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# The Attorney Unshackled: SEC Rule 2(e) Violates Clients' Sixth Amendment Right To Counsel

Steven C. Krane\*

## I. Introduction

Federal regulation of the economy has been the subject of substantial debate during the past several years. This debate has apparently been resolved in favor of those who envision a strong economy as one in which the government plays a smaller role.<sup>1</sup> An important facet of fiscal recovery through conservative economics is an increase in private capital investment, much of which will occur through the medium of securities.<sup>2</sup> Thus, the securities bar will find itself increasingly active in the next several years.

It is therefore necessary for the bar to understand fully both its responsibilities to the public and its obligations to its clients. Unfortunately, the Rules of Practice of the Securities and Exchange Commission (SEC)<sup>3</sup> provide little guidance to the securities bar.

The SEC enforces federal securities law by conducting investigations which may lead to criminal prosecutions, civil injunctions or administrative proceedings to impose remedial sanctions. The SEC is at once investigator, prosecutor, adjudicator and disciplinarian. Although the SEC is primarily concerned with brokers and dealers in securities, the agency has directed more of its recent efforts toward regulating the conduct of the securities bar.

The principal tool of this regulation of attorneys has been rule 2(e) of the SEC Rules of Practice.<sup>4</sup> Rule 2(e) provides in pertinent

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1 The election of Ronald Reagan would appear to indicate that the American people favor such policies. See, e.g., Smith, *Republican Gains Victories in All Areas and Vows to Act on Economy*, N.Y. Times, Nov. 5, 1980, at A1, col. 6; Tolchin, *Republican Majority is Possible in Senate, the First in 26 Years*, N.Y. Times, Nov. 5, 1980, at A1, col. 3.

2 See *Final Report of SEC Transition Team*, reprinted in 587 SEC. REG. & L. REP. (BNA) K-1, at K-1 (1981) [hereinafter *Transition Team Report*]. See also *Muzzling the Watchdog*, THE ECONOMIST, Jan. 31, 1981, at 72.

3 17 C.F.R. §§ 201.1-28 (1981).

4 17 C.F.R. § 201.2(e) (1981). An attorney may also be subject to civil actions brought by the SEC or private parties. Although case law is relatively underdeveloped, attorneys can

part:

The Commission may deny, temporarily, or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice of and opportunity for hearing in the matter (i) not to possess the requisite qualifications to represent others, or (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws . . . , or the rules and regulations thereunder.<sup>5</sup>

The SEC has vigorously enforced this provision against attorneys and accountants, often in situations which lend little or no assistance to those attempting to identify and circumscribe that conduct which is prohibited. Rule 2(e) discourages an attorney from representing his client "zealously within the bounds of the law, which

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be held liable for violations of federal securities laws. *See* SEC v. Spectrum, Ltd., 489 F.2d 535 (2d Cir. 1973) (reversing denial of injunction against attorney for negligence in rendering opinion); SEC v. Frank, 388 F.2d 486 (2d Cir. 1968) (liability for preparation of prospectus with actual knowledge of misrepresentations); *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968) (liability for failure to reasonably investigate truth of unexpertised portions of registration statement). The most celebrated non-rule 2(e) attorney liability case is *SEC v. National Student Mktg. Corp.*, 457 F. Supp. 682 (D.D.C. 1978), where the court refused to grant an injunction against the defendant lawyers.

Despite the availability of these other sanctions, the SEC has used rule 2(e) as its primary disciplinary tool. This article will focus on this method of SEC enforcement. For other discussions of professional responsibility in the securities practice, see generally Daley & Karmel, *Attorney's Responsibilities: Adversaries at the Bar of the SEC*, 24 EMORY L.J. 747 (1975); Gruenbaum, *Corporate/Securities Lawyers: Disclosure, Responsibility, Liability to Investors*, and National Student Marketing Corp., 54 NOTRE DAME LAW. 795 (1979) [hereinafter Gruenbaum]; Hazen, *Corporate Mismanagement and the Federal Securities Act's Antifraud Provisions: A Familiar Path With Some New Detours*, 20 B.C.L. REV. 819 (1979); Johnson, *The Dynamics of Rule 2(e): A Crisis for the Bar*, 1975 UTAH L. REV. 629 [hereinafter Johnson]; Johnson, *The Expanding Responsibilities of Attorneys in Practice Before the SEC: Disciplinary Proceedings Under Rule 2(e) of the Commission's Rules of Practice*, 25 MERCER L. REV. 637 (1974); Karmel, *Attorneys' Securities Laws Liabilities*, 27 BUS. LAW. 1153 (1972); Kosek, *Professional Responsibility of Accountants and Lawyers Before the Securities and Exchange Commission*, 72 L. LIB. J. 453 (1979); Lipman, *The SEC's Reluctant Police Force: A New Role for Lawyers*, 49 N.Y.U. L. REV. 437 (1974) [hereinafter Lipman]; Lorne, *The Corporate and Securities Adviser, The Public Interest, and Professional Ethics*, 76 MICH. L. REV. 423 (1978); Lowenfels, *Expanding Public Responsibilities of Securities Lawyers: An Analysis of the New Trend in Standard of Care and Priorities of Duties*, 74 COLUM. L. REV. 412 (1974) [hereinafter Lowenfels]; Marquis, *An Appraisal of Attorneys' Responsibilities Before Administrative Agencies*, 26 CASE W. RES. L. REV. 285 (1976); Shipman, *The Need for SEC Rules to Govern the Duties and Civil Liabilities of Attorneys Under the Federal Securities Statutes*, 34 OHIO ST. L.J. 231 (1973); Sonde, *Professional Responsibility—A New Religion, or the Old Gospel?*, 24 EMORY L.J. 827 (1975) [hereinafter Sonde]; Comment, *SEC Disciplinary Rules and the Federal Securities Laws: The Regulation, Role and Responsibilities of the Attorney*, 1972 DUKE L.J. 969; Comment, *Attorney Liability Under SEC Rule 2(e): A New Standard?*, 11 TEX. TECH L. REV. 83 (1979) [hereinafter Texas Tech Comment].

5 17 C.F.R. § 201.2(e)(1) (1981).

includes . . . enforceable professional regulations.”<sup>6</sup> Because of the nebulous boundaries of the “professional regulation” enforced by the SEC, an attorney may balk at advancing controversial claims, or at using his best professional judgment and expertise for the benefit of his client.

The argument that SEC disciplinary proceedings against attorneys violate the constitutional right to counsel of those being represented before the SEC has increased in popularity.<sup>7</sup> Commentators who have addressed the issue have failed to propound concrete legal arguments to support their contentions, and instead either have assumed that the sixth amendment guarantee of counsel<sup>8</sup> applies to persons represented before the SEC<sup>9</sup> or have asserted basic policy considerations<sup>10</sup> for the extension of a constitutional right previously guaranteed only to those accused of crimes.<sup>11</sup>

This article proposes that the safeguards guaranteed criminal defendants under the sixth amendment should be extended to those persons involved in “quasi-criminal” proceedings or subject to “civil” but nevertheless punitive sanctions. An attorney representing a client in an SEC proceeding is intimidated by the mere existence of potential liability under the nebulous rule 2(e); such intimidation attenuates advocacy and thereby violates the client’s constitutional right to counsel.<sup>12</sup> Moreover, because SEC proceedings are frequently brought against attorneys who are *not* involved in SEC administrative proceedings, but who are merely involved in the

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6 ABA MODEL CODE OF PROFESSIONAL RESPONSIBILITY, EC 7-1 (1980).

7 See, e.g., *In re Keating Muething & Klekamp*, Securities Exchange Act of 1934 Release No. 15,982 (July 2, 1979) (Karmel, Comm’r, dissenting), reprinted in 17 SEC DOCKET 1149, 1162 (1979); Marsh, *Rule 2(e) Proceedings*, 35 BUS. LAW. 987, 1010-11 (1980) [hereinafter Marsh]; Freeman, *Lawyer’s Duty Should Be to Client, Not Government*, Legal Times of Wash., Aug. 25, 1980, at 11-12 [hereinafter Freeman].

8 U.S. CONST. amend. VI. The amendment states in pertinent part: “In all criminal prosecutions, the accused shall enjoy the right . . . to have the Assistance of Counsel for his defense.”

9 See *In re Keating*, Muething & Klekamp, Securities Exchange Act of 1934 Release No. 15,982 (July 2, 1979) (Karmel, Comm’r, dissenting), reprinted in 17 SEC DOCKET 1149, 1162 (1979); Marsh, *supra* note 7, at 1010-11. See generally Freedman, *A Civil Libertarian Looks at Securities Regulation*, 35 OHIO ST. L.J. 280 (1974) [hereinafter Freedman].

10 See Freeman, *supra* note 7, at 11-12.

11 See, e.g., *Argersinger v. Hamlin*, 407 U.S. 25 (1972); *McMann v. Richardson*, 397 U.S. 759 (1970); *Gideon v. Wainwright*, 372 U.S. 335 (1963); *Hannah v. Larche*, 363 U.S. 420 (1960); *In re Groban*, 352 U.S. 330 (1957). But see *Kennedy v. Mendoza-Martinez*, 372 U.S. 144 (1963), discussed at text accompanying notes 122-32 *infra*.

12 The rather limited statutory right to counsel in administrative proceedings under the Administrative Procedure Act, 5 U.S.C. § 555(b) (1976), will be discussed in a later section of the article. See text accompanying notes 89-95 *infra*.

preparation of documents or in other so-called advisory capacities, there is a substantial chilling effect on both the client's right to counsel and the attorney's right to practice his chosen profession.<sup>13</sup>

## II. The Essence of Rule 2(e)

A recent study of rule 2(e) concluded that there has been a dramatic increase in the number of rule 2(e) proceedings against attorneys over the past thirty years.<sup>14</sup> Most of these were settled "without any adjudication on the evidence of the respondent's guilt or innocence."<sup>15</sup> Thus, the escalated SEC offensive against lawyers has been mostly met with unconditional surrender. A full understanding of the way the SEC uses rule 2(e) requires an analysis of the scope of the rule and an examination of its development.

### A. *The Scope of Rule 2(e): "Practice" Defined*

The operative language of rule 2(e) states that the SEC "may deny, temporarily or permanently, the privilege of appearing or practicing before it in any way"<sup>16</sup> to those who violate any of the three enumerated standards.<sup>17</sup> By broadly defining "practicing," the SEC has brought the entire securities bar within its disciplinary purview. Rule 2(g)<sup>18</sup> states that:

[P]racticing before the Commission shall include, but shall not be limited to (1) transacting any business with the Commission; and (2) the preparation of any statement, opinion or other paper by any attorney, accountant, engineer or other expert, filed with the Commission in any registration statement, notification, application, report or other document with the consent of such attorney, accountant, engineer or other expert.<sup>19</sup>

The definition of practice has been expanded by judicial interpretation beyond representation of a client at SEC administrative hearings and the preparation of documents and reports to be filed with the SEC. Practice has been held to include the giving of any

13 See *In re Keating*, Muething & Klekamp, Securities Exchange Act of 1934 Release No. 15,982 (July 2, 1979) (Williams, Chairman, concurring), reprinted in 17 SEC DOCKET 1149, 1165 (1979); Marsh, *supra* note 7, at 1011.

14 Marsh, *supra* note 7, at 988-89. The increase "appears to be an almost geometric progression." *Id.* at 989.

15 *Id.* at 989-90.

16 17 C.F.R. § 201.2(e)(1) (1981).

17 *Id.* See text accompanying note 5 *supra*.

18 17 C.F.R. § 201.2(g) (1981).

19 *Id.*

advice regarding the securities laws.<sup>20</sup> Moreover, the SEC has used the language in rule 2(g), "but shall not be limited to,"<sup>21</sup> to encompass the preparation or dissemination of oral or written opinions, any advice to an issuer of securities, and even the provision of "consulting services to any other attorney regarding any security to be offered to the public unless such other attorney states, in writing, that he alone is responsible for the preparation of any oral or written opinions to be disseminated regarding the public offering . . . ."<sup>22</sup>

By broadly defining practice and by maintaining an air of confusion around the standards of rule 2(e), the SEC has forced securities attorneys to do little else besides practice securities law. The expertise and compulsive due diligence required by the SEC virtually ensures a high degree of specialization in the securities bar. While this may result in the administration of the federal securities laws by proficient and experienced lawyers, the SEC has also justified vigorous assertion of rule 2(e) with the argument that the rule merely deprives an attorney of a small portion of his legal practice.<sup>23</sup>

The SEC stated that "a suspension from practice before this Commission would not be as serious as a court-ordered suspension which would completely bar the attorney from engaging in any form of law practice during the period of the suspension."<sup>24</sup> The SEC thus forces attorneys to devote substantially all their energies to the securities field, and at the same time asserts that should a lawyer be deprived of his "privilege"<sup>25</sup> to practice before the SEC, he can still earn a living through the nonexistent remainder of his practice—a

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20 See SEC v. Ezrine, [1972-73 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,594 (S.D.N.Y. 1972), quoted in Daley & Karmel, *supra* note 4, at 764. For a discussion of rule 2(g) as it relates to accountants, see Downing & Miller, *The Distortion and Misuse of Rule 2(e)*, 54 NOTRE DAME LAW. 774, 775-76 (1979) [hereinafter Downing & Miller].

21 17 C.F.R. § 201.2(g) (1981).

22 *In re* Richard D. Hodgin, Securities Exchange Act of 1934 Release No. 16,225 (Sept. 27, 1979), reprinted in 18 SEC DOCKET 458, 459-60 (1979). See also Marsh, *supra* note 7, at 993-95.

23 See Gonson, Outline of the Securities and Exchange Commission's Enforcement and Disciplinary Initiatives with Respect to Attorneys, N.Y. St. Bar Ass'n Disciplinary Symposium, May 2, 1980, at 2-3 & n.2 [hereinafter Gonson].

24 *In re* Murray A. Kivitz, Securities Act Release No. 5163 (June 29, 1971), reprinted in [1970-71 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,144, at 80,479, *rev'd on other grounds*, 475 F.2d 956 (D.C. Cir. 1973). See also *In re* Emanuel Fields, Securities Act Release No. 5404 (June 18, 1973), reprinted in 2 SEC DOCKET 1, 4-5 n.20 (1973): "The disciplinary sanctions that we impose on lawyers can affect only their capacity to engage in our rather narrow type of practice."

25 17 C.F.R. § 201.2(e)(1) (1981). But see *Kivitz v. SEC*, 475 F.2d 956 (D.C. Cir. 1973): "[W]e have always viewed an attorney's license to practice as a 'right' which can not lightly or capriciously be taken from him." *Id.* at 962.

small comfort, indeed.<sup>26</sup>

### B. *The Development of Rule 2(e)*

#### 1. *Emanuel Fields* and Footnote 20

Rule 2(e) developed as a principal part of the SEC regulatory structure with *In re Emanuel Fields*.<sup>27</sup> Although this opinion is frequently cited in rule 2(e) proceedings,<sup>28</sup> the conduct of Fields was rather egregious. Fields had been the subject of four permanent injunctions restraining him from violating the registration and antifraud provisions of the federal securities laws, and was charged "with having schemed to defraud as well as with violations of the Securities Act's registration requirements."<sup>29</sup> Fields' entire defense consisted "solely of a legal attack on [the SEC's] power to discipline him or indeed to discipline any attorney who practices before" the SEC.<sup>30</sup> The SEC held that it had the power to disbar, based on several court decisions.<sup>31</sup> In a footnote<sup>32</sup> the SEC asserted that a rule 2(e) order is not as severe a sanction as total disbarment.<sup>33</sup> But footnote 20 is often cited<sup>34</sup> for its discussion of the role of an attorney in

26 An SEC Solicitor notes that "a bar to practice before the Commission can be a very substantial sanction to a specialist in securities laws." Gonson, *supra* note 23, at 2 n.2.

27 Securities Act Release No. 5404 (June 18, 1973), *reprinted in* 2 SEC DOCKET 1 (1973).

28 2 SEC Docket, at 2.

29 *Id.*

30 *Id.*; see *Goldsmith v. Board of Tax Appeals*, 270 U.S. 117, 122 (1926); *Herman v. Dulles*, 205 F.2d 715, 716 (D.C. Cir. 1953); *Schwebel v. Orrick*, 153 F. Supp. 701, 704 (D.D.C. 1957), *aff'd on other grounds*, 252 F.2d 919 (D.C. Cir.), *cert. denied*, 356 U.S. 927 (1958).

31 Securities Act Release No. 5404 (June 18, 1973), *reprinted in* 2 SEC DOCKET, at 4-5 n.20 (1973).

32 See text accompanying notes 23-26 *supra*. Footnote 20 of the *Fields* decision states in part:

An order of this Commission that suspends or terminates an attorney's ability to practice is a serious—a very serious—matter for us and for him. Nothing that we say here should be construed as minimizing the gravity of such a step. Yet we think it well to note that the impact of an order by us under our Rule 2(e) is not nearly so devastating as is that of the order of a court barring a man from practicing law at all. The disciplinary sanctions that we impose on lawyers can affect only their capacity to engage in our rather narrow type of practice. A lawyer barred from appearing before us is still free to hold himself out to the world as a lawyer, to practice before all tribunals save this one, and to counsel clients with respect to the infinite variety of legal problems that do not impinge on the area affected by the federal securities statutes.

2 SEC DOCKET, at 4 n.20.

33 See, e.g., *Touche Ross & Co. v. SEC*, 609 F.2d 570, 579 (2d Cir. 1979); *In re Carter & Johnson*, Securities Exchange Act of 1934 Release No. 17,597 (Feb. 28, 1981), *reprinted in* 593 SEC. REG. & L. REP. (BNA) N-1, at N-3 n.21 (1981); *In re Carter & Johnson*, Initial Decision (Mar. 7, 1979), *reprinted in* 494 SEC. REG. & L. REP. (BNA) F-1, at F-15 (1979); *In re Keating, Muething & Klekamp*, Securities Exchange Act of 1934 Release No. 15,982 (July 2, 1979),

the securities practice:

[One must not overlook] the peculiarly strategic and especially central place of the private practicing lawyer in the investment process and in the enforcement of the body of federal law aimed at keeping that process fair. Members of this Commission have pointed out time and time again that the task of enforcing the securities laws rests in overwhelming measure on the bar's shoulders. These were statements of what all who are versed in the practicabilities of securities law know to be a truism, i.e., that this Commission with its small staff, limited resources, and onerous tasks is peculiarly dependent on the probity and the diligence of the professionals who practice before it.<sup>34</sup>

Despite the uncertain legitimacy of this claim,<sup>35</sup> the SEC proceeded in footnote 20 to elaborate upon the nature of the work of a securities attorney and the duty he owes to the investing public:

Very little of a securities lawyer's work is adversary in character. He doesn't work in courtrooms where the pressure of vigilant adversaries and alert judges checks him. He works in his office where he prepares prospectuses, proxy statements, opinions of counsel, and other documents that we, our staff, the financial community, and the investing public must take on faith. This is a field where unscrupulous lawyers can inflict irreparable harm on those who rely on the disclosure documents that they produce. Hence we are under a duty to hold our bar to appropriate rigorous standards of professional honor.<sup>36</sup>

The SEC, however, does not take the documents "on faith." The extensive review of disclosure documents by the SEC staff provides a strong element of adversarial pressure upon the securities lawyer, as does the threat of disciplinary sanctions imposed by bar associations and judicial committees.<sup>37</sup>

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reprinted in 17 SEC DOCKET 1149, 1165 (1979) (Williams, Chairman, concurring); Gruenbaum, *supra* note 4, at 802 n.33; Kosek, *Professional Responsibility of Accountants and Lawyers Before the Securities and Exchange Commission*, 72 L. LIB. J. 453, 463 (1979); Johnson, *supra* note 4, at 640; Lipman, *supra* note 4, at 450 n.70; Lowenfels, *supra* note 4, at 424; Shipman, *The Need for SEC Rules to Govern the Duties and Civil Liabilities of Attorneys Under the Federal Securities Statutes*, 34 OHIO ST. L.J. 231, 296 (1973); Sonde, *supra* note 4, at 861-62. Many of these authorities neglect to mention in citing the *Fields* language that it is derived from a footnote.

34 2 SEC DOCKET, at 4-5 n.20. *But see* Lipman, *supra* note 4, at 475: "[T]he superior financial resources of the SEC, and, in some cases, the superior abilities of its lawyers, often result in an unequal presentation of the merits of each side of an issue." (footnotes omitted).

35 *See* text accompanying notes 230-32 *infra*.

36 2 SEC DOCKET, at 5 n.20.

37 *See* Lipman, *supra* note 4, at 450 n.70. *But see* Lowenfels, *supra* note 4, at 423-24.



2. Rule 2(e) Matures: *Touche Ross and Keating, Muething & Klekamp*

In 1979, three opinions were rendered, at different levels of the SEC disciplinary process, which caused increased concern on the part of all professionals. In March, an administrative law judge issued the initial decision *In re Carter & Johnson*.<sup>38</sup> In June, the Second Circuit decided *Touche Ross & Co. v. SEC*.<sup>39</sup> Finally, in July, the SEC issued its opinion in *In re Keating, Muething & Klekamp*.<sup>40</sup>

In *Touche Ross*, the United States Court of Appeals for the Second Circuit affirmed the power of the SEC to discipline accountants under rule 2(e)<sup>41</sup> despite the lack of express congressional authorization for such action.<sup>42</sup> The court based its decision upon its perception of the legitimacy of the SEC's power to "protect the integrity of its own processes."<sup>43</sup> The court also noted the "mere fact" that the rule is of long standing and that "no court has ever held that the rule is invalid."<sup>44</sup> In dicta, the court drew upon the *Emanuel Fields* opinion, paraphrasing yet qualifying the noted footnote 20:

The role of the accounting and legal professions in implementing the objectives of the disclosure policy has increased in importance as the number and complexity of securities transactions has increased. By the very nature of its operations, the Commission, with its small staff and limited resources, cannot possibly examine, with the degree of close scrutiny required for full disclosure, each of the many financial statements which are filed. Recognizing this, the Commission necessarily must rely heavily on both the accounting and legal professions to perform their tasks diligently and responsibly. Breaches of professional responsibility jeopardize the achievement of the objectives of the securities laws and can inflict great damage on public investors.<sup>45</sup>

38 Initial Decision (Mar. 7, 1979), reprinted in 494 SEC. REG. & L. REP. (BNA) F-1 (1979). See text accompanying notes 60-68 *infra*.

39 609 F.2d 570 (2d Cir. 1979).

40 Securities Exchange Act of 1934 Release No. 15,982 (July 2, 1979), reprinted in 17 SEC DOCKET 1149 (1979).

41 609 F.2d at 582. In fact, that was the only issue before the court, because the appeal arose from Touche Ross' action for declaratory and injunctive relief against the SEC to enjoin the rule 2(e) proceeding that had been commenced against it. *Id.* at 572-74.

42 *Id.* at 577-78. See generally Comment, *Regulation of the Accounting Profession Through Rule 2(e) of the SEC's Rules of Practice: Valid or Invalid Exercise of Power?*, 46 BROOKLYN L. REV. 1159 (1980).

43 609 F.2d at 581. The court also noted that there was no express statutory prohibition against such power. *Id.*

44 *Id.* at 578. The court recognized, however, that a rule is not valid merely because it is "long standing." *Id.*

45 *Id.* at 580-81.

Thus, while the court accepted the SEC's complaint of "small staff and limited resources," it rejected the assertion that the SEC must take documents for filing "on faith." The argument of the court is persuasive—the SEC cannot thoroughly inspect every document and must rely to a great extent on the integrity of the bar. But that reliance does not counterbalance the deprivation of the regulated client's constitutional right to counsel. Despite its arguable infirmities, the *Touche Ross* case is "the only declarative statement of SEC authority to promulgate rule 2(e), and according to the court, rule 2(e) is a valid exercise of the SEC's authority."<sup>46</sup>

Shortly after *Touche Ross*, the SEC issued *In re Keating, Muething & Klekamp (KMK)*.<sup>47</sup> KMK consented to an order imposing remedial sanctions pursuant to rule 2(e) for having failed to include certain material information in documents filed with the SEC.<sup>48</sup> Moreover, the SEC held an entire law firm accountable for the actions of only a few partners, because the firm did not have adequate internal procedures to ensure "that disclosure documents filed with the Commission include all material facts about a client of which it has knowledge as a result of its legal representation of the client."<sup>49</sup> The KMK firm, however, was unusual in that the majority of its work was done for one particular corporate client,<sup>50</sup> and several of the KMK partners were interested parties and directors of this client.<sup>51</sup> While a court might take notice of the peculiar facts of *KMK* in applying the ruling to future rule 2(e) proceedings, the SEC is not likely to do so.<sup>52</sup>

Commissioner Karmel's dissent in *KMK* is the best exposition of the opposition to rule 2(e). Commissioner Karmel had mounted similar attacks against other SEC enforcement sanctions prior to *KMK*.<sup>53</sup> A good summary of the argument was made by the Com-

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46 Texas Tech Comment, *supra* note 4, at 104.

47 Securities Exchange Act of 1934 Release No. 15,982 (July 2, 1979), *reprinted in* 17 SEC DOCKET 1147 (1979).

48 *Id.* at 1155-56.

49 *Id.* at 1156 (footnote omitted).

50 *See id.* "[A]lmost every member of KMK was involved in some aspect of [the client's] representation. Indeed, KMK derived a large part of its fees, at times ranging from 50 to 80 percent of its billings, from representation of [the client] and its subsidiaries." *Id.*

51 *See id.* at 1150.

52 *But see id.* at 1166 (Williams, Chairman, concurring): "Given all the relevant facts and circumstances of this case, where virtually the entire firm was acting in a capacity more akin to house counsel, than outside counsel, the firm is properly the subject of this proceeding."

53 *See, e.g., In re Spartek Inc.*, Securities Exchange Act of 1934 Release No. 15,567 (Feb. 14, 1979) (Karmel, Comm'r, dissenting), *reprinted in* 16 SEC DOCKET 1094, 1101 (1979); Securities Exchange Act of 1934 Release No. 15,664 (Mar. 21, 1979) (Karmel, Comm'r, dissent-

missioner herself:

As a general policy matter, I believe that it is repugnant to our adversary system of legal representation to permit a prosecutorial agency to discipline attorneys who act as counsel to regulated persons. The frequently made distinction between the lawyer as an adversary and the lawyer as an advisor cannot and should not be made by an agency with significant prosecutorial responsibilities.<sup>54</sup>

Commissioner Karmel continued to propound this viewpoint until her resignation from the SEC in 1980.<sup>55</sup>

Chairman Williams concurred specifically to refute the allegations in Commissioner Karmel's dissent.<sup>56</sup> Chairman Williams' view is that despite the "potential for misuse or abuse inherent in an agency which has been given both enforcement and regulatory powers," the SEC should not "ignore or refuse to exercise an effective disciplinary tool under the appropriate circumstances."<sup>57</sup>

With *KMK*, rule 2(e) and the surrounding controversy had become the *cause celebre* of the securities field.<sup>58</sup> But at the same time a case, which might have clarified many of the cloudy issues regarding rule 2(e), was pending before the SEC. This case was *In re Carter & Johnson*.<sup>59</sup>

### 3. *Carter & Johnson*: All in All, Not Worth the Wait

Perhaps William R. Carter (Carter) and Charles J. Johnson, Jr. (Johnson) were the only two people for whom the decision in *In re Carter & Johnson* was worth the nearly two year wait from the date of the Initial Decision of the Administrative Law Judge (ALJ).<sup>60</sup> The ALJ found that Carter and Johnson had engaged in "unethical" and

ing), *reprinted in* [1978-79 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,014, at 81,558. *See also* Kripke, *The SEC, Corporate Governance, and the Real Issues*, 36 BUS. LAW. 173, 196-98 (1981).

54 17 SEC DOCKET, at 1157.

55 *See, e.g., In re Plotkin, Yolles, Siegel & Turner*, Securities Act Release No. 6105 (Aug. 15, 1979) (Karmel, Comm'r, dissenting), *reprinted in* 18 SEC DOCKET 64, 65 (1979); *In re Richard D. Hodgins*, Securities Exchange Act of 1934 Release No. 16,225 (Sept. 27, 1979) (Karmel, Comm'r, dissenting), *reprinted in* 18 SEC DOCKET 458, 460 (1979); *In re Bernard J. Coven*, Securities Exchange Act of 1934 Release No. 16,448 (Dec. 21, 1979) (Karmel, Comm'r, dissenting), *reprinted in* 19 SEC DOCKET 12, 13 (1979); *In re Darrell L. Nielson*, Securities Exchange Act of 1934 Release No. 16,479 (Jan. 10, 1980) (Karmel, Comm'r, dissenting), *reprinted in* [1979-80] FED. SEC. L. REP. (CCH) ¶ 82,446.

56 17 SEC DOCKET, at 1163.

57 *Id.* at 1165.

58 *See* Marsh, *supra* note 7, at 987.

59 Securities Exchange Act of 1934 Release No. 17,597 (Feb. 28, 1981), *reprinted in* 593 SEC. REG. & L. REP. (BNA) N-1 (1981).

60 *See* note 40 *supra*; *In re Carter & Johnson*, Initial Decision (Mar. 7, 1979), *reprinted in* 494 SEC. REG. & L. REP. (BNA) F-1 (1979).

"improper" professional conduct<sup>61</sup> despite their allegation that the terms are unconstitutionally vague.<sup>62</sup> In its decision, the SEC recognized that:

[t]he ethical and professional responsibilities of lawyers who become aware that their client is engaging in violations of the securities laws have not been so firmly and unambiguously established that we believe all practicing lawyers can be held to an awareness of generally recognized norms.<sup>63</sup>

Without stating that the conduct of Carter and Johnson was in fact professional and ethical,<sup>64</sup> the SEC proceeded to "hereby giv[e] notice of its interpretation of 'unethical or improper professional conduct' as that term is used in rule 2(e)(1)(ii)."<sup>65</sup>

The case involved the collapse of the National Telephone Company (National), which leased telephone equipment systems to commercial customers under long-term leases. National required a substantial initial cash outlay to finance the equipment and its marketing and installation before lease payments began. Accordingly, National was forced to seek outside financing to provide working capital until lease payments began. National obtained financing with conditions designed to prevent overexpansion of operations. These funds were insufficient, and National filed for bankruptcy in 1975.<sup>66</sup>

During this period, National was represented by Carter and Johnson. National issued a misleading press release that concealed its precarious cash position, and filed overstated earnings and revenue figures with the SEC. Despite Carter and Johnson's repeated warnings that the company was violating the securities laws, National's chairman issued the questionable information.<sup>67</sup> The case against Carter and Johnson centered around their obligation to go beyond attempted persuasion of a corporate officer when that officer refused to heed advice of counsel.

The ALJ found that Carter and Johnson's failure to go to the

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61 17 C.F.R. § 201.2(e)(1)(ii) (1981).

62 494 SEC. REG. & L. REP. at F-11. The SEC is currently seeking comments on its definition of "unethical or improper professional conduct," *see* text accompanying note 70 *infra*. *See* Ranii, *ABA Opposes Securities Lawyers' Code*, Nat'l L.J., Dec. 7, 1981, at 5.

63 593 SEC. REG. & L. REP. at N-17.

64 The new standards set forth by the SEC were not valid retroactively; Carter and Johnson were held not to have violated the standards merely because the standards did not exist at the time of their conduct. *Id.* at N-19.

65 *Id.* at N-17.

66 *See id.* at N-4 to -5.

67 *See id.* at N-6 to -13.

National board of directors was in itself a breach of professional responsibility.<sup>68</sup> The ALJ stated:

The matter of counsel responsibility when confronted with irregular or illegal client activity involves a delicate balance between judgment and courage. Counsel needs to guard against falling prey to blandishments of client [*sic*] by accepting repeated evasion and rationalization, or worse, to allow himself to be drawn into or become a party to the illegal activity. Decision concerning the point at which further persuasion in the face of client defiance becomes futile cannot be postponed indefinitely. To drift may be as culpable as to connive. At some point it becomes necessary to take a stand.<sup>69</sup>

Unfortunately, the ALJ did not define either the "some point" or what "stand" was required to be taken. That, in essence, was the purpose of the *Carter & Johnson* decision, and the SEC did indeed attempt to clarify the nebulous rule 2(e) standard.

Even in the narrow *Carter & Johnson* context, the SEC's delineation of professional responsibility deserves particular attention. The SEC stated:

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.<sup>70</sup>

There are three steps to the SEC's analysis of noncompliance problems, and each is subject to variable interpretations. First, which attorneys have "significant responsibilities" in a client's compliance program? Presumably, the senior partner in charge of the client's affairs would fall within this definition. Perhaps a junior partner or senior associate to whom was delegated responsibility for "effectuation of a company's compliance with the disclosure requirements of the federal securities laws" would also fall within the rubric of "significant responsibilities." But what of the junior associate who is given responsibility for the preparation of the more mechanical and repetitive documents to be filed with the SEC? How significant must the responsibilities be before an attorney will be subject to liability for failure to take "prompt steps" to remedy the situation?

The SEC has given significantly more guidance in defining the

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68 494 SEC. REG. & L. REP. at F-3.

69 *Id.* at F-15.

70 593 SEC. REG. & L. REP. at N-19 (emphasis added).

other two variables in the *Carter & Johnson* test. A "substantial and continuing failure" to satisfy disclosure requirements is not "isolated disclosure action or inaction" on the part of the client.<sup>71</sup> However, "there may be isolated disclosure failures that are *so serious* that their correction becomes a matter of primary professional concern."<sup>72</sup> Although the SEC has merely substituted one variable, "so serious," for another, "substantial and continuing," attorneys can at least be sure that they must take "prompt steps" after more than one occurrence of inaccurate disclosure. Nevertheless, the SEC has left itself room for imaginative applications of rule 2(e).

The critical question of the *Carter & Johnson* test is what constitutes the taking of "prompt steps" to end a client's noncompliance. The SEC states that while "counselling accurate disclosure" may be sufficient for awhile, "there comes a point at which a reasonable lawyer must conclude that his advice is not being followed, or even sought in good faith, and that his client is involved in a continuing course of violating the securities laws."<sup>73</sup> At that point, the SEC requires that an attorney "take further, more affirmative steps" to clear himself of an inference of cooption into the client's scheme. What steps will satisfy this obligation is not clear, although the SEC suggests that an attorney might resign, but not prematurely,<sup>74</sup> or that he might approach the board of directors or other management personnel to enlist their aid.<sup>75</sup> These are merely suggested courses of action for an attorney; the ultimate standard is barely more lucid than was "unethical or improper professional conduct."

What is required, in short, is *some prompt action*, [though not necessarily successful] 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 . . . . So long as a lawyer is acting in *good faith* and exerting *reasonable efforts* to prevent violations of the law by his client, his professional obligations have been met.<sup>76</sup>

The "conclusion" referred to in the opinion, which will decide

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71 *Id.*

72 *Id.*

73 *Id.*

74 *Id.* Indeed, premature resignation would help neither the enforcement of the securities laws nor the attorney's practice.

75 *Id.*

76 *Id.* (emphasis added) (footnote omitted). The substance of the omitted footnote is included in brackets within the text of the quotation.

whether an attorney is suspended or disbarred, will of course be made by the SEC.

In sum, an attorney after *Carter & Johnson* knows that if his client commits more than one, or perhaps only one, act of inaccurate disclosure, the attorney must do "something." Whether that something is sufficient to exonerate the attorney will be determined in proceedings under rule 2(e). Attorneys are still unable to determine whether their conduct will subject them to suspension or disbarment. And when a severe sanction with nebulous standards is placed in the hands of an agency with investigative, prosecutorial and adjudicatory powers, the client's right to be represented in the regulatory process by unintimidated counsel is violated.

### III. Applicability of the Sixth Amendment to Practice Before the SEC

It is the intention of this article to present the legal community with a constitutional argument against rule 2(e). This article will show that due to the quasi-criminal or punitive nature of the SEC's regulatory structure, clients being represented before the SEC are entitled to the effective assistance of counsel. Rule 2(e) eviscerates that right by its intimidation of counsel and its chilling effect<sup>77</sup> on the entire attorney-client relationship.

#### A. *Right to Counsel in an Administrative Context: Present Status of the Law*

The sixth amendment guarantees all criminal defendants the right to the assistance of counsel on their behalf.<sup>78</sup> Mere representation, however, has been held not to satisfy this constitutional guarantee; the defendant also has a right to effective counsel.<sup>79</sup> Before this

77 The phrase "chilling effect" is used in this article to draw an analogy to the cases which invalidate overbroad restrictions on constitutional freedoms. The concept has traditionally been confined, however, to first amendment rights. See *Law Students Civil Rights Research Council, Inc. v. Wadmond*, 401 U.S. 154, 159 (1971); *accord*, *Arnett v. Kennedy*, 416 U.S. 134 (1974); *Broadrick v. Oklahoma*, 413 U.S. 601 (1973); *Gooding v. Wilson*, 405 U.S. 518 (1972); *Baird v. State Bar of Ariz.*, 401 U.S. 1 (1971); *In re Stolar*, 401 U.S. 23 (1971); *United States v. Raines*, 362 U.S. 17 (1960); *Hatch v. Reardon*, 204 U.S. 152 (1907). See also *SEC v. Wall Street Transcript Corp.*, 422 F.2d 1371 (2d Cir. 1970); *Marketlines, Inc. v. SEC*, 384 F.2d 264 (2d Cir. 1967).

78 U.S. CONST. amend. VI. See note 8 *supra*. This right obligates the state to provide counsel to indigent criminal defendants. *Gideon v. Wainwright*, 372 U.S. 335, 342-45 (1963).

79 See *McMann v. Richardson*, 397 U.S. 759 (1970). The Court stated that "if the right to counsel guaranteed by the Constitution is to serve its purpose, defendants cannot be left to the mercies of incompetent counsel, and . . . judges should strive to maintain proper stan-

right to counsel was articulated, the Supreme Court, in *Hannah v. Larche*,<sup>80</sup> had ruled that there is no due process guarantee in the context of hearings before the Civil Rights Commission, a purely nonadjudicatory body.<sup>81</sup> The Court noted that "the Commission does not and cannot take any affirmative action which will affect an individual's legal rights. The only purpose of its existence is to find facts which may subsequently be used as the basis for legislative or executive action."<sup>82</sup> In contrast, the Court also stated that "when governmental agencies adjudicate or make binding determinations which directly affect the legal rights of individuals, it is imperative that those agencies use the procedures which have traditionally been associated with the judicial process."<sup>83</sup>

The *Hannah* decision held that due process safeguards are neither necessary nor appropriate in proceedings before a nonadjudicatory body. Subsequent decisions, however, have established a bifurcated test for the application of constitutional rights before administrative agencies. When an agency acts to "adjudicate or make binding determinations which directly affect the legal rights of individuals," due process safeguards apply. When the agency acts in a nonadjudicatory manner, the constitutional rights are inapplicable.<sup>84</sup> What this dichotomy fails to perceive is that the *Hannah* Court looked to the nature of the agency proceeding to determine whether constitutional protections applied.<sup>85</sup>

The majority opinion in *Hannah* prompted an impassioned dis-

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dards of performance by attorneys who are representing defendants in criminal cases in their courts." *Id.* at 771.

80 363 U.S. 420 (1960). See *Anonymous Nos. 6 & 7 v. Baker*, 360 U.S. 287, 291-92 (1959); *In re Groban*, 352 U.S. 330, 332-33 (1957).

81 363 U.S. at 441. The case involved the rules of procedure in fact-finding hearings before the Commission on Civil Rights. The rules gave neither a right to receive notice of specific charges, nor a right to confront and cross-examine witnesses. *Id.* at 442-45.

82 *Id.* at 441.

83 *Id.* at 442. See *Butz v. Economou*, 438 U.S. 478 (1978), in which the Court stated: "We think that adjudication within a federal administrative agency shares enough of the characteristics of the judicial process that those who participate in such adjudication should also be immune from suits for damages." *Id.* at 512-13. Moreover, the Court found "that the role of the modern federal hearing examiner or administrative law judge . . . is 'functionally comparable' to that of a judge." *Id.* at 513.

84 See *FCC v. Schreiber*, 329 F.2d 517 (9th Cir. 1964), *modified on other grounds*, 381 U.S. 279 (1965). See also *SEC v. Csapo*, 533 F.2d 7 (D.C. Cir. 1976); *Great Lakes Screw Corp. v. NLRB*, 409 F.2d 375 (7th Cir. 1969); *SEC v. Higashi*, 359 F.2d 550 (9th Cir. 1966).

85 The *Hannah* Court specifically distinguished the SEC from the Civil Rights Commission because the SEC was an adjudicatory body which could use information from investigations in administrative and injunctive proceedings. 363 U.S. at 461-63.



sent by Justice Douglas.<sup>86</sup> Justice Douglas viewed administrative proceedings as threats to the judicial process:

Farming out pieces of trials to investigative agencies is fragmentizing the kind of trial the Constitution authorizes. It prejudices the ultimate trial itself, and puts in the hands of officials the awesome power which the Framers entrusted only to judges, grand jurors and petit jurors drawn from the community where the accused lives. It leads to government by inquisition.<sup>87</sup>

Indeed, the modern concept of a "quasi-judicial agency proceeding" arose out of the *Hannah* opinion.<sup>88</sup> But the right to counsel in such proceedings was subsequently limited to the statutory right granted under section 6 of the Administrative Procedures Act (APA).<sup>89</sup>

Under the APA, "a person compelled to appear before an agency or representative thereof is entitled to be accompanied, represented, and advised by counsel or, if permitted by the agency, by other qualified representative."<sup>90</sup> Courts have held that because administrative orders are "not criminal judgments," persons appearing before administrative agencies are not entitled to appointed counsel and, accordingly, the government is not obligated to provide such counsel.<sup>91</sup> Most courts, however, acknowledge the affected person's right to employ counsel if he so chooses.<sup>92</sup> The APA right to counsel

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<sup>86</sup> *Id.* at 493 (Douglas, J., dissenting). Justice Douglas's opinion was joined by Justice Black. *Id.*

<sup>87</sup> *Id.* at 508 (Douglas, J., dissenting).

<sup>88</sup> Although the "quasi-judicial" concept may be traced back to *Morgan v. United States*, 304 U.S. 1 (1938), it was not used extensively until the post-*Hannah* era. In *Morgan*, the Court stated:

The vast expansion of this field of administrative regulation in response to the pressure of social needs is made possible under our system by adherence to the basic principles that the legislature shall appropriately determine the standards of administrative action and that in administrative proceedings of a quasi-judicial character the liberty and property of the citizen shall be protected by the rudimentary requirements of fair play.

*Id.* at 14-15. See also *Goldsmith v. Board of Tax Appeals*, 270 U.S. 117 (1926), in which the Court held that because of "the quasi-judicial nature of its duties," *id.* at 121, the Board could discipline attorneys and other professionals practicing before it. It is difficult to understand how an agency may be quasi-judicial for purposes of disciplining attorneys and not quasi-judicial for purposes of administrative proceedings.

<sup>89</sup> Administrative Procedures Act, 5 U.S.C. § 555 (1976). See *FCC v. Schreiber*, 329 F.2d 517, 525-26 (9th Cir. 1964), modified on other grounds, 381 U.S. 279 (1965).

<sup>90</sup> 5 U.S.C. § 555(b) (1976). See *Daley & Karmel*, *supra* note 4, at 796-804.

<sup>91</sup> See *Boruski v. SEC*, 340 F.2d 991, 992 (2d Cir.), cert. denied, 381 U.S. 943 (1965); accord, *Feeney v. SEC*, 564 F.2d 260, 262 (8th Cir. 1977), cert. denied, 435 U.S. 969 (1978); *Nees v. SEC*, 414 F.2d 211, 221 (9th Cir. 1969); *United States v. Bloom*, 450 F. Supp. 323, 338 (E.D. Pa. 1978); *Grover v. United States*, 200 Ct. Cl. 337, 347 (1973).

<sup>92</sup> See, e.g., *Nees v. SEC*, 414 F.2d 211, 221 (9th Cir. 1969); *Great Lakes Screw Corp. v.*

cannot be limited in the absence of a formally adopted regulation.<sup>93</sup> Courts are reluctant to allow an agency's regulations to override the statutory right to counsel, especially if the rule "bears directly and prejudicially upon the interests of the person himself."<sup>94</sup> An agency, however, is not "obligated to assure . . . 'reasonabl[y] competent and effective representation' within the meaning of criminal cases . . . ."<sup>95</sup>

Neither the APA right to counsel nor the application of constitutional due process safeguards to administrative proceedings is adequate to support a challenge to the constitutionality of rule 2(e).<sup>96</sup> The present right to counsel merely allows a person to select his own attorney in an adjudicative administrative proceeding. It can be argued, however, that the sixth amendment right to counsel applies to all administrative proceedings and regulatory matters, indeed, to a securities practice as broad as that delineated in rule 2(g).<sup>97</sup> The next section of this article will discuss theories under which such an argument can be made.

## B. *Extending the Scope of Constitutional Safeguards Beyond Criminal Prosecutions: A Merger of Two Theories*

### 1. Quasi-Criminal Proceedings

The concept of the quasi-criminal proceeding was derived from *Boyd v. United States*.<sup>98</sup> *Boyd* involved an attempted subpoena of business records for use in a forfeiture proceeding. The Court stated that forfeiture proceedings, "though they may be civil in form, are in their nature criminal," that is "of [a] quasi-criminal nature."<sup>99</sup> The Court held that the fourth and fifth amendment guarantees were applicable to such proceedings, reasoning that the search and seizure of books to bring about a forfeiture was essentially the same as forcing a

NLRB, 409 F.2d 375, 380-81 (7th Cir. 1969); *Grover v. United States*, 200 Ct. Cl. 337, 347 (1973).

93 See *Backer v. Commissioner*, 275 F.2d 141, 143-44 (5th Cir. 1960).

94 *SEC v. Higashi*, 359 F.2d 550, 553 (9th Cir. 1966). See also *SEC v. Csapo*, 533 F.2d 7, 11 (D.C. Cir. 1976); *Great Lakes Screw Corp. v. NLRB*, 409 F.2d 375, 380-81 (7th Cir. 1969).

95 *Sartain v. SEC*, 601 F.2d 1366, 1375 (9th Cir. 1979) (citing *Cooper v. Fitzharris*, 586 F.2d 1325 (9th Cir. 1978) (en banc), cert. denied, 440 U.S. 974 (1979)).

96 See generally Comment, *The Applicability of the Sixth or Seventh Amendment Right to a Jury Trial in OSHA Penalty Proceedings*, 45 U. CIN. L. REV. 108 (1976); Note, *O.S.H.A.'s Civil Penalties—Should They Be Afforded Sixth Amendment Protection?*, 28 BAYLOR L. REV. 722 (1976).

97 17 C.F.R. § 201.2(g) (1981). See text accompanying notes 16-26 *supra*.

98 116 U.S. 616 (1886).

99 *Id.* at 633-34.

person to testify against himself at a trial.<sup>100</sup>

The quasi-criminal concept was reaffirmed in *One 1958 Plymouth Sedan v. Pennsylvania*.<sup>101</sup> The case involved the improper search and seizure of an automobile and its contents, bootlegged liquor. Writing for the Court, Justice Goldberg reiterated the *Boyd* dictum,<sup>102</sup> and continued:

It would be anomalous indeed, under these circumstances, to hold that in the criminal proceeding the illegally seized evidence is excludable, while in the forfeiture proceeding, requiring the determination that the criminal law has been violated, the same evidence would be admissible. That the forfeiture is clearly a penalty for the criminal offense and can result in even greater punishment than the criminal prosecution has in fact been recognized by the Pennsylvania courts.<sup>103</sup>

A number of lower court opinions utilized the quasi-criminal concept in fourth amendment challenges to governmental searches and seizures.<sup>104</sup> The Supreme Court, however, subsequently restricted the scope of the fourth amendment exclusionary rule. In *United States v. Calandra*,<sup>105</sup> the Court held that "standing to invoke the exclusionary rule has been confined to situations where the gov-

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100 *Id.* at 630. The Court thus extended the fourth and fifth amendment zone of privacy. *Id.* at 630. This zone of privacy concept was recently limited by the Supreme Court. See *Andresen v. Maryland*, 427 U.S. 463 (1976); *Fisher v. United States*, 425 U.S. 391 (1976). See generally Note, *The Life and Times of Boyd v. United States (1886-1976)*, 76 MICH. L. REV. 184 (1977).

It can be persuasively argued that the holding of *Boyd* reduces the "quasi-criminal" language to mere dictum. See Clark, *Civil and Criminal Penalties and Forfeitures: A Framework for Constitutional Analysis*, 60 MINN. L. REV. 379, 414-20 (1976) [hereinafter Clark]. Thus, the quasi-criminal doctrine is actually dictum transformed by subsequent misinterpretation.

101 380 U.S. 693 (1965).

102 "[A] forfeiture proceeding is quasi-criminal in character. Its object, like a criminal proceeding, is to penalize for the commission of an offense against the law." *Id.* at 700.

103 *Id.* at 701.

104 See *Pizzarello v. United States*, 408 F.2d 579 (2d Cir.), cert. denied, 396 U.S. 986 (1969) (holding invalid a tax assessment based on illegally seized evidence); *Knoll Assoc. v. FTC*, 397 F.2d 530 (7th Cir. 1968) (fourth amendment applicable in FTC proceeding). See also *Olmstead v. United States*, 277 U.S. 438 (1928); *Iowa v. Union Asphalt & Roadoils, Inc.*, 281 F. Supp. 391, 407-08 (S.D. Iowa 1968); *In re Terkeltoub*, 256 F. Supp. 683, 685-86 (S.D.N.Y. 1966); *Lassoff v. Gray*, 207 F. Supp. 843, 846-49 (W.D. Ky. 1962). In *Olmstead*, Justice Brandeis stated:

In a government of laws, existence of the government will be imperilled if it fails to observe the law scrupulously. Our Government is the potent, the omnipresent teacher. For good or for ill, it teaches the whole people by its example. Crime is contagious. If the Government becomes a lawbreaker, it breeds contempt for law; it invites every man to become a law unto himself; it invites anarchy.

277 U.S. at 485 (dissenting opinion).

105 414 U.S. 338 (1974).

ernment seeks to *incriminate* the victim of an unlawful search.”<sup>106</sup> The Court in *United States v. Janis*<sup>107</sup> stated that “in the complex and turbulent history of the exclusionary rule, the Court has never applied it to exclude evidence from a civil proceeding, federal or state.”<sup>108</sup> The decision did not rest upon the civil nature of the proceeding, however, but upon the “intrasovereign” nature of the constitutional violation. The deterrent purpose of the rule would not be furthered by suppressing evidence illegally seized by a “sovereign” different from the one seeking to use it.<sup>109</sup>

Although the *Janis* Court did not rely on the civil nature of the proceeding, some lower courts have interpreted the decision to mean that the exclusionary rule is applicable only in criminal prosecutions.<sup>110</sup> Other courts have simply retreated to applying the quasi-criminal doctrine only in forfeiture cases.<sup>111</sup> The few cases which have addressed the propriety of using the quasi-criminal doctrine in administrative proceedings have ruled against its application.<sup>112</sup>

Although it may not have much vitality, a mutated form of the quasi-criminal doctrine may be of assistance to the argument proposed by this article. A trend has developed among courts and scholars to look not to the proceeding involved but to the nature of the law sought to be applied for a determination of quasi-criminal status.<sup>113</sup> Most notably, the Supreme Court in *United States v. Ward*<sup>114</sup> held that the imposition of a penalty under the Federal Water Pollution Control Act was not a quasi-criminal proceeding because of the

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106 *Id.* at 348 (emphasis added) (citations omitted).

107 428 U.S. 433 (1976).

108 *Id.* at 447.

109 *Id.* at 456 & n.32. Evidence illegally seized by a state criminal law enforcement agent was sought to be excluded from use in a federal tax evasion action.

110 Compare *Smyth v. Lubbers*, 398 F. Supp. 777, 794-95 (W.D. Mich. 1975) (pre-*Janis* decision in which a college disciplinary proceeding was held quasi-criminal; marijuana illegally seized from a student dormitory room was excluded from the proceeding) with *Morale v. Grigel*, 422 F. Supp. 988, 1000-01 (D.N.H. 1976) (post-*Janis* decision in which college disciplinary proceeding was held not to be a criminal prosecution; marijuana illegally seized from student dormitory room was not excluded from the proceeding). But see *Savina Home Indus. v. Secretary of Labor*, 594 F.2d 1358, 1362 & n.5 (10th Cir. 1979).

111 See *United States v. Pappas*, 613 F.2d 324, 328 (1st Cir. 1979); *United States v. Huber*, 603 F.2d 387, 396-97 (2d Cir. 1979).

112 See *Savina Home Indus. v. Secretary of Labor*, 594 F.2d 1358, 1366-67 (10th Cir. 1979); *NLRB v. South Bay Daily Breeze*, 415 F.2d 360, 362 (9th Cir. 1969), *cert. denied*, 397 U.S. 915 (1970).

113 See, e.g., *United States v. Ward*, 448 U.S. 242, 254-55 (1980); *Savina Home Indus. v. Secretary of Labor*, 594 F.2d at 1362 n.6; Clark, *supra* note 100, at 381.

114 448 U.S. 242 (1980).

non-punitive nature of the law itself.<sup>115</sup> Using the punitive nature of the sanction, as opposed to the proceeding, as the criterion for the application of safeguards usually reserved for criminal defendants<sup>116</sup> is the key to the success of the argument that SEC rule 2(e) deprives clients of their constitutional right to counsel.

## 2. Punitive Sanctions: *Kennedy v. Mendoza-Martinez*

Although the sixth amendment specifically applies only to criminal proceedings, there has been a growing trend toward the expansion of the amendment's protections to encompass more than what are traditionally viewed as criminal prosecutions. This trend reached the Supreme Court in the late 1950s in *Trop v. Dulles*<sup>117</sup> and *Greene v. McElroy*.<sup>118</sup> Both of these cases involved the extension of due process safeguards based upon the punitive nature of the sanction imposed in the proceeding, regardless of whether the proceeding had been labeled "criminal." The Court in *Trop* stated:

In deciding whether or not a law is penal, this court has generally based its determination upon the purpose of the statute. If the statute imposes a disability for the purposes of punishment—that is, to reprimand the wrongdoer, to deter others, etc.—it has been considered penal. But a statute has been considered nonpenal if it imposes a disability, not to punish, but to accomplish some other legitimate governmental purpose.<sup>119</sup>

The *Greene* court agreed that the purpose of the statute determines its nature, and that due process safeguards must apply to administrative proceedings.<sup>120</sup>

<sup>115</sup> *Id.* at 253.

<sup>116</sup> *See* Clark, *supra* note 100, at 381, wherein the author defined the term "quasi-criminal":

Laws that provide for punishment but are civil rather than criminal in form have sometimes been labeled "quasi-criminal" by the Supreme Court. These laws, broadly speaking, provide for civil money penalties, forfeitures of property, and the punitive imposition of various disabilities, such as the loss of professional license or public employment.

*Id.* (footnotes omitted). Indeed, the court in *Savina Home Indus. v. Secretary of Labor*, 594 F.2d 1358 (10th Cir. 1979), was prompted by Professor Clark's definition to note that "[u]nder this definition an argument could be made that [administrative] civil penalties constitute quasi-criminal sanctions." *Id.* at 1362 n.6.

<sup>117</sup> 356 U.S. 86 (1958).

<sup>118</sup> 360 U.S. 474 (1959).

<sup>119</sup> 356 U.S. at 96 (footnotes omitted).

<sup>120</sup> *See* 360 U.S. at 507-8. *See also* *Hannah v. Larche*, 363 U.S. 420, 505 (1960) (Douglas, J., dissenting).

a. *Development of a Two-Tiered Test*

The major problem facing courts is deciding whether the "civil" penalty is, in effect, a punitive sanction.<sup>121</sup> Not until *Kennedy v. Mendoza-Martinez*<sup>122</sup> did the Supreme Court squarely confront the question. The Court set forth a two-tiered test which has become the standard by which courts determine whether a sanction is punitive.<sup>123</sup> *Mendoza-Martinez* involved the statutory divestiture of U.S. citizenship from a person who left the United States to evade the draft during World War II.<sup>124</sup> For the first tier, the Court looked to the legislative history of the statute. Noting that there is an "imperative necessity for safeguarding these rights to procedural due process [even] under the gravest of emergencies,"<sup>125</sup> the Court held that "Congress has plainly employed the sanction of deprivation of nationality as a punishment . . . without affording the procedural safeguards guaranteed by the Fifth and Sixth Amendments."<sup>126</sup> Accordingly, the sanction could not be imposed without all the incidents of a criminal trial, "including . . . assistance of counsel . . . ."<sup>127</sup>

Having based its conclusion on "objective manifestations of congressional purpose,"<sup>128</sup> that is, upon congressional debates and reports,<sup>129</sup> the Court did not reach the second tier of its proposed analysis. The Court did, however, delineate this second tier, which consists of seven factors to be considered in relation to the statute of its face," in the absence of "conclusive evidence of congressional intent as to the penal nature of a statute . . . ."<sup>130</sup> Divined from case law, these seven factors are:

Whether the sanction involves an affirmative disability or restraint, whether it has historically been regarded as a punishment, whether it comes into play only on a finding of *scienter*, whether its operation will promote the traditional aims of punishment—retribution and deterrence, whether the behavior to which it applies is already a crime, whether an alternative purpose to which it may rationally be

121 See Hart, *The Aims of the Criminal Law*, 23 L. & CONTEMP. PROB. 401, 431 (1958).

122 372 U.S. 144 (1963).

123 The Supreme Court recently reaffirmed the vitality of the *Mendoza-Martinez* tests in *United States v. Ward*, 448 U.S. 242 (1980).

124 372 U.S. at 146-52.

125 *Id.* at 165.

126 *Id.* at 165-66.

127 *Id.* at 167.

128 *Id.* at 169.

129 See *id.* at 170-84.

130 *Id.* at 169.

connected is assignable to it, and whether it appears excessive in relation to the alternative purpose assigned . . . .<sup>131</sup>

These factors are "certainly neither exhaustive, nor dispositive . . . but provide some guidance" to courts in deciding whether a given statute is punitive.<sup>132</sup>

b. *Scholarly Modification of the Punitive Intent Doctrine*

The reasons for applying criminal protections to civil-labeled sanctions have been variously stated. One commentator argued that civil administrative penalties are "susceptible to arbitrary application" and are "tantamount to administrative blackmail."<sup>133</sup> Another theorized that because "some non-criminal sanctions are as grave as some criminal sanctions, . . . consistency ought to require that protection be afforded whenever a person is threatened with a grave sanction."<sup>134</sup> A third asserted that the possibility for abuse is greater in an administrative context where a broad range of imaginative but "civil" penalties may be devised by "ingenious minds when freed from the confines of judicial convention."<sup>135</sup> Recently, however, other scholars have set forth theories which add to the list of factors and enhance the utility of the legislative history to be considered by a court in analyzing punitive sanctions.

The new factors look primarily to the nature of the punishment imposed, as do several of the *Mendoza-Martinez* factors. These involve, however, the "infamy" or "stigma"<sup>136</sup> associated with the imposition of the penalty, and the non-compensatory, retributive, and deterrent nature of the sanction.<sup>137</sup> The infamous punishment concept was developed in the late nineteenth century in *Wong Wing v. United States*,<sup>138</sup> in which imprisonment at hard labor for violations of immigration laws, while not labeled "criminal," was held to be "infa-

131 *Id.* at 168-69 (footnotes omitted).

132 *United States v. Ward*, 448 U.S. 242, 251 (1980).

133 Murphy, *Money Penalties—An Administrative Sword of Damocles*, 2 SANTA CLARA LAW. 113, 134 (1962).

134 Comment, *The Concept of Punitive Legislation and the Sixth Amendment: A New Look at Kennedy v. Mendoza-Martinez*, 32 U. CHI. L. REV. 290, 292 (1965).

135 McKay, *Sanctions in Motion, The Administrative Process*, 49 IOWA L. REV. 441, 446-49 (1964).

136 See Clark, *supra* note 100, at 401-03, 406-10.

137 Charney, *The Need for Constitutional Protections for Defendants in Civil Penalty Cases*, 59 CORNELL L. REV. 478, 497-500 (1974) [hereinafter Charney].

138 163 U.S. 228 (1896).

mous" and therefore punitive in nature.<sup>139</sup> If the infamous punishment doctrine lends any support to the article's argument, it does so to prove that the "civil" label should be lightly regarded when evaluating statutes for punitive elements.<sup>140</sup>

Professor Henry Hart noted that "[W]hat distinguishes a criminal from a civil sanction . . . is the judgment of community condemnation which accompanies and justifies its imposition."<sup>141</sup> While not infamous, then, a penalty may stigmatize its target perhaps more than would a minor yet "criminal" offense. One commentator put forth the example of a "large civil penalty imposed for intentional failure to comply with anti-pollution laws" in contrast with "a small fine labeled 'criminal' imposed for a traffic offense."<sup>142</sup> Indeed, such a view is far more reasonable with regard to corporate defendants that cannot themselves be physically imprisoned, pilloried, whipped or subjected to other "infamous" punishments.

In *United States v. Ward*,<sup>143</sup> however, the Supreme Court found a civil penalty provision of the Federal Water Pollution Control Act *not* to be punitive.<sup>144</sup> In making its determination, the Court simply looked to the civil label of the statute.<sup>145</sup> Such a perfunctory analysis is hardly consistent with the law of punitive sanctions. Perhaps, then, this decision may be explained by the nature of the sanction involved. Ward challenged a provision which was designed to remedy oil spills by requiring prompt notification to the U.S. Government of any such occurrences.<sup>146</sup> The funds collected as fines for violations of the provision were to be used to finance the administration of the Act and were in that sense, "remedial."<sup>147</sup>

A remedial purpose is inconsistent with the criminal law.<sup>148</sup> Ac-

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139 One commentator explains *Mendoza-Martinez* as an extension of this infamous punishment doctrine. See Clark, *supra* note 110, at 401-02.

140 See Charney, *supra* note 137, at 513-14.

141 Hart, *The Aims of the Criminal Law*, 23 L. & CONTEMP. PROB. 401, 404 (1958). See also *Village of Laurel Hollow v. Laverne, Inc.*, 24 A.D. 2d 615, 262 N.Y.S.2d 622 (1965) (mem.): "The term 'penalty' involves the idea of punishment, and its character is not changed by the mode in which it is inflicted, whether by civil action or a criminal prosecution." *Id.* at 615, 262 N.Y.S.2d at 624.

142 Clark, *supra* note 100, at 408.

143 448 U.S. 242 (1980).

144 *Id.* at 251.

145 *Id.* at 250-51. The Court paid cursory attention to the *Mendoza-Martinez* factors, but gave them little weight in the decision. *Id.* at 250.

146 *Id.* at 247.

147 *Ward v. Coleman*, 598 F.2d 1187, 1191 (10th Cir. 1979), *rev'd sub nom.* *United States v. Ward*, 448 U.S. 242 (1980). See *United States v. Ward*, 448 U.S. at 249.

148 See H. PACKER, *THE LIMITS OF THE CRIMINAL SANCTION* 23-26 (1968).



tions authorized to compensate for damages or loss are not criminal; suits brought to punish defendants are criminal.<sup>149</sup> A relevant delineation of the compensation-punishment distinction was made by LaFave and Scott:

Criminal law and the law of torts (more than any other form of civil law) are related branches of the law; yet in a sense they are two quite different matters. The aim of the criminal law . . . is to *protect the public against harm*, by punishing harmful results of conduct or at least situations (not yet resulting in actual harm) which are likely to result in harm if allowed to proceed further . . . . With crimes, the state itself brings criminal proceedings to protect the public interest but not to compensate the victim . . . .<sup>150</sup>

This is an ideal summary of Congress' intent in enacting the federal securities laws—to protect the public from harm and to prevent future violations. The next section of this article will examine the legislative history of the securities laws pursuant to the first tier of the *Mendoza-Martinez* test, as modified by the compensation-punishment distinction. Because that legislative history is dispositive of the punitive nature of the securities laws, evaluation of the securities laws with respect to the seven factors stated in the second tier of the *Mendoza-Martinez* test is unnecessary.

### C. *The Punitive Nature of SEC Sanctions*

At the time of the enactment of the Securities Act of 1933 (1933 Act)<sup>151</sup> and the Securities Exchange Act of 1934 (1934 Act)<sup>152</sup> the prevailing mood in Congress was retributive—to punish those people thought to be responsible for the Great Depression. Congressman Rayburn, a sponsor of the 1933 Act, stated in the House:

These hired officials of our great corporations who permitted, who promoted, who achieved the extravagant expansion of the financial structure of their respective companies today present a pitiable spectacle. Five years ago they arrogated to themselves the greatest privileges. They scorned the interference of the Government. They dealt with their stockholders in the most arbitrary fashion. They called upon the people to bow down to them as the real rulers of the country. Safe from the pitiless publicity of Government supervision, unrestrained by Federal statute, free from any formal control, these few men, proud and arrogant, and blind, drove the

149 See Charney, *supra* note 137, at 497.

150 W. LAFAVE & A. SCOTT, CRIMINAL LAW § 3, at 11 (1972) (emphasis added). See also Charney, *supra* note 137, at 497-500.

151 15 U.S.C. § 77 (1976).

152 15 U.S.C. § 78 (1976).

country to financial ruin. Some of them are fugitives from justice in foreign lands; some of them have committed suicide; some of them are under indictment; some of them are in prison; all of them are in terror of the consequences of their own deeds.<sup>153</sup>

These sentiments were not unique. Other members of Congress spoke of the "crooks" from whom the public was to be protected,<sup>154</sup> the "shrewd and crafty men, skilled in the tricks of a crooked game, [who] sit around a table and deliberately and premeditatedly plan, by devising cunning schemes and resorting to every conceivable trick of financial legerdemain, to loot an unwary public of millions of dollars earned by the sweat of the brow."<sup>155</sup>

The stated purpose of the 1933 Act is to "provide full and fair disclosure,"<sup>156</sup> to protect the public from fraud. The civil and criminal penalties incorporated into the Act serve the dual purposes of (1) ensuring compliance to protect the public against harm, and (2) deterring future violations which would likely result in harm. These purposes are precisely those which LaFave and Scott identified as the elements which distinguish a criminal law from a civil law.<sup>157</sup> That such were the purposes of Congress in enacting the 1933 Act is evident from an examination of the congressional debates.

Early in the House debate, Congressman Rayburn stated:

Let me repeat that what we seek to attain by this enactment is to make available to the prospective purchaser, if he is wise enough to use it, all information that is pertinent that would put him on notice and on guard, and then let him beware. On the other hand, we demand of the seller that he give full and fair information with

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153 77 CONG. REC. 2918 (1933) (remarks of Rep. Rayburn).

154 *Id.* at 2935 (remarks of Rep. Chapman).

155 *Id.* See *id.* at 2928 (remarks of Rep. Kelly): "Two forces oppose the necessary action. Those who desire destruction and overthrow wish us to drift on ruin. There are also stupidly selfish interests who will permit destruction rather than surrender what they regard as the right to reap profit from the helplessness of others," *id.* at 2938 (remarks of Rep. Beck):

From what I have seen of corporate business in this country, I believe that if we had prosecuting attorneys and judges who would speed the trial of criminal cases, and as a result, if there were more of this class of predatory millionaires in jail and less [*sic*] of them in palatial homes on Fifth Avenue, we would not have any necessity for this legislation. [Applause.]

*Id.* at 2944 (remarks of Rep. Gibson):

Our country has been under attack from two classes of enemies, the criminal who breaks the law for private gain and the man who, under the cover of the law, has by false representation taken the savings of his less fortunate fellow men. These two classes may be comprehended by that modern term "racketeers." They have, to use a common expression, "bled the country white."

156 Securities Act of 1933, Pub. L. No. 73-22, 18 Stat. 74 (preamble).

157 See text accompanying note 150 *supra*.

reference to the security offered, under penalty of both civil and criminal liability if he evades or conceals material facts. If the seller is a wise man he will also beware.<sup>158</sup>

Congressman Wolverton echoed these sentiments, stating that "to insure care and remove possibility [*sic*] of untrue or extravagant statements of fact, civil as well as criminal responsibility is fixed upon the issuer, every officer, director, or agent who permits his name to be used in connection therewith."<sup>159</sup> It appears evident that the "civil" penalties were intended to punish violators and to deter future violations, all in the interest of protecting the public from harm. The penalties are therefore criminal.<sup>160</sup>

A similar conclusion may be reached with respect to the congressional intent in enacting the 1934 Act, which was also aimed at eliminating certain abuses of the stock exchanges. One Congressman summed up the feeling behind the bill:

I hold no brief for those who would deliberately interfere with or hamper legitimate business. On the other hand, I insist that since the stock market has in the past been guilty of practices that transcend the legitimate, they, as well as all other offenders, should be brought within the law that calls for an honest, fair, and open chance for the citizen who desires to invest his money in legitimate securities. If in doing so he loses through the natural or ordinary hazard in industry and commerce, that is a loss he is willing to take. But if he is sheared like a lamb through a rigged market, through manipulations, resulting from wash sales and matched orders, he has a legitimate cause for complaint, and it is his Government's business, through its legislative and executive branches, to throw about this stock-purchasing and stock-selling business such safeguards as will make these tricky devices, so long indulged in, impossible in the future.<sup>161</sup>

Some spoke of protecting the public,<sup>162</sup> others of punishing those evil

158 77 CONG. REC. 2919 (1933) (remarks of Rep. Rayburn).

159 *Id.* at 2931 (remarks of Rep. Wolverton). *See also id.* at 2932 (remarks of Rep. Maryland): "[The Act's] provisions will protect innocent purchasers from the designs of fraudulent stock and bond promoters; . . . it will, in fact, cause the seller to beware of the penalties for its violation, and relieve the purchaser somewhat of the old rule of caveat emptor, 'Let the buyer beware.'"

160 *See also id.* at 2952-54. The above cited comments have been derived exclusively from the debates in the House of Representatives. This is because the Senate debate on its version of the Act was greatly attenuated. The House bill, H.R. 5480, was ultimately adopted with little change by the Senate. Accordingly, the Senate debates are inconsequential to an analysis of congressional intent. *See generally id.* at 2983.

161 78 CONG. REC. 7717 (1934) (remarks of Rep. Ford). *See* H.R. REP. NO. 1383, 73d Cong., 2d Sess. 3 (1934), *reprinted in* 78 CONG. REC. 7701, 7702-03 (1934).

162 78 CONG. REC. 7690 (1934) (remarks of Rep. Cooper).

men who had done foul deeds, "leaving a slimy trail of legalized burglary, rotten riggings of markets, and feculent odors of grand larceny that led from coast to coast and Gulf to Lakes, and smelled to high heaven."<sup>163</sup>

Much of the dispute over the 1934 Act concerned the proposed establishment of the SEC to administer the federal securities laws. In particular, the sweeping regulatory authority of the proposed SEC caused some concern: "It is doubtful whether ever in the history of Congress such a wide and sweeping delegation of power has been given to any administrative body to create by rule and regulation crimes punishable by severe fine and imprisonment, or both."<sup>164</sup> Most of the debate involved the propriety of vesting in an administrative agency the power to inflict severe sanctions upon violators of statutes, rules and regulations.

The overwhelming congressional intent in enacting the 1933 and 1934 Acts was punitive. The sanctions were designed to punish violators and to deter future violations, all to protect the public from harm.<sup>165</sup> Moreover, securities sanctions are stigmatic because they can severely damage the business or personal reputations of their targets.<sup>166</sup> Assuming, arguendo, that there exists a securities law or regulation purely civil in nature, that is purely compensatory and not retributive or deterrent, such a law would not dissolve the punitive taint which runs through the entire regulatory scheme. Indeed, the basis of this article's argument is that the securities laws as a whole are punitive—they seek to protect the unwary investor from harm through the punishment and deterrence of once and future offenders. Corporations, broker-dealers, and other entities operate under a panoply of laws and regulations, and cannot anticipate whether the SEC will subject them to penalties labeled civil or criminal, or whether severe or light sanctions will be imposed.<sup>167</sup> Surely such entities are entitled to constitutional safeguards when criminal charges are pressed; because the civil penalties of the securities laws were in-

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163 *Id.* at 7941 (remarks of Rep. Truax).

164 *Id.* at 8112 (remarks of Rep. Cooper). *See generally id.* at 8112-13 (remarks of Rep. Cooper). *See also id.* at 8273 (colloquy of Senator Black and Senator Steiwer).

165 *See generally* Transition Team Report, *supra* note 2, at K-2.

166 *See generally* Lacy, *Adverse Publicity and SEC Enforcement Procedure*, 46 FORDHAM L. REV. 435 (1977).

167 *See* Bennett, *For the Defense: Opposing the Government in Securities Cases*, 3 J. CONTEMP. L. 2, 10 (1976); Gellhorn, *Administrative Prescription and Imposition of Penalties*, 1970 WASH. U.L.Q. 265, 276.

tended to be punitive, their targets are also entitled to constitutional protection.

The denial of counsel which rule 2(e) perpetrates cannot be confined to all provisions except those which are purely "civil." Because of the overriding responsibility of an attorney to represent his client thoroughly, the denial of the right to counsel for purposes of even one phase of practice before the SEC operates to consume and eviscerate the constitutional right to counsel and the attorney-client relationship. The overwhelmingly punitive nature of the securities laws points to the conclusion that an entity being represented in any phase of the securities practice, as defined in SEC rule 2(g),<sup>168</sup> is entitled to the assistance of counsel, a right guaranteed by the sixth amendment to the U.S. Constitution.<sup>169</sup>

#### IV. The Unshackling: Rule 2(e) Violates the Sixth Amendment

This article has shown that the sixth amendment guarantee of counsel should apply to entities dealing with the SEC. In this section, the nature of that constitutional right will be examined in the context of the two major roles of an attorney in the securities practice—advocate and advisor. As a practical matter, however, it is first necessary to resolve one of the threshold questions of constitutional litigation: whether the party raising the claim has standing to sue. Certainly, there is standing if the client claims a deprivation of its right to counsel; the "case or controversy" requirement of Article III of the Constitution is thereby satisfied.<sup>170</sup>

An attorney subject to a rule 2(e) proceeding may also claim that the rule is invalid because his client is deprived of sixth amendment rights. The attorney is not asserting his own right, however, but is in the posture of a third party. Physicians have been allowed to assert their constitutional rights to practice their chosen profession, a right established by the Supreme Court in *Meyer v. Nebraska*,<sup>171</sup> in the context of cases involving abortion laws.<sup>172</sup> Courts which have

168 17 C.F.R. § 201.2(g) (1981).

169 Because the legislative history of the securities laws is dispositive as to the question of punitive intent, this article will not reach the second tier proposed in *Mendoza-Martinez*. Note, however, that a discussion of most of the seven factors is subsumed in the above analysis.

170 U.S. CONST. art. III; see C. WRIGHT, LAW OF FEDERAL COURTS § 13, at 42-50 (3d ed. 1976).

171 262 U.S. 390, 399-400 (1923). See *Board of Regents v. Roth*, 408 U.S. 564 (1972); *Greene v. McElroy*, 360 U.S. 474 (1959).

172 See *Roe v. Wade*, 410 U.S. 113 (1973); *Nyberg v. City of Virginia*, 495 F.2d 1342 (8th Cir.), cert. denied, 419 U.S. 891 (1974); *Larkin v. Bruce*, 352 F. Supp. 1076 (D. Wis. 1972), appeal dismissed, 483 F.2d 1407 (7th Cir. 1973).

addressed the issue have found the right of attorneys "to challenge any act which interferes with his professional obligations to his client and thereby, through the lawyer, invades the client's constitutional right to counsel," to be an even stronger case for the grant of third party standing.<sup>173</sup> Consequently, the constitutional claim may be raised by either the attorney or the client.

A. *Undue Interference with the Attorney-Client Relationship: The Lawyer as Advocate*

The attorney's obligation to his client has long been the subject of debate. At one extreme is the celebrated view of Henry Lord Brougham, who stated in 1819:

An advocate in the discharge of his duty knows but one person in the world, and that person is his client. To save that client by all means and expedients [*sic*], and at all hazards and costs to other persons, among them to himself, is his first and only duty; and in performing this duty he must not regard the alarm, the torments, the destruction he may bring upon others.<sup>174</sup>

At the other extreme is the view that the lawyer should be independent of his client, and should act as would an auditor.<sup>175</sup> A more moderate approach, a reasonable compromise, has been reached and embodied in the Code of Professional Responsibility (CPR). Although currently undergoing revision, the CPR represents a reasoned and fair approach to the problem of professional conduct. The CPR, while containing some vague terms, is sufficiently detailed to address specific situations which a lawyer may face. In rule 2(e), however, the SEC has distilled the CPR and an entire body of case law from fifty states into the simple phrase, "unethical or improper professional conduct."<sup>176</sup> This might be acceptable if rule 2(e) and the

173 Wounded Knee Legal Defense/Offense Comm. v. FBI, 507 F.2d 1281, 1284 (8th Cir. 1974). See also *Keker v. Procnunier*, 398 F. Supp. 756, 760-61 (E.D. Cal. 1975). But see *Silver v. Queen's Hosp.*, 518 F.2d 555 (9th Cir. 1975) (mem.) (dictum), quoted in *Keker v. Procnunier*, 398 F. Supp. at 760-61 n.3. The *Keker* court stated:

This court can perceive no reason why . . . the attorneys . . . should not . . . be permitted to raise the question of violation of Sixth Amendment rights. The mirror-image of the client's Sixth Amendment right to effective counsel is the attorney's right to practice his profession without undue governmental interference. The vindication of one is consequently dependent upon the vindication of the other.

398 F. Supp. at 765.

174 G. SHARSWOOD, A COMPEND OF LECTURES ON THE AIMS AND DUTIES OF THE PROFESSION OF THE LAW 29 (1854) (quoting Henry Lord Brougham).

175 See text accompanying notes 210-20 *infra*.

176 17 C.F.R. § 201.2(e)(1)(ii) (1981).

CPR were coextensive; the SEC, however, had disclosed its view that such is not the case.<sup>177</sup>

Any impermissible interference in the attorney-client relationship violates the client's right to counsel. Many courts have wrestled with the question whether particular conduct constitutes a constitutional violation, and the vast majority has determined that governmental intimidation of counsel is impermissible. In fact, any undue interference with the attorney's representation of his client violates the sixth amendment. Rule 2(e) is such an intrusion.

## 1. The Intimidating SEC

### a. *The Judicial Definition of "Intimidation"*

The right to counsel "may not be fettered by harassment of government officials," stated the United States Court of Appeals for the Eighth Circuit in *Wounded Knee Legal Defense/Offense Committee v. Federal Bureau of Investigation*.<sup>178</sup> That case, however, involved allegedly improper arrests of and physical assaults on committee members by government agents.<sup>179</sup> While *Wounded Knee* is an extreme case, its principle is clear—such harassment will not be tolerated under the Constitution. Similarly, it is clear that when the government actually intrudes upon the attorney-client relationship, through electronic surveillance devices, undercover agents "planted" in the defense camp, or the like, a strong claim exists that the sixth amendment has been violated.<sup>180</sup>

Rule 2(e) however, is neither physical abuse nor physical intrusion. It violates the sixth amendment by psychologically attenuating the scope of conduct of an attorney, keeping him out of the grey expanse between egregiousness and triviality.<sup>181</sup> Even when there is

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177 See text accompanying notes 60-76 *supra*.

178 507 F.2d 1281, 1284 (8th Cir. 1974).

179 *Id.* at 1283 & n.3.

180 See, e.g., *Weatherford v. Bursey*, 429 U.S. 545 (1977); *United States v. Irwin*, 612 F.2d 1182 (9th Cir. 1980); *United States v. Crow Dog*, 532 F.2d 1182 (8th Cir. 1976), *cert. denied*, 430 U.S. 929 (1977); *United States v. Choate*, 527 F.2d 748 (9th Cir. 1975), *cert. denied*, 425 U.S. 971 (1976). The Court in *Weatherford* declined to rule that an actual intrusion into the attorney-client relation is a *per se* violation of the right to counsel, because in that case there was no tainted evidence, no communication of defense strategy, and no purposeful intrusion. See 429 U.S. at 557-58. The implication of *Weatherford*, however, is that an intentional intrusion would violate the sixth amendment. See generally Comment, *Constitutional Law—Sixth Amendment—Right to Counsel—Confidentiality of Attorney-Client Consultation*, 16 DUQ. L. REV. 269 (1977-78). Justice Marshall dissented in *Weatherford*, arguing that any intrusion is a violation of the sixth amendment. See 429 U.S. at 564-68 (Marshall, J., dissenting).

181 See generally Lipman, *supra* note 4, at 453.

no physical intrusion, there may still be a constitutional violation. As Judge Frankel stated in *In re Terkel*,<sup>182</sup> a civil case:

The ultimate interest to be protected is the privacy and confidentiality of the lawyer's work in preparing the case. It is the violation of that interest that is held offensive to the Constitution in the case of eavesdropping and spying. The protection would be a thin illusion if the Government could have for the asking what it has, in rare lapses, sought by less genteel means.<sup>183</sup>

Minor irregularities in governmental conduct, however, have been held not to violate the sixth amendment. For example, there was no violation when a trial judge instructed the attorney to elicit evidence in a chronological fashion.<sup>184</sup> A prosecutor's isolated question implying misconduct on the part of defense counsel was also held not to violate the client's right to counsel.<sup>185</sup> Nor was a statement by government attorneys that defense counsel would be called as a prosecution witness violative of the sixth amendment.<sup>186</sup>

However, a trial judge's refusal to allow an attorney to make a closing argument was found violative in both a jury trial<sup>187</sup> and a non-jury proceeding.<sup>188</sup> Deprivation of the effective assistance of counsel was found when the

court had demeaned counsel and . . . such counsel was afraid to be a vigorous advocate for fear of the judge's reaction. After the court had told counsel three times that counsel needed a lawyer for himself, had questioned counsel's competence, and had stated that the court would have counsel investigated by Disciplinary Committee of the Bar Association, counsel [unsuccessfully] moved for trial before a different judge in the district.<sup>189</sup>

The court in *Bursten v. United States*<sup>190</sup> summarized the thrust of these cases, stating when counsel is so unnerved that he cannot "devote his

182 256 F. Supp. 683 (S.D.N.Y. 1966). The case involved an application to compel an attorney to give testimony before a grand jury. *Id.*

183 *Id.* at 685.

184 *United States v. Moton*, 493 F.2d 30 (5th Cir. 1974).

185 *United States ex rel. Perry v. Mulligan*, 544 F.2d 674 (3d Cir. 1976), *cert. denied*, 430 U.S. 972 (1977); *United States v. Rangel*, 488 F.2d 871 (5th Cir.), *cert. denied*, 416 U.S. 984 (1974).

186 *Lyons v. United States*, 325 F.2d 370 (9th Cir. 1963), *cert. denied*, 377 U.S. 969 (1964).

187 *Patty v. Bordenkircher*, 603 F.2d 587 (6th Cir. 1979).

188 *Herring v. New York*, 422 U.S. 853 (1975).

189 *United States v. Davis*, 442 F.2d 72, 74 (10th Cir. 1971). *Cf. Cooper v. United States*, 403 F.2d 71, 73 (10th Cir. 1968) (judge's conduct characterized as "no more than displays indicative of a firm control of the proceedings falling well within the reasonable bounds within which a trial judge may act").

190 395 F.2d 976 (5th Cir. 1968), *cert. denied*, 409 U.S. 843 (1972).



best talents to the defense of his client, then this is ground for reversal, no matter what counsel's experience and equipoise may be."<sup>191</sup>

b. *The Intimidating Effect of Rule 2(e)*

Rule 2(e) is indeed an unnerving force exerted on attorneys by the SEC. Many commentators have noted the rule's effect on the legal profession. "An attorney cannot adequately represent his clients when he is worried about his own liability."<sup>192</sup> "No lawyer is going to be able to give independent advice if he's going to be watching out for his own skin."<sup>193</sup> Because of the combination of increasing attorney liability and the more aggressive assertion of rule 2(e),

it may be questionable that many attorneys will still be willing to zealously represent a client . . . if the client's position is not clearly and undoubtedly in compliance with any and all views of the securities laws, rather than just arguably so, even though the securities laws are still unclear and nebulous in many areas and are subject to varying interpretations.<sup>194</sup>

The SEC has, moreover, been known to *actually* intimidate attorneys, by threats of prosecution under rule 2(e) or otherwise.<sup>195</sup> Monroe Freedman discussed the system of "rewards" and "punishments" used by the SEC to control attorney conduct:

The rewards consist of favored treatment to some lawyers in their appearances before the Commission . . . That . . . represents a conscious effort to encourage lawyers to trade off the rights of some clients in order to curry favor with the Commission and thereby advance the rights of other clients. . . . The punishments are directed toward intimidating attorneys into foregoing zealous advocacy on behalf of their clients. One attorney, engaged in vigorous defense of his client's rights, was advised by a staff member that he should "take a look at the National Student Marketing complaint," in which attorneys were named as respondents.<sup>196</sup>

There is no way to determine how frequently such instances of actual intimidation occur.<sup>197</sup> Assuming, however, that the majority

191 395 F.2d at 983.

192 Daley & Karmel, *supra* note 4, at 825.

193 P. HOFFMAN, LIONS IN THE STREET 171 (1973).

194 Johnson, *The Expanding Responsibilities of Attorneys in Practice Before the SEC: Disciplinary Proceedings Under Rule 2(e) of the Commission's Rules of Practice*, 25 MERCER L. REV. 637, 660 (1974). *Accord*, Lipman, *supra* note 4, at 474.

195 See Freedman, *supra* note 9, at 283-84. See also Comment, *SEC Disciplinary Rules and the Federal Securities Laws: The Regulation, Role and Responsibilities of the Attorney*, 1972 DUKE L.J. 969, 1010; Freedman, *supra* note 9, at 285.

196 Freedman, *supra* note 9, at 285.

197 SEC Solicitor Paul Gonson states: "[T]he Commission has never, or virtually never,

of SEC attorneys are rational, fair-minded individuals<sup>198</sup> who would not even consider threatening attorneys with prosecution for zealous advocacy, the potential for such threats still remains.<sup>199</sup> The vesting of broad disciplinary power in a multi-functioned administrative agency is compounded by the vagueness of the standards of conduct set out in rule 2(e).

## 2. The Vagueness of Rule 2(e)

The SEC has consistently avoided the creation of discernable boundaries for attorney conduct acceptable under rule 2(e). This vagueness leads to suppression of attorney conduct to a level perceived as "safe," that is, unlikely to subject the lawyer to a proceeding under rule 2(e). A thorough examination of the rule 2(e) standards is virtually impossible, as there are no identifiable standards embodied in the rule;<sup>200</sup> this article will nevertheless attempt to discern what conduct is prohibited by the SEC.

Rule 2(e)(1)(i) provides for the suspension or disbarment of any person found "not to possess the requisite qualifications to represent others . . . ."<sup>201</sup> There is no indication of the nature of the qualifications which the SEC deems "requisite." The phrase may mean that one who is not qualified to practice law, in the generic sense, may not practice before the SEC. The phrase may also be designed to require specific competence in the securities field. If the generic interpretation is proper, then rule 2(e) is redundant because it would coincide with the CPR and the state bar rules. However, if rule 2(e)(1)(i) requires some undefined degree of specialization, the SEC's argument that the rule is innocuous compared to complete disbarment is not valid.<sup>202</sup>

Rule 2(e)(1)(ii) contains two phrases of equal indefinability. An attorney may be suspended or disbarred if he is found "to be lacking in character or integrity or to have engaged in unethical or improper

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brought a Rule 2(e) proceeding against a lawyer who appeared as an advocate for a client under investigation or accused of past wrongdoing . . . . It is almost impossible to point to an actual case that appears to have resulted from vindictiveness." Gonson, *supra* note 23, at 22 n.28.

198 See H. KRIPKE, *THE SEC AND CORPORATE DISCLOSURE: REGULATION IN SEARCH OF A PURPOSE* 2-3 (1979).

199 It should be also noted that SEC attorneys have immunity from civil liability for their actions. See *Carlsberg v. Gatzek*, 442 F. Supp. 813 (C.D. Cal. 1977).

200 See Johnson, *supra* note 4, at 657; Marsh, *supra* note 7, at 995-98.

201 17 C.F.R. § 201.2(e)(1)(i) (1981).

202 See text accompanying notes 16-26 *supra*.

professional conduct . . . .”<sup>203</sup> The first of these phrases gives the SEC “a blank check to suspend or disbar”<sup>204</sup> a person based on a subjective definition of “character.” Moreover, to the extent that “integrity” is defined in its usual way, denoting “adherence to a code of moral, . . . or other values”<sup>205</sup> it should coincide with the many provisions of the CPR. There is, however, some indication that the SEC views “integrity” for the securities bar as requiring a stricter adherence to a moral code than that of a nonsecurities attorney.<sup>206</sup>

The other phrase in rule 2(e)(1)(ii) is the frequently discussed “unethical or improper professional conduct.” A logical interpretation of “unethical” could be that it denotes a violation of the provisions of the CPR. However, the SEC has interpreted rule 2(e) to exceed the CPR’s standards for conduct, and to require an attorney to ensure his client’s compliance with securities laws by actions beyond mere attempts to convince.<sup>207</sup> Because the SEC’s definition of the term “unethical” is inconsistent with the commonly accepted principles of the CPR, there is no way an attorney can be sure that his conduct will not subject him to disciplinary action under rule 2(e). This situation is exacerbated in the case of “improper” conduct. Because both the words “unethical” and “improper” are used in the same clause, they cannot be intended to be synonymous. Professor Marsh opined that “improper” “should mean something more than conduct which is viewed with displeasure by the Commission; however, it is impossible to say what more is required.”<sup>208</sup>

Because rule 2(e) is ambiguous, subjective and nebulous,<sup>209</sup> it is virtually impossible for an attorney to discern the borderline between zealous advocacy and conduct which rule 2(e) proscribes. Surely one

203 17 C.F.R. § 201.2(e)(1)(ii) (1981).

204 Marsh, *supra* note 7, at 996.

205 See WEBSTER’S SEVENTH NEW COLLEGIATE DICTIONARY 439 (1967).

206 Indeed, the SEC has frequently expressed its view that the unique role of securities attorneys requires of them a higher standard of care than that required of other attorneys. See generally text accompanying notes 221-37 *infra*.

207 See discussion of *In re Carter & Johnson* in the text accompanying notes 60-76 *supra*.

208 Marsh, *supra* note 7, at 996-97.

209 Rule 2(e)(1)(iii), 17 C.F.R. § 201.2(e)(1)(iii) (1981), provides for suspension or disbarment of a person who has “willfully violated” the federal securities laws. Though the SEC has attempted to define the term so it is not vague, it has nevertheless confined attorney conduct to a minimum of zealotry. “Willfulness” has been defined as the intentional commission of an act, regardless of whether the act was known to be a violation of the securities laws. See *Tager v. SEC*, 344 F.2d 5 (2d Cir. 1965). See also *SEC v. Blatt*, 583 F.2d 1325 (5th Cir. 1978); *Arthur Lipper Corp. v. SEC*, 547 F.2d 171 (2d Cir. 1976), *cert. denied*, 434 U.S. 1009 (1977). “[I]n other words, he [who committed the act] did not do what he did while sleepwalking.” Marsh, *supra* note 7, at 997.

cannot expect to avoid hazy areas when the issues are not clearly resolvable, but the haze should be confined to the smallest possible area. The SEC in rule 2(e) has not striven to minimize the haze; it has created a massive and effective smoke screen.

B. *Undue Interference with the Attorney-Client Relationship: The Lawyer as Advisor*

The sixth amendment right to counsel should apply with full force to situations in which the attorney is not "advocating" his client's position *per se*, but is advising his client regarding the intricacies of the federal securities laws. Such is the definition of practice asserted by the SEC for purposes of commencing disciplinary proceedings.<sup>210</sup> Because rule 2(e) applies to any attorney engaged in practice before it, it should follow that any impingement on the attorney's representation of the client in any capacity recognized by the SEC as practice violates the sixth amendment.

To fully understand the nature of the violation of the right to counsel when the attorney is acting as an advisor, it is necessary to examine the nature of that role. There has been considerable debate regarding the varying duties and responsibilities of an attorney-advisor and his relationship with his client, the public and the regulatory authority. The SEC has attempted in recent years to restructure the attorney-client relationship to further its own goals. This restructuring, however, has hardly met with universal acceptance. Moreover, it constitutes, in conjunction with the omnipresent threat of a rule 2(e) proceeding, impermissible interference with the right and duty of an attorney to zealously represent the interests of his client.

1. The Nonlitigating Securities Attorney: Advisor, Advocate, or Auditor?

Whether an attorney is an advocate in the courtroom and something completely different in the law office is an issue that has yet to be resolved. Because the distinction between advocate and advisor is a difficult one to make,<sup>211</sup> several scholars have asserted that the distinction is irrelevant. As Monroe Freeman stated:

[O]ur legal system is basically an adversarial one and every lawyer—whether drafting a contract, counselling in a business venture, writing a will, or performing any other service on behalf of a cli-

210 See 17 C.F.R. § 201.2(g) (1981) and text accompanying note 19 *supra*.

211 See Coleman, *The Different Duties of Lawyers and Accountants*, 30 BUS. LAW 91 (spec. issue 1975).

ent—acts in such a way as to protect the client from being at a disadvantage in potential future litigation. Particularly should that be so, in a free society, when the potential adversary is the government itself. In that sense, and it is a crucial one, every lawyer is an advocate, irrespective of whether he or she ever enters a courtroom.<sup>212</sup>

There are, of course, those who disagree with this point of view, and base their concept of a bifurcated practice on the distinction between the past and future conduct of a client.<sup>213</sup> The advocate deals with past conduct, and is therefore presented with an existing situation. The advisor, however, is responsible for shaping the future conduct of his client, and should consequently be held to a higher standard of care for the interests of third parties.<sup>214</sup> This theory was espoused by Chairman Williams in speeches during his tenure on the SEC,<sup>215</sup> and was reiterated by him in his concurrence in *In re Keating, Muething & Klekamp*.<sup>216</sup>

It has occasionally been asserted that the attorney-advisor should be independent of his client, just as auditors are independent of theirs. This proposal has met with nearly unanimous opposition,<sup>217</sup> even from those who perceive the SEC as having the power to regulate attorney conduct.<sup>218</sup> The attorney does not certify documents, as does an auditor;<sup>219</sup> attorneys are not specifically named as

212 Freedman, *supra* note 9, at 287-88.

213 See, e.g., Gruenbaum, *supra* note 4, at 800-02; Sonde, *supra* note 4, at 862-63.

214 See Gruenbaum, *supra* note 4, at 800-01. See also ABA MODEL CODE OF PROFESSIONAL RESPONSIBILITY, EC 7-2 (1980).

215 See Speech by SEC Chairman Harold M. Williams, Corporate Accountability and the Lawyer's Role, before the ABA Section of Corporation, Banking & Business Law (Aug. 8, 1978), reprinted in 465 SEC. REG. & L. REP. (BNA) H-1, at H-3 (1978).

216 Securities Exchange Act of 1934 Release No. 15,982 (July 2, 1979) (Williams, Chairman, concurring), reprinted in 17 SEC DOCKET 1149, 1163, 1165.

217 See Daley & Karmel, *supra* note 4, at 758-59; Lipman, *supra* note 4, at 450-52; Lowe & Kripke, *Summary and Conclusions*, 30 BUS. LAW. 224, 224-26 (spec. issue 1975); Lorne, *The Corporate and Securities Advisor, The Public Interest, and Professional Ethics*, 76 MICH. L. REV. 423, 463-64 (1978).

218 See Sonde, *supra* note 4, at 833-34.

219 See American Fin. Co., 40 S.E.C. 1043 (1962):

Though owing a public responsibility, an attorney in acting as the client's advisor, defender, advocate and confidant enters into a personal relationship in which his principal concern is with the interests and rights of his client. The requirement of the [Securities] Act of certification by an independent accountant, on the other hand, is intended to secure for the benefit of public investors the detached objectivity of a disinterested person. The certifying accountant must be one who is in no way connected with the business or its management and who does not have any relationship that might affect the independence which at times may require him to voice public criticisms of his client's accounting practices.

responsible for defects in a registration statement, as are auditors.<sup>220</sup> Moreover, the multi-faceted relationship between a client and its lawyers makes it impracticable if not impossible to require independence in some matters and zealous advocacy in other, even contemporaneous, situations.

## 2. Public Responsibility: Attorney as Policeman

Another concept which has been applied to the securities practice is that the lawyer has a duty to the public that overrides his traditional obligations to his client. This concept views the securities bar as an extension of the enforcement arm of the SEC, and therefore even more susceptible to disciplinary action than the average attorney. That the bar is the "SEC's reluctant police force"<sup>221</sup> was first asserted in the famous footnote 20 to the SEC's opinion *In re Emanuel Fields*.<sup>222</sup> In *Fields*, the SEC stated that because it, with its "small staff and limited resources,"<sup>223</sup> could not adequately accomplish the task of ensuring compliance with the securities laws, much reliance upon the integrity and expertise of the private securities bar would be necessary.<sup>224</sup>

The *Fields* footnote sparked debate over the desirability of conscripting attorneys into the SEC enforcement army. Several commentators have identified the competing concerns. Lowenfels recognized that conscription would tend to upgrade the quality of disclosure documents by "engender[ing] greater care, more due diligence, and more meticulous and painstaking preparation,"<sup>225</sup> but would also operate to deprive marginally successful clients of legal services and to create an overly restrained bar.<sup>226</sup> On balance, however, Lowenfels favored establishing an enforcement army.<sup>227</sup> This support was subsequently countered by Frederick Lipman. Noting that the SEC's position requires an attorney faced with a conflict "to

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*Id.* at 1049. The SEC concluded that the concurrent roles of attorney-advisor and auditor are incompatible. *Id.* at 1050.

220 See Securities Act of 1933, § 11(a)(4), 15 U.S.C. § 77k(a)(4)(1976); Loss, *Summary Remarks*, 30 BUS. LAW. 163, 164 (spec. issue 1975).

221 See Lipman, *supra* note 3, at 437.

222 Securities Act Release No. 5404 (June 18, 1973), reprinted in 2 SEC DOCKET 1, 4-5 n.20 (1973). See text accompanying notes 27-36 *supra*.

223 2 SEC DOCKET, at 5 n.20.

224 See *id.* at 4-5 & n.20. See also Gadsby, *The Securities Exchange Commission*, 11 B.C. INDUS. & COM. L. REV. 833 (1970).

225 Lowenfels, *supra* note 4, at 435.

226 See *id.*

227 *Id.* at 437-38.

favor the faceless mass of potential securities buyers over the company which is in fact his employer,"<sup>228</sup> Lipman stated:

Although lawyers occasionally have aided management-perpetuated fraud, by and large the securities bar has shown an outstanding record in attempting to secure compliance with the securities laws by the management of public companies. This compliance was not obtained by lawyers policing their clients' activities by threats of public disclosure. Rather, the confidence the client had in the lawyer's undivided loyalty fostered an atmosphere of trust and candor which enabled the client to be persuaded to take a broad view of his long-term self-interest. . . . [T]his confidential relationship cannot survive if the SEC is successful in its efforts to make securities lawyers an adjunct to the Commission's enforcement division.<sup>229</sup>

Despite widespread support for the Lipman view of the attorney-client relationship,<sup>230</sup> the SEC continued to assert its view of the

228 See Lipman, *supra* note 4, at 441.

229 *Id.* at 469. See also Johnson, *supra* note 4, at 658:

A lawyer is not, and should not be, an agent of the government; he is a bulwark between the citizen and the agency, neither attempting to devise means of fitting his client within the questionable interstices of the law nor seeking to prostitute his ethics for the benefit of his client. A lawyer serves the public by drafting documents which adequately bring his client into full compliance with the securities laws; he serves the public by vigorously defending his client against agency thrusts; and most importantly, a lawyer serves the public by taking every possible ethical action to assure that the conduct of the agency does not in any way jeopardize the liberties which are so vital to the legal profession. He performs these functions from a position of independence from external forces, under the mandate of a superior system of regulation, and within a self-policing system; [of the delicate balance which sustains individual liberties and the sophisticated and essential securities regulation process.]

230 See, e.g., Cooney, "The SEC's Enforcement Theory," in *Responsibility of Lawyers Advising Management*, 30 BUS. LAW. 29, 31-32 (spec. issue 1975); Johnson, *supra* note 4, at 658; Johnson, *The Expanding Responsibilities of Attorneys in Practice Before the SEC: Disciplinary Proceedings Under Rule 2(e) of the Commission's Rules of Practice*, 25 MERCER L. REV. 637, 667-69 (1974); Kosek, *supra* note 4, at 468-69; Lowe & Kripke, *Summary and Conclusions*, 30 BUS. LAW. 223, 224-25 (spec. issue 1975); Freeman, *supra* note 7, at 12. But see Marquis, *An Appraisal of Attorneys' Responsibilities Before Administrative Agencies*, 26 CASE W. RES. L. REV. 285, 285-92 (1976); Redlich, *Lawyers, the Temple, and the Market Place*, 30 BUS. LAW. 64, 68-69 (spec. issue 1975); Sonde, *supra* note 4, at 847-49. See also SEC v. Arthur Young & Co., 590 F.2d 785 (9th Cir. 1979):

To accept the SEC's position would go far toward making the accountant both an insurer of his client's honesty and an enforcement arm of the SEC. We can understand why the SEC wishes to so conscript accountants. Its frequently late arrival on the scene of fraud and violations of securities laws almost always suggests that had it been there earlier *with the accountant* it would have caught the scent of wrongdoing and, after an unrelenting hunt, bagged the game. What it cannot do, the thought goes, the accountant can and should. The difficulty with this is that Congress has not enacted the conscription bill that the SEC seeks to have us fashion and fix as an interpretative gloss on existing securities laws.

attorney as policeman.<sup>231</sup> But there has been a move to severely curtail SEC enforcement activity which can result in two discrete but divergent effects.<sup>232</sup> The cutback in enforcement of the federal securities laws could signal an end to the abuse of rule 2(e), thus mitigating the *in terrorem* effect of the rule on attorneys. However, the reduction in enforcement personnel and activity would require greater reliance on the securities bar by the SEC to ensure regulated parties' compliance with the federal securities laws. A move in the latter direction would perhaps increase the number of rule 2(e) proceedings as well as expand the type of conduct deemed to violate the rule. Decreased rule 2(e) activity is more likely, however, in view of the trend to deregulate American business and thereby to increase productivity and improve general economic conditions. Conscription of attorneys is tantamount to the placing of government agents in the board rooms of American corporations. If one rejects the concept of a bifurcated practice, and adheres to the theory that all attorneys are, in essence, advocates, such conscription constitutes an unconstitutional intrusion into the attorney-client relationship.

### C. *Life Without Rule 2(e): Alternatives to SEC Disciplinary Actions*

Rule 2(e) is not the exclusive sanction against attorneys who engage in questionable conduct. Private civil actions, criminal prosecutions, and state disbarment proceedings are all used to punish the miscreant lawyer. Even supporters of rule 2(e) recognize that the rule is supplemental in that it merely complements the self-regulation of the bar.<sup>233</sup> Former SEC Chairman Williams, for example, opined that "the most fruitful issue for examination . . . is whether the bar's enforced standards of competence and integrity are sufficient to protect against lawyer abuse of those components of the public interest embodied in the federal securities laws."<sup>234</sup> Indeed, greater reliance will be placed on the self-regulation of the legal profession, regardless of whether such regulation is currently sufficient<sup>235</sup>

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*Id.* at 788 (emphasis added) (footnote omitted).

231 See *What the SEC Expects from Corporation Lawyers*, FORTUNE, Oct. 23, 1978, at 143 (interview with Stanley Sporkin).

232 See Transition Team Report, *supra* note 2, at K-7 to K-9; *Serving Up Shad for the SEC*, NEWSWEEK, Mar. 9, 1981, at 68; Noble, *S.E.C. to Review Enforcement Policy*, N.Y. Times, Nov. 17, 1981, at D28, col. 3.

233 See, e.g., Sonde, *Professional Disciplinary Proceedings*, 30 BUS. LAW. 157 (spec. issue 1975); Williams, *Professionalism and the Corporate Bar*, 36 BUS. LAW. 159, 164 (1980).

234 Williams, *Professionalism and the Corporate Bar*, 36 BUS. LAW. 159, 164 (1980).

235 See, e.g., Johnson, *supra* note 4, at 651-53; Texas Tech Comment, *supra* note 4, at 107-08.



or not<sup>236</sup> to deter and punish the unscrupulous.

Nevertheless, state bar associations are naturally better equipped to cope with disciplinary problems. State disciplinary proceedings, which operate under the relative specificity of the CPR, are inherently more fair than rule 2(e) proceedings. Moreover, the state bar standards themselves, because they are tangible, are more likely to promote a suitable mix of zealous advocacy and ethical conduct within the profession. State bar associations have more experience with disciplinary proceedings than does the SEC, and as such are more likely to adjudicate the rights of the attorney in accord with commonly accepted standards of professional conduct.<sup>237</sup>

## V. Conclusion

During the past decade, attorneys have been confronted with an extraordinary increase in the SEC's use of rule 2(e) disciplinary proceedings. This constitutes a deprivation of constitutionally required counsel for the SEC-regulated client. Even though the sixth amendment is facially applicable only to criminal prosecutions, a theory has developed which extends the amendment's safeguards to proceedings brought under punitive statutes. An examination of the legislative history of the federal securities laws exposes the punitive intent of Congress in enacting those statutes. Accordingly, the sixth amendment guarantees should apply to proceedings before the SEC.

Rule 2(e) impermissibly interferes with the proper functioning of the attorney-client relationship, in that it is an intimidating force which serves to severely attenuate advocacy. The potential for misuse of the rule exists because the SEC acts as prosecutor, investigator, adjudicator, and disciplinarian. Moreover, the vagueness of the standards of rule 2(e) makes it nearly impossible for an attorney engaged in an ongoing practice to determine whether specific past or prospective conduct will subsequently be deemed violative of the rule. The SEC through its releases and decisions has done much to perpetuate the vagueness of rule 2(e) standards.

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236 See, e.g., Kosek, *Professional Responsibility of Accountants and Lawyers Before the Securities and Exchange Commission*, 72 L. LIB. J. 453, 468-69 (1979); Comment, *SEC Disciplinary Rules and the Federal Securities Laws: The Regulation, Role and Responsibilities of the Attorney*, 1972 DUKE L.J. 969, 975. See also Winter, *Discipline: Lawyer Discipline Probed in the States*, 66 A.B.A.J. 1193 (1980).

237 It bears emphasis that the commission does not regard itself as a disciplinary authority for attorneys in the sense that state bar disciplinary officials so regard themselves, nor does the Commission have any program as such for policing the ethics of the bar generally or even of the attorneys who practice before it. Gonson, *supra* note 23, at 1.

The role of an attorney cannot logically be divided into those of advocate and advisor, especially in the context of the securities practice. The SEC, moreover, seeks to assert rule 2(e) in situations other than those in which the attorney is actually appearing before or at an administrative proceeding. The drafting or preparing of documents for filing with the SEC, or the giving of advice to clients regarding the federal securities laws, are considered practice before the SEC. Improper conduct, as determined pursuant to the subjective standards of the agency, may result in the suspension or disbarment of the attorney from practicing before the SEC. Consequently, rule 2(e) not only violates the sixth amendment when attorneys actually appear before the SEC, but has a chilling effect upon the entire securities practice.

Rule 2(e) cannot and should not be saved. It is an unwelcome anachronism in an era of increasing self-regulation of industry and decreasing governmental involvement in the economy. Only if attorneys are permitted to represent their clients zealously within the bounds of the law can the adversary method for the determination of legal rights and remedies be preserved.