of the description. The attorney's comments shall become part of the corporation's submission to the Commission.

[1979 Transfer Binder] Fed. Sec. L. REP. (CCH) ¶ 82, 144, pp. 82,050-51.
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K, and in its annual report to shareholders, representations to
the effect that each attorney employed or retained by the company
has been instructed to report promptly to the board of di-
rectors any violations (or probable violations) of law discovered
by the attorney through reasonable diligence. Attorney’s re-
ports would be required if the violations "could result in materi-
al financial liability for the corporation; call into question the
quality and integrity of management . . . or are part of a pattern
or practice of recurring activity." Compliance would require
that the full board had considered each attorney’s report and
take “all actions determined to be appropriate,” and that “infor-
mation regarding such violations or probable violations had
been conveyed to the independent auditors if, in the opinion of
the board, the violations or probable violations are materi-
al.” Furthermore, the Institute would require the circumstances
prompting the resignation or dismissal of an attorney advising
the corporation with respect to any laws administered by the
SEC to be described on a Form 8-K.

Several aspects of this proposal are worthy of comment.
First, it comes into play only after a violation occurs. The propo-
sal appears to impose no obligation to prevent the violation.
Secondly, the requirement that the auditors be informed of the
violation applies only to the board; the lawyer has satisfied his
obligation by informing the board of the violation. The attor-
ney’s actual responsibility under the proposal may be somewhat
incongruous with the Institute’s view of the corporate lawyer’s
client. The former director of the Institute has expressed the
view that “what the code of professional responsibility says is
that the lawyer’s responsibility is to the corporate entity. What
that ought to mean is that he is responsible to shareholders, the
board, and management, and also that he has a special obliga-
tion to the general public as well.” Although the Institute has
adopted an expansive view of the corporate lawyer’s client, the
proposal it makes does not attempt to impose an extraordinarily
broad duty on the lawyer since there is no duty to do anything
before a wrong is committed and, in any event, the lawyer does
not have any duty of public disclosure.

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138. See supra note 6.
140. Id.
141. Id. at ¶ 82,144, pp. 82,050-52.
142. Chicago Tribune, December 16, 1979, § 5 at 3.
143. Although it could be argued that this proposal does not represent
the full scope of the duty that the Institute wishes to see imposed on a law-
ner since it did make a proposal to require lawyers to make public disclo-
sure of corporate wrongdoing, the following statement of the Institute’s
The Institute's proposal is unique in its simplicity. The lawyer does not have to assess a myriad of factors before deciding what to do as he would under the Model Rules or the CPR. Even so, it has been alleged that the implementation and monitoring of the proposal by large law firms would be very difficult.\textsuperscript{144}

\textbf{Policy Analysis}

Having discussed alternate approaches to attorney responsibility, it is necessary to examine the policy considerations which underlie the standards recommended by the authorities. The frequently articulated arguments, along with those considered relevant by this author, but not significantly explored elsewhere is discussed in the following sections. Most of the controversy revolves around the disclosure dilemma. Accordingly, that issue is of predominant concern in the following discussion.

\textit{Frequently Articulated Arguments}

\textit{Opposing the Imposition of a Duty of Disclosure}

The principal argument against extending a disclosure requirement to securities attorneys is that such a rule would discourage clients, fearful of being "turned in," from confiding fully in their attorneys. This argument proceeds on two levels. First, it is claimed that discouraging the client from disclosing all relevant facts would encourage, rather than prevent, securities violations by depriving the lawyer of the opportunity to persuade the client not to violate the law. Second, this argument considers the harm to the client who is unable to benefit from its lawyer's fully informed advice. The client's interest would be especially prejudiced if effective representation in pending litigation depended upon the lawyer's knowledge of prior events which, if disclosed, could implicate the client in additional litigation. A client in such a position is not apt to divulge all the facts to its lawyer; the client's immediate interests are thus prejudiced.

With respect to the first argument, it has been suggested that a duty of disclosure might discourage clients from seeking

\textsuperscript{144} Id. (comments contained in published account of dual interview of Mr. Halperin and Mr. Sommer).
legal assistance. This situation arises, e.g., in the preparation of formal SEC filings. No statute directs lawyers to prepare such documents. If lawyers are required to inform the SEC of securities violations, many companies will simply have nonlawyers handle this function.

Similarly, a duty of disclosure would inhibit a client's willingness to confide in counsel in a case where a previous wrong, if detected, would create a contingent liability. If the client discusses the past actions with counsel who concludes that a wrong did take place, and that disclosure of the violations is required, the client must either agree to disclose the wrong in its next SEC filing or counsel would be obligated to reveal the client's intention to violate the law by its refusal to report the previous wrongs. Confiding in counsel virtually guarantees a lawsuit where otherwise none might have been brought. Given these circumstances, a client would be less than candid when consulting counsel.

The argument that lawyer-client confidentiality facilitates the prevention of wrongful conduct hinges on two factors: (1) the willingness of clients to confide fully in the lawyer under

145. In the particular area of the securities laws, if the client does not believe that the lawyer-client privilege will be respected, it is a virtual certainty that the conversations between the client and the lawyer will not take place at all, or at least will not take place with the lawyer for the corporation who sees to the disclosure documents . . . . As a result society will be deprived of the vital opportunities in hard cases to stop violations before they occur.

Leiman, supra note 97, at 275-76.

146. "The lawyer is not indispensable as the preparer of SEC disclosure documents . . . . Consequently, a public company, faced with the choice of employing a competent but potentially disloyal lawyer or a less competent but completely loyal administrative assistant, may very well dispense with the lawyer's more costly services." Lipman, supra note 13, at 469. Given the complexity of today's securities laws and the often huge liabilities that can be incurred for a violation it seems at least questionable whether corporations would attempt to prepare their disclosure documents totally without legal assistance. In any event, market forces would be likely to require the use of counsel in the preparation of documents used as part of a public offering of securities. Cf. Lorne, The Corporate and Securities Advisor, The Public Interest and Professional Ethics, 76 Mich. L. Rev. 432, 470 (1978). Still, it would seem that some routine documents such as 10-K and 10-Q reports could be prepared exclusively by lay personnel.

147. Such a possibility is not of merely esoteric significance. Former SEC Commissioner Pollack has argued that in such a situation (title defect on major part of corporate assets on which statute of limitations will soon run) the lawyer should be and is required to ensure disclosure. Cohen, Wheat, Henderson, Professional Responsibility—The Corporate Bar 4 Inst. on SEC. Reg. (PLI) 181, 235 (1973).

148. Where counsel is not apprised of the facts regarding the client's activities it is obviously impossible for him to intervene to prevent future harm: Were corporate managers to feel that their attorneys were no longer entitled to act in their traditional role of confidential counselor to corporate clients, they might be less inclined to communicate with their at-
a regime of confidentiality and, (2) the likelihood that the lawyer will be able to dissuade the client from committing securities violations. Even if the assurance of confidentiality induces the client to reveal his intention to violate the securities laws, confidentiality serves to prevent violations only if the client is willing to heed the lawyer's admonition to refrain from the wrongful conduct. It has been asserted that lawyers are frequently successful in dissuading their client from engaging in wrongful conduct.  

The argument, however, falls short in two respects. First, in many of the cases in which the attorney has been able to persuade the client to abandon a proposed course of action, the attorney did so despite legitimate arguments favoring the legality of the conduct. The existence of a good faith ground for believing that the client's conduct is legitimate would release the lawyer from the obligation to disclose the client's activities. The attorney and client may simply conclude, however, that the anticipated cost of pursuing the course of conduct, e.g., investigations, publicity, litigation costs, fines and judgments, exceeds the expected benefits of pursuing the transaction. Even under a disclosure regime, attorney and client could investigate the legality of the proposed transaction in a straightforward manner. Thus the obligation of disclosure would not have prevented the communication unless the client erroneously perceived that the proposed course of conduct was utterly indefensible. Since clients are normally not familiar with the law, it is possible that such an erroneous perception will impede communication between lawyer and client.

Second, it is questionable whether clients who intend to perpetrate obvious securities violations, i.e., those which would clearly trigger the disclosure rule, will refrain merely because the lawyer so advises. Clearly, such a client is not likely to need a legal opinion to alert it to the fact that it proposes to break the

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149. Leiman, *supra* note 97, at 276. However, if we assume that there is a high level of candor in this relation, then the existence of the permissive disclosure provision in the CPR (DR 4-101(C)(3)) may undercut the argument. If clients are willing to disclose all relevant information to their attorneys when it is at least possible that they will disclose their involvement in a securities violation, one questions whether obligatory disclosure would drastically decrease candor.

150. Of course, if the client erroneously perceived that the proposed course of conduct was utterly indefensible, a disclosure obligation could deny the lawyer the opportunity to dissuade the client from such course of conduct.
law. Certainly there are some individuals and corporations, who because of their unfamiliarity with the securities laws, unwittingly involve themselves in blatant violations. The intervention of counsel would presumably prevent violations in such cases. The intervention of counsel would also prevent violations where a client realizes the illegality of an activity but not its gravity. There may also be situations where the intention of one employee (of the client) to violate the law is not known to the other employees.

The validity of the argument, that confidentiality promotes adherence to the law, depends on the existence of a significant number of cases in which counsel is able to prevent his client from engaging in a transaction that would otherwise be necessary for counsel to report under a regime of disclosure. Although it is not possible to obtain empirical evidence of the number of such cases, there may well be fewer than originally supposed.

Nevertheless, even without its claimed social benefits, lawyer-client candor and guaranteed confidentiality permit the client to benefit from the lawyer's fully informed judgment. As clients become aware of their lawyers' disclosure duty, they may become reluctant to convey information. Without relevant information, the lawyer may be unable either to insure that the client remains within the law or to give the client informed advice.151

Disclosure of past wrongdoing to counsel may sometimes be to the client's advantage when he is involved in litigation. Such knowledge can avoid inconsistent representations and surprise as a result of any tactics or evidence employed by the opposition. It is arguable, however, that at the most, this argument would serve to justify excluding lawyers, acting as advocates, from the scope of the duty to reveal client securities violations.152 This is the approach proposed by former Commis-

151. Note, The Duties and Obligations of the Securities Lawyer: The Beginning of a New Standard for the Legal Profession? 1975 DUKE L.J. 121, 142-43; see also Gruenbaum, supra note 16, at 817 (client unwillingness to make full disclosure to counsel could "impede effective legal representation").
152. See supra note 17.

On a more general level, "it has been pointed out that most of the SEC's proceedings against lawyers have involved lawyers acting as advisers rather than as advocates." Gruenbaum, supra note 16, at 802.

A second justification that is often asserted for compelling the SEC lawyer to work for the government rather than for his or her client is the notion that there is an essential distinction between the litigating attorney and the office attorney. What that argument ignores is that our legal system is basically an adversarial one, and every lawyer—whether drafting a contract, counseling in a business venture, writing a will or performing any other service on behalf of a client—acts in such a way
sioner Sommer and possibly adopted by the SEC (in that both proceedings initiated by the SEC were against lawyers who were not acting as advocates in connection with the objectionable transaction). In response it has been argued that it is a misnomer to distinguish between “advisers” and “advocates” for purposes of defining the scope of the attorney’s duty to reveal client securities violations. This contention is based on the notion that every action performed by a lawyer on behalf of his client in a so-called advisory context is intended to militate in the client’s favor in case of litigation arising from the transaction in question.

Although this response certainly has substantial force, one point should be noted in rebuttal. It is not entirely clear that simply because an attorney seeks to protect his client’s interest in possible future litigation, his need for information pertaining to the client’s past transgressions is exactly the same as it would be if he actually represented the client in present litigation.

Apart from the anticipated decline in client candor, the quality of the lawyer’s advice may be adversely affected by the imposition of a duty to disclose his client’s securities violations. Such a duty potentially imposes personal responsibility on the lawyer for the client’s misdeeds.

It has been argued that requiring the lawyer to shoulder such personal responsibility will induce him to place his own interests ahead of the client’s. The concern is that the lawyer, understandably wanting to play it safe, may steer the client away from perfectly legal actions in order to avoid a decision as to whether disclosure is necessary. To the extent that this tendency causes the lawyer to prevail upon the client to reject courses of action that are clearly illegal, the societal interest is well served. The problem arises where a client’s proposed action appears to the lawyer to be on the borderline between legality and illegality. If the conduct is found to be illegal, and the lawyer did not disclose it, the lawyer may be sanctioned. On the other hand, if the conduct was legal, and the lawyer publicly accused the client of a violation, the lawyer has violated his fiduciary obligation to the client. Thus, the lawyer has an incentive to steer the client away from transactions not clearly illegal in order to avoid the disclosure dilemma.

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as to protect the client from being at a disadvantage in potential future litigation.


153. See infra notes 154-56 and accompanying text.

154. The ABA has adopted the following view:
The question becomes whether the SEC could disagree with the attorney's judgment regarding the defensibility of a course of conduct. Often, the answer is yes. The securities law is normally in a state of flux with issues that appear muddled one year resolved the next. Accordingly, conduct that may be borderline when proposed may be viewed as a gross violation when considered later by the SEC or a court. Indeed, subsequent decisions which clearly establish the illegality of the client's conduct and which are published before the attorney is consulted could be construed as notice to the attorney of the illegality of the client's conduct, thus triggering the duty of disclosure.  

Even in relatively well settled areas of the securities law, it may be difficult for the attorney to determine with certainty, whether a particular transaction is proscribed. But assuming that there is at least room for argument, the SEC is not likely to ignore an attorney's good-faith determination that conduct is legal. If counsel can point to a nonfrivolous argument in the client's favor, he need not fear personal liability if the client, apprised of the risks, goes ahead with the proposed transaction. Counsel may, however, not wish to risk testing the validity of his argument. It would be less risky simply to emphasize the risks of the proposed action in hopes of inducing the client to refrain from acting. Doing so eliminates the risks, for the lawyer, of SEC prosecution and of losing the client if he feels compelled at some point to go to the SEC. Even assuming that there are social benefits associated with reducing the number of borderline transactions, the substantive law would be a better way of deterring these transactions. It is simply inappropriate for the client, who stands to profit if he can legally consummate his transaction in the manner intended, to be influenced by the per-

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The client's actions should not be improperly narrowed through the insistence of an attorney who may, perhaps unconsciously, eliminate available choices from consideration because of his concern over possible personal risks if the position is taken which, though supportable, is subject to uncertainty or contrary to a known, but perhaps erroneous, position of the SEC or a questionable lower court decision. Report to the ABA House of Delegates from the Section of Corporation, Banking and Business Law, 31 BUS. LAW. 543, 545 (1975). See also Myers, The Attorney-Client Relationship and the Code of Professional Responsibility: Suggested Attorney Liability for Breach of Duty to Disclose Fraud to the Securities and Exchange Commission, 44 FORDHAM L. REV. 1113, 1117 (1976).

155. A situation similar to the one described did exist several years ago in connection with the definition of a private offering. In relatively short order, the courts (especially the 5th Circuit), became significantly less lenient in allowing defendants to claim the benefits of the exemption. Had the question of what constituted a private offering been presented to a practitioner before all of the cases in the line had been decided, he would have faced the problem referred to in the text.
sonal interest of the lawyer. The client should be permitted to assume the risk in a borderline case, independently of his lawyer's, possibly biased, influence.¹⁵⁶

**Supporting the Imposition of a Duty of Disclosure**

It has often been argued that because the SEC lacks the resources to completely police the securities markets, it is necessary to enlist the services of the securities bar to force compliance with the securities laws. The rationale is that since lawyers are often essential in securities transactions, if the lawyer is aware that he may be personally liable if a transaction violates the law, he will do his utmost to ensure that the client either complies with the law or mitigates harms attributable to violations the lawyer could not prevent. This would free the SEC to use its limited enforcement resources to fully police lawyers and accountants, rather than spreading its resources over the much larger group of direct market participants.¹⁵⁷

This argument is, however, virtually indefensible. There seems little reason to accord any greater significance to the needs of the SEC than to the needs of any other law enforce-

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¹⁵⁶. One commentator has recognized the social desirability of not having the lawyer impinge on the client's decisionmaking authority: "[We must recognize] the interest of clients and of society in having ultimate decisionmaking authority rest with the client. It is important to recognize society's interest in having decisions made by the persons who will receive their primary economic benefits or burdens." Lorne, The Corporate and Securities Adviser, The Public Interest, and Professional Ethics, 76 Mich. L. Rev. 425, 487 (1978).

¹⁵⁷. Stanley Sporkin has indicated that this rationale is what prompted the SEC to begin its effort to make securities lawyers police the activities of their clients:

A crooked deal, a shady deal, a bad deal, call it what you like, isn't a deal unless it has access to the marketplace, and this access can be provided only by the professionals. We can't watch 15,000 brokers, but we sure as hell can watch the people they use. Cut it down that way, you have a smaller universe to police.

We started by saying, in effect, "You people, you lawyers and you accountants, you are going to be held responsible when you put your name on paper that comes to this commission for filing." Now right away this doubles or triples your enforcement staff, because they must take measures so they are not unwitting participants in a bad deal.


The SEC has made the same point in more formal fashion in a Rule 2(e) proceeding against an attorney. In re Emanuel Fields, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,407, p. 83,172 (June 18, 1973) (securities bar responsible for enforcing the federal securities laws because of the SEC's limited resources). Requiring the lawyer to disclose also helps the SEC in its task of preventing harm to investors where the client cannot be dissuaded from violating the law, i.e., the disclosure serves to warn potential victims of the client's violation.
It seems ridiculous to make the duties of lawyers vary with the extent of congressional largesse to the SEC. Extending this argument to its logical conclusion suggests that if the SEC enforcement budget is increased there is less need for attorneys to be held responsible for their client's activities. Such an argument falls of its own weight.

A more plausible argument is that imposition of a duty of disclosure will deter client violations. The client is less likely to engage in illegal conduct if a disclosure requirement reduces the possibility that the unlawful scheme will succeed. A major consideration is whether a disclosure duty will deter unlawful activity altogether, or merely prompt the client to effect his fraudulent schemes without the lawyer's knowledge.

Since the lawyer is not indispensable in many securities transactions, disclosure requirements may simply induce clients to proceed without the lawyer's assistance. However, given the complexity of securities law, it is doubtful that many major securities transactions could be effected without the advice of counsel. Therefore, requiring disclosure would probably prevent some violations.

Other actions could be taken to deter violations including an increase in the civil and criminal penalties imposed on violators. Also, making private suits easier to win and more profitable for successful plaintiffs would provide an incentive for

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158. In responding to the SEC argument of resource inadequacy after it has advanced in the Fields case, Dean Freedman declared, "I have heard the same justification given in virtually every case of police abuse and every prosecutorial circumvention of constitutional rights with which I have been involved." Freedman, A Civil Libertarian Looks at Securities Regulation, 35 Ohio St. L.J. 280, 281 (1974). Undoubtedly, lawyers would be of assistance to the police in getting violent criminals off the streets if, in contrast to existing law, the admission of highly relevant but illegally obtained evidence were permitted in criminal prosecutions. Mapp v. Ohio, 367 U.S. 643 (1961). However, lawyers are unwilling to let the demonstrable needs of the police outweigh the other implicated interests.

159. "Surely, the ethical obligations of the legal profession should not be varied from year to year depending on the vicissitudes of congressional generosity to the SEC," Lipman, supra note 14, at 465.

160. This position has also been urged as both an explanation of the SEC's activities in this area, Cheek, Professional Responsibility and Self Regulation of the Securities Lawyer, 32 Wash. & Lee L. Rev. 597, 600 (1975), and an independent justification for such a policy. Note, Client Fraud and the Lawyer—An Ethical Analysis, 62 Minn. L. Rev. 89, 117 (1977).

161. See supra notes 145-46 and accompanying text.

162. For example, the Sherman Antitrust Act, 15 U.S.C. §§ 1–7 (1976), approach of awarding a large multiple of actual damages to successful civil plaintiffs would both encourage private suits and directly deter violations by increasing the risks of loss that must be borne by those intending to violate the securities laws. Similarly, the substantive standards governing liability under the securities laws could be modified to facilitate recovery by private plaintiffs. For example, Congress could overrule Ernst & Ernst v.
private plaintiffs (and the plaintiffs' securities bar) to seek out and prosecute violations. Accordingly, if the imposition of personal liability on the securities bar is to be justified as a deterrent, there must be some showing that imposing such liability will have a significantly greater deterrent effect than any alternate measures. Notably, it is only in the securities area that there has been a proposal to modify the standards governing lawyers' behavior as a means of deterring client misconduct.  

While it can be argued that counsel is better able to force clients to obey the securities law because he has more information about the client's activities, this factor may not be important. Many securities frauds involve the nondisclosure of adverse information regarding the client's business fortunes. Such information will often be made public when the client's deteriorating finances bring the concealed crisis to a head, e.g., when obligations can no longer be met or independent investigations are launched. Not coincidently, in both of the cases used by the SEC to formulate a standard of conduct for the securities bar, the client wrongdoing was eventually disclosed despite counsel's silence. If it is likely that violations will surface without disclosure requirements, then the deterrent effect of imposing such a duty would be reduced.

A third argument frequently invoked to justify a disclosure duty is that the investing public relies on the securities bar to protect its interest to such an extent that it is appropriate to impose special obligations on this section of the bar. This argument states that because lawyers play a pivotal role in many securities transactions, the public should and does count on the lawyer to ensure the legality of the transaction.

This argument prompts two responses. First, it is questionable whether the investing public really views the lawyer as a

Hochfelder, 425 U.S. 185 (1976), and allow recovery of damages under § 10(b) of the 1934 Act on a showing of negligent misrepresentation.


165. Id.

166. The claim has been made that, "[t]oday, lawyers play an indispensable and essential role in the affairs of corporations. In this regard, the advice of lawyers often determines whether any particular transaction will occur, and if it does, then with whom, at what price, and where it will occur." Gruenbaum, supra note 16, at 527. On a more specific note, "[a former] SEC staff member has argued that lawyers have a more general duty to perform a due diligence investigation because the public relies on the names of lawyers which appear in prospectuses and other disclosure documents as a kind of surety for the securities which they purchase." Lipman, supra note 14, at 466.
guarantor. It has been argued that many investors do not even read prospectuses and, therefore, could not be relying on the representations of the attorney named therein to ensure their truthfulness.\(^\text{167}\) Presumably, other disclosure documents receive no more attention than prospectuses. Second, even if investors do feel that the securities lawyer is guaranteeing full compliance with the law, such reliance is misplaced. Few would claim that because most warranties on consumer goods are drafted by lawyers such warranties are certain to be entirely fair to consumers. Similarly, few would believe that a corporate merger was not anticompetitive simply because a lawyer was instrumental in the negotiations leading to it. The lawyer is, after all, retained and paid by the client to protect the client's interest and, therefore, it is unrealistic for the public to rely upon the lawyer to place the public interest ahead of the client's interest.\(^\text{168}\)

In response, it is argued that even if it is not reasonable to assume that lawyers act to ensure the legality of client activities, the lawyer's key role in the preparation of information about issuers justifies the imposition of such a responsibility on him in the future, because he is in the best position to prevail upon the client to comply with the law. This argument presupposes that securities lawyers are not already making substantial efforts to see that clients comply with the law. It would not be rational for the public to rely on the securities bar as guarantors of the accuracy of all representations made in connection with the sale of securities. If the public can currently count on securities attorneys to actively discourage proposed illegal conduct of which they are aware, accordingly, it is unnecessary to impose special enforcement duties on securities attorneys unless the vindication of unjustified, unprecedented, and possibly nonexistent public expectations is desired.

If lawyers are already making efforts to ensure the legality of client activities, then the addition of a duty of disclosure seems to serve only the purpose of deterrence of client wrongdoing. A.A. Sommer, Jr. has expressed the view that the securities bar is presently making an affirmative effort to see that clients comply with the law.

I don't know of a security or a corporate lawyer who, if he were aware of the fact that management was doing something illegal, told them that it was illegal and told them to stop it and they re-

\(^{167}\) Lipman, supra note 14, at 466.

\(^{168}\) This viewpoint does not, of course, amount to instructing the lawyer to disregard the public interest when counseling his clients, but merely that any existing public expectations that the lawyer is a guarantor of client representations are unjustified.
fused... I don't know of any corporate lawyer of any standing who wouldn't then go to the board of directors and say, "Look, fellows, you've got a problem." I don't think there's been a very good case made for the idea that corporate lawyers today are not fulfilling their responsibilities.169

Arguments Not Extensively Explored Elsewhere

The difficulty of identifying reportable violations is a factor militating against the imposition of a disclosure duty. All the proposals which seek to require disclosure are triggered not by the lawyer's reasonable belief that certain conduct violates the law, but by a considerably more rigorous standard; the violation must be clearly established; clear beyond a reasonable doubt; clearly a violation; etc.170 The most logical interpretation of these standards is that disclosure is contingent upon the absence of any nonfrivolous argument in favor of the legality of the conduct.

A problem arises from the existence of such an exacting standard along with the serious consequences of inappropriate disclosure. If the lawyer alleges client misconduct to the SEC, serious consequences ensue for the client: the fact that an investigation has started may depress the market for the client's securities; new public financing may become difficult or impossible; reputations of executives may be damaged; and management may be required to divert its attention from the business to the investigation. The client will suffer some of these sanctions even if no violation is found. In addition, if the lawyer violates his fiduciary duty to the client by going to the SEC when he had no duty to do so, he may incur financial liability and ir-reparable damage to his professional reputation. Of course, if the lawyer had a duty to disclose client misconduct but did not, he will be subject to severe sanctions.

If the lawyer goes to the SEC with allegations of client misconduct and a violation is found to exist, one would think that the lawyer would be immune from liability for inappropriate disclosure. However, the fact that a violation has occurred does not mean that the lawyer acted properly. He was entitled to disclose only if a violation was clearly established at the time he made his disclosure.171 Even if the client was ultimately held liable, the lawyer could still be sued for inappropriate disclosure on the theory that he did not have reason to believe that the

169. Chicago Tribune, December 16, 1979, § 5 at 3 (dual interview with Mr. Sommer and Charles Halperin).
170. See Model Code, supra note 69, at DR 7-102(B).
171. Id.
violation was clearly established on the basis of the information then available to him. Even if a violation is clearly established, such immunity may be useless to the lawyer if, as is frequently the case in securities litigation, the client settles. Settlement could provide the client with a strong case for wrongful disclosure since, by definition, a settlement means that the client was not found to have violated the law.\textsuperscript{172} There is no good reason to extend the immunity rule to cover settlements since a defendant who has not violated the law \textit{i.e.}, the attorney's disclosure was unwarranted, might settle to avoid the expense and adverse publicity accompanying a trial. Even in the case of a clear violation, the SEC, because of its limited resources, may settle to expedite resolution of the case. Thus, the lawyer who publicly accuses his client of wrongdoing is very vulnerable in the event of a settlement; he cannot know when he goes to the SEC whether the SEC is willing and able to fully litigate the case and has no way of knowing whether or not private plaintiffs will settle.

Where the original case was settled, the propriety of the lawyer's disclosure, as well as the legality of the client's conduct, would be determined in the client's action against the lawyer. The lawyer would be subjected to a long trial and adverse publicity. These factors would provide a substantial incentive for the lawyer to settle with the former client even if the lawyer's original allegations were justified.

In addition, while it is often difficult, in any area, to ascertain a violation of law without a trial, the nature of the securities area makes this an almost impossible task. The securities laws are often imprecise, with cases turning on the meaning of ambiguous terms like "control," "reasonable business judgment," "public offering," and "materiality."\textsuperscript{173} Even in clear cases of wrongdoing there can normally be some argument made for the legality of the conduct. For example, where the existence of a falsehood in an SEC filing is undisputed, the client may always deny its materiality, or where the client has not disclosed material developments regarding its business, as required by Rule 10b-5, it can claim that it was merely delaying the disclosure for

\textsuperscript{172} By settling a suit a defendant obviously avoids a finding that he was guilty of the charge against him.

\textsuperscript{173} It has been observed that "[t]he securities laws involve many complex issues which seem to be constantly changing. Attorneys charge it is unfair to hold them liable for acts of their clients which arguably could have been seen as within the law." Note, \textit{The Duties and Obligations of the Securities Lawyer: The Beginning of a New Standard for the Legal Profession?}, 1975 DUK\textsc{e} L.J. 121, 144.
a legitimate business reason.\textsuperscript{174}

Given the imprecision of the law in the securities area, it is asking a lot of an attorney to declare that the client's activity is such a clear violation that no nonfrivolous argument could be made in the client's behalf. Counsel's predicament worsens if he is expected to disclose the client's intention to commit a future violation because the exact nature of the proposed activity may not be clear and the client can abandon its supposedly wrongful scheme before putting it into effect. In this event, the lawyer risks a suit for wrongful disclosure based on the client's contention that no fraud was ever intended. Furthermore, the client's superior access to records may allow it to destroy incriminating evidence and to fabricate exonerating evidence.

A second line of analysis not extensively considered elsewhere is the treatment of the disclosure problem in other areas of the law. This section of the article will consider the scope of the lawyer's duty to reveal client violations of various non-securities laws in both business and nonbusiness contexts.

In the business area, the only authority specifically dealing with this question is the income tax regulations governing the conduct of attorneys and accountants who practice before the Internal Revenue Service. The first of these provisions states:

Each attorney, certified public accountant, or enrolled agent who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error or omission from any return, document, affidavit, or other paper which the client is required by the revenue laws of the United States to execute, \textit{shall advise the client promptly of the fact of such noncompliance, error, or omission.}\textsuperscript{175}

A second provision defines "disreputable conduct," for which the tax practitioner is subject to discipline, to include "\{g\}iving false or misleading information or participating in any way in the giving of false or misleading information to the Department of the Treasury . . . knowing such information to be false or misleading."\textsuperscript{176} These provisions certainly impose no duty of disclosure on attorneys and may or may not require an attorney representing a client engaged in tax fraud to withdraw from the

\textsuperscript{174} \textit{Financial Indus. Fund, Inc. v. McDonnell Douglas Corp.}, 474 F.2d 514 (10th Cir. 1973), \textit{cert. denied}, 414 U.S. 874. It would seem that this argument was open to the attorney and client in \textit{In re Carter} in view of management's claim that its refusal to disclose the need to implement the LMP was attributable to its attempt to negotiate a waiver of its obligation to implement the plan. Of course, even acceptance of this argument would not excuse the issuance of the excessively optimistic press releases.

\textsuperscript{175} 31 C.F.R. \textsection{10.21} (1977) (emphasis added).

\textsuperscript{176} 31 C.F.R. \textsection{10.51(b)} (1977).
representation depending on how broadly “participating” is defined.Outside the tax area, the business practitioner is under no duty to disclose client misconduct, indicating, perhaps, that the traditional rules of confidentiality apply.\footnote{177} Outside the business area, the question of disclosure has arisen mainly in connection with professionals who are aware that their clients intend to commit, or have committed, acts of violence. The most celebrated case, \emph{Tarasoff v. Regents of the University of California},\footnote{178} involved a psychotherapist rather than a lawyer. In \emph{Tarasoff}, a psychotherapist who knew of his patient’s intention to kill a particular person was held to be negligent for not informing the victim or the police before the killing occurred. The court rejected the therapist’s defense of a statutory obligation to preserve patient confidences because the statute imposing the obligation permitted disclosure when necessary to protect the person or property of another.\footnote{179} With respect to a lawyer’s obligation to disclose when necessary to prevent a client from endangering human life, one commentator has expressed the view that, “[o]ne wouldn’t question the lawyer’s obligation if the situation were one where a hazardous drug is let loose on the public [by the client]. It would plainly be a lawyer’s duty to report the situation to authorities who could prevent the drug from damaging the public users.”\footnote{180} A case dealing with this issue, \emph{People v. Belge},\footnote{181} involved two lawyers who, while defending a client in a criminal prosecution, were told by the client that he had committed two murders and hidden the bodies in a specified location which he disclosed to the lawyers. The lawyers found and photographed the bodies but did not disclose their knowledge to anyone until the client confessed the crime. One of the lawyers was indicted for violating a New York statute which requires anyone aware of an unreported death to notify the authorities. He was acquitted because of the obligation of confidentiality, but the court indi-

\footnote{177} This supposition is supported by at least one commentator: “It is noteworthy that no federal administrative agency other than the SEC has adopted, proposed, or even informally advocated imposing upon lawyers obligations similar to those proposed by the SEC.” Lipman, \emph{supra} note 14, at 476.
\footnote{178} 17 Cal. 3d 425, 551 P.2d 334, 131 Cal. Rptr. 14 (1976).
\footnote{179} \textit{Id.} at 441, 551 P.2d at 346-47, 131 Cal. Rptr. at 27. Several legal commentators have indicated that this holding could be used as authority for the position that a duty of disclosure should be imposed on the securities attorney who is aware of his client’s securities fraud. \textit{E.g.,} Gruenbaum, \emph{supra} note 16, at 826; Hoffman, \emph{supra} note 19, at 1397.
\footnote{180} Leiman, \emph{supra} note 97, at 273.
icated that a closer question would have been presented if the indictment had been for obstruction of justice. The New York State Bar Association Committee on Professional Ethics also exonerated the attorney, ruling "that the attorney had an ethical duty to withhold the incriminating information about his client's previous murders." This view has been criticized. Although one could attempt to reconcile Belge with an expansive view of the lawyer's obligation, by noting that in Belge the attorneys were not in a position to prevent the client's crime, the attorneys' silence allowed a confessed double murderer to avoid apprehension, obviously posing a threat to the public, probably caused innocent people to be the subject of police investigation and prolonged the period of agonizing uncertainty for the families of the victims.

What are the implications of the preceding discussion in the securities area? It appears that the cases in which a duty of disclosure is imposed on professionals involve situations where the disclosure prevents the client from endangering the life of another. This rationale, although controversial, is inapplicable to the securities area. Second, it is ironic that, while there is controversy over whether a lawyer must disclose his client's past murders, the SEC is attempting to require disclosure of past securities violations.

Obviously, there is a social interest in having those who violate the securities laws brought to justice. However, there is certainly no less interest in facilitating the prompt apprehension of

182. 83 Misc. 2d 186, 191, 372 N.Y.S.2d 798, 803 (1975), aff'd, 50 A.D.2d 1088 (1975), aff'd per curiam, 41 N.Y.2d 60 (1976). In its affirmance, the appellate division also indicated that the attorney's obligation of confidentiality is not absolute. 50 A.D.2d 1088.

183. Comment, Problem of an Attorney in Possession of Evidence Incriminating his Client: The Need for a Predictable Standard, 47 U. Cin. L. Rev. 431, 433 (1978). Dean Freedman has expressed his view that the action of the two lawyers was entirely correct: "In short, not only did the two lawyers behave properly, but they would have committed a serious breach of professional responsibility if they had divulged information that was contrary to their client's interest." Freedman, Where the Bodies are Buried: The Adversary System and the Obligation of Confidentiality, 10 Crim. L. Bull. 979, 981 (1974). This response may invite the question of whether the murderer was actually out on bail during the first prosecution. Obviously, if he was not out on bail during the first trial, the lawyers' silence did not allow him to directly inflict further harm on anyone. However, there is no indication that the answer to this question played any role in the courts' analysis since none of the cited opinions ever mentioned whether or not the killer was free on bail. In any event, the attorneys' silence presumably caused innocent people to be the subject of police investigation and did prolong the uncertainty for the victims' families.

murderers and preventing unwarranted police investigation of innocent people. Accordingly, it seems anomalous to impose a higher level of responsibility on the securities lawyer than on an attorney for an unapprehended murderer.

The business area provides further support for the rule of confidentiality. Apparently, with the exception of the SEC, those responsible for enforcing business regulations feel that it is possible to satisfactorily enforce those laws without imposing special responsibilities on lawyers. A former SEC chairman has attempted to justify this disparity:

I think it is very dangerous to draw analogies between the securities laws and other laws in trying to decide what is the professional's responsibility. There are a long line of cases going back to when the securities acts were enacted stating that the legislation is remedial and that its purposes are to be broadly construed. So, I see a trend in the securities area different from that in the divorce, tax or antitrust fields. 185

This argument is unpersuasive. First, the securities laws are certainly not the only federal remedial legislation; the antitrust laws also fit this description. More importantly, the fact that legislation is remedial does not establish the need for large scale alterations in the traditional attorney-client relationship for enforcement purposes.

Although the imposition of greater attorney responsibility in all areas might be desirable, the fact that those responsible for enforcing other business laws do not find it necessary to advocate disclosure should establish a presumption against such action. Such a presumption could be overcome in the securities area by a demonstration that enforcement of securities laws is uniquely difficult and that extending the disclosure requirement to lawyers would significantly ameliorate the difficulties. Merely proclaiming that the securities laws are remedial, without somehow distinguishing them, does not justify the imposition of additional burdens upon the securities practitioner.

A third policy consideration, not extensively explored, is the impact of a rule requiring attorney disclosure of securities violations to the client's shareholders. Over the long run it would be to the advantage of the corporate entity to force compliance with the securities laws. Thus it will often be to the advantage of long-term shareholders to require counsel to disclose management wrongdoing. The issue is not so simple, however, when considering the interest of short-term shareholders.

The difficulty with imposing a duty of disclosure is most apparent in the case where the client refuses to disclose, in current SEC filings, some past, undetected violation. Disclosure here virtually invites lawsuits by aggrieved parties; lawsuits which might never be brought if the lawyer conceals his client's unwillingness to disclose the previous wrong.

In this situation, there is a conflict between the interests of various classes of shareholders. Disclosure would, at least temporarily, depress the client's stock prices. This would be adverse to the interest of shareholders who intend to sell their holdings in the near future. Conversely, potential shareholders would obviously benefit from disclosure of the corporation's potential liabilities. The effect on long-term shareholders depends on a comparison of the benefits of the ouster of corrupt or incompetent management with the detriment of lawsuits against the corporation arising from the disclosure.186

Moreover, even where the securities violation involves misrepresentation in the sale of securities to existing shareholders, such shareholders may be harmed by disclosure of the violation. Disclosure of possible fraud in the sale of a company's securities will certainly cause their price to fall when potential investors become aware of the previously concealed adverse information and call the general honesty and competence of the management into question. The shareholders may also be adversely af-

186. At least one commentator has recognized the existence of this conflict. Small, An Attorney's Responsibilities Under Federal and State Securities Laws: Private Counselor or Public Servant?, 61 CAL. L. REV. 1189, 1223 (1975) [hereinafter cited as Small]. Some commentators have suggested that requiring disclosure here is always detrimental to the interests of the shareholders. Lipman, supra note 14, at 460. "In short the Commission would require disclosure of information which is diametrically opposed to the interest of the company and its shareholders." Hoffman, supra note 19, at 1412-18. This view may fail to recognize the benefits to some shareholders of facilitating the discharge of corrupt management or it may reflect the judgment that even for long term shareholders, these benefits are outweighed by the costs discussed above. Former Commissioner Pollack has recognized the conflict between the interest of many of the shareholders in nondisclosure and the public interest in disclosure but has indicated that he prefers to see the public interest prevail: "You have to balance the public interest against the interest of the corporation and when errors are made and they affect people outside, sometimes your only alternative is to disclose and suffer the consequences rather than to compound your liability by inducing other people to come." Cohen, Wheat, Henderson, Professional Responsibility—The Corporate Bar, 4 INST. ON SEC. REG. (PLI) 181, 231 (1973). Other commentators suggest that either present law imposes no such disclosure obligation, Cf. Leiman, supra note 97, at 286; Cohen, Wheat, Henderson, Professional Responsibility—The Corporate Bar, 4 INST. ON SEC. REG. (PLI) 181, 233-34, or that even if the client does have such an obligation, the lawyer may assist the client in preparing a 10-K which makes no reference to the contingent liability without subjecting himself to sanctions. Hoffman, supra note 19, at 1418; Small, supra note 186, at 1227.
fected by claims against the corporation by former shareholders who sold before the disclosure but who may be able to assert securities claims anyway. Furthermore, the shareholders may be disadvantaged because of difficulties in obtaining new financing, resulting from revelations questioning the trustworthiness of the company’s financial disclosure documents.

Disclosure of the fraud will, of course, allow existing shareholders to assert personal claims under the securities laws. It is debatable, however, whether such suits will fully compensate them for their loss. The biggest obstacle to full recovery by shareholders is the time element. The price of the company’s outstanding securities will drop immediately upon disclosure while any recovery is likely to be in the fairly distant future. Thus, a shareholder who wishes to liquidate his holdings while the suit is pending may have a short-term cash-flow problem. In addition, legal fees, not usually recoverable from the defendant, normally take a sizeable chunk out of any recovery. As a practical matter, therefore, a defrauded shareholder may be better off if the fraud is never disclosed. If a disclosure duty is to be imposed, it should be justified on the basis that the benefit to the investing public greatly outweighs any detrimental impact upon shareholders.

Validity of the Distinction Between Past and Future Securities Violations

A fourth set of considerations concerns the distinction between past and future violations in defining the scope of the lawyer’s duty. A requirement of disclosure before a violation occurs arguably serves to protect the public. However, when the violation that the attorney would be required to disclose is the client’s refusal to reveal the material contingent liability attributable to the initial violation, disclosure by the attorney does not, in most cases, prevent the infliction of harm on the public. Rather, concealment of the client’s refusal to disclose

188. Recent decisions in the two major SEC initiated proceedings have indicated that the attorney’s duty to disclose arises in part from his obligation to his client’s shareholders. “[T]he attorneys’ responsibilities to their corporate client required them to take steps to ensure that the information would be disclosed to the shareholders.” SEC v. National Student Mktg. Corp., 457 F. Supp. 682, 713 (D.D.C. 1978). “It is concluded that respondents failed to carry out their professional responsibilities with respect to appropriate disclosure to all concerned including stockholders, directors and the investing public . . . .” In re Carter and Johnson [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,175, at p. 82,183 (emphasis added). There is absolutely no discussion in either opinion of the possible adverse repercussions that disclosure would have for the existing shareholders.
maintains the price of corporate securities. And, while existing security holders may have paid a higher price than they would have had the violations been disclosed before they bought, they will also receive a higher price when they sell. The harm is, therefore, shifted from existing shareholders to those purchasing from them. It is critical to note that disclosure under these circumstances does not prevent the infliction of any new harm, but merely transfers the risk of harm from one group to another.

The issue then is whether the loss associated with the undisclosed information is to be borne by existing shareholders, or by those purchasing from them. In view of the improbability of preventing harm to someone, the rationale which requires disclosure of future offenses should not apply when past conduct is the issue. The implication of this conclusion is that the continuous disclosure required by the 1914 Act should not affect the scope of the lawyer's responsibility except where disclosure can prevent an initial violation. Accordingly, the future crime provisions of DR 4-101(c)(3) should not be applied literally in the securities context. Preventing the future crime of nondisclosure of a past violation does not normally prevent harm to investors.189 Injury is prevented only where the imminent violation is failure to report something other than a completed past transgression.190

189. The commentary that has been addressed to this issue thus far has made the point that under whatever standards currently govern lawyers' conduct in this context, the continuous disclosure system is highly relevant to the lawyer's duty. E.g., Cohen, Wheat, Henderson, Professional Responsibility—The Corporate Bar, 4 Inst. on Sec. Reg. (PLI) 181 (1973).

[One thing that does distinguish this field from many others is the continuousness or the repetitiousness of some of the problems—the fact that yesterday's violations or yesterday's crime or fraud or whatever can become today's or tomorrow's disclosure problem. So what you can do in the ordinary course of practicing law about the revelation of a past crime or fraud does not necessarily apply when you get to this miserable problem of what you do with the ongoing disclosure process, with next month's 8-K or next year's 10-K.]

190. An additional implication of the imposition of a duty of disclosure on the securities lawyer in this context is that the client is disadvantaged as a result of its consultation with the lawyer. It is possible that the original wrong would never have been disclosed if counsel had not been consulted but the consultation with counsel has ensured disclosure. It is worth considering whether it is appropriate to penalize clients for using legal services in such situations.
The Relevance of the Client's Ability to Satisfy Judgments to the Appropriate Scope of the Lawyer's Duty

The final consideration in this analysis is whether the lawyer should consider his client's financial ability to satisfy whatever judgments arise from his violation in determining whether disclosure is required. As noted above, mandated disclosure is said to, *inter alia*, protect investors from the harm attributable to a particular violation. The danger to investors is greatest when the client is unable to satisfy a judgment stemming from its violations thereby leaving aggrieved investors without an adequate remedy. On the other hand, where it is clear that any judgment arising from a securities violation could be satisfied, it may be less important to prevent the violation since the aggrieved parties could recover their losses through shareholders' suits.

Prevention of irreparable harm is clearly the purpose of the Model Rules which require disclosure of a client's intention to kill or inflict serious physical harm on another. Similarly, a securities violation, for which the wrongdoer is unable to compensate those aggrieved by his action, might be considered irreparable and thus an appropriate subject for mandated disclosure.

SUGGESTED FORMULATION OF THE APPROPRIATE STANDARD

The final section of this paper is devoted to proposals for the appropriate standard of conduct. A major premise of these proposals is that the corporate counsel's true clients are the shareholders. Thus, these proposals place the shareholders' interests above any conflicting interests. There is a fundamental distinction between requiring the lawyer to affirmatively assist in bringing his client to justice and requiring the lawyer to refrain from facilitating his client's indiscretions. The corporate attorney's role as a shareholders' advocate is severely undermined where the lawyer is required, concomitantly, to champion the

191. *See supra* notes 189-90 and accompanying text.
192. There should not be great practical difficulty in the application of this criterion since damages for many securities violations are often readily ascertainable and counsel should be able to get a fairly good idea of the client's ability to bear them by referring to the client's published financial statements. For example, § 11(e) of the 1933 Act contains an elaborate specification of the measure of damages in § 11 suits while § 12(2) of the same Act basically provides for a simple recission measure of damages. Rule 10b-5 has been applied to provide a sort of "expectation" measure of damages, i.e., the difference between what the plaintiff paid/received for his security and what he would have paid/received if the defendant had not breached his duty of disclosure.
public interest. In short, the lawyer cannot be effective, as a lawyer, when he is also required to be a policeman.

When counsel becomes aware of information that would indicate to a reasonable securities lawyer that his client’s conduct probably violates the securities laws, counsel should be required to make some preliminary investigation into the client’s activities. This duty to investigate applies to both past and future violations. A fairly high degree of certainty applies to this duty; it must be probable that the conduct violates the securities laws because the initiation of an investigation into the client’s conduct may generate enough animosity toward counsel by management to seriously impair the lawyer-client working relationship.\textsuperscript{193}

It is impossible to prescribe the exact scope of the investigation but consultation with those primarily responsible for the suspected conduct would usually be necessary. The responses elicited in this consultation would determine the necessity of further inquiries. When time is limited, no obligation to investigate should be imposed on the attorney because of the overriding interest in ensuring that the lawyer assumes an adversarial posture \textit{vis à vis} his client only in cases where there is good reason to believe there was a violation. Of course, where the initial evidence of fraud is extraordinarily trustworthy, less investigation is required to justify further action.

Where the information from the lawyer’s investigation would cause a reasonable securities attorney to believe that a violation had occurred or is imminent, and this conclusion is supported by clear and convincing evidence, counsel should inform the individual(s) responsible for the violation of his conclusion and prevail upon them to refrain from future violations and/or bring past violations to the attention of the board of directors. If the confronted individual refuses to comply, counsel should bring his suspicions to the client’s board of directors unless time constraints make it impossible to do so. In the case of a past violation, as defined in the preceding Section, disclosure to the board exhausts counsel’s obligation. In the case of a future violation, counsel’s additional obligations depend on the

\textsuperscript{193} No negligence standard has been imposed here, \textit{i.e.}, investigation would be required where counsel should be aware of information indicating that a violation is probable, because such a standard would encourage counsel to assume a sort of permanent investigatory posture. Such a position is inconsistent with counsel’s role as a confidante of the client, a role that is worthy of preservation simply because the maintenance of such a relationship is essential if the client is to have the benefit of a candid and thorough discussion of its entire legal situation. A lawyer cast in an investigatory role will not enjoy the trust of management to the extent necessary for a proper working relationship to exist.
board's response. If the board abandons the objectionable
course of action, counsel has no further duty. If the board re-
fuses to abandon the objectionable conduct, counsel must re-
frain from further advisory representation of the client in
securities matters.\textsuperscript{194} Withholding advice is a logical response
since, in all probability, any advice sought at this juncture will
be sought in an effort to avoid the consequences of the wrong.

Different considerations arise when the issue is whether the
lawyer may defend the client in proceedings brought as a result
of a wrong which the lawyer knew the client was going to com-
mit. First, by defending the client, the lawyer is not assisting
the violation. Second, our adversary system entitles even a
wrongdoer to insist, with the assistance of a trained advocate,
that the case against him be proved.

Where the securities attorney's client is an individual inves-
tor rather than a corporation, the preceding step is obviously in-
applicable. If the client refuses to abandon its intention to
perpetrate a future violation, the mandatory withdrawal provi-
sion is triggered.\textsuperscript{195} With respect to a past violation no action
beyond directing the client to rectify its violation need be taken.

Once counsel withdraws representation, he should be re-
leased from further obligation except where the following crite-
ria exist: 1) the client appears irrevocably committed to the
course of conduct in question; 2) reasonable securities counsel
would conclude, on the basis of existing authority, that the con-
duct cannot be supported by a nonfrivolous argument, and; 3) it
appears, on the basis of the financial data available to the public
as well as the most realistic estimate of the damages attributa-
table to the violation, that the client would not be able to satisfy all
money judgments likely to result from the violation.\textsuperscript{196} Only if
all three of the above criteria are satisfied, should the attorney
disclose the client's intentions to the SEC.

An explanation of the rationale underlying the general rule
and the exception are in order. With respect to past violations,
the only possible purpose served by a duty of disclosure is de-
terrence. The argument that the SEC's lack of resources justi-
ifies using securities lawyers to police the markets is meritless.
Once the fraud has occurred, disclosure merely prevents the

\textsuperscript{194} The rationale underlying this position is that it is simply inappropri-
ate for the attorney to take any action to assist the client in pursuing an
illegal course of conduct.

\textsuperscript{195} See \textit{MODEL CODE}, \textit{supra} note 69, at DR 2-110(B)(2) (1979).

\textsuperscript{196} In order to avoid requiring the lawyer to immerse himself in the law
of bankruptcy when applying this criterion, the criterion will be deemed
satisfied if the liability created by the judgement would make the client
insolvent.
shifting of the harm to potential purchasers of the client's securities without preventing harm to investors as a whole.\textsuperscript{197} Even assuming \textit{arguendo} that the public is relying on the lawyer to ensure his client's compliance with the law, the fact that the fraud occurred indicates that such reliance is misplaced. Moreover, there exist more effective, more appropriate modes of enforcing compliance. The deterrence rationale is thus insufficient justification for the disclosure rule. The unwillingness of regulatory authorities in other areas of the law to compel attorneys to disclose client misconduct which is not life-endangering tends to indicate that other deterrents are satisfactory.\textsuperscript{198} Furthermore, as suggested, a large proportion of securities violations ultimately surface without attorney intervention. Theoretically, this fact should, itself, be a deterrent.

Even if disclosure did have some modest deterrent effect, the negative implications of mandatory disclosure far outweigh the benefits. The adverse effects of a disclosure requirement, summarized, are: (1) that such a requirement would induce the attorney to influence the client's conduct so as to protect the attorney's interest; (2) the excessive degree of risk and difficulty entailed in the identification of reportable violations, and; (3) the possible harm to the shareholders associated with disclosure. Furthermore, since disclosure has the effect of imposing serious sanctions on the client, it is undesirable to impose such a burden on the client without the benefit of any judicial consideration prior to the imposition of the sanction.

Disclosure of future violations, admittedly, could prevent injury to third parties. Even so, the detriments associated with extending any disclosure rule at all to attorneys outweigh the benefits. All the arguments against requiring attorneys to divulge the client's past violations may be aptly used to argue against requiring attorney disclosure of future violations. In addition, the attorney faces a greater risk of liability to his client for wrongful disclosure here than he does in the case of a past violation; the client might abandon the proposed fraud and then deny that it was ever contemplated. Assuming that a judgment in favor of the victims of the violations could be satisfied, the potentially injurious effect of a disclosure rule upon the attorney, his client, and the attorney-client relationship, is of graver concern than is the comparatively nominal loss suffered by the victims of an undisclosed scheme.\textsuperscript{199} The requirement that the

\begin{itemize}
\item \textsuperscript{197} See \textit{supra} notes 189-90 and accompanying text.
\item \textsuperscript{198} See \textit{supra} pp. 420-24.
\item \textsuperscript{199} Certainly, the necessity of incurring legal fees in order to prosecute a claim under the securities laws increases the benefits to potential victims
\end{itemize}
lawyer terminate his representation of the client who will not refrain from objectionable conduct may be an effective and, in any case, more palatable deterrent. Once apprised of the possible consequences, many clients are likely to abandon their dubious plans. Threatened loss of the lawyer's assistance in drafting documents, rendering opinions, negotiating, etc., is also likely to prevent the consummation of many illegal transactions.

By contrast, if the client's conduct is unequivocally illegal, and it is clear that the client will not be able to satisfy judgments against it, the subordination of attorney-client interests to the interests of potential victims may be justified. Only rarely, however, are the circumstances so straightforward. With even less frequency do blatant violations remain undiscovered and undisclosed by someone other than the perpetrator's lawyer. The question becomes whether an attorney disclosure rule should be adopted because of the relatively few cases in which its benefits will outweigh its detriments.

Theoretically, the attorney could be required to assess the likelihood that his client's misconduct will be disclosed by someone else. If disclosure by someone else is unlikely, the attorney would be required to supply the information himself. Formulating criteria for such a judgment would, however, be impossible. In conjunction with the necessity of determining whether there is a violation, whether the violation is "clear," and whether the client is able to satisfy a judgment stemming from the violation, the burden of assessing the likelihood of detection would be overwhelming. In light of the difficulty of identifying client violations, the burden of establishing that an attorney failed to satisfy any of the obligations set out above should be on the party making such a claim against the attorney.

To summarize, this proposal addresses the interests of several parties, in the securities area, affected by the issue of a disclosure duty. The lawyer's incentive to steer the client away from any particular course of action is minimized since in virtually all cases the lawyer will be free of any obligation to disclose. Accordingly, the client receives the benefits of the wrongdoing of requiring the lawyer to disclose his client's intentions. However, this factor is not significant enough to affect the overall balance of considerations. Even assuming that the victims do find their net recovery to be somewhat less than their loss, so long as they recover the better part of their loss, the other implicated interests outweigh their interest in completely preventing any loss.

200. Although it is conceivable that an attorney could be subjected to liability for wrongful resignation since a resignation may be deemed a breach of the lawyer's fiduciary duty if it prevents the consummation of a transaction, this will not be a great problem under this formulation. The express exception to the lawyer's obligation of investigation, etc. for situations in
lawyer's objective analysis. The public interest is served by prohibiting lawyers from assisting clients' securities violations and requiring disclosure of clear violations where such disclosure is the only way of preventing irreparable harm to investors. The interest of the shareholders is recognized by prohibiting the lawyer from making public accusations of wrongdoing while requiring that the board of directors be apprised of all management securities violations. This protects existing shareholders against sudden drops in the market attributable to the lawyer's action while encouraging exposure of corrupt management. The lawyer is spared the risks imposed upon him by a general duty of disclosure.

Although this proposal does not fully accommodate all of the interests of the parties affected, it does serve to accommodate the major interests involved. It also constitutes at least a beginning of the analysis necessary to maximize the collective well-being of all securities market participants.