SEC GENERAL COUNSEL'S REMARKS ON LAWYER DISCIPLINARY PROCEEDINGS

Remarks to the New York County Lawyers' Association
New York, New York
January 13, 1982
LAWYER DISCIPLINARY PROCEEDINGS BEFORE
THE SECURITIES AND EXCHANGE COMMISSION
Edward F. Greene, General Counsel, Securities and Exchange Commission

I would like to discuss my views with respect to the policies and procedures for disciplining lawyers who practice before the S.E.C.

Rule 2(e) of the Commission's Rules of Practice governs the discipline of professionals. They may be suspended from practicing before the Commission for conduct constituting violations of the federal securities laws or improper professional conduct. Although Rule 2(e) applies to "any person" appearing or practicing before the Commission, and has been applied to members of several professions particularly to accountants, I will address my remarks primarily to its application to lawyers.

Certain of the legal and policy issues raised by Rule 2(e) have generated criticism by the securities bar. Indeed, the depth of the opposition to the rule was apparent when the ABA's Board of Governors formally adopted as the ABA's statement the critical response of its Section of Corporation, Banking and Business Law to the Commission's release soliciting comments on the Rule 2(e) standard of professiona1 conduct announced in the *Carter/Johnson* case.

Some of the important questions raised by the bar before and after the *Carter/Johnson* decision are: 1) does the Commission have the legal authority to adopt and administer such a rule; 2) what are the appropriate bases of disciplinary actions against lawyers if such authority does exist; 3) if lawyers are to be disciplined for violations of ethical and professional standards, as well as violations of law, what are the standards and who should promulgate them; and 4) what should the interrelationships be between Rule 2(e) and the Commission's enforcement program.

I have only recently been appointed General Counsel. Because of the role delegated to the General Counsel concerning Rule 2(e) matters, I have begun to take a fresh look at the rule and the controversy it has generated. Today, in the interest of promoting a discussion with the bar on these important issues, I would like to share some of my preliminary thoughts. These, of course, are my personal views and not those of the Commission or the staff.

My initial tentative view is that as a general matter the Commission should ordinarily only institute Rule 2(e) proceedings if the misconduct alleged is (i) a violation of established state law ethical or professional misconduct rules and (ii) has a direct impact on the Commission's internal processes, such as where the lawyer participates directly or indirectly in the preparation of disclosure documents filed with the Commission.

If the lawyer's conduct amounts to a violation of, or aiding and abetting a violation of the federal securities laws, we should as a general matter sue to enjoin the attorney for repetition of such conduct, not bring a 2(e) proceeding. If a federal district court judge finds that the lawyer should be enjoined or that he has aided and abetted or committed a violation, the Commission should consider whether his conduct, if it did not have a direct impact on its internal processes, was nevertheless so egregious as to warrant suspension. If it did have an impact on such processes, suspension may be called for in appropriate circumstances. Under unusual circumstances or where it is difficult to determine whether the conduct amounted to aiding and abetting, it may not be feasible or desirable to sue the lawyer with respect to his conduct. In such cases, a Rule 2(e) proceeding might therefore be appropriate.

Finally, we should be sensitive to the problems of parallel proceedings against the client and the attorney. Absent unusual circumstances, perhaps we should try as a matter of policy to adjudicate the client's conduct first.

Content of Rule 2(e)

But first, a brief overview, before I elaborate. Rule 2(e) may be applied in three different situations: first, when an attorney is suspended or disbarred by the appropriate state or local disciplinary authorities or is convicted of a felony or certain misdemeanors; second, when an attorney has been permanently enjoined by a federal district court or found to have violated or aided and abetted a violation of the federal securities laws. Or third, when the Commission initiates an original administrative proceeding before an administrative law judge at the request of the General Counsel. The third application has been highly controversial.

The rule provides three independent bases on which sanctions can be imposed if the Commission initiates such a proceeding: (1) lack of qualifications to represent others; (2) unethical or improper professional conduct; or (3) willful violations or aiding and abetting violations of the securities laws. We are not speaking here of contumacious conduct in a particular administrative proceeding before the Commission; that is governed by a different Rule [2f] and is not controversial. Neither "requisite qualifications" nor "unethical or improper professional conduct" are defined; nor is there any indication whether their meaning is to be derived from Commission interpretation or by reference to some other authority empowered to set standards for professional conduct. Indeed, Rule 2(e) can be read in such a way that the Commission appears to have assumed the power to define appropriate professional conduct with respect to securities law matters.

Recent Developments

Although the Commission has initiated more than 100 Rule 2(e) proceedings against attorneys during the rule's 46 year history, the vast majority of these were not litigated. They were derivative proceedings based upon injunctions, convictions or disbarments, or were entered by consent. Indeed, many of the consent proceedings were requested by the bar as a way of settling injunctive proceedings against them.

Oddly enough, the case that initially aroused the concerns of the bar regarding a lawyer's proper role in securities transactions was brought by the Commission as an injunctive action. In 1972, the Commission sued *National Student Marketing* and others. Several lawyers were charged with aiding and abetting violations of the antifraud provisions of the securities laws. The Commission also alleged that the lawyers should have "blown the whistle" on their client. Although the "whistle-blowing" allegations were later withdrawn, the Commission's complaint had the effect of crystalizing the bar's awareness of its relations with the Commission and the Commission's expectations of counsel's function.

Several years later, the Commission initiated a public disciplinary proceeding against Touche Ross, an accounting firm. Touche Ross sued the Commission to enjoin the proceeding. The Second Circuit upheld our authority to adopt and administer the rule. And, in strong dicta, the Court suggested that the same policy requirements applicable to accountants would also be applicable to attorneys. The Court emphasized that the Commission must rely heavily on both professions to perform their tasks diligently and responsibly if the Commission is to process the volume of securities filings that it receives; it noted that breaches of professional responsibility jeopardize the achievement of the objectives of the securities laws.

Shortly after *Touche Ross*, the Commission initiated a Rule 2(e) proceeding against the firm of Keating, Muething & Klekamp. Although the case was settled by consent, it revealed the strong divergent views within the Commission itself concerning Rule 2(e). However, the brewing controversy came to a head in 1979 when the initial decision of the administrative law judge was issued in one of the very few litigated Rule 2(e) proceedings, *In the Matter of Carter and Johnson*. The judge determined that Carter and Johnson violated the federal securities laws and their professional responsibilities by assisting their client in authoring a false and misleading press release and filings with the Commission, and by failing to bypass the chief executive officer and report to some higher authority in the corporation that its failure to make required disclosures was a continuing violation of law. In February 1981, the Commission reversed the determination of the administrative law judge and dismissed the proceeding. The opinion is particularly significant because of its discussion of several issues of continuing import, including the Commission's authority to adopt Rule 2(e), aiding and abetting liability of attorneys, and violations of standards of professional responsibility by attorneys.

The Commission, relying heavily on the analysis of the Second Circuit in *Touche Ross*, strongly reaffirmed its authority to adopt and administer Rule 2(e). The Commission found, however, that Carter and Johnson had not aided and abetted their client's violations. Thus, they could be sanctioned only if they had engaged in improper professional conduct. The Commission reaffirmed its view that lawyers should be expected to conform to generally recognized standards of conduct, whether or not a particular standard had been formally adopted by the Commission. It concluded, however, that it could not state with certainty that a generally recognized standard of conduct governing the conduct at issue existed at the time of the respondents' actions. Therefore, they were not sanctioned. The Commission did, however, enunciate a standard of conduct which it would apply *prospectively*.

> "When a lawyer with significant responsibilities in the effectuation of a company's

compliance with the disclosure requirement of the federal securities laws becomes aware that his client is engaged in a substantial and continuing failure to satisfy those disclosure requirements, his continued participation violates professional standards unless he takes prompt steps to end the client's noncompliance."

This was the first time in a litigated proceeding that the Commission had formulated an ethical rule of professional conduct in interpreting the phrase "improper professional conduct" in Rule 2(e). Although references were made to various codes of professional responsibility, those codes were not adopted as giving content to the rule. Rather, I believe that the Commission promulgated its own standard.

Commission Release Soliciting Comments on the Announced Rule 2(e) Standard of Ethical Conduct

In September 1981, the Commission issued a release soliciting comments *solely* on whether the standard of ethical conduct enunciated in the *Carter* opinion should be amended.

Administration of Rule 2(e)

The threshold issue, of course, is whether the Commission has the authority to adopt any rule at all.

The Commission's position with respect to its authority has been sanctioned by the Second Circuit, a circuit experienced in securities matters. From a regulatory perspective, it would therefore be unwise, in my judgment, to withdraw from the field entirely. We need the rule to protect the public and the integrity of its administrative processes, especially when the misconduct is egregious. This is particularly so because the Commission has found that what may appear at first blush to be an attractive alternative - referral of egregious conduct to state disciplinary bodies - has proved to be ineffective. In most cases, these disciplinary associations have failed to take any action upon Commission referral and have not notified the Commission of the reasons for their inaction.

The real controversy concerns the Commission's use of original administrative proceedings to adjudicate violations of the securities laws and professional misconduct. For me the real issues here are: (i) determining which cases of misconduct have a sufficient nexus to the integrity of the Commission's administrative processes to justify the Commission's initiating its own proceeding; (ii) deciding whether sanctions should be imposed for violation of ethical or professional conduct standards, as opposed to violations of law; and (iii) if so, determining which bodies are the appropriate authorities to develop such standards.

Of course, in the area of securities matters, there are numerous capacities in which a lawyer can represent a client. Particularly harmful to the Commission's own processes is when a lawyer, acting in an *advisory* role, abets the client in filing materially false or misleading disclosure documents with the Commission. In this case, Rule 2(e) disciplinary proceedings are appropriate and justified.

However, absent extraordinary circumstances I would be concerned if our office were to urge the Commission to invoke Rule 2(e) to exercise disciplinary authority over attorneys rendering legal advice to clients concerning matters arising under the federal securities laws, but who do not actually appear before the Commission or who are not involved in the preparation of reporting and disclosure documents filed with the Commission. Such an application of Rule 2(e) could entangle the Commission in the regulation of lawyers' routine office practice. This traditional area is generally more appropriately left to state and local regulation, and to Commission injunctive actions in cases where the lawyer has aided violations of the securities laws. Unless there are unusual circumstances, to which we must be sensitive, the impact of this type of conduct on the efficient functioning of the Commission is generally more tenuous.

Of course, I would continue to urge that the Commission proceed vigorously against such attorneys in injunctive actions for aiding and abetting any violations of the securities laws. And if a court finds that there has been a violation, the Commission should be able to bar or suspend such lawyer's right to appear before it if the conduct were egregious.

When a lawyer actually appears before the Commissioner or its staff in a representative capacity in the course of a law enforcement matter, any misconduct also has a direct and harmful effect on the integrity of the Commission's processes. Indeed, Rule 203.7(e) of the Rules of Practice and Investigation states that a Rule 2(e) proceeding may be appropriate with respect to dilatory, obstructionist or contumacious conduct during the course of an investigation. However, because the threat of institution of Rule 2(e) proceedings in situations where the lawyer appears as an *advocate* could have a serious chilling effect on zealous representation and be a harbinger of prosecutorial abuse, I would generally not recommend Commission disciplinary proceedings against attorneys appearing as advocates. Where conduct is egregious, such as the subornation of perjury, I believe that Commission referrals to the Justice Department or to state and local disciplinary authorities are perhaps the more appropriate way to proceed.

Another issue of prime importance is whether Rule 2(e) should be used to sanction lawyers for unprofessional conduct and violations of ethical standards *or* solely for violations of law. To my knowledge, the Commission has never brought a disciplinary proceeding against an attorney based solely on a failure to meet ethical or professional standards. As a general matter, Rule 2(e) proceedings have been based primarily on charges of violating or aiding and abetting violations of the securities laws, in part because the line between aiding and abetting and improper conduct is very difficult to draw. If, however, in an unusual case Rule 2(e) were to be used to discipline attorneys for violations of ethical or professional standards, the question arises as to whether state standards should be used, or whether the Commission should develop its own? This issue is undoubtedly a thorny one. Practice before the Commission is essentially a "national" practice. However, unlike the situation for accountants, there are no uniform standards that govern all attorneys who practice before the Commission. Although the ABA's *Code of Professional Responsibility* provides well- recognized norms of conduct, it has been modified by many jurisdictions. Thus, were we to apply the standards from the lawyer's licensing state, attorneys from different jurisdictions who engaged in similar misconduct before the Commission could be subject to different standards for determining whether *sanctionable* misconduct had occurred.

But if all attorneys who practice before the Commission should be held to the same standards of ethical or professional conduct, who should promulgate the standards and pursuant to what authority? The Commission could, I suppose, issue its own set of rules; however, I do not think we have the time or the expertise to fashion an appropriate code of conduct. Thus, if the Commission doesn't issue its own rules, and decides to defer to existing state ethical standards and norms of conduct, how does it decide whether those have been violated? If the Commission attempted to interpret and apply the local norms, wouldn't there inevitably develop a federal common law, even though the Commission was purporting to interpret state law? Yet, if it requested interpretive assistance from local authorities, is there any assurance they would have the resources to advise the Commission promptly?

Here I would propose a compromise for discussion. First, until more definite action is taken with respect to the proposed Model Rules of Federal Agency Discipline, which I will discuss in a moment, the Commission should as an interim measure rely upon standards of conduct that are already adopted by the lawyer's licensing body. Of course, the very nature of these standards requires that they be drafted broadly, and the Commission will be required to interpret the standards as they apply to practice of securities law before the Commission.

I do not, however, believe that the Commission's views on the meaning of state and local standards of conduct should be addressed in reports issued pursuant to Section 21(a) of the Exchange Act, which authorizes the Commission to publish information concerning violations of the law. Rather, such interpretations should be announced in adjudicatory or rulemaking proceedings. Thus, I would not favor the approach recently taken in the *Gotten* matter, in which a report was issued on the activities of an attorney, with his consent, in which it delineated certain standards of conduct for lawyers who render opinions in securities transactions.

Secondly, the Commission should give serious consideration to the proposed Model Rules of Federal Agency Discipline, in which the Standing Committee on Professional Discipline of the American Bar Association attempts to resolve this issue of a uniform standard for lawyers who practice before federal agencies. The proposed Model Rules would vest jurisdiction in the federal district courts to discipline attorneys who practice before federal agencies. The state or local bar authority would prosecute the action, and the aggrieved agency would act only as complaining witness. The Model Rules contemplate a code of professional conduct to be promulgated by the United States District Court for the District of Columbia, which would be supplemented by specialized standards adopted by individual agencies pursuant to the Administrative Procedure Act. This code would govern the conduct of persons appearing "directly" before the agency, whereas local codes of conduct would govern the practice of others, thus preserving local standards except where the lawyer is engaged in an essentially national practice. The adoption of uniform standards to govern federal agency practice would be a welcome alternative to reliance on multiple and diverse state codes of conduct. I might note that one potential but remediable problem with the Model Rules is that they do not define what activities constitute appearing or practicing before an agency.

Other important issues arise when one considers that the Commission is also a law enforcement agency with the power to prosecute violations of the federal securities laws. I sympathize with those who are concerned that the prospect of a future disciplinary action by the Commission

might chill the independent and zealous representation of a client by his lawyer. Is it realistic to expect that a lawyer will give his client the best advice without any concern for potential personal exposure? Despite this reservation, some would argue that lawyers' actions have always been restricted by rules of ethical and professional conduct. A lawyer is certainly not privileged to violate the law or ethical and professional standards in the representation of his client. In this sense, Commission disciplinary actions, which only enforce existing standards, should have no chilling effect beyond that already created by the existence of state and local disciplinary authorities.

But we must recognize that other issues permeate this area. Lawyers may view the Commission's disciplinary actions as requiring them to divide their loyalties, and their clients may perceive that the threat of disciplinary actions interferes with effective representation. We also should promote the valuable function that counsel provides by vigorous advocacy of differing positions before the Commission, rather than being perceived as undermining counsel's independence.

In addition to the threat of a disciplinary proceeding against the attorney, what effect would it have if the Commission decides to proceed against the client in an injunctive action or administrative proceeding and simultaneously to proceed against the attorney in a Rule 2(e) proceeding? The Commission has on occasion charged a lawyer in a Rule 2(e) proceeding with aiding and abetting the violations of his client, who is a defendant in a civil action. If the Commission chose to do so, it could add the lawyer as a defendant as well, or it could delay the disciplinary proceeding until after the successful conclusion of the civil action. Or it may do both. This would avoid the potentially anomalous situation in which the lawyer is found by an administrative law judge to have aided and abetted his client's violation, although a federal judge later concludes that there is no violation by the client. On the other hand, there are sound reasons for the Commission's exercise of its prosecutional discretion in the selection of its forum. For one thing, a Rule 2(e) proceeding is more appropriate when the Commission's primary aim is to protect its processes rather than to enforce the securities laws. In addition, administrative proceedings--with the concomitant protection of judicial review--are traditionally used to avoid delay, which is one of the major drawbacks of referring disciplinary matters to state and local authorities or instituting injunctive actions. In the *Carter & Johnson* case, for example, the Rule 2(e) proceeding was completed two years before the trial in the injunctive action was scheduled to begin.

Although I need to give the matter more thought, I recognize that there may be good reasons for adopting a policy that absent special circumstances, a lawyer should be named as a co-defendant in the injunctive action or the administrative proceeding postponed until after the court has ruled in the injunctive matter. However, I am not yet prepared to make a recommendation on this point.

Conclusion

Just to summarize, I think we should recognize that Rule 2(e) accomplishes a necessary function by protecting the integrity of the Commission's processes. But, absent special circumstances, the Commission should generally limit these proceedings to those instances that pose the most direct threat of harm to those processes - that is conduct involved in the preparation and filing of

reporting and disclosure documents with the Commission. Other types of misconduct may be more appropriately addressed in an injunctive action or a referral to state disciplinary bodies. When the attorney's alleged misconduct is predicated on theories of aiding and abetting liability, as it almost always is when the conduct involves the preparation and filing of documents, and the Commission is also proceeding against the principals in a simultaneous injunctive action, I believe that the wisest course for the Commission to follow is to add the attorney to the injunctive action as a co-defendant. If that is not possible for unusual reasons, then an administrative proceeding under Rule 2(e) could be commenced. And, in those administrative proceedings based upon violations of standards of ethical or professional conduct, I believe that the Commission should use existing state law standards. Finally, the Commission should give serious consideration to the recently proposed Model Rules of Federal Agency Discipline with a view of encouraging the establishment of a truly effective uniform disciplinary system for attorneys who practice before federal agencies.

Thank you.