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Corporate/Securities Lawyers: Disclosure, Responsibility, Liability to Investors, and National Student Marketing Corp.

Samuel H. Gruenbaum*

I. Introduction

Over the past several years, a considerable amount of concern has attended the matter of lawyers' liability and responsibility under the federal securities laws in connection with transactions and activities of clients.¹ The level of concern heightened significantly in 1972 when the Securities and Exchange Commission (hereinafter referred to as SEC or Commission) filed its complaint in *SEC v. National Student Marketing Corp.*² Among other things, the complaint alleged that two large law firms and various individuals who were partners in the firms, committed violations of the anti-fraud provisions of the federal securities laws by failing to disclose to the SEC certain information relating to the merger of their clients—National Student Marketing Corporation (hereinafter referred to as NSMC) and Interstate National Corporation (hereinafter referred to as Interstate). Less than two weeks after the complaint was filed, the Wall Street Journal reported that it had become "the best-read document since *Gone With the Wind*."³

The SEC's allegations added a new dimension to the issues concerning lawyers' liability and responsibility. For the first time it was alleged that lawyers

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1 For extensive citations to law review articles and other commentaries on the subject, see Hoffman, *On Learning of a Corporate Client's Crime or Fraud—The Lawyer's Dilemma*, 33 BUS. LAW. 1389, 1404-05 n.38 (1978); Sonde, *Professional Responsibility—A New Religion, or the Old Gospel*, 24 EMORY L. J. 827, 827-28 n.6 (1975).

2 SEC v. National Student Mktng. Corp., [1971-1972 Transfer Binder] FED. SEC. L. REP. (CGH) ¶ 93,360 (D.D.C. 1972).

As the district court noted in its discussion concerning the lawyers' liability:

The filing of the complaint in this proceeding generated significant interest and an almost overwhelming amount of comment within the legal profession on the scope of a securities lawyer's obligations to his client and to the investing public. The very initiation of this action, therefore, has provided a necessary and worthwhile impetus for the profession's recognition and assessment of its responsibilities in this area. SEC v. National Student Mktng. Corp., 457 F. Supp. 682, 714 (D.D.C. 1978).

3 Green, *Irate Attorneys—A Bid to Hold Lawyers Accountable to Public Stuns, Angers Firms*, Wall St. J., Feb. 15, 1972, at 1, col. 1. More recently, the New York Times featured an article highlighting many of the conflicting considerations confronting lawyers in determining their obligations to corporate clients as opposed to the investing public. The article pointed out the divergence in views within the legal profession on the issues involved, and made it clear that resolution of the issues was a matter of great importance. Miller, *What a Lawyer Owes His Client—A.B.A., S.E.C. Study Changes in Corporate Law Standards*, New York Times, Dec. 17, 1978, § F., at 1, col. 5.

acting in their professional capacities violated the federal securities laws by failing to stop their clients' transaction, and, failing that, to inform the SEC that the clients had made materially misleading statements in proxy soliciting materials distributed to their shareholders. In August 1978, the district court held that the lawyers had aided and abetted violations of the anti-fraud provisions of the federal securities laws.⁴ The decision has been appealed.⁵

The issues underlying attorneys' liability and responsibility under the federal securities laws with respect to the activities of their clients are complex and often perplexing. This perplexity can be traced in part to confusion concerning the ethical and legal principles involved in analyzing these issues. This article will explore and clarify these principles generally, and apply them to the facts of *National Student Marketing Corp.* In the final analysis, a proper account of the principles will help define the contours of lawyers' responsibility and liability in this area of the law.

II. *National Student Marketing Corp.*—The Facts

During June 1969, representatives of NSMC and Interstate reached an agreement in principle for the merger of their corporations. Each was a publicly held company, and the merger was to be accomplished through a public exchange of NSMC stock for all of Interstate's outstanding stock. After extensive negotiations, a merger agreement was entered into between the two parties.

The agreement provided for mutual and parallel provisions as to such matters as warranties and representations, a comfort letter from independent accountants, and counsel opinion letters concerning legal aspects of the merger.⁶ The agreement also contained conditions precedent to the consummation of the merger. In particular, the agreement required Interstate's counsel to deliver an opinion letter to NSMC concerning legal aspects of the merger,⁷ and NSMC's independent public accountants to deliver a comfort letter to Interstate.⁸ The

4 457 F. Supp. at 715. The Commission made little effort to distinguish between principals and aiders and abettors in its charges against the defendants. The district court, recognizing that the distinction may be dwindling in light of recent developments, nonetheless characterized the charges against the attorney defendants as aiding and abetting. In this regard, the charges fell into four categories:

(1) the failure of the attorney defendants to take any action to interfere in the consummation of the merger;

(2) the issuance by the attorneys of an opinion with respect to the merger;

(3) the attorneys' subsequent failure to withdraw that opinion and inform the Interstate shareholders or the SEC of the inaccuracy of the nine-month financials [which were included in the proxy soliciting materials]; and

(4) the issuance by the attorneys . . . of an opinion . . . concerning the validity of [certain stock sales by officers of Interstate during the week following the merger].

457 F. Supp. at 700, 712. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38 (2d Cir. 1978); Note *Rule 10b-5 Liability After Hochfelder: Abandoning the Concept of Aiding and Abetting*, 45 U. CHI. L. REV. 218 (1977).

The court in *National Student Mktg Corp.* concurred with the Commission's allegations concerning the attorneys' failure to interfere in the consummation of the merger, but concluded that the remaining charges did not by themselves substantially facilitate the violation and therefore did not amount to aiding and abetting. 457 F. Supp. at 712.

5 457 F. Supp. 682, *appeals pending*, Nos. 1052-54 (D.C. Cir. 1978).

6 457 F. Supp. at 689.

7 *Id.* at 690. Similarly, NSMC's counsel was required to deliver such an opinion letter to Interstate.

8 *Id.* Similarly, Interstate's independent public accountants were required to deliver a comfort letter to NSMC. Both NSMC and Interstate utilized the same independent public

accountants' comfort letter was to cover NSMC's interim financial statements as of and for the nine-month period ending May 31, 1969. Finally, the agreement provided that notwithstanding any stockholder vote of approval of the agreement, the board of directors of each corporation could waive any of the conditions precedent to the respective corporation's obligations.

Both corporations utilized proxy statements to secure shareholder approval of the merger.⁹ Interstate's proxy materials included NSMC's proxy statement and a copy of the merger agreement. NSMC's proxy statement contained NSMC's financial statements as of and for the nine-month period ending May 31, 1969. Interstate urged its shareholders to carefully consider NSMC's proxy statement as such information was "important to [the shareholders'] consideration of the proposed merger."¹⁰

The closing meeting took place in New York on the afternoon of October 31, 1969, at NSMC's counsels' law offices. The meeting commenced, but the comfort letter from NSMC's independent accountants had not arrived. One of NSMC's lawyers telephoned the accountants and inquired about the letter. The accountants proceeded to dictate it over the telephone to a secretary who then typed it out. The letter stated that significant adjustments totalling \$884,000 were required in NSMC's income statement for the nine-month period ending May 31, 1969, thus reducing NSMC's previously reported net income of \$700,000 to a loss of \$184,000.¹¹ A copy of the typed letter was delivered to the conference room where the closing was taking place. The two members of the law firm representing Interstate¹² read the unsigned letter, as did Interstate's president and chief executive officer. The NSMC representatives were then asked several questions concerning the adjustments, and they gave their assurances that the adjustments would not have a significant effect on NSMC's predicted year-end earnings, and that a substantial portion of the adjustments would be recovered.

Viewing the letter as a serious matter, and the adjustments contained therein as significant and important, the Interstate representatives and Interstate's counsel conferred privately to consider their alternatives. Resolicitation of Interstate's shareholders was considered, but rejected since it was felt that any alternative which would delay the merger would probably result in an extension of time to a point beyond the merger upset date of November 28, 1969.¹³ Interstate's president and chief executive officer asked one of Interstate's lawyers whether the merger could proceed on the basis of an unsigned comfort letter, and the lawyer responded that it could. The parties then exchanged various docu-

accounting firm.

⁹ Both corporations represented and warranted that the information, including the financial statements contained in their respective proxy statements, was true and correct. *Id.* at 689.

¹⁰ *Id.* at 690.

¹¹ The accountants delivered a signed comfort letter the following Monday, November 3, 1969, which reduced the total adjustments to \$784,000, thus reducing the loss after the adjustments to \$84,000. *Id.* at 696.

¹² One of the members of this law firm was also a director of Interstate. *Id.* at 688.

¹³ The merger agreement required that the merger be consummated on or before November 28, 1969. *Id.* at 690.

Among the alternatives considered were: (1) delaying or postponing the closing, either to secure more information or to resolicit the shareholders with corrected financials; (2) closing the merger; or (3) calling it off completely. *Id.* at 694.

ments necessary to close the merger transaction, including an opinion letter from Interstate's lawyer concerning the legal aspects of the merger and the closing was consummated.

The upheaval which resulted in the legal profession from the filing of *National Student Marketing Corp.* stemmed from paragraph 48(i) of the complaint. The SEC alleged:

[A]s part of the fraudulent scheme [Interstate's counsel] . . . failed to refuse to issue their opinions . . . and failed to insist that the financial statements be revised and shareholders be resolicited, and failing that, to cease representing their respective clients and under the circumstances, notify the plaintiff Commission concerning the misleading nature of the nine-month financial statements.¹⁴

This contention has appeal considering the critical importance of the lawyers' advice and opinion to the consummation of the merger transaction. It is the significance of the lawyers' role in securities transactions which lends appeal to a claim such as that made by the SEC.

III. The Role of Lawyers in Securities Transactions

Lawyers play an essential role in securities matters. As former Commissioner A.A. Sommer, Jr., stated:

In a word, and the word is Professor Morgan Shipman's, the professional judgment of the attorney is often the "pass key" to securities transactions. If he gives an opinion that an exemption is available, securities get sold; if he doesn't give the opinion, they don't get sold. If he judges that certain information must be included in a registration statement, it gets included (unless the client seeks other counsel or the attorney crumbles under the weight of client pressure); if he concludes it need not be included, it doesn't get included.¹⁵

14 SEC v. National Student Mktg. Corp. [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,360 (D.D.C. 1972).

The SEC initially filed its action against several other parties, including NSMC's counsel. By the time the district court rendered its opinion in *National Student Mktg. Corp.* in August 1978, the cases against all of the parties, except Interstate's president, the law firm which acted as outside counsel to Interstate and two of its partners, had been disposed of. 457 F. Supp. at 686-87.

15 Sommer, *The Emerging Responsibilities of the Securities Lawyer*, [1974] FED. SEC. L. REP. (CCH) ¶ 79,631, p. 83,689.

It has been suggested that the extremely broad participation of lawyers in the disclosure process under the federal securities laws resulted from the apprehension of civil liability by issuers, corporate officers, directors, underwriters and experts. Cooney, *The Registration Process: The Role of the Lawyer in Disclosure*, 33 BUS. LAW. 1329, 1329-31 (Special Issue March 1978). Section 11 of the Securities Act of 1933 imposes liability on such persons for material misstatements or omissions contained in registration statements filed with the Commission, which have become effective. While Section 11 contains provisions for what is commonly referred to as a "due diligence" defense to a charge of liability, the issuer (registrant) has absolute liability under the section for material misstatements or omissions. The parameters of due diligence were dealt with extensively in the landmark cases of *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968), and *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544 (E.D.N.Y. 1971).

Lower courts have held that an implied private cause of action for damages exists under § 17(a) (general anti-fraud) of the Securities Act of 1933. *Schaefer v. First Nat'l Bank*

Once this "pass key" is obtained from the lawyer, millions of dollars change hands, securities are distributed to the investing public, and changes in corporate ownership and control take place. Millions of individuals are affected by these events. Most of the time, however, such individuals are in no position to influence the structure, terms, conditions or any other aspect of the events.

As a result, protection of the individuals' interests must come from the corporations, if it is to come at all. The federal securities laws were enacted to effectuate this end. One commentator characterized such laws as "the first federal consumer legislation."¹⁶ Since corporations must be sensitive to the interests of their shareholders, so must legal advisers be sensitive to these interests when rendering advice and issuing opinions to the corporations. Lawyers' obligations to the interests of their clients dictate that they be cognizant of their clients' responsibilities to others. Moreover, the important and substantial nature of lawyers' involvement in the securities affairs of corporate clients is strong reason for insisting upon a keen sensitivity to shareholders' interests.¹⁷

It must be emphasized that the pertinent issues addressed here concern lawyers acting as advisers, not lawyers involved in litigation or otherwise acting as advocates. Although lawyers' responsibilities are often understood from the perspective of the lawyer as an advocate, the vast changes which have occurred in

of Lincolnwood, 509 F.2d 1287, 1293 (7th Cir. 1975); *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1283-84 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970). However, the Supreme Court has expressly left open the question of whether such a cause of action exists. *International Bhd. of Teamsters v. Daniel*, U.S. 47 U.S. L. W. 4135, 4136 n.9 (1979); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 733 n.6 (1975).

Similarly, the breadth of liability for material misstatements or omissions in periodic reports typically filed with the Commission or disseminated to shareholders under the provisions of the Securities Exchange Act of 1934 provides an impetus for a high degree of involvement by lawyers in the preparation of such reports. See § 10(b) and Rule 10b-5 (general anti-fraud, § 14(a) and Rule 14a-9 (false and misleading statements in proxies), § 14(e) (anti-fraud in connection with tender offers), and § 18(a) (false and misleading statements in any application, report, or document filed with the Commission pursuant to the provisions of the Exchange Act or the rules and regulations thereunder). An implied private cause of action for damages exists under §§ 10(b) and 14(a) of the Exchange Act. *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6 (1971), *J. I. Case Co. v. Borak*, 377 U.S. 426 (1974); Under § 14(e) a defeated tender offeror has no such cause of action, but the question remains open with respect to tender offerees and others. *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 24 (1977). An express private cause of action for damages is provided for in § 18(a) of the Exchange Act.

16 Sommer, *supra* note 15.

17 Criticism of the legal profession's shortcomings in this regard was echoed as early as 1934, when former Supreme Court Justice William O. Douglas stated:

All of [the regulatory] measures, of course, merely check on control rather than cure a fundamental condition which underlies the whole problem. The condition has been reflected by the amazing absence of social consciousness on the part of directors and business executives and by their lack of any awareness of the implications and results of many practices which flourished in recent years. It has not been so much a matter of depravity and of evil intent as the consequence of cutting as close to the mythical legal line as possible. This lack of social mindedness has not been wholly or largely that of business. It has been equally shared by lawyers. It has been evidenced by the almost perverted singleness of purpose with which they have championed the cause of their clients, whether it be in the drafting of a deposit agreement, the handling of a merger, the conduct of a reorganization, or the marketing of securities. It resulted in getting accomplished what clients wanted but without regard for the long-term consequences of those accomplishments. That singleness of purpose has been wholly incompatible with the use of these aggregations of capital for either the welfare of the investors or the good of the public.

Douglas, *Directors Who Do Not Direct*, 47 HARV. L. REV. 1305, 1328-29 (1934).

our society dictate a change in perspective.¹⁸ Today's lawyer, in particular the corporate securities lawyer, plays the role of adviser far more than the role of advocate. It is imperative that lawyers' responsibilities be reexamined in light of this changed role. In the words of former Supreme Court Justice Harlan Fiske Stone:

Before [the Bar] can function at all as the guardian of public interests committed to its care, there must be appraisal and comprehension of the new conditions and the changed relationships of the lawyer to his clients, to his professional brethren and the public. That appraisal must pass beyond the petty details of form and manners which have been so largely the subject of our codes of ethics, to more fundamental consideration of the way in which our professional activities affect the welfare of society as a whole. Our canons of ethics for the most part are generalizations designed for an earlier era.¹⁹

A. *The Role of Lawyers as Advisers*

The role of a legal adviser is fundamentally different from the role of an advocate. The Code of Professional Responsibility (hereinafter referred to as CPR), as adopted by the American Bar Association (hereinafter referred to as ABA) effective January 1, 1970, distinguishes between the responsibilities of a lawyer acting in these different capacities.²⁰ As an advocate, a lawyer generally deals with past conduct.²¹ The CPR instructs an advocate to resolve doubts in favor of his client,²² and to "urge any permissible construction of the law favorable to his client, without regard to his professional opinion as to the likelihood that the construction will ultimately prevail."²³ As an advocate, a lawyer's "conduct is within the bounds of the law, and therefore permissible, if the position taken is supported by the law or is supportable by a good faith argument for an extension, modification, or reversal of the law."²⁴

An adviser usually assists in determining *future* conduct and relationships. In this regard, the CPR urges an adviser to give his opinion as to what he believes the decisions of the courts would likely be based on applicable law,²⁵ and how such decisions would legally and practically affect the matter at hand.²⁶ Moreover, an adviser may withdraw from the representation if his client chooses to proceed contrary to his judgment and advice, even if the client's contemplated

18 See Lorne, *The Corporate and Securities Adviser, the Public Interest, and Professional Ethics*, 76 MICH. L. REV. 425 (1978).

19 Stone, *The Public Influence of the Bar*, 48 HARV. L. REV. 1, 10 (1934).

20 ABA CODE OF PROFESSIONAL RESPONSIBILITY EC 7-3, 7-4 and 7-5.

The CPR also states: "Where the bounds of law are uncertain, the action of a lawyer may depend on whether he is serving as advocate or adviser. A lawyer may serve simultaneously as both advocate and adviser, but the two roles are essentially different." EC 7-3.

21 *Id.* EC 7-3.

22 *Id.*

23 EC 7-4.

The lawyer . . . is not an umpire, but an advocate. He is under no duty to refrain from making every proper argument in support of any legal point because he is not convinced of its inherent soundness. . . . His personal belief in the soundness of his cause or of the authorities supporting it, is irrelevant.

ABA Opinion 280 (1949) (cited in EC 7-4 n.11).

24 EC 7-4.

25 EC 7-3.

26 EC 7-5.

conduct is within the bounds of the law.²⁷ An advocate is not as free to withdraw.²⁸

Thus, an adviser's responsibilities require him to give broad consideration to the implications of the various interests which will be affected by his client's contemplated conduct. This broad perspective may well include the public interest. As one commentator explained:

Today's lawyers perform two distinct types of functions [the functions of counselor and advocate], and our ethical standards should, but in the main do not, recognize these two functions. . . .

[T]he ethical standards to be applied to the counselor . . . should require a greater recognition and protection for the interest of the public generally than is presently expressed in the canons. Also, the counselor's obligation should extend to requiring him to inform and to impress upon the client a just solution of the problem, considering all interests involved.²⁹

The obligation to recognize and consider interests beyond those of the client will, in the case of a corporate client, require the adviser to focus on how the corporation's contemplated conduct will affect its shareholders. In the final analysis, the beneficiaries of such a practice should be both the corporation and its shareholders. Clearly, corporations have a strong interest in promoting the interests of their shareholders and, therefore, the adviser's perceptions and criticisms of how any contemplated conduct will affect such shareholders should be made with the objective of furthering this end.

Thus, lawyers advising corporate clients are not free to ignore the shareholders' interests, despite the rubric of unquestioned devotion and loyalty to the "client."³⁰ The lawyer's responsibility to society³¹ requires him to consider and

27 EC 7-8. An adviser must have a greater sense of propriety and fairness as to the effects of his client's conduct on others:

The man who has been called into court to answer for his own actions is entitled to a fair hearing. Partisan advocacy plays its essential part in such a hearing, and the lawyer pleading his client's case may properly present it in the most favorable light. A similar resolution of doubts in one direction becomes inappropriate when the lawyer acts as counselor. The reasons that justify and even require partisan advocacy in the trial of a cause do not grant any license to the lawyer to participate as legal adviser in a line of conduct that is immoral, unfair, or of doubtful legality. In saving himself from this unworthy involvement, the lawyer cannot be guided solely by an unreflective inner sense of good faith; he must be at pains to preserve a sufficient detachment from his client's interests so that he remains capable of a sound and objective appraisal of the propriety of what his client proposes to do.

Professional Responsibility: Report of the Joint Conference, 44 A.B.A.J. 1159, 1161 (1958) (cited in EC 7-3 n.9).

28 EC 7-8.

29 Thode, *The Ethical Standard for the Advocate*, 39 TEX. L. REV. 575, 578-79 (1961) (cited in EC 7-3 n.9). Other commentators, however, have rejected the proposition that a lawyer's responsibilities differ depending on the posture of his representation. See, e.g., Freedman, *Professional Responsibility in Securities Regulation*, N.Y.L.J., April 24, 1974, at 4, col. 3.

30 See *Fund of Funds, Ltd. v. Arthur Andersen & Co.*, 567 F.2d 225, 233 (2d Cir. 1977) (client had absolute right to undivided loyalty of law firm which client had retained); *Udall v. Littell*, 366 F.2d 668, 675-76 (D.C. Cir. 1966), cert. denied, 385 U.S. 1007 (1967) ("an attorney . . . is bound to the highest duty of fidelity, honor, fair dealing and full disclosure to a client"). See also 567 F.2d at 233 n.16; *Cinema 5 Ltd. v. Cinerama, Inc.*, 528 F.2d 1384, 1386 (2d Cir. 1976); *Hafer v. Farkas*, 498 F.2d 587, 589 (2d Cir. 1974) (lawyer's duty to his client is tantamount to that of fiduciary or trustee).

EC 5-1 provides:

speak out on what he perceives the consequences of his client's contemplated conduct will be on its shareholders.

It has been pointed out that most of the SEC's proceedings against lawyers have involved lawyers acting as advisers, rather than as advocates.³² The Commission has repeatedly emphasized that advisers and advocates have different responsibilities under the federal securities laws. In *In re Emanuel Fields*, the Commission said:

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.³³

One year after the *Fields* case, in *In re Arthur Andersen & Co.*, the Commission again spoke about the role of advisers in securities matters:

Professionals involved in the disclosure process are in a very real sense representatives of the investing public served by the Commission, and, as a result, their dealings with the Commission and its staff must be permeated with candor and full disclosure. It cannot resemble an adversary relationship more appropriate to litigants in court, because the Commission is not an adverse party in this context.³⁴

A literal reading of this statement limits its scope to professionals' duty of "candor and full disclosure" to the Commission and its staff. However, considering

The professional judgment of a lawyer should be exercised, within the bounds of the law, solely for the benefit of his client and free of compromising influences and loyalties. Neither his personal interests, the interests of other clients, nor the desires of third persons should be permitted to dilute his loyalty to his client.

See also ABA CODE OF PROFESSIONAL RESPONSIBILITY DR 5-105(A) and EC 4-1.

31 ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preamble. It may even be that a lawyer's responsibility to society as envisioned by the CPR makes it inappropriate to limit his obligations to the client's shareholders in the case of a corporate client. There may be an obligation to recognize and consider the interests of the public at large.

32 Sonde, *supra* note 1, at 836.

33 *In re Emanuel Fields*, FED. SEC. L. REP. (CCH) ¶ 79,407, p. 83,174-75 n.20 (1973).

Fields, a lawyer, had been enjoined from violations of the registration and anti-fraud provisions of the federal securities laws on four separate occasions. The Commission instituted non-public administrative proceedings against him pursuant to SEC Rule 2(e), 17 C.F.R. § 201.2(e) (1978), of its Rules of Practice, and, after a hearing, barred him from practice before it. Fields challenged the Commission's disciplinary authority under Rule 2(e), and the court of appeals affirmed the Commission's action. *Fields v. SEC*, No. 73-1722 (D.C. Cir. order dated April 15, 1974).

Under Rule 2(e), the Commission has the authority to discipline professionals who practice before it. This authority is limited to cases involving professionals who (1) do not possess the requisite qualifications to appear or practice before the Commission in the representation of others; (2) are lacking in character or integrity; (3) have engaged in unethical or improper professional conduct; or (4) have willfully violated, or willfully aided and abetted violations of, the provisions of the Securities Acts. Rule 2(e) proceedings have, with rare exception, been adjudicated privately, rather than publicly. See *In re Touche Ross & Co.*, FED. SEC. L. REP. (CCH) ¶ 80,720 (1976) (order for public proceedings against proceedings against public accounting firm).

34 *In re Arthur Andersen & Co.*, [1973-1974 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,900, p. 84,263 (1974). But see *American Fin. Co.*, 40 S.E.C. 1043, 1049 (1962), where the Commission said, "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 statement that "[p]rofessionals involved in the disclosure process are . . . representatives of the investing public served by the Commission," it is clear that the duty of "candor and full disclosure" was also meant with reference to the investing public.

The SEC's position seems to be buttressed on the lawyer-adviser's role as a participant in the decision-making process in securities matters. Here the lawyer-adviser does more than merely counsel on the technicalities of the law. The regulation of securities matters is so comprehensive that the lawyer must advise on every aspect of a contemplated transaction. The lawyer's advice can affect who may buy and sell, the prices at which transactions may be effected, when transactions may be effected, and where transactions may be effected. So broad is the reach of a lawyer's advice in securities matters, and so necessary is his involvement, that he thereby becomes a participant in the matter, and must assume a direct responsibility to those who will be affected by it.³⁵ As former Commissioner Sommer claimed:

Consequently, I would suggest that all the old verities and truisms about attorneys and their roles are in question and in jeopardy—and, unless you are ineradicably dedicated to the preservation of the past, that is not all bad.

I would suggest that in securities matters (other than those where advocacy is clearly proper) the attorney will have to function in a manner more akin to that of the auditor than to that of the advocate. This means several things. . . . It means he will have to be acutely cognizant of his responsibility to the public who engage in securities transactions that would never have come about were it not for his professional presence.³⁶

In *SEC v. Spectrum, Ltd.*, the Second Circuit expressed its view on the role of advisers under the federal securities laws:

The securities laws provide a myriad of safeguards designed to protect the interests of the investing public. Effective implementation of these safeguards, however, depends in large measure on the members of the bar who serve in an advisory capacity to those engaged in securities transactions.³⁷

35 As former Supreme Court Justice Stone stated:

We must remember, nevertheless, that the very conditions which have caused specialization, which have drawn so heavily upon the technical proficiency of the Bar, have likewise placed it in a position where the possibilities of its influence are almost beyond calculation. . . . Without the constant advice and guidance of lawyers business would come to an abrupt halt. And whatever standards of conduct in the performance of its function the Bar consciously adopts must at once be reflected in the character of the world of business and finance. Given a measure of self-conscious and cohesive professional unity, the Bar may exert a power more beneficent and far-reaching than it or any other non-governmental group has wielded in the past.

Stone, *The Public Influence of the Bar*, 48 HARV. L. REV. 1, 9-10 (1934).

36 Sommer, *supra* note 15, at p. 83,689-90.

Recently, Chairman Harold M. Williams had occasion to comment on the role of advisers and advocates:

As an advocate—e.g., in the courtroom—except in unusual situations, his [the lawyer's] job is to vindicate the client's position, to justify what the client did in the past or wishes to do in the future. In the advisor capacity, however, the lawyer's role is different. It is there that he has the opportunity to bring considerations of both ethics and law to bear on the corporation's future conduct.

Williams, *Corporate Accountability and the Lawyer's Role*, 34 BUS. LAW. 7, 13 (1978).

37 489 F.2d 535, 536 (2d Cir. 1973).

The underlying rationale for this position would appear to be the necessarily high degree of involvement of advisers in the securities transactions of their clients. Similarly, in the disclosure process, advisers play a very important role by reason of their influence over what is and is not disclosed by their clients.³⁸ As Judge Gessell recently stated, "[E]very businessman must rely to some extent on the advice of outside counsel and auditors as to the appropriate contents of filings with the SEC."³⁹ Investors rely on this process. It is the only practical means of affording them the protections which were intended by the federal securities laws.⁴⁰ As Professor Mundheim stated it:

The point that is being raised is that, under certain theories developing under the securities laws, people are beginning to develop expectations that as a matter of law lawyers have responsibility to look out for people who have not traditionally been viewed as their clients. . . .

As the securities law develops to impose obligations on a lawyer for the issuer to have responsibility for the investors in a public offering, expectations are created with respect to the conduct of lawyers for the issuer.⁴¹

B. *Legal Opinions and Participation in the Disclosure Process*

Legal opinions play an important part in a large variety of securities transactions. They are required by law in registration statements filed with the SEC⁴² and are frequently sought in securities transactions which do not require the filing of reports with governmental bodies but which involve important questions concerning compliance with the securities laws.⁴³ Even when opinions are not absolutely required, as a matter of practice and good sense they are obtained. Doubtlessly, few transactions would proceed with adverse legal opinions. A legal opinion is frequently the red or green light to the consummation of a securities transaction.

In *United States v. Benjamin*,⁴⁴ Judge Friendly addressed the matter of professionals' exposure to criminal liability for opinions rendered in securities transactions:

In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar. Of course, Congress did not mean that any mistake of law

³⁸ *Id.* See Cooney, *supra* note 15.

³⁹ SEC v. S. Hayward Wills, No. 77-0097 (D.D.C. Dec. 14, 1978).

⁴⁰ See Fischer v. Kletz, 266 F. Supp. 180, 189 (S.D.N.Y. 1967). See also Van Dusen, Jr., *Ethics and Specialized Practice—An Overview of the Momentum for Reexamination*, 33 BUS. LAW. 1565, 1568 (Special Issue March 1978).

⁴¹ Discussion by Participants and Panel, *Relations with Management and Individual Financial Interests*, 33 BUS. LAW. 1227, 1250-51 (Special Issue March 1978) (comments of Professor Robert H. Mundheim).

⁴² See Item (23) of Schedule A under the Securities Act (counsel must opine on the legality of the securities being registered).

⁴³ Some examples include legal opinions concerning the unregistered distribution of securities, the use of a statutory prospectus and the sale of "control" stock pursuant to the rules under the Securities Act. See also note 15 *supra*.

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

or misstatement of fact should subject an attorney or an accountant to criminal liability simply because more skillful practitioners would not have made them. But Congress equally could not have intended that men holding themselves out as members of these ancient professions should be able to escape criminal liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen or have represented a knowledge they knew they did not possess.⁴⁵

Benjamin strongly suggests that a lawyer may not proceed blindly in rendering his opinion, but instead must carefully scrutinize the facts and circumstances before him. Such requirements are, of course, a means of achieving the desired goal of protecting the investing public.

In *National Student Marketing Corp.*, the SEC argued that under *Benjamin* the lawyers' failure to refuse to issue their legal opinion upon receipt of the unsigned comfort letter from the accountants constituted a violation of the anti-fraud provisions of the federal securities laws.⁴⁶ The court ruled that the legal opinion did not substantially assist the violations alleged and therefore could not be considered to have aided and abetted the violations. However, had the lawyers refused to issue their opinion, it must seriously be doubted whether the merger would have proceeded to close. The Interstate representatives and lawyers appreciated that the information contained in the comfort letter was "significant" and "important."⁴⁷ Doubtless, a refusal by the lawyers to issue their opinion as a result of the comfort letter would have substantially affected the decision of the Interstate representatives to proceed with the merger. Moreover, liability should have resulted from the issuance of the opinion letter since, unlike the lawyer in *Benjamin* who pleaded ignorance of the facts, the lawyers in *National Student Marketing Corp.* admitted knowledge of the relevant facts.

In *SEC v. Frank*,⁴⁸ the Second Circuit dealt with a lawyer who had been found to have violated the anti-fraud provisions of the federal securities laws as a result of his participation in the preparation of a misleading offering circular which had been used to sell stock in a public offering. The defendant argued against the district court's findings on the basis that the misleading portion of the offering circular had been prepared by the officers of the issuer "and that his function had been that of a scrivener helping them to place their ideas in proper form."⁴⁹ Judge Friendly responded by reiterating his admonition in *Benjamin* concerning the importance of accountants' certificates and lawyers' opinions.⁵⁰ Judge Friendly added:

A lawyer has no privilege to assist in circulating a statement with regard to

⁴⁵ *Id.* at 863.

⁴⁶ SEC Post-Trial Brief at 150, *SEC v. National Student Mktng Corp.*, 457 F. Supp. 682 (D.D.C. 1978). The court in *National Student Mktng. Corp.* did not address the *Benjamin* case.

⁴⁷ 457 F. Supp. at 694. Indeed, upon receipt of the unsigned letter, both counsel for and the representatives of Interstate caucused privately to consider their alternatives in light of the significance of the information contained in the letter. See text accompanying note 12 *supra*.

⁴⁸ 388 F.2d 486 (2d Cir. 1968).

⁴⁹ *Id.* at 488.

⁵⁰ 328 F.2d at 863.

securities which he knows to be false simply because his client has furnished it to him . . . [A] lawyer, no more than others, can escape liability for fraud by closing his eyes to what he saw and could readily understand.⁵¹

The court in *Frank* again focused on public interest considerations and rejected the argument that the lawyer was a mere "scrivener" for management. Instead, it suggested that a lawyer must exercise some measure of independence in securities matters rather than blindly championing the client's cause. In addition, the statement that a lawyer has no privilege to assist in circulating a statement with regard to securities which he knows to be false suggests that a lawyer's involvement in a securities matter may be viewed as that of a "participant." In view of the comprehensive nature of the federal securities laws and the breadth of legal assistance required in securities matters, this approach is realistic and is a practical means of effectuating implementation of the protections intended by the Securities Acts. Finally, *Frank* goes one step further than *Benjamin* and suggests that there may be circumstances under which a lawyer passing on an offering circular is required "to run down possible infirmities in his client's story of which he has been put on notice."⁵²

In the latter part of 1973, the Second Circuit again dealt with the issue of attorneys' responsibilities under the federal securities laws in the *Spectrum* case.⁵³ *Spectrum* involved, among other things, the use of an attorney's opinion letter to sell unregistered securities allegedly in violation of §5 of the Securities Act.⁵⁴ In remanding the case to the district court for further proceedings, Chief Judge Kaufman, in a unanimous decision, commented on the appropriate rule of law to be applied by the district judge in assessing the attorney's conduct. In this regard, Judge Kaufman instructed that the attorney's conduct as an aider and abettor in a §5 violation should be judged on a negligence standard,⁵⁵ reasoning that

51 388 F.2d at 489.

52 *Id.* In *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643, 690 (S.D.N.Y. 1968), a similar suggestion was made, but the court stated that a lawyer need not go so far as to conduct an audit. In one of his earlier decisions that grew out of the *National Student Mktng. Corp.* fraud, Judge Parker stated, "Lawyers are not free to ignore the commercial substance of a transaction which could obviously be misleading to stockholders and the investing public. Courts have not hesitated to pierce through legalistic form in order to circumvent violation of the securities laws." SEC v. *National Student Mktng. Corp.*, 402 F. Supp. 641, 647 (D.D.C. 1975). See generally *United States v. Sarantos*, 455 F.2d 877, 880-81 (2d Cir. 1972).

In *SEC v. Coven*, 581 F.2d 1020 (2d Cir. 1978), cert. denied U.S. (1979), the Second Circuit affirmed a district court finding that the defendant, a lawyer, had aided and abetted a violation of § 17(a) of the Securities Act by unconditionally, but incorrectly, representing in an opinion letter to the escrow agent in an "all or none" stock offering that the minimum number of shares required to be sold before the offering could close had in fact been sold. The district court found that the lawyer failed to make any inquiries concerning the number of shares that had been sold. The district court and the court of appeals refused to permit the lawyer to shut his eyes to what he could plainly see or represent a knowledge he did not have. See 328 F.2d at 863; 388 F.2d at 488.

53 *SEC v. Spectrum, Ltd.*, 489 F.2d 535 (2d Cir. 1973).

54 Section 5 of the Securities Act prohibits the public offer or sale of securities unless an effective registration statement is on file with the SEC. Section 3 of the Act exempts various securities, and § 4 exempts certain transactions from the registration requirements of § 5.

55 489 F.2d at 541. Accord, *SEC v. Rega*, F. Supp. (S.D.N.Y. 1975). See also *SEC v. Universal Major Indus. Corp.*, 546 F.2d 1044 (2d Cir. 1976); *SEC v. Management Dynamics, Inc.*, 515 F.2d 801 (2d Cir. 1975); *United States v. Sarantos*, 455 F.2d 877 (2d Cir. 1972).

[t]he legal profession plays a unique and pivotal role in the effective implementation of the securities laws. Questions of compliance with the intricate provisions of these statutes are ever present and the smooth functioning of the securities markets will be seriously disturbed if the public cannot rely on the expertise proffered by an attorney when he renders an opinion on such matters. . . .

. . . In the distribution of unregistered securities, the preparation of an opinion letter is too essential and the reliance of the public too high to permit due diligence to be cast aside in the name of convenience. The public trust demands more of its legal advisers than "customary" activities which prove to be careless.⁵⁶

Although *Spectrum* was a § 5 case, its rationale is analogous to cases involving the anti-fraud provisions of the federal securities laws.⁵⁷ The critical factor would appear to be the role of the lawyer in the transaction and the importance of his opinion or conduct to its consummation.⁵⁸ This rationale is consistent with the suggestion in *Frank* that the nature of a lawyer's involvement in a securities matter may cast him as a "participant" in a transaction. The rationale seems realistic since, in practice, a lawyer's opinion is the prerequisite to the consummation of a transaction.

The ABA has concluded that a lawyer rendering a legal opinion which is to be used as the basis for the sale of unregistered securities must have an adequate familiarity with the underlying facts on which the opinion is based.⁵⁹ The SEC has posited this same requirement.⁶⁰ In taking this position, both the ABA and the SEC recognized the importance of legal opinions in the distribution of unregistered securities. Moreover, the ABA recognized the far-reaching consequences which an opinion letter can have when it admonished that a lawyer "must not be oblivious to the extent to which others may be affected if he is derelict in fulfilling [his] responsibility [to his client]."⁶¹ This point was implicitly made by the Special Committee on the Lawyer's Role in Securities Transactions⁶² when it discussed the key position of lawyers in securities transactions:

In all of these situations, the lawyer's advice is intended as a guide for action by the client, and what is often desired by the client is a judgment as to the legal risks of a proposed course of action. Written legal opinions may also be necessary to comply with legal or negotiated conditions of a transaction.⁶³

⁵⁶ 489 F.2d at 541-42.

⁵⁷ See *SEC v. Coven*, 581 F.2d 1020 (2d Cir. 1978), cert. denied, _____ U.S. _____ (1979).

⁵⁸ See 546 F.2d 1044; 515 F.2d 801; *SEC v. Century Inv. Transfer Corp.*, FED. SEC. L. REP. (CCH) ¶ 93,232 (S.D.N.Y. 1971).

⁵⁹ Formal Opinion 335 of the Committee on Ethics and Professional Responsibility of the American Bar Association, 60 A.B.A.J. 488 (1974).

⁶⁰ Securities Act Release No. 4445, Securities Exchange Act Release No. 6721 (February 2, 1962), FED. SEC. L. REP. 91 (1962).

⁶¹ See note 59 *supra*.

⁶² The Association of the Bar of the City of New York, *Report By Special Committee on Lawyers' Role in Securities Transactions*, 33 BUS. LAW. 1343 (Special Issue March 1978) [hereinafter cited as *Special Committee on Lawyers' Role*].

⁶³ *Id.* at 1349.

The Special Committee also recognized that despite the limited purpose which a lawyer's opinion may be intended to serve, its presence, and therefore the lawyer's association with the transaction, could be construed by others to add an air of legitimacy to the document (*e.g.*, prospectus or registration statement) in which the opinion appears, or the transaction for which it was rendered. In this regard, the Special Committee recommended that a lawyer should consider including a legend on his opinion expressly stating the limited nature of the opinion, and cautioning readers not to construe it as implying anything about any other matter.⁶⁴

Recognizing the implication that a lawyer's association with a securities transaction may lend an appearance of legitimacy to the transaction, former Commissioner Sommer stated:

It seems to me there are circumstances where the lawyer is on some sort of notice that there may be an offense against the securities law about to be committed, and if he touches that in any degree, has his name associated with it, gives an opinion that assists in the offering, or does anything else, it seems to me, he may very well be tainted with the whole thing.⁶⁵

A lawyer may not permit others to rely on his opinion or representations when he knows that such opinion or representations have become misleading or are false.⁶⁶ In such circumstances, an affirmative obligation to halt the continued reliance by others arises. This may be accomplished by withdrawing the opinion or representations, and, in appropriate circumstances, disclosing the reasons therefore.⁶⁷ The potential harm to others is too great to permit any other solution,

64 The recommended legend reads: "[The lawyer/law firm] has passed on the validity of the securities being issued [or other specific matters, *e.g.*, status of litigation] but purchasers of the securities offered by this Prospectus should not rely on [the lawyer/law firm] with respect to any other matters." *Id.* at 1361.

65 Discussion by Participants and Panel, *The Registration Process: The Role of the Lawyer in Disclosure*, 33 BUS. LAW. 1329, 1387 (Special Issue March 1978) (comments of A.A. Sommer, Jr.). See also Hoffman, *On Learning of a Corporate Client's Crime or Fraud—The Lawyer's Dilemma*, 33 BUS. LAW. 1389, 1417-18 (Special Issue March 1978); Discussion by Participants and Panel, *Relations with Management and Individual Financial Interests*, 33 BUS. LAW. 1227, 1250-51 (Special Issue March 1978) (comments of Professor Robert H. Mundheim).

66 An opinion rendered for or susceptible to future use may become erroneous at a future date. Even though an opinion may be dated or contain language which disclaims responsibility to inform the relying party of changed circumstances, a lawyer should not knowingly permit the use of a false opinion or an opinion based on erroneous facts.

Chappell and Cheek, *The Development of Law Firm Policies and Procedures Relating to Securities Matters*, II Managing Corporate Disclosure (PLI) 973, 997 (1978).

The Special Committee on Lawyers' Role in Securities Transactions also supported this position in Guideline Seven to Part III (The Lawyer's Role in Assisting in Preparation of Registration Statements). *Special Committee on Lawyers' Role*, *supra* note 61, at 1361. *Cf. id.* at 1355 (Guideline Seven to Part II: Guidelines for Written Legal Opinions in Securities Transactions).

67 Sonde, *supra* note 1, at 561; See *Fitzgerald v. McFadden*, 88 F.2d 639, 644 (2d Cir. 1937) (lawyer acting as agent for his client was held liable to plaintiff where lawyer allowed plaintiff to act on the basis of a statement made by lawyer, which lawyer knew had become false). In *State v. Rogers*, 226 Wisc. 39, 275 N.W. 910 (1937), a lawyer who knew, but did not disclose to the disinterested management of his corporate-client, that a principal of the corporation had embezzled funds raised by the corporation in the public sale of securities, was held to have violated the state blue sky statute aimed at such misconduct. The court ruled that the lawyer "was in such a position that he could not remain neutral and do nothing." *Id.* at 914. The court concluded: "This is not a case where an attorney and officer of a company was unwittingly led into a situation involving moral and legal consequences. . . . [H]is own testimony shows that he was aware of the legal and moral implications involved." *Id.* at 915.

and the lawyer's obligation to society requires that he act in this way.⁶⁸ If a lawyer were permitted to remain silent, it would amount to a sanctioning of inaction which assists the perpetration of a wrong on others.⁶⁹

In *National Student Marketing Corp.*, the lawyers' opinion stated that, among other things, Interstate had taken all required corporate action necessary to authorize the merger, and that all action required to be taken by law and by the merger agreement had been validly taken.⁷⁰ The court in *National Student Marketing Corp.* concluded that "[u]pon receipt of the unsigned comfort letter, it became clear [to the lawyers] that the merger had been approved by the Interstate shareholders on the basis of materially misleading information."⁷¹ Despite this conclusion, the court refused to find liability arising out of the issuance of the opinion letter.⁷² It would seem, however, that the lawyers were under an obligation to withdraw their opinion, as after receipt of the comfort letter, the opinion was no longer correct.⁷³ It may be supposed that the opinion added an appearance of legitimacy to the merger since the Interstate shareholders had approved the merger on the basis of proxy soliciting materials which included the merger agreement—which contained express provisions for the exchange of legal opinions. By refusing to find liability for issuance of the opinion, the court implicitly sanctioned the issuance of a false legal opinion. The egregiousness of this implication cannot be sufficiently emphasized when considering the thousands of shareholders who were affected by, and the dollar value of, the merger.

IV. Lawyers' Duty to Disclose to Shareholders

The most difficult question presented in *National Student Marketing Corp.*,

68 ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preamble states:

Lawyers, as guardians of the law, play a vital role in the preservation of society. The fulfillment of this role requires an understanding by lawyers of their relationship with and function in our legal system. A consequent obligation of lawyers is to maintain the highest standards of ethical conduct.

69 See *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 97 (5th Cir. 1975) (inaction as a form of substantial assistance when the alleged aider and abettor has a duty to disclose). See also *Brennan v. Midwestern United Life Ins. Co.*, 417 F.2d 147, 154 (7th Cir. 1969), cert. denied, 397 U.S. 989 (1970).

As one commentator explained the SEC's position:

We are saying that when you have facts that suggest to you, as a matter of some objective level of common sense and judgment, there is something fishy—or when you know that there is a fraud going on—you have got a duty to do something about it. And you do not stand by and issue legal opinions or do anything else in that context to further that conduct.

Discussion by Participants and Panel, *The Registration Process: The Role of the Lawyer in Disclosure*, 33 BUS. LAW. 1329, 1384 (Special Issue March 1978) (comments of Theodore Sonde). See also Seymour, *The Choicest Fruit that Grows upon the Tree of English Liberty*, 47 N.Y. St. B.J. 83, 121 (1975); Sonde, *supra* note 1, at 834.

70 The opinion delivered by the lawyers at the closing stated, among other things:

7. The Plan has been duly executed and delivered by Interstate and is a valid and binding obligation in accordance with its terms and any corporate action by Interstate required in order to authorize the transactions therein contemplated has been taken.

....

10. All other actions and proceedings required by law or the Plan to be taken by Interstate at or prior to the effective date in connection with the Plan and the transactions provided for therein have been duly and validly taken.

71 457 F. Supp. at 713.

72 See text accompanying note 46 *supra*.

73 See notes 64-68 *supra* and accompanying text.

and the one which gave rise to the greatest concern in the legal profession, arose out of the SEC's allegation that the lawyers should have, failing any effort to halt the merger, informed the SEC of the information contained in the comfort letter.⁷⁴ The lawyers contended that "imposition of such a duty [would] require lawyers to go beyond their accepted role in securities transactions [and would] compel them to 'err on the side of conservatism, . . . thereby inhibiting clients' business judgments and candid attorney-client communications.'" ⁷⁵ The SEC's position was met with strong resistance from the private bar. The suggestion that lawyers have a duty to "blow the whistle" on their clients was considered repugnant to the inveterate principle of devotion and loyalty to the client, and contrary to the obligation to maintain the client's confidences and secrets. Professor Homer Kripke criticized this view, characterizing it as preaching a "new religion" which is "in conflict with an older religion—the old religion of simple-minded devotion to the client and to the duty to maintain the client's confidences."⁷⁶ Others have been less tactful in their criticism.⁷⁷

The district court's opinion in *National Student Marketing Corp.* touched on the sensitive issue raised by the SEC, but fell short of fully addressing or resolving it. The court concluded that the lawyers should have spoken out at the closing concerning the materiality of the information contained in the unsigned comfort letter, and the concomitant requirement of disclosure to and resolicitation of the Interstate shareholders.⁷⁸ The court suggested rather strongly, however, that the lawyers had a duty themselves, failing any effort to halt the merger, to disclose the information to the shareholders. Nonetheless, the court declined to determine the full extent of the lawyers' obligations, since it found liability on their failure to take any steps whatsoever to delay the closing pending disclosure and resolicitation.⁷⁹

In order to properly assess whether a lawyer has any obligation to disclose

⁷⁴ See text accompanying note 14 *supra*.

⁷⁵ 457 F. Supp. at 713.

⁷⁶ Kripke, *Summary and Conclusions, Proceedings of the ABA National Institute of Advisers to Management, Responsibilities and Liabilities of Lawyers and Accountants*, 30 BUS. LAW. 223, 224-25 (Special Issue March 1975).

⁷⁷ See Freedman, *The SEC in Action*, ACROSS THE BOARD (1977).

⁷⁸ The pertinent passages of the court's opinion were: "But, at the very least, they were required to speak out at the closing concerning the obvious materiality of the information and the concomitant requirement that the merger not be closed until the adjustments were disclosed and approval of the merger was again obtained from the Interstate shareholders." 457 F. Supp. at 713.

⁷⁹ The pertinent passages of the district court's opinion raise several questions which must be analyzed before the conduct of the lawyers can be judged proper or improper:

1. If, as the court concluded, "the attorneys' responsibilities to their corporate client required them to take steps to ensure that the information would be disclosed to the shareholders," did the attorneys, in the absence of Interstate's willingness to do so, have a duty to disclose the information to the shareholders? Moreover, why did "the attorneys' responsibilities to their corporate client" require "them to take steps necessary to ensure that the information would be disclosed to the shareholders"? Did "the attorneys' responsibilities to their corporate client" also impose responsibilities to the client's shareholders? Who was the client?
2. What "fiduciary responsibilities to client shareholders" did the attorneys have, and did those responsibilities impose a duty on the attorneys to disclose the information to the shareholders in the absence of Interstate's doing so? Again, who was the client?
3. How could counsel have fulfilled its "duty to the Interstate shareholders to delay the closing of the merger pending disclosure and resolicitation with corrected

information to a corporate-client's shareholders, three issues must be examined. First, who is the "client" when a lawyer is retained by a corporation? Second, what responsibilities, if any, does a lawyer retained by a corporation have to the corporation's shareholders? Finally, if a lawyer retained by a corporation has responsibilities to the corporation's shareholders, do those responsibilities supercede the lawyer's duty to maintain the client's confidences and secrets?

A. Who Is the Client and Responsibility to Shareholders

The CPR identifies the corporate client in EC 5-18 as follows:

A lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity.⁸⁰

As a practical matter, this is less than helpful to lawyers who must deal with the many conflicts which arise in the representation of corporations.⁸¹ EC 5-18 also provides that "[i]n advising the entity, a lawyer should keep paramount its interests and his professional judgment should not be influenced by the personal desires of any person or organization."⁸² Surely the lawyers in *National Student*

financials"? If counsel's client was the "corporation," why did they have a duty to the "shareholders"? Did counsel's duty to the shareholders require them to disclose the information in the absence of Interstate's doing so?

4. If counsel had a duty to see to it that the information was disclosed to the shareholders, did that duty supercede or give precedence to counsel's responsibility to maintain the client's confidences and secrets?

The foregoing narrows down to three essential questions:

- (1) Who was the "client"?
- (2) What responsibilities, if any, did Interstate's counsel have to the Interstate shareholders?
- (3) If Interstate's counsel had responsibilities to the shareholders, did those responsibilities supercede or give precedence to the duty to maintain the client's confidences and secrets?

These questions are examined in the text accompanying note 80 *infra*.

80 EC 5-18.

81 See *Westinghouse Elec. Corp. v. Kerr-McGee Corp.*, 580 F.2d 1311 (7th Cir. 1978); Williams, *Corporate Accountability and the Lawyer's Role*, 34 BUS. LAW. 67 (1978). For examples of the perplexing conflicts which can arise, see Marsh, *Relations with Management and Individual Financial Interests*, 33 BUS. LAW. 1227 (Special Issue March 1978); Ferren, *The Corporate Lawyer's Obligation to the Public Interest*, 33 BUS. LAW. 1253 (Special Issue March 1978).

In re Carter and Johnson, SEC REG. & L. REP. (BNA) No. 494, F-1 (Mar. 14, 1979), the administrative law judge appears to have been of the view that where the question concerns material misstatements or omissions, the board of directors, at the first instance, is the "client." However, the decision went on to conclude that the professional responsibility of the lawyers imposed obligations on them which ran to the stockholders and investing public as well. *Id.* The clear implication is that in the opinion of the Law Judge, the lawyers would have had to disclose the alleged misstatements and omissions to the shareholders and investing public if the board of directors, after being advised, did not. See *The Code of Professional Responsibility of Lawyers Engaged in Securities Law Practice—A Report by the Committee on Counsel Responsibility and Liability*, 30 BUS. LAW. 1289 (1975); see also ABA Committee on Professional Ethics, Opinion No. 202 (1940).

82 EC 5-18. Pointing to the prohibition against serving two masters who have conflicting interests, Dean Redlich noted that a lawyer, in the case of a corporate-client, must not confuse the interests of his real client with those of its management. He then added:

I do not mean to suggest that it is easy for the lawyer to define the interest of the entity, as distinct from those of the director, officer, or employee. But too often the question isn't even asked. Nothing could be more central to the mission of the advisor to management than to define the identity and interest of his client.

Marketing Corp. would have received little guidance from EC 5-18 as to whose interests to be responsive to once the unsigned comfort letter was received.

Despite the vagueness of EC 5-18, a lawyer must nonetheless determine whose interests he owes his allegiance to if he is to properly carry out his responsibilities. It is conceivable that EC 5-18 was intentionally written broadly so as to permit lawyers to determine whose interests they must represent on a situation-by-situation basis. This would be a reasonable approach considering the innumerable conflicts which can and do arise in representing corporate-clients. And perhaps EC 5-18's language that a lawyer owes his allegiance "to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity" does not mean that the entity's interests are necessarily different than the interests of the persons connected with it. It would not distort the meaning of EC 5-18 to read it as saying, nor would it be unreasonable to suggest, that a lawyer must view the interests of the "entity" on the basis of the contemplated conduct or transaction which he has been retained to counsel in, and that those interests may include none, any, or all of the stockholders, directors, officers, employees, representatives, or other persons connected with the entity. Viewed from this perspective, a lawyer would obtain considerable guidance from EC 5-18. Indeed, it would not be surprising if in many cases the entity's interests were the same as the interests of those persons connected with it.

To suggest that a lawyer retained by a corporation has responsibilities to the corporation's shareholders is not inconsistent with EC 5-18. While a corporation's board and management should be accorded considerable leeway in making "business judgments," in the final analysis, the corporation, and therefore its board and management, is accountable to the corporation's shareholders. Indeed, in some circumstances corporations are not permitted to act without approval from their shareholders. In these cases, the shareholders effectively determine what the corporation's interests are based on their own interests. Attempts to distinguish the varying interests may often be more confusing than helpful. For example, in one case where a corporation attempted to draw a distinction between its management's and shareholders' interests, the Court stated:

[I]t must be borne in mind that management does not manage for itself and that the beneficiaries of its action are the stockholders. Conceptualistic phrases describing the corporation as an entity separate from its stockholders are not useful tools of analysis. They serve only to obscure the fact that management has duties which run to the benefit ultimately of the stockholders. . . . There may be many situations in which the corporate

Redlich, *Lawyers, the Temple, and the Market Place*, 30 BUS. LAW 65, 68 (Special Issue March 1975).

On a different note, Harold Marsh, Jr. stated that as he perceived the contemporary principles, a lawyer for a corporation must treat the legally constituted majority of the board of directors as "the corporation." "Any other rule would result in making it impossible for the attorney for the corporation to determine to whom he owes his loyalty and would set the attorney up as an arbiter of corporate policy asserting the right to overrule the policy decisions of the board of directors." Marsh, *supra* note 81, at 1234. Compare *Valente v. PepsiCo, Inc.*, 68 F.R.D. 361 361, 368 (D. Del. 1975): "[A] corporation is at least in part, the association of its shareholders."

However, EC 5-18 provides: "A lawyer employed or retained by a corporation or similar entity owes his allegiance to the entity and not to a stockholder, director, officer, employee, representative, or other person connected with the entity."

entity or its management, or both, have interests adverse to those of some or all stockholders. But when all is said and done management is not managing for itself.⁸³

A lawyer cannot ignore this corporation-shareholder relationship when representing a corporate client. In many instances the shareholders' interests are the same as the corporation's, and counsel for the corporation therefore has a responsibility to the shareholders.

Today's corporations accumulate great sums of capital through aggregations of the investing public's funds. Such activities are attended by the concomitant requirements of full and fair disclosure to investors. Lawyers who advise corporations of such activities must be cognizant of the aim of the disclosure laws: protection of those persons whose funds are being sought.⁸⁴ The intent of the federal securities laws is to protect investors. Effective implementation, however, of the protections designed by these laws is only possible with the assistance of the private bar which plays such a large part in most securities matters.⁸⁵ In what seems to have been a moment of frustration during a panel discussion, former Commissioner Francis M. Wheat stated:

[T]he public perception is that the lawyer sits back and tries to keep everything bottled up. Quite the opposite, I think the developing ethical responsibility of business lawyers is to get the problems out and to solve them in such a way that the public is not injured. That includes primarily the public as the stockholders in the corporate entity.

That is putting it in a very mushy fashion, but it does seem to me that we get all mixed up in our underwear when we try to talk about lawyers having duty to the public and duties to the SEC and duties to everybody. Our fundamental duty is to our client and that duty, if spelled out correctly, is going to put a hand [*sic*] to the problem. . . .⁸⁶

In *Garner v. Wolfenbarger*,⁸⁷ the Fifth Circuit held that a corporation's claim of attorney-client privilege could be subordinated to the corporation's shareholders' interest in obtaining the information sought

where the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public requires that the availability of the privilege be subject to the right of the stockholders to show cause why it should not be invoked in the particular instance.⁸⁸

The focus on the corporation-shareholder relationship was the determining criterion for assessing the shareholders' rights against the corporation's claim of

83 *Garner v. Wolfenbarger*, 430 F.2d 1093, 1101 (5th Cir. 1970), *cert. denied sub. nom. Garner v. First American Life Ins. Co.*, 401 U.S. 974 (1971).

84 See text accompanying note 19 *supra* for discussion of the adviser's role in securities matters.

85 See text accompanying note 19 *supra*.

86 Discussion by Participants and Panel, *Obligation to the Public Interest*, 33 BUS. LAW. 1279, 1284 (Special Issue March 1978) (comments of Francis M. Wheat).

87 430 F.2d 1093.

88 *Id.* at 1103-04.

its rights. The *Garner* rationale suggests that at least in some instances, the corporation's and the shareholders' interests are identical.⁸⁹ In reviewing the district court's reliance on two English cases which treat the corporation-shareholder relationship analogous to that between beneficiaries and trustees,⁹⁰ the court in *Garner* said, "Though not binding precedents, these English cases are persuasive recognition that there are obligations, however characterized, that run from corporation to shareholder. . . ."⁹¹

These obligations, and the suggestion that there is an overlap between a corporation's and its shareholders' interests necessarily lead to the inference that if a lawyer owes his allegiance to a corporation,⁹² then he also owes his allegiance to its shareholders.⁹³ It has even been stated that a public company's counsel's responsibilities are primarily to the company's investors, rather than the company.⁹⁴ However, one need not go so far if the investors' interests are put into proper perspective.⁹⁵

While the court in *National Student Marketing Corp.* found no need to fully determine the extent of the lawyers' obligations to Interstate's shareholders, it did state that the lawyers had "fiduciary responsibilities to the Interstate [client] shareholders."⁹⁶ The court did not give its basis for this statement, but it would be reasonable to assume that it was the corporation-shareholder relationship which gave rise to it. This appears to be in accord with what the court in *Garner* said.

The lawyers in *National Student Marketing Corp.* argued that they had no duty to halt the merger or disclose the information contained in the comfort letter, as that was a business judgment which they properly left for the Interstate representatives. The court responded to this argument by stating that it was not a justification for the lawyers' failure to make a "legal decision."⁹⁷ This is consistent with the teachings of the CPR, which instruct that decisions are properly left to the client if made within the framework of the law.⁹⁸ However, it would seem that where the facts and circumstances are sufficiently certain and the conclusion is clear, as was the case in *National Student Marketing Corp.*, there is no sense in applying the "business judgment" restraint on the lawyer. The decision then becomes a legal one which the lawyer is better equipped than

89 See text accompanying note 80 *supra*.

90 *Gourand v. Edison Gower Bell Tel. Co.*, 57 L.T.Ch. 498, 56 L.T. 813 (1888); and *W. Dennis & Sons, Ltd. v. West Norfolk Farmers' Manure & Chem. Co.*, 2 All E.R. 94, 112 L.J.Ch. 239, 169 L.T. 74, 59 TLR 298, 87 Sol. Jo. 211 (1943).

91 430 F.2d at 1102.

92 EC 5-18.

93 See *Broad v. Rockwell Int'l Corp.*, [1976-1977 Transfer Binder] FED. SEC. L. REP. (CGH) ¶ 95,894 (N.D. Tex. 1977); *Relations with Management and Individual Financial Interests*, 33 BUS. LAW. 1239 (Special Issue March 1978) (commentary by Kenneth J. Bialkin) (the corporate interests refer to the corporation's economic interests for the most part or, in appropriate circumstances, to the shareholder body, or both).

94 See *Garrett*, SEC. REG. & L. REP. (BNA), No. 223, A-16 (Oct. 17, 1978). See also Sommer, *supra* note 15.

95 See text accompanying note 80 *supra*.

96 457 F. Supp. at 714.

97 *Id.* at 713-14.

98 EC 7-5, 7-7 and 7-8.

the client to make. In view of the fiduciary responsibility to the client,⁹⁹ arguably there exists an obligation on the part of the lawyer to prevent the client from acting outside the bounds of the law.

The CPR urges a lawyer to express his viewpoint in the decision-making process. A lawyer should exert his best efforts to assure that all relevant considerations have been examined. However, the CPR cautions "that the decision to forego legally available objectives or methods because of non-legal factors is ultimately for the client."¹⁰⁰ Against this background, the court's opinion in *National Student Marketing Corp.* appears to be in perfect harmony with the CPR. As a practical matter, and in keeping with the teachings of the CPR, the lawyers in *National Student Marketing Corp.* should have, as a first step, advised the Interstate representatives that the merger could not proceed without disclosure and resolicitation.¹⁰¹ Instead, the lawyers did nothing, which is the reason that the court found it unnecessary to carry its analysis any further. However, once the lawyers knew that the merger had been approved by the shareholders on the basis of false information, their obligations to the shareholders required them to speak out.¹⁰²

This position finds support in the recent decision of *In re Carter and Johnson*,¹⁰³ an SEC administrative proceeding. In that case, the Commission alleged that lawyers for a publicly held corporation violated, and aided and abetted violations of, the anti-fraud and reporting provisions of the Exchange Act. The violations were alleged to have occurred as a result of material misstatements and omissions contained in the company-client's press releases, letters to shareholders, and filings with the Commission. In holding that the lawyers had violated, and aided and abetted violations of the law as alleged, the administrative law judge appears to have been of the view that the lawyers had an obligation to the company's shareholders, as well as investors in general.¹⁰⁴ The law judge did not conclude that the lawyers had a duty, as a matter of law to go directly to the shareholders or investors.¹⁰⁵ However, from a professional responsibility perspective under the CPR, the law judge concluded that the lawyers

failed to carry out their professional responsibilities with respect to appropriate disclosure to all concerned, including stockholders, directors and the investing public, of the material facts described herein, and thus knowingly engaged in unethical and improper professional conduct, as charged in the Order.¹⁰⁶

Finally, the law judge was of the view that as a matter of law, once the

99 See *Fund of Funds, Ltd. v. Arthur Andersen & Co.*, 567 F.2d 225 (2d Cir. 1977); *Cinema 5, Ltd. v. Cinerama, Inc.*, 528 F.2d 1384 (2d Cir. 1976); *Haft v. Farkas*, 498 F.2d 587 (2d Cir. 1974); *Udall v. Littell*, 366 F.2d 668 (D.C. Cir. 1966), *cert. denied*, 385 U.S. 1007 (1967).

100 EC 7-8.

101 *Id.* EC 7-7. See *State v. Rogers*, 226 Wisc. 39, 275 N.W. 910 (1937); *Cooney, The Registration Process: The Role of the Lawyer in Disclosure*, 33 BUS. LAW. 1329, 1335-36 (Special Issue March 1978).

102 226 Wisc. 39, 275 N.W. 910.

103 SEC. REG. & L. REP. (BNA) No. 494, F-1 (Mar. 14, 1979).

104 *Id.*

105 See note 81 *supra*.

106 SEC. REG. & L. REP. (BNA) No. 494, F-1 (Mar. 14, 1979).

lawyers were put on alert that violations were occurring or were about to occur, they should have embarked on some course of action which would have stopped or prevented the violation from occurring.¹⁰⁷ However, other than indicating that the lawyers had a duty to the directors, shareholders, and investors, and suggesting that the lawyers should have gone to the board of directors as a first step, the law judge did not suggest how the lawyers might have stopped or prevented the violations from occurring.

B. *Lawyers' Duty to Reveal Information*

The SEC's position that the lawyers in *National Student Marketing Corp.* had a duty to disclose the information contained in the unsigned comfort letter finds support in the CPR. Foremost in this regard is DR 7-102(B)(1), which provides:

A lawyer who receives information clearly establishing that:

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

In addition, several other provisions of the CPR support the SEC's position and require a lawyer to disclose information.¹⁰⁸ The disclosure requirement usually arises in situations involving the client's dishonest or fraudulent conduct, misrepresentation or otherwise illegal conduct. The duty to disclose is usually accompanied by a duty to withdraw from the representation.

Although DR 7-102(B)(1) excepts privileged communications from the duty to reveal, if a client's contemplated conduct amounts to an intent to commit a "crime," DR 4-101(C)(3) suggests that the information necessary to prevent its commission may be revealed without regard for whether the information is privileged.¹⁰⁹ Also, a lawyer must consult applicable statutory and case law to determine what disclosure requirements, if any, exist since the CPR prohibits a lawyer from concealing or knowingly failing "to disclose that which

¹⁰⁷ *Id.*

¹⁰⁸ The CPR provides that a lawyer: may not "[e]ngage in conduct involving dishonesty, fraud, deceit or misrepresentation," DR 1-102(A)(4); must withdraw from the representation if "[h]e knows or it is obvious that his continued employment will result in violation of a Disciplinary Rule," DR 2-110(B)(2); may withdraw from the representation if his client "[p]ersonally seeks to pursue an illegal course of conduct," DR 2-110(C)(1)(b); may withdraw if "[h]is continued employment is likely to result in a violation of a Disciplinary Rule," DR 2-110(C)(2); may reveal "[c]onfidences or secrets when permitted under Disciplinary Rules or required by law or court order," DR 4-101(C)(2); may reveal "[t]he intention of his client to commit a crime and the information necessary to prevent the crime," DR 4-101(C)(3); may "[r]efuse to aid or participate in conduct that he believes to be unlawful, even though there is some support for an argument that the conduct is legal," DR 7-101(B)(2); shall not "[c]onceal or knowingly fail to disclose that which he is required by law to reveal," DR 7-102(A)(3); shall not "[k]nowingly make a false statement of law or fact," DR 7-102(A)(5); shall not "[c]ounsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent," DR 7-102(A)(7); and shall not "[k]nowingly engage in other illegal conduct or conduct contrary to a Disciplinary Rule," DR 7-102(a)(8).

¹⁰⁹ DR 4-101(C)(3) provides: "A lawyer may reveal the intention of his client to commit a crime and the information necessary to prevent the crime."

he is required by law to reveal"¹¹⁰ and permits a lawyer to reveal "[c]onfidences or secrets when . . . required by law. . . ."¹¹¹ A lawyer's noncompliance with the requirements of the CPR, however, will not necessarily result in civil liability. The CPR was not intended to establish standards for civil liability for professional misconduct.¹¹² However, there is authority¹¹³ for the proposition that the standards set by the accounting profession should be the determining factor in judging whether accountants have fulfilled their responsibilities under the federal securities laws, and this proposition may well be applicable to lawyers and the CPR.¹¹⁴ Thus, the CPR may be an important consideration in determining civil liability.¹¹⁵

The argument against the duty to disclose is founded upon the fear that imposition of such a duty would greatly damage the confidential relationship enjoyed by lawyers with their clients. The damage would result from clients' apprehension of revealing information to their lawyers, which in turn would impede effective legal representation and in the end would be detrimental to the administration of justice. As Commissioner Roberta S. Karmel put it several years before joining the Commission:

Holding attorneys to the high ethical standards suggested in the *National Student Marketing* complaint has an easy public interest appeal, which is difficult to criticize. Nevertheless, the idea that an attorney has a duty to the SEC or the public to investigate the information he receives from his clients in connection with an SEC registration statement or other filing and disclose any falsities discovered could prove inimical to existing attorney-client relationships.¹¹⁶

¹¹⁰ DR 7-102(A)(3).

¹¹¹ DR 4-101 (C)(2).

¹¹² ABA CASE OF PROFESSIONAL RESPONSIBILITY, Preamble. See *Herman v. Acheson*, 108 F. Supp. 723 (D.D.C. 1952), *aff'd sub nom. Herman v. Dulles*, 205 F.2d 715 (D.C.Cir. 1953). *E.F. Hutton & Co. v. Brown*, 305 F. Supp. 371, 377 n.7 (S.D. Tex. 1969) (the CPR has no statutory force). However, in *Fund of Funds, Ltd. v. Arthur Andersen & Co.*, 567 F.2d 225, 227 n.2 (2d Cir. 1977), the court of appeals stated that the CPR "is recognized by both state and federal courts within this circuit as providing appropriate guidelines for proper professional behavior" (citing *NCK Organization Ltd. v. Bregman*, 542 F.2d 128, 129 n.2 (2d Cir. 1976)).

¹¹³ *SEC v. Arthur Young & Co.*, 590 F.2d 785 (9th Cir. 1979); *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968). But see *United States v. Simon*, 425 F.2d 796 (2d Cir. 1969), *cert denied*, 397 U.S. 1006 (1970).

¹¹⁴ *Id.*

¹¹⁵ While analysis of a lawyer's responsibility to reveal information under the Canons, Ethical Considerations and Disciplinary Rules of the CPR may itself be difficult and involved, the most difficult task confronting a lawyer is the task of shaping the facts involved and giving clear definition to what he perceives to be the problem. A lawyer's decision to reveal information, if not firmly founded, will lead to a transgression of the CPR, as "the authority to make decisions is exclusively that of the client and, if made within the framework of the law, such decisions are binding on his lawyer." EC 7-7. Moreover, an unfounded decision to reveal information may injure the client which could constitute a violation of DR 7-101(A)(3)'s express prohibition from intentionally prejudicing or damaging a client during the professional relationship, unless required by DR 7-102(B). The difficulty of the task confronting the lawyer is well stated in the CPR:

In fulfilling his professional responsibilities, a lawyer necessarily assumes various roles that require the performance of many difficult tasks. Not every situation which he may encounter can be foreseen, but fundamental ethical principles are always present to guide him. Within the framework of these principles, a lawyer must with courage and foresight be able and ready to shape the body of the law to the ever-changing relationships of society.

ABA CODE OF PROFESSIONAL RESPONSIBILITY, Preamble.

¹¹⁶ Karmel, *Attorneys' Securities Laws Liabilities*, 27 BUS. LAW. 1153, 1159-60 (1972).

....

Hopefully, the legitimate public interest in preserving the confidential relationship between attorney and client will be regarded as more important than the SEC's apparent intention of enlisting the aid of private practitioners to implement enforcement of the securities laws.¹¹⁷

Others have echoed concerns similar to those of Commissioner Karmel. In a 1975 Statement of Policy,¹¹⁸ the House of Delegates of the ABA adopted the recommendation of the Section of Corporation, Banking and Business Law, which concluded:

We do not believe that the policy of disclosure as embodied in the SEC laws warrants an exception to the basic confidentiality of the attorney-client relationship. Such exceptions have to date been carefully reserved by the CPR for far more critical and limited situations. The statutes administered by the SEC give it no power to require disclosure by lawyers concerning their clients beyond what is provided in the CPR.¹¹⁹

However, the only argument of substance is the concern for the possible damage to the attorney-client relationship. As for the other arguments, the courts, the Commission, and the ABA have repeatedly recognized that lawyers involved in the disclosure process cannot take client representations on blind faith, but rather must take some steps, short of an audit, to satisfy themselves that the information they receive from their clients is accurate.¹²⁰ The United States Supreme Court, in *J. I. Case v. Borak*,¹²¹ as well as several lower courts and the Commission, has recognized that the private bar plays an important role in the effective implementation of the disclosure laws in securities matters. The public and the Commission necessarily rely on this assistance as a means of implementing the protections the securities laws were intended to effect.¹²² Professor Wigmore laconically stated the real problem: "In order to promote freedom of consultation of legal advisers by clients, the apprehension of compelled disclosure by the legal advisers must be removed; hence the law must prohibit such disclosure except on the client's consent."¹²³

117 *Id.* at 1164.

118 61 A.B.A. J. 1085 (1975).

119 ABA Section of Corporation, Banking and Business Law, *Recommendation* 31 Bus. Law. 544, 547 (1975).

120 SEC v. Management Dynamics, Inc., 515 F.2d 801 (2d Cir. 1975); SEC v. Spectrum, 489 F.2d 535 (2d Cir. 1973); United States v. Sarantos, 455 F.2d 877 (2d Cir. 1972); United States v. Simon, 425 F.2d 796 (2d Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970); SEC v. Frank, 388 F.2d 486 (2d Cir. 1968); United States v. Benjamin, 328 F.2d 854 (2d Cir.), *cert. denied*, 377 U.S. 953 (1964); SEC v. National Student Mktg. Corp., 402 F. Supp. 641 (D.D.C. 1975); Escott v. BarChris Constr. Corp., 283 F. Supp. 643 (S.D.N.Y. 1968); *In re Emanuel Fields*, FED. SEC. L. REP. (CCH) ¶ 79,407 (1973); Formal Opinion 335 of the Committee on Ethics and Professional Responsibility of the American Bar Association, 60 A.B.A. J. 488 (1974); Securities Act Release No. 4445, Securities Exchange Act Release No. 6721 (Feb. 2, 1962), FED. SEC. L. REP. (CCH) ¶ (1962); *Special Committee on Lawyers' Role*, *supra* note 61.

121 377 U.S. 426 (1964).

122 515 F.2d 801; 489 F.2d 535; 388 F.2d 486; 328 F.2d 854; *In re Arthur Andersen & Co.*, FED. SEC. L. REP. (CCH) ¶ 79,407 (1973).

123 8 J. WIGMORE, EVIDENCE IN TRIALS AT COMMON LAW § 2291, at 545 (J. McNaughton rev. ed. 1961).

An analysis of the duty to reveal under DR 7-102(B)(1) requires careful examination of several significant questions, the two most difficult of which are: Who is the client and when are communications privileged and thereby excepted from the duty to reveal? The first question has already been dealt with,¹²⁴ and the second question will be examined after a brief review of what "clearly establishing," "fraud," and "person or tribunal" are intended to mean in the context which they are used in DR 7-102(B)(1).

1. "Clearly Establishing"

DR 7-102(B)(1) provides that the duty to reveal arises only when a lawyer receives information "clearly establishing" that his client has perpetrated a fraud in the course of the representation. In 1975 the ABA House of Delegates addressed this point:

In appropriate circumstances, a lawyer may be permitted or required by the Disciplinary Rules under the CPR to resign his engagement if his advice concerning disclosures is disregarded by the client and, if the conduct of a client clearly establishes his prospective commission of a crime or the past or prospective perpetration of a fraud in the course of the lawyer's representation, even to make the disclosure himself. However, the lawyer has neither the obligation nor the right to make disclosure when any reasonable doubt exists concerning the client's obligation of disclosure, i.e., the client's failure to meet his obligation is not clearly established, except to the extent that the lawyer should consider appropriate action, as required or permitted by the CPR, in cases where the lawyer's opinion is expected to be relied on by third parties and the opinion is discovered to be not correct, whether because it is based on erroneous information or otherwise.¹²⁵

This statement finds some support in ABA Opinion 314, which provides that a lawyer must disclose the confidences of his client if "the facts in the attorney's possession indicate beyond reasonable doubt that a *crime* will be committed."¹²⁶ However, it must be noted that ABA Opinion 314 deals with a client's intent to commit a *crime*, which is a matter specifically addressed in DR 4-101(C)(3). Although DR 7-102(B)(1) expressly requires that the information received by the lawyer "clearly establish" the perpetration of a fraud, DR 4-101(C)(3) has no such express standard. The authority of the House of Delegates' adoption of a "beyond a reasonable doubt" standard for DR 7-102(B)(1) in the face of the express "clearly establishing" standard must be seriously questioned. Moreover, the House of Delegates provided no support for its limitation on the duty of disclosure to situations where the lawyer has issued an opinion which "is expected to be relied on by third parties and the opinion is discovered to be not correct." No support can be found for this limitation in the CPR. However, to the extent that a "fraud" may constitute a *crime*, the House of Delegates would be correct in holding a "beyond a reasonable doubt" standard

¹²⁴ See text accompanying note 80 *supra*.

¹²⁵ House of Delegates of the ABA, *Statement of Policy*, 61 A.B.A.J. 1085 (1975) (adopting recommendation of ABA Section of Corporation, Banking and Business Law, 31 BUS. LAW. 544, 545 (1975)).

¹²⁶ See DR 4-101(C)(3) n.16 (emphasis added).

applicable under DR 4-101(C)(3). But this would not resolve the duty to disclose under the "clearly establishing" standard of DR 7-102(B)(1).

2. "Fraud"

The question of what constitutes "fraud" under DR 7-102(B)(1) must be considered in assessing the duty to reveal. ABA Formal Opinion 341, issued in 1975, adopts the common law view of fraud and provides that it presupposes *scienter or the intent to deceive*.¹²⁷ ABA Canon of Professional Ethics No. 41, the precursor of DR 7-102(B)(1), required disclosure of *fraud and deception*.¹²⁸ In *Ernst & Ernst v. Hochfelder*,¹²⁹ the Supreme Court, after an extensive analysis of the interrelationships of the Securities Acts, held that the terms "manipulative" and "deceptive" as used in § 10(b) of the Exchange Act presupposed *scienter*. The Court defined *scienter* as "a mental state embracing intent to deceive, manipulate or defraud"¹³⁰ and left open the question of whether recklessness, in some circumstances, constitutes *scienter*.¹³¹ Whether *Hochfelder's* definition of *scienter* applies to ABA Formal Opinion 341, and therefore to DR 7-102(B)(1), is an open question. In a recent decision, *SEC v. S. Hayward Wills*,¹³² Judge Gessell suggested that the *Hochfelder* *scienter* requirements is limited to a showing of *deceit* which is expressly stated in § 10(b) and may not apply to a showing of *fraud* which is expressly stated in § 17(a) of the Securities Act.¹³³ However, the Supreme Court's statement in *International Brotherhood of Teamsters v. Daniel*¹³⁴ that the anti-fraud provisions of the Securities Acts impose "indefinite and uncertain disclosure obligations,"¹³⁵ suggests that violations of the anti-fraud provisions, and therefore the commission of fraud under the securities laws, will be very difficult to prove.

Application of the principles laid down by the courts to the CPR would clarify significantly the responsibilities of lawyers under the CPR. In this regard, the absence of the word *deception* in DR 7-102(B)(1), as compared to its pres-

127 ABA Formal Opinion 341; See Ferren, *The Corporate Lawyer's Obligation to the Public Interest*, 33 BUS. LAW 1253, 1260 n.13 (Special Issue March 1978).

128 ABA CANONS OF PROFESSIONAL ETHICS No. 41 provided:

When a lawyer discovers that some fraud or deception has been practiced, which has unjustly imposed upon a court or a party, he should endeavor to rectify it; at first, by advising his client, and if his client refuses to forego the advantage thus unjustly gained, he should promptly inform the injured person or his counsel, so that they may take appropriate steps.

129 425 U.S. 185 (1976).

130 *Id.* at 193-94 n.12.

131 It must be emphasized that *Hochfelder's* holding that *scienter* is required in order to state a cause of action under § 10(b) applies to private damage actions. The question "whether *scienter* is a necessary element in an action for injunctive relief under § 10(b) and Rule 10b-5" was left open by the Supreme Court. 425 U.S. at 193-94 n.13. The lower courts have differed on this issue in their decisions since *Hochfelder*. See *SEC v. Arthur Young & Co.*, 590 F.2d 785 (9th Cir. 1979); *SEC v. Blatt*, 583 F.2d 1325 (5th Cir. 1978); *SEC v. American Realty Trust*, 586 F.2d 1001 (4th Cir. 1978); *SEC v. Coven*, 581 F.2d 1020 (2d Cir. 1978), *cert. pending*, No. 78-956 (filed December 15, 1978); *SEC v. Bausch & Lomb, Inc.*, 565 F.2d 8 (2d Cir. 1977); *SEC v. World Radio Mission, Inc.*, 544 F.2d 535 (1st Cir. 1976); *SEC v. Southwest Coal & Energy Co.*, 439 F. Supp. 820 (N.D. La. 1977).

132 F. Supp. (D.D.C. 1978). See also note 131 *supra*.

133 In *Hochfelder*, the Supreme Court suggested that the language of § 17(a) may be broader than the language of § 10(b) and therefore may not require a showing of *scienter* to prove a violation. *Ernst & Ernst v. Hochfelder*, 425 U.S. at 212-13 & n. 32.

134 434 U.S. 1061 (1979).

135 *Id.*

ence in *ABA Canons of Professional Ethics No. 41*, suggests that something less than scienter, as defined in *Hochfelder*, constitutes fraud under DR 7-102(B)(1). However, the reference to deceit in ABA Formal Opinion 341 implies that proof of scienter is required. Moreover, in light of *Daniel*, it may be quite difficult to prove fraud under the federal securities laws, which would limit the duty to reveal under DR 7-102(B)(1) to the more egregious situations.

Finally, the question of what constitutes fraud may be entirely different in the context of SEC administrative proceedings. In this regard, the Commission has followed the standard of willfulness as set forth in *Tager v. SEC*, which states:

It has been uniformly held that "willfully" in this context means intentionally committing the act which constitutes the violation. There is no requirement that the actor be aware that he is violating the Rules or Act.¹³⁶

Indeed, the Commission has rejected the applicability of *Hochfelder* to its administrative proceedings.¹³⁷ The result of this is that it leaves lawyers in a quandary. If a finding of "fraud" under DR 7-102(B)(1) requires proof of scienter as defined in *Hochfelder*, then knowledge that a violation is being committed would seem to be essential. However, in SEC administrative proceedings applying the *Tager* standard, knowledge whether the conduct in question violates the law is not essential to a lawyer's assessment of his responsibility to speak out. Consequently, the SEC has, if *Hochfelder* is applicable to the determination of what constitutes "fraud" under the CPR, imposed a standard higher than is required under the CPR. This means that the SEC could, in a given situation, be requiring lawyers to violate the CPR by imposing on them a duty to speak out when the conduct in question amounts to fraud under the *Tager* test, but not under *Hochfelder*. This result is untenable, especially in view of the fact that Commission's Office of the General Counsel argued that the CPR should be determinative in judging lawyers' conduct in SEC administrative proceedings.

3. "Person or Tribunal"

DR 7-102(B)(1)'s duty to reveal is limited to revealing the fraud to the affected "person" or "tribunal." The CPR defines "person" to include "a corporation, an association, a trust, a partnership, and any other organization or legal entity."¹³⁸ "Tribunal" includes "all courts and all other adjudicatory bodies."¹³⁹ An ABA Committee has interpreted "tribunal" to exclude a governmental agency except in the context of a hearing or proceeding.¹⁴⁰

136 344 F.2d 5, 8 (2d Cir. 1965); *In re Carter and Johnson*, SEC. REG. L. REP. (BNA) No. 494, F-1 (Mar. 14, 1979).

137 *Arthur Lipper Corp. v. SEC*, 547 F.2d 171, 180 (2d Cir. 1976), *rehearing denied*, 551 F.2d 915 (1977), *cert. denied*, 434 U.S. 1009 (1978); *In re Carter and Johnson*, SEC. REG. & L. REP. (BNA) (No. 494 F-1, Mar. 14, 1979); *FAI Investment Analysts, Inc.*, Securities Exchange Act of 1934 Release No. 13695 (June 29, 1977), *appeal pending*, No. 77-2415 (5th Cir.)

138 ABA CODE OF PROFESSIONAL RESPONSIBILITY, Definition No. 3.

139 ABA CODE OF PROFESSIONAL RESPONSIBILITY, Definition No. 6.

140 *The Code of Professional Responsibility of Lawyers Engaged in Securities Law Practice—A Report by the Committee on Counsel Responsibility and Liability*, 30 BUS. LAW. 1289, 1299 (1975); Ferren, *supra* note 81, at 1260.

As an administrative agency, the SEC would likely be included within the definition of "person" as an "organization or legal entity." Moreover, the duty to reveal to the SEC arguably exists by virtue of the SEC's function as a servant of and conduit for the investing public, which includes the persons affected by a securities fraud. Finally, DR 1-103(A) requires a lawyer to report unprivileged knowledge of, among other things, a lawyer's conduct involving dishonesty, fraud, deceit, or misrepresentation¹⁴¹ to a tribunal or other authority empowered to investigate or act upon such conduct. Arguably, this would require a lawyer to report his own conduct to the SEC,¹⁴² since the SEC has the authority to investigate and act upon the described conduct.

C. *Privileged Communications*

Privileged communications are expressly excepted from DR 7-102(B)(1)'s revelation requirement. ABA Formal Opinion 341 defined "privileged communication" as including "those confidences and secrets that are required to be preserved by DR 4-101."¹⁴³ DR 4-101(B)(1) prohibits a lawyer from revealing his client's "confidences" or "secrets."¹⁴⁴ The ethical prohibition is broader than the prohibitions of the attorney-client privilege,¹⁴⁵ and "exists without regard to the nature or source of information or the fact that others share the knowledge."¹⁴⁶ As the Seventh Circuit recently instructed: "To the extent evidentiary, procedural, or agency rules are generally instructive, we should accept their guidance. However, those rules should not strictly control the application of ethical principles."¹⁴⁷

Prior to January 1, 1970, the effective date of the CPR, the ABA apparently had given the lawyer's duty to maintain his client's confidences priority over the duty to reveal the client's intention to commit a crime and the actual commission of fraud, deception or perjury during the course of the representation.¹⁴⁸ When the CPR first became effective in 1970, DR 7-102(B)(1)'s exception for privileged communications did not exist. The exception was added

141 DR 1-103(A)(4).

142 17 CFR 201.2(e) (1978) gives the Commission authority to discipline professionals who practice before it for, among other things, violations of the provisions of the Securities Acts. Section 20 of the Securities Act and § 21 of the Exchange Act give the Commission and its staff the authority to investigate possible violations of the provisions of the Securities Acts. Since a lawyer's conduct involving fraud, deceit or misrepresentation can violate the anti-fraud provisions of the Securities Acts, the SEC is an "authority empowered to investigate or act upon such conduct" within the meaning of DR 1-103(A).

143 ABA Formal Opinion 341 (1975).

144 DR 4-101(A) provides:

"Confidence" refers to information protected by the attorney-client privilege under applicable law, and "secret" refers to other information gained in the professional relationship that the client has requested to be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.

145 EC 4-4; *First Wis. Mortgage Trust v. First Wis. Corp.*, 584 F.2d 201 (7th Cir. 1978).

146 EC 4-4.

147 584 F.2d 201.

148 For a detailed analysis, see Ferren, *supra* note 80, at 1261-66. See also Redlich, *supra* note 82, at 70.

Generally, the pre-Code obligations to disclose a client's fraud, deception or perjury were either limited expressly by the Canons, or narrowed by later opinions of the ABA. See ABA CANONS OF PROFESSIONAL ETHICS Nos. 29 (duty to reveal client's commission of perjury), 37 (duty to preserve client's confidences, except announced intention to commit a crime), and 41 (duty to reveal client's fraud or deception). See also ABA Formal Opinions 23 (1930), 155 (1936), 156 (1936), 268 (1945) and 341 (1975).

by amendment in 1974, apparently because of a concern that without it there might be a conflict with state law obligations to protect privileged communications.¹⁴⁹ In a 1975 Statement of Policy,¹⁵⁰ the House of Delegates of the ABA adopted the recommendation of the Section of Corporation, Banking and Business Law, which concluded:

This vital confidentiality of consultation and advice [between lawyer and client] would be destroyed or seriously impaired if it is accepted as a general principle that lawyers must inform the SEC or others regarding confidential information received by lawyers from their clients even though such action would not be permitted or required by the CPR. Any such compelled disclosure would seriously and adversely affect . . . the ability of lawyers as advocates to represent and defend their clients' interests.

In light of the foregoing considerations, it must be recognized that a lawyer cannot, consistently with his essential role as legal adviser, be regarded as a source of information concerning possible wrong-doing by clients. Accordingly, any principle of law which, except as permitted or required by the CPR, permits or obliges a lawyer to disclose to the SEC otherwise confidential information, should be established only by statute after full and careful consideration of the public interests involved, and should be resisted unless clearly mandated by law.¹⁵¹

The Special Committee of the Bar of the City of New York on the Lawyer's Role in Securities Transactions came to the same conclusion.¹⁵²

The attorney-client privilege is an inveterate principle in the law. It first arose during the reign of Elizabeth I in "consideration for the *oath and the honor* of the attorney rather than for the apprehension of his client."¹⁵³ By the mid-1800's, the privilege was recognized as belonging to the client, and included "communications made, first, during any other litigation, next, during a controversy but not yet looking to litigation; and, lastly, in any consultation for legal advice, wholly irrespective of litigation or even of controversy."¹⁵⁴

The policy underlying the privilege is the promotion of freedom of consultation. This is accomplished through elimination of the apprehension of disclosure without consent.¹⁵⁵ However, the privilege applies only to confidential

149 ABA National Institute, *Advisers to Management*, 30 BUS. LAW. 13, 20 (Special Issue March 1975) (remarks of Lewis H. Van Dusen, Jr.); Lorne, *The Corporate and Securities Adviser, The Public Interest, and Professional Ethics*, 76 MICH. L. REV. 425, 444 (1978).

150 61 A.B.A. J. 1079, 1085 (1975).

151 ABA Section of Corporation, Banking and Business Law, *Report to House of Delegates*, 31 BUS. LAW. 544 (1975).

152 *Special Committee on Lawyer's Role*, *supra* note 62, at 1362:

The Committee agrees, however, with the ABA position that the circumstances in which the lawyer has an affirmative obligation under the CPR to disclose confidences or secrets of the client are quite properly rare.

The Committee believes that imposition of affirmative duties to disclose confidences or secrets to third parties in situations beyond those required by the CPR—on pain of professional discipline—is an exceedingly serious step which should be taken only if clearly mandated by law.

153 8 J. WIGMORE, EVIDENCE § 2290, at 542 (J. McNaughton rev. ed. 1961); *Radiant Burners, Inc. v. American Gas Ass'n*, 320 F.2d 314, 318 (7th Cir.), *cert. denied*, 375 U.S. 929 (1963).

154 8 J. WIGMORE, EVIDENCE § 2290, at 545 (J. McNaughton rev. ed. 1961).

155 *Id.* "The evidentiary privilege and the ethical duty not to disclose confidences both arise from the need to encourage clients to disclose all possibly pertinent information to their attorneys, and both protect only the confidential information disclosed." *E.F. Hutton & Co. v. Brown*, 305 F. Supp. 371, 394 (S.D. Tex. 1969) (citations omitted).

communications between the client and his legal adviser.¹⁵⁶

The attorney-client privilege is applicable to corporations.¹⁵⁷ Since a corporation can speak only through its agents, representatives, and employees, the corporation's privilege is applicable to confidential communications (written and oral) by such persons. However, the courts are divided as to which of these persons' communications are covered by the corporation's privilege.¹⁵⁸

In the first case, *City of Philadelphia v. Westinghouse Electric Corp.*,¹⁵⁹ a "control group" test was applied. Under the control group test, a communication is subject to the corporation's attorney-client privilege if the employee making it "is in a position to control or even to take a substantial part in a decision about any action which the corporation may take upon the advice of the attorney, or if he is an authorized member of a body or group which has that authority."¹⁶⁰ The rationale behind this test is that an employee in such a position "personifies" the corporation when he communicates with the lawyer.¹⁶¹ However, the employee's authority to participate in the decision concerning the corporate action must be actual, not apparent.¹⁶²

The second test came in *Harper & Row Publishers, Inc. v. Decker*.¹⁶³ Under the *Harper & Row* test, "an employee of a corporation, though not a member of its control group, is sufficiently identified with the corporation so that his communication to the corporation's attorney is privileged where the employee makes the communication at the direction of his superiors in the corporation and where the subject matter upon which the attorney's advice is sought by the corporation and dealt with in the communication is the performance by the employee of the duties of his employment."¹⁶⁴ However, the Court in *Harper & Row* cautiously pointed out that the employee it was describing does not include an employee who fortuitously observes an event that could give rise to corporate liability.¹⁶⁵ Such an employee was considered to resemble a bystander,

156 The attorney-client privilege exists where the following four conditions are found:

- (1) The communications must originate in a *confidence that they will not be disclosed*;
- (2) This element of *confidentiality must be essential* to the full and satisfactory maintenance of the relation between the parties;
- (3) The *relation* must be one which in the opinion of the community ought to be sedulously *fostered*;
- (4) The *injury* that would inure to the relation by the disclosure of the communications must be *greater than the benefit* thereby gained for the correct disposal of litigation.

See note 153 *supra*.

157 *United States v. Louisville & Nashville R.R.*, 236 U.S. 318 (1915); *Diversified Indus. Inc. v. Meredith*, 572 F.2d 596, 606 (8th Cir. 1978) (en banc); *United States v. Bartlett*, 449 F.2d 700 (8th Cir. 1971); *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970), *cert. denied*, 401 U.S. 974 (1971); *Valente v. Pepsico, Inc.*, 68 F.R.D. 361 (D. Del. 1975).

158 See 572 F.2d at 606; *Harper & Row Publishers, Inc. v. Decker*, 423 F.2d 487 (7th Cir. 1970), *aff'd by an equally divided court*, 400 U.S. 348 (1971). Compare *City of Philadelphia v. Westinghouse Elec. Corp.*, 210 F. Supp. 483 (E.D. Pa. 1962), *mandamus and prohibition denied sub nom.*, *General Elec. Co. v. Kirkpatrick*, 312 F.2d 742 (3rd Cir. 1962), *cert. denied*, 372 U.S. 943 (1963).

159 210 F.Supp. 483.

160 *Id.* at 485.

161 *Id.*

162 *Id.*

163 423 F.2d 487.

164 *Id.* at 491-92.

165 *Id.* at 491.

and therefore not within the intendment of the privilege.

Finally, a modified *Harper & Row* test was announced by the Eighth Circuit in *Diversified Industries, Inc. v. Meredith*.¹⁶⁶ Under *Diversified*, the privilege applies

if (1) the communication was made for the purpose of securing legal advice; (2) the employee making the communication did so at the direction of his corporate superior; (3) the superior made the request so that the corporation could secure legal advice; (4) the subject matter of the communication is within the scope of the employee's corporate duties; and (5) the communication is not disseminated beyond those persons who, because of the corporate structure, need to know its contents.¹⁶⁷

The reason for the modification was the fear that under the control group test corporations would funnel corporate communications through their lawyers and thereby shield information from the discovery process.¹⁶⁸ Also, under *Diversified*, the corporation must show that the employee's communication meets all of the listed criteria before the privilege will be sustained.

Thus, counsel may conclude that although a communication would otherwise be confidential, the position of the communicant in the corporation is controlling. Unfortunately, counsel may not be in a position to determine which communicants' communications are privileged and which are not because of the different tests applied.¹⁶⁹ However, counsel should be aware that in most instances not all employee communications will be privileged.

Although the authorities agree that a corporation is entitled to a claim of attorney-client privilege, there is considerable authority for the proposition that the privilege should be construed narrowly and strictly.¹⁷⁰ The reason for this construction is the realization that application of the privilege detracts from full disclosure and therefore is detrimental to the administration of justice. Consequently, the injury to the attorney-client relationship which would follow from disclosure must outweigh the benefit society would gain from disclosure.¹⁷¹ Therefore, application of the privilege must be considered on an ad hoc basis.¹⁷²

The attorney-client privilege does not apply to communications concerning the prospective commission of a crime or fraud.¹⁷³ There is no societal benefit

166 See note 158 *supra*.

167 572 F.2d at 609.

168 *Id.*

169 This problem is made even more difficult by reason of the liberal venue provisions of the Securities Acts. Counsel may be unable to predict where suit will be brought, and therefore, which test will be applied.

170 572 F.2d at 612; 320 F.2d at 323; *United States v. United Shoe Mach. Corp.*, 89 F. Supp. 357, 358 (D. Mass. 1950); See 8 J. WIGMORE § 2291, at 545 (J. McNaughton rev. ed. 1961).

171 8 J. WIGMORE § 2285, at 527 (J. McNaughton rev. ed. 1961); 320 F.2d at 323.

172 320 F.2d at 324.

173 *Garner v. Wolfinbarger*, 430 F.2d at 1103. See *United States v. Aldridge*, 484 F.2d 655 (7th Cir. 1973); *United States v. Shewfelt*, 455 F.2d 836 (9th Cir. 1972); *Hyde Constr. Co. v. Koehring Co.*, 455 F.2d 337 (5th Cir. 1972); *United States v. Bartlett*, 449 F.2d 700 (8th Cir. 1971).

It has even been suggested that communications concerning prospective action of questionable legality are subject to the crime-fraud exception to the attorney-client privilege. 430 F.2d at 1103.

to be gained from protection of such communications.¹⁷⁴ What is involved here is a balancing of interests—society's interest in promoting full disclosure to legal advisers, and thereby promoting effective legal representation, balanced against society's interest in furthering the administration of justice through disclosure of the entire truth. A recent California Supreme Court decision¹⁷⁵ held that a therapist who determines, or who should have determined under applicable professional standards, that a patient poses a serious threat of violence to others has a "duty to exercise reasonable care to protect the foreseeable victim of that danger."¹⁷⁶ There was no exception to the therapist-patient privilege for contemplated conduct of the kind involved, yet the court concluded that the therapist had an affirmative duty to protect the foreseeable victim. To be sure, the case involved possible physical injury to a person, but the decision reached by the court makes certain the possibility that in some circumstances, the adverse effect to society, or at least to the foreseeable victims, can outweigh the policy underlying the privilege. The adverse effects need not be limited to physical injuries. Judge Friendly's statement in *Benjamin* bears repetition here: "In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar."¹⁷⁷

In *United States v. Bartlett*,¹⁷⁸ the chief executive officer of an issuer, having been convicted of fraud in connection with the sale of unregistered securities (§ 17(a) of the Securities Act), wire fraud and mail fraud, appealed the conviction contending that, among other things, the trial court's admission of the issuer's counsel's testimony concerning certain communications violated the attorney-client privilege and therefore constituted prejudicial error. While the court concluded that there was no attorney-client relationship established and the communications were not confidential, it also held that even if the elements necessary to establish the privilege were present, the privilege was lost under the crime-fraud exception.¹⁷⁹ *Bartlett* implies that fraud under § 17(a) comes within the strictures of the crime-fraud exception to the privilege. Since a showing of fraud under § 10(b) and Rule 10b-5 is at least as difficult as a showing under § 17(a),¹⁸⁰ § 10(b) and Rule 10b-5 fraud also comes within the crime-fraud exception. This logic should extend to the other anti-fraud provisions of the Exchange Act.¹⁸¹ Lawyers may therefore be able to rely on the law as it has developed under the anti-fraud provisions of the Securities Acts to determine whether a client's communication, albeit confidential, comes under the crime-fraud exception to the privilege, and therefore is not privileged.

174 However, communications concerning past wrongdoings are privileged. See J. WIGMORE § 2298, at 573 (J. McNaughton rev. ed. 1961).

175 *Tarasoff v. Regents of Univ. of Cal.*, 17 Cal. 3d 425, 551 P.2d 334, 131 Cal. Rptr. 14 (1976), *vacating* 13 Cal. 3d 177, 529 P.2d 553, 118 Cal. Rptr. 129 (1974).

176 *Id.* at 429, 551 P.2d at 345, 131 Cal. Rptr. at 25.

177 See note 45 *supra*.

178 See note 157 *supra*.

179 *Id.* at 704.

180 See text accompanying note 128 *supra*.

181 See §§ 14(a), 14(d), 14(e) and 15(c) of the Exchange Act, and the rules and regulations thereunder.

In *United States v. Tellier*,¹⁸² the Second Circuit concluded that a confidential communication is not privileged if not intended to be confidential. "Thus it is well established that communications between an attorney and his client, though made privately, are not privileged if it was understood that the information communicated in the conversation was to be conveyed to others."¹⁸³ Moreover, although the communications at issue in *Tellier* were never in fact conveyed to anyone else, the court concluded that the privilege did not apply because the client did not intend that the communications be kept confidential in the first place.¹⁸⁴ The holding in *Tellier* implies that client communications to counsel in connection with the preparation of documents or statements which the client knows may include such communications, or parts thereof, and which the client intends to or expects will be communicated to others, albeit confidential when made, are not privileged. Therefore, in many instances, client communications to counsel in connection with the preparation of filings with the Commission and reports to shareholders will not be privileged.

V. Conclusion

Over the past several decades, the dynamics of business and business structures have changed dramatically. During the course of these changes, business increasingly reached out to the public, seeking capital needed to meet the growing demands of and new opportunities in society. Coincidentally, regulation of business expanded to a point where today virtually every phase of business is touched by some form of regulation.

As regulation grew, lawyers became increasingly involved in the affairs of business. Soon, lawyers found themselves participating in the deliberations over most significant corporate considerations. Eventually, the considerations which the lawyers were uniquely qualified to advise on became so significant that their advice often was a controlling factor. Today, lawyers play an indispensable and essential role in the affairs of corporations. In this regard, the advice of lawyers often determines whether any particular transaction will occur, and if it does, then with whom, at what price, and where it will occur.

The federal securities laws were enacted to protect the investing public. These laws are so complex, and the scheme by which their protections are intended to be effected is of such a design, that effective implementation of the ends sought to be achieved by the laws requires the assistance of the private bar. Such assistance is a necessary supplement to governmental action, and because of the legal adviser's high degree of involvement in the securities affairs of his corporate-client, he is in a uniquely strategic position to lend such assistance.

In serving a corporate-client, a lawyer must be acutely cognizant of the client's responsibilities to its shareholders. In this regard, the shareholders often have the same interests as the corporate-client, and the lawyers service to one will effectively give service to the other. However, there are circumstances when the varying interests are not easily reconcilable, and it is at that point when the

182 255 F.2d 441 (2d Cir.), cert. denied, 358 U.S. 821 (1958).

183 *Id.* at 447 (citations omitted).

184 *Id.*

lawyer-adviser is faced with his most difficult decisions. Since the adviser's loyalty must be to his corporate-client, an examination of what embodies such a client leads to the realization that shareholders also have a significant interest to be protected by the adviser. This interest is the well-being of the corporation, and thus the protection of shareholder investments. Consequently, the lawyer may find himself concerned with multiple interests.

While the CPR attempts to provide some guidance in this area, in practice it is of little help. The obligations which corporations have to their shareholders must, to some degree, be shouldered by the lawyer-adviser who counsels the corporations. There may even be circumstances so serious or so urgent that the lawyer may have to take some action on his own so as not to frustrate the ends sought to be achieved by the law. This is a concept developing in the law which has given rise to a great deal of concern in the legal profession.