

WALKING THE TIGHTROPE: THE COMPREHENSIVE LIABILITIES OF SECURITIES PROFESSIONALS IN THE UNITED STATES

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1. Introduction

During the past decade, the liabilities of securities professionals have escalated markedly under the federal securities laws. This article surveys the theories underlying the imposition of such legal liabilities and the principal types of liabilities, focusing on the securities professional qua professional, providing services to clients. The discussion treats the liabilities of lawyers, accountants, underwriters, broker-dealers, and investment advisers, acting in their professional capacities. It does not extend to securities professionals serving as corporate directors or selling securities for their own accounts.

The most noteworthy trend in professionals' responsibilities under the federal securities laws has been the dramatic increase in actions against lawyers and accountants, whose express statutory liabilities are more limited than those of other securities professionals. Since the early 1970s, the Securities and Exchange Commission (SEC) has instituted over 120 disciplinary cases against lawyers under SEC rule 2(e) [1], while less than ten such cases were instituted prior to 1970 [2]. This geometric increase in the number of SEC disciplinary proceedings against lawyers has occurred despite the creation by the American Bar Association of a Committee on Counsel Responsibility and Liability, which is active today [3]. Evidence that accountants are increasingly subject to liability for their activities as securities professionals is found in the nearly 100 Accounting Series Releases relating to enforcement actions against 135 accounting firms and practitioners [4]. The great majority of these were issued by the SEC after 1970.

This marked expansion of the liabilities of securities professionals applies to firms as well as to individual practitioners. Major law and accounting firms have been respondents in SEC enforcement actions. In fact, almost all of the large accounting firms have been named in SEC disciplinary proceedings [5].

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2. Theories underlying the legal liabilities of securities professionals

Before examining types of legal liabilities to which securities professionals are subject, one must ask why securities professionals are increasingly targeted by the SEC and private litigants to bear responsibility for questionable securities transactions. What are the theories for imposing legal liabilities on these non-principals in securities transactions? In theory, it is possible simply to impose legal responsibilities on the clients of securities professionals and to define the scope of professionals' responsibilities through contracts between the clients and the securities professionals. United States law has progressed on a different path, moving beyond a contract theory of professional responsibility. The theories that appear to have guided federal law on its current path include: (1) the "access" or "passkey" theory; (2) the "super fiduciary" theory; and (3) the "source of money" theory [6].

2.1. "Access" or "passkey" theory

The fundamental assumption of the "access" or "passkey" theory [7] is that securities professionals control entry to the capital markets. Securities professionals supply the "passkey" to the markets through their role in providing services and advice to principals in securities transactions. They are therefore obliged to assure that the markets remain fair and orderly.

The seminal case for the access theory involved a criminal prosecution of an accountant and a lawyer charged with engaging in a conspiracy to sell unregistered securities and to defraud investors. In *United States v. Benjamin* [8], federal court of appeals Judge Henry J. Friendly remarked: "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" [9]. Although the SEC has embraced Judge Friendly's statement as the cornerstone of the "access" theory, the theory has been developing for some time. As early as the 1950s, the SEC instituted administrative proceedings, including a 2(e) disciplinary proceeding, against a United States lawyer who had given a legal opinion to a Canadian lawyer and a Canadian promoter regarding sales within the United States of unregistered Canadian corporate stocks that were allegedly free from registration requirements [10].

The "access" theory has developed into a comprehensive theory of liability. In its most extreme form, it posits that securities professionals are in a better position to prevent abuses than anyone else. In the technically complex capital markets, securities professionals are the only participants able to regulate market access. As holders of the "passkey" to the markets, these professionals are able either to prevent the "bad guy" from entering the markets or to make certain that all potential problems are fully disclosed. In other words, this is the most efficient point on which to put enforcement pressure.

Why must the role of the lawyer as independent guardian of the gates of the capital markets be legally prescribed? Is it not reasonable to expect securities professionals to assume this role as a natural outgrowth of enlightened self-interest? Another aspect of the “access” theory provides the answer. Capital markets constitute a valuable resource which may be disrupted if investor confidence is undermined. A few scandals have the potential to wreak incalculable losses. In essence capital markets are a type of public good. The government is unwilling to entrust the fate of these markets to individual securities professionals, because the social cost of even a few irresponsible decisions with respect to fraudulent transactions is potentially too great for the risk of unguided private regulation.

2.2. “Super fiduciary” theory

A second theory of liability can be denominated the “super fiduciary” theory. On the one hand, the theory is anchored to the notion that securities professionals owe fiduciary duties to their clients in addition to their contractual duties. Thus, under this theory a lawyer or investment banker may not relieve himself of all responsibility for a securities offering through the contract. Nor is it possible by contract to require customers of broker-dealers to arbitrate rather than prosecute their claims in court.

This theory can be explained, in part, by a concern about the disparity in expertise between clients and securities professionals. Nevertheless, even sophisticated clients will not be bound by contractual provisions that totally exculpate professionals. At the same time, however, the “super fiduciary” theory rests on the premise that the securities professional owes a duty to the government. Here the “super fiduciary” theory seems to intersect with the “access” theory. Under both the “access” and the “super fiduciary” theories the lawyer is more akin to the independent “ombudsman” than the advocate. The duty of the lawyer to take steps promptly to end the client’s noncompliance with the federal securities laws supplants the duty to maintain client confidentiality. The lawyer’s “police” functions [11] might include going to the board of directors (the “duty to seek higher authority” within the corporate structure) or public disclosure (the duty to “blow the whistle”).

A conflict exists between the two types of fiduciary duty – to the client and to the public. Members of the securities bar are acutely aware of this conflict.

2.3. “Source of money” theory

The third theory for imposing liabilities on securities professionals is simply that they are excellent sources of money. This theory finds its primary application in private damage actions.

The “source of money” theory is grounded in practicality, not in law. First,

securities professionals are often the surviving “deep pockets” when clients have gone bankrupt or have left the jurisdiction. In such situations, courts sometimes look to the securities professionals to reimburse a plaintiff who has clearly suffered a legal wrong from someone. This theory is also based on the recognition that securities professionals may be good risk spreaders. An investment bank or law firm that pays large money damages is likely to purchase insurance against monetary damages. The cost of premiums will be spread among all customers of the firms. In effect, the professional is spreading the risk of an insolvent or unreachable client among all its clients.

3. Principal types of legal liabilities

3.1. Secondary liability: Aiding and abetting

The common law doctrine of aiding and abetting [12] has been a major source of secondary liability [13] for securities professionals. Without explicit statutory mandate [14], aiding and abetting liability has been judicially and administratively grafted onto sections of the securities laws, principally the antifraud provisions [15], thereby expanding the scope of professionals’ responsibilities.

Aiding and abetting liability is part of the common law of torts. Following the lead of *Brennan v. Midwestern United Life Insurance Co.* [16], courts have repeatedly invoked the Restatement of Torts when establishing this form of secondary liability [17]. Section 876 of the Restatement provides in part: “For harm resulting to a third person from the tortious conduct of another, a person is liable if he... (b) knows that the other’s conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself...” [18].

The principles of the Restatement have been reformulated by the United States courts of appeals in securities cases; a consensus now exists regarding the elements that constitute aiding and abetting. The courts generally require: (1) proof of an independent wrong, *i.e.* a securities law violation by a primary violator; (2) proof that the alleged aider–abettor knew of the violation and of his own role in the illegal activity; and (3) proof that the alleged aider–abettor knowingly and substantially assisted in the violation [19].

Proof of the independent wrong presents no difficulty in most aiding and abetting cases. The courts differ, however, on the standards of proof required to satisfy the second and third elements of liability: the state of mind necessary for the imposition of liability and the extent to which liability must be based upon affirmative action as opposed to silence and inaction.

Although proof of scienter [20] is required for a finding of aiding and abetting liability regardless of whether or not such proof is a condition

precedent to the imposition of primary liability under the particular statutory provision [21], the courts are divided on whether recklessness may satisfy the scienter requirement. The Supreme Court has reserved judgment on the issue in the primary liability context [22]. In secondary liability cases, some federal courts of appeals have required a finding that the defendant was aware that he was assisting in the primary violation [23]. Other courts of appeals have held that recklessness is sufficient to meet the scienter element [24]. Still other courts have developed a standard that combines the above approaches by positing a sliding scale of scienter. Under this mixed approach, a showing of recklessness will satisfy the scienter requirement where the alleged aider-abettor owes a direct fiduciary duty to the defrauded party [25], but “[s]omething closer to an actual intent to aid in the fraud” is necessary in an aiding and abetting context where no fiduciary relationship is involved [26].

Another unresolved question is whether silence and inaction satisfy the third element of aiding and abetting liability – knowing and substantial assistance in the primary violation. The Supreme Court has yet to address this issue. The Court of Appeals for the Ninth Circuit has declined to adopt the inaction theory, holding that mere inaction can never give rise to liability for aiding and abetting a violation of rule 10b-5 [27].

Other courts have been willing to impose liability for inaction where there is either a separate duty to act or a higher degree of scienter. In *SEC v. National Student Marketing Corp.* [28], the district court found that the attorney-defendants aided and abetted violations of antifraud provisions when they breached a duty to disclose material information to the shareholders of their corporate client [29]. Alternatively, the Court of Appeals for the Third Circuit has emphasized the importance of scienter when an aiding and abetting claim is based on the defendant’s inaction. That court stated in *Rochez Brothers, Inc. v. Rhoades*: “Inaction may be a form of assistance, but only where the plaintiff is able to show that the silence of the aider-abettor was consciously intended to aid the securities law violation” [30].

Other courts combine the approaches of *National Student Marketing* and *Rochez Brothers* and posit a dual standard for aiding and abetting liability where silence and inaction are involved. This standard, first articulated in *Woodward v. Metro Bank* [31], was recently adopted by the SEC in *In re Carter & Johnson*: “When it is impossible to find any duty of disclosure, an aider and abettor should be found liable only if scienter of the high ‘conscious intent’ variety can be found. Where some special duty of disclosure exists, then liability should be possible with a lesser degree of scienter” [32].

Securities professionals have been increasingly drawn into securities litigation under the aiding and abetting doctrine. The Supreme Court has never expressly considered whether aiding and abetting liability is a valid theory under the securities laws [33], and there are indications that the Court may tighten the reins on secondary liability [34].

One commentator has argued that the recent restrictive approach of the Supreme Court towards the availability of implied private damage remedies in securities cases indicates that, if confronted with the issue today, the Court would not recognize the validity of secondary liability theories [35]. *Touche Ross & Co. v. Redington* [36] and *Transamerica Mortgage Advisors, Inc. v. Lewis* [37] hold that no implied remedies are available in the absence of affirmative evidence that Congress intended such remedies. Congressional intent must therefore define the scope of liability. "If tort law cannot provide a basis for implying a remedy [to expressly proscribed conduct], it necessarily follows that it cannot, without more, be used to redefine the scope of conduct prohibited by statute" [38]. Looking to the statutory framework of the securities acts and in particular to the provisions expressly imposing secondary liability [39], the commentator concludes that Congress did not intend to expand liability through application of the aiding and abetting theory.

Despite the concerns articulated above, the Supreme Court is not likely to negate secondary liability. As recently as spring 1982, the Supreme Court moderated its restrictive approach towards implied rights of action. In *Merrill Lynch, Pierce, Fenner & Smith v. Curran* [40], the Court held that where the comprehensive re-examination and significant amendment of a statute left intact the statutory provisions under which the federal courts had routinely and consistently implied a cause of action, such legislative action is itself evidence that Congress affirmatively intended to preserve the remedy. It is arguable that Congress' failure to forbid aiding and abetting liability when it extensively amended the securities laws in 1975 implies its endorsement of such liability.

3.2. *Express liabilities*

3.2.1. *Section 11 of the Securities Act of 1933*

A specified group of securities professionals is expressly liable to purchasers of securities under the Securities Act of 1933 [41]. This class is more narrowly defined than the class of individuals subject to secondary liability under the aiding and abetting theory. Section 11 [42], which establishes civil liabilities for material misstatements or omissions in a registration statement, is unique among other express liability provisions of the securities laws because of its specific designation of persons who may be liable for violations of the Act and because of its elaborate statement of defenses afforded those persons.

Section 11 provides a right of action to any person who acquires a security issued in an offering covered by a defective registration statement [43]. The purchaser need only prove that at the time the registration statement became effective, it "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading" [44]. Thus, the purchaser is not required to

establish reliance on the misstatement or omission, except where the security is acquired “after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement” [45]. Nor is it necessary to prove scienter on the part of the defendants. This absolute liability provided by Section 11(a) is tempered by the “due diligence” defenses afforded by Section 11(b) that in effect impose a negligence standard of liability [46], except in the case of an issuer-defendant, who is always absolutely liable.

The test of materiality, the heart of a Section 11 claim [47], has been defined in the abstract, though it may prove difficult to apply in practice. SEC rule 405 defines material facts as “those matters as to which an average prudent investor ought reasonably to be informed before purchasing the security registered” [48]. The Supreme Court stated the test of materiality to be applied to a proxy statement in *TSC Industries, Inc. v. Northway, Inc.*:

An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote...It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the “total mix” of information made available [49].

This definition has recently been applied by lower courts under Section 11 of the 1933 Act [50].

Section 11 specifically identifies those persons who may be sued by the purchaser: first, everyone who signs the registration statement [51], including the issuer (who is obliged to sign) [52]; second, both incumbent and prospective directors of the issuer [53]; third, “experts” who have assisted in the preparation of the registration statement [54]; and fourth, all underwriters of the offering [55].

Of particular interest for this article are the provisions relating to experts and underwriters. Section 11(a) (4), the provision covering experts, reads:

[Any person acquiring a security covered by the registration statement may sue] every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement or as having prepared or certified any report or valuation which is used in connection with the registration statement [56].

The accountant who certifies financial statements contained in the registration statement is expressly subject to liability as an expert. Other securities professionals are not typically treated as experts under Section 11. A lawyer, however, may be held liable where he has provided expertise on certain portions of a

registration statement [57]. Thus, a lawyer who delivers a tax opinion for use in a tax shelter offering will be deemed a statutory expert [58]. Similarly, lawyers' opinions regarding title to property or the validity of patents are considered "expertised" portions of the registration statement [59].

As noted above, underwriters of an offering are expressly liable for a misleading registration statement under Section 11. Liability extends to all members of the syndicate, regardless of the size of their individual participations in the offering [60]. Underwriters are also directly liable as "sellers" under Section 12 of the Securities Act [61].

The primary defenses afforded persons subject to liability under Section 11(a) are detailed in Section 11(b). Section 11(b) provides a due diligence defense to all defendants except the issuer, who is absolutely liable. If a defendant is able to demonstrate that he met the statutory standard of care, no liability will be imposed.

Both the statutory language and the authoritative case applying the statute, *Escott v. BarChris* [62], make it clear that the standard of due diligence required of experts turns on the responsibility of the particular professional for the defective portion of the registration statement. The expert is liable for those portions of the registration statement expressly made upon his authority as an expert [63]. There is no liability for either "expertised" portions not attributed to that expert or "nonexpertised" portions of the registration statement. In *BarChris*, the accountant-defendants were held responsible only for the audited figures that they had prepared [64].

Regarding the "expertised" portion for which a defendant is liable, the expert is entitled to show that: "he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact" [65]. This due diligence standard requiring an affirmative duty to verify the accuracy of the "expertised" portions of the registration statement contrasts with the duty imposed on nonexperts (including underwriters) with respect to the "expertised" portions. Nonexperts may reasonably rely on experts. Their due diligence defense need only consist of a showing that they had "no reasonable ground to believe and did not believe" that there were misstatements or omissions of material facts [66].

Section 11(c) defines the standard of reasonableness as "that required of a prudent man in the management of his own property" [67]. At the very least, the duty of reasonable investigation requires that the expert comply with accepted professional standards. The *BarChris* court found that the accountant-defendants conducted a verification procedure which failed to conform to generally accepted auditing standards [68]. The court also stated in dictum that "accountants should not be held to a standard higher than that recognized in their profession" [69]. However, accepted professional standards may not

provide an adequate benchmark for liability where there is an allegation that the accountant misrepresented that which he knew, as opposed to an allegation that the accountant failed to discover a material fact because he omitted a professionally accepted procedure [70]. In *United States v. Simon* [71], the Court of Appeals for the Second Circuit held that conformity to generally accepted accounting principles [72] does not necessarily immunize an accountant from liability where he knowingly participated in the misrepresentation of fact on a financial statement.

Underwriters are held to a high standard of care under Section 11. They may reasonably rely on the “expertised” portions of the registration statement, but they must verify the “nonexpertised” portions. As the court held in *BarChris*, “in order to make the underwriters’ participation in this enterprise of any value to the investors, the underwriters must make some reasonable attempt to verify the data submitted to them” [73]. Thus, unlike “experts”, the underwriters’ liability is not confined to a limited area. Rather, they have general liability for the contents of a registration statement.

In the leading article on *BarChris* [74], Professor Ernest Folk enumerates the policy considerations underlying the imposition of such a stringent duty of care on underwriters. First, by underwriting an issue, the investment banker is publicly perceived to have attested to the quality of the issuer. Second, because of their expertise and staffing capabilities, underwriters occupy a position that readily allows them to verify facts concerning an issuer. Third, underwriters have great flexibility and discretion in undertaking an issue because they usually do not sign a binding contract with the issuer until the day the registration statement becomes effective. Fourth, the underwriters’ position vis-à-vis the issue imposes a significant degree of responsibility. The scope of their authority with respect to the issue includes: an important role in pricing the offering; the power to form a syndicate; control over the public availability of a “hot issue”; and the ability to “make a market” in the securities of the issuer.

Some question remains whether Section 11 responsibilities vary between classes of underwriters. *BarChris* held that participating underwriters are liable where they have relied on the conduct of the lead underwriter who has failed to meet the prescribed standard of diligence [75]. The court specifically refrained, however, from considering whether the participating underwriters would have been immunized if the lead underwriter had made a reasonable investigation [76]. Folk’s view is that participating underwriters should be allowed to delegate their investigatory responsibility to the lead underwriters [77]. The participants’ liability should be predicated on the diligence of the lead underwriter. The SEC has adopted a slightly different position, outlining a separate duty for participating underwriters. Under its approach, a “participant may relieve himself of the tasks of actually verifying the representations in the registration statement, but... he must satisfy himself that the managing under-

writer makes the kind of investigation the participant would have performed if he were manager” [78].

Although a comprehensive examination of the responsibilities of professionals in their capacity as directors is beyond the scope of this article, it is significant that *BarChris* seems to establish a higher degree of care for “specialist directors” [79] than for other directors. In *BarChris*, two outside directors, an attorney who drafted the registration statement, and a partner in the lead underwriting firm, were held liable as directors but under standards generally applicable to their professions. Thus, the standard of diligence for such “specialist” directors is more stringent than that imposed on outside directors who have no special expertise in the registration process.

A final issue is whether aiding and abetting theory can extend liability beyond those defendants specifically named in Section 11. Relying on the Supreme Court’s restrictive approach to implied remedies [80], courts are tending to conclude that the express language of Section 11 precludes aiding and abetting liability under Section 11 [81]. As one court remarked, “to sanction aiding and abetting [liability] would be to essentially gut the statutory definitions of meaning” [82].

3.2.2. *Section 2(11) of the Securities Act of 1933*

The scope of Section 11 liability expands when read in conjunction with Section 2(11) [83], the statutory definition of an underwriter. As already indicated, underwriters are expressly subject to civil liability under Section 11 for deficiencies in the registration statement [84]. It follows that by limiting or expanding the definition of underwriters, one limits or expands the class of potential defendants under Section 11. Section 2(11) expands the scope of liability by defining underwriters “not with reference to the particular person’s general business but on the basis of his relationship to the particular offering. No distinction is made between professional investment bankers and rank amateurs” [85].

The term “underwriter” as defined by Section 2(11) of the Securities Act, includes: “any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking...” [86]. Thus, the statutory definition of underwriter encompasses a broad range of behavior related to the distribution of securities: buying with a view to distribution; selling or soliciting in connection with the distribution; or participation in the distribution.

3.2.3. *Section 12 of the Securities Act of 1933*

Section 12(1) of the Securities Act of 1933 [87], imposes civil liability on any person who “offers or sells a security in violation of section 5”, which requires

registration of security issuances. No defense is available with respect to Section 12(1) liability where a purchaser proves a violation of Section 5 by the seller.

Section 12(2) of the Securities Act [88], a general antifraud provision, creates a cause of action for a purchaser of securities against one who sold him the securities by means of a prospectus or oral communication that included a misstatement of, or omitted to state, a material fact. Unlike Section 12(1), Section 12(2) provides the seller an affirmative defense to the statutory violation. The seller is not liable if he is able to “sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission” [89].

The courts have expanded the scope of professional responsibility under these provisions by expanding the “seller” class of defendants. Under both Sections 12(1) and 12(2), the seller of a security is liable to the “purchaser”. If “seller” were narrowly defined as “actual seller,” Section 12 would be interpreted as requiring “strict privity”. Such an interpretation would restrict the class of defendants and consequently limit the liabilities of securities professionals under Sections 12(1) and 12(2). If “seller” is defined to include parties outside the immediate sales relationship, the “strict privity” requirement is eliminated and Section 12 becomes a means for imposing liability on a broader class of securities professionals.

The Court of Appeals for the Fifth Circuit has been a leader in establishing liability for collateral participants under Section 12. In devising a test for determining “seller” status under both Sections 12(1) and 12(2), that court in *Hill York Corporation v. American International Franchises, Inc.* [90], rejected a “strict privity” requirement in favor of a “proximate cause” test: “Did the injury to the plaintiff flow directly and proximately from the actions of this particular defendant?” [91]. The court emphasized that the “proximate cause” test was intended as a middle ground between the “antiquated ‘strict privity’ concept and the overbroad ‘participation’ concept that would hold all those liable who participated in the events leading up to the transaction” [92].

The Fifth Circuit recast the *Hill York* “proximate cause” test in *Lewis v. Walston & Co.* [93] by focusing on the issue of whether the defendant’s actions were “a ‘substantial factor’ in bringing about the plaintiff’s purchases” [94]. A subsequent opinion, *Pharo v. Smith* [95], read *Hill York* and *Lewis* as

limiting sections 12(1) and 12(2) sellers (i) to those in privity with the purchaser and (ii) to those whose participation in the buy-sell transaction is a substantial factor in causing the transaction to take place. Mere participation in the events leading up to the transaction is not enough. But beyond the words “substantial factor,” we have no guideposts other than the factual situations presented... to assist us in determining whether to impose strict liability [96].

In *Croy v. Campbell* [97], applying the test it had articulated in *Hill York* and *Pharo*, the court held that an attorney whose connection with the sale was

limited to advising the purchaser on its tax consequences was not a Section 12(2) seller. The attorney made no attempt to persuade plaintiffs to make the purchase. He made no representations to them concerning the operational aspects of the project in which the plaintiffs ultimately invested. In determining that the attorney's participation had not proximately caused plaintiff's injury, the court emphasized that "this conclusion should not be interpreted to mean that a lawyer who participates in the transaction can never be a seller for purposes of section 12" [98]. Indeed, in a subsequent case, *Junker v. Croy* [99], the court held the attorney-defendant liable as a Section 12(2) seller, finding that he was a "key participant" in the transaction. "His role was not that of a passive advisor as was that of the attorney in *Croy*; rather, he was an active negotiator in the transaction, acting as an agent-in-fact as well as attorney-at-law, implementor not counsellor" [100]. Thus, an attorney may be liable as a Section 12 seller when he goes beyond his professional role into a promotional role. This situation contrasts with that of the underwriter or broker who in his professional capacity directly effects the sale of securities, thereby meeting the "proximate cause" or "substantial factor" test.

The participation theory of liability developed under Section 12 is distinct from other theories of secondary liability. With respect to the latter, some courts acknowledge a general rule of privity but recognize exceptions in cases of controlling persons as sellers and in cases of aiders and abettors [101]. These courts impose liability on the basis of the Section 15 "control" provision [102], or simply extend the language of Section 12 itself to include aiders, abettors, and controlling persons as sellers. The Court of Appeals for the Fifth Circuit has explicitly refused to extend the Section 12 language to include aiders, abettors, and controlling persons as sellers [103].

The distinction between the participation theory and these other theories of secondary liability may be academic. As noted above, the participation theory has no analytic content. Standards can only be inferred from the courts' applications of the test to specific factual circumstances. Perhaps the district court was correct in *In re Caesars Palace Securities Litigation*:

[As a result of the decisions in this area] it would be nothing more than an exercise in semantic hair-splitting for this Court to attempt to delineate a legally cognizable distinction between those categories of persons who have previously been exposed to liability under §12(2) and those persons charged with aiding and abetting and conspiring in the violation of §12(2). No one of these formulations is a "magic word"; in effect, each of them indicates participation to one degree or another. Determination of the extent of this participation and whether or not it is sufficient to impose liability upon the secondary defendant must obviously await discovery [104].

Courts that have interpreted strictly the privity requirement of Section 12 have found support for their approach in the recent Supreme Court cases that narrowly construe the securities acts and reject their expansion through tort and criminal theories [105]. In *Collins v. Signetics Corp.* [106], the Court of

Appeals for the Third Circuit looked to the literalist approach of the Supreme Court in concluding that in the absence of a special relationship between the issuer-defendant and the seller, such as control, a purchaser who is not in privity with the issuer has no claim against the issuer under Section 12(2). The court reasoned:

We have no difficulty in concluding that Congress intended the unambiguous language of §12(2) to mean exactly what it says: “Any person who... (2) offers or sells a security... shall be liable to the person purchasing from him....” This section is designed as a vehicle for a purchaser to claim against his immediate seller. Any broader interpretation would not only torture the plain meaning of the statutory language but would also frustrate the statutory schema because Congress has also provided a specific remedy for a purchaser to utilize against the issuer as distinguished from the seller of a security [*i.e.* Section 11] [107].

3.3. Administrative proceedings against broker–dealers and investment advisers

An important means for imposing liability on securities professionals is the administrative proceedings of the Securities and Exchange Commission and the self-regulatory organizations [108]. This section considers the statutory basis for proceeding against registered broker–dealers and investment advisers as well their employees.

3.3.1. Section 15 of the Exchange Act of 1934

The Securities and Exchange Commission is explicitly empowered to investigate possible violations of the securities laws [109]. If an investigation uncovers violations by broker–dealers [110] or investment advisers [111] the Commission may institute administrative disciplinary proceedings to establish responsibility for violations and to impose sanctions. These administrative proceedings impose professional standards on broker–dealers and investment advisers.

The statutory authority of the SEC to proceed against broker–dealer firms is set forth in Section 15(b) (4) of the Securities Exchange Act [112]. Section 15(b) (4) provides a wide range of sanctions with which the SEC may discipline the firm: censure, limitations on the firm’s activities, suspension for up to a year, and revocation of the firm’s registration. Persons associated with broker–dealer firms [113] are also subject to SEC disciplinary action. Section 15(b) (6) authorizes the Commission to “censure or place limitations on the activities or functions of any person associated, or seeking to become associated, with a broker or dealer, or suspend for a period not exceeding twelve months or bar any such person from being associated with a broker or dealer” [114]. The Investment Advisers Act of 1940, as amended in 1975, provides comparable statutory authority for the institution of administrative disciplinary proceedings against investment advisers and associated persons [115].

In order to impose one of the enumerated sanctions, the SEC must find

certain statutory violations specified in Section 15(b)(4) of the Securities Exchange Act or, correspondingly, in Section 203(e) of the Investment Advisers Act. These grounds for imposing liability are incorporated into Section 15(b)(6) of the Securities Exchange Act and Section 203(f) of the Advisers Act, the sections dealing with the liability of associated individuals. The Commission must show that the firm or associated individual: (1) willfully made a material misstatement or omission in any report to the Commission [116]; or (2) willfully violated any provision of the securities acts or rules promulgated thereunder [117]; or (3) “willfully aided, abetted, counseled, commanded, induced or procured the violation by any other person... or has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes” [118].

Until recently the standard of proof required to sustain a finding of one of the aforementioned violations in an administrative proceeding was a disputed issue. The SEC has consistently applied a “preponderance of the evidence” standard [119]. The burden of proof allocates between the litigants the risk of erroneous decision-making in a proceeding, and a mere preponderance standard divides the risk in a “roughly equal fashion” [120].

In *Collins Securities Corporation v. SEC* [121], the Court of Appeals for the District of Columbia rejected the use of the preponderance standard for certain administrative disciplinary proceedings. *Collins* held that the more stringent “clear and convincing evidence” standard should be applied in 1934 Act broker-dealer proceedings when fraud is charged and severe sanctions imposed. In *Whitney v. SEC* [122], the court reiterated its decision in *Collins*, holding that “any sanction imposed under section 15(b) which depends on fraud must be sustained by clear and convincing evidence” [123]. The adoption of such a standard shifts the balance of risk away from the securities professionals and toward the public.

The *Collins* and *Whitney* decisions did not purport to be all-encompassing. In *Investors Research Corporation v. SEC* [124], the same court emphasized that *Collins* “required the higher standard in *fraud* actions where a *severe sanction* is imposed” [125]. Accordingly, the court held that the preponderance standard was sufficient in administrative proceedings for a violation of Section 17(e) (1) of the Investment Company Act of 1940 [126] because fraud was not charged and because the sanction of censure was not severe [127].

The Supreme Court in effect overruled *Collins* and *Whitney* in *Steadman v. SEC* [128]. At the administrative level, the SEC had applied the preponderance standard in determining whether the petitioner had violated antifraud provisions of the federal securities laws. Affirming the decision of the Court of Appeals for the Fifth Circuit, the Supreme Court held that the “preponderance of the evidence” standard governs SEC administrative proceedings. Justice Brennan, writing for the majority, found that Congress had prescribed the degree of proof that must be adduced by the proponent of a rule or order in an

administrative proceeding. The securities laws do not indicate which standard of proof governs Commission adjudications. The Court therefore looked to Section 7 of the Administrative Procedure Act concerning agency hearings [129]. The Court construed the explicit language of Section 7, in light of legislative history, as evidencing congressional intent to adopt the preponderance standard. This conclusion was further supported by the the Commission's long-standing practice of imposing sanctions according to the preponderance of the evidence.

In addition to meeting the preponderance test, the Commission must also demonstrate that the defendant acted "willfully" [130]. The classic interpretation of willfulness was articulated in *Tager v. SEC* [131]. The Court of Appeals for the Second Circuit held that for the purpose of Section 15, willful simply means that the act constituting the violation was done intentionally: "There is no requirement that the actor also be aware that he is violating one of the Rules or Acts" [132].

Some commentators contend that the courts will read *Ernst & Ernst v. Hochfelder* [133] to require a more stringent definition of "willful", at least in cases where fraud is alleged [134]. A requirement of scienter in administrative disciplinary proceedings would necessitate a showing of "either intent to violate the law, or at least actual or constructive knowledge that the law is being violated" [135]. The Court of Appeals for the District of Columbia has remarked in passing that "willfulness...is more or less congruent with *Hochfelder's* use of 'scienter'" [136]. In *Arthur Lipper Corp. v. SEC* [137], the Court of Appeals for the Second Circuit, in reviewing a Section 15(b) proceeding based on a Section 10(b) violation, assumed *arguendo* that the *Hochfelder* culpability standard applied in disciplinary proceedings [138]. And in *Steadman v. SEC* [139], the Court of Appeals for the Fifth Circuit held that scienter must be shown in administrative disciplinary proceedings for violations of Section 17(a) (1) of the Securities Act [140] and Section 206(1) of the Investment Advisers Act [141], two basic antifraud provisions [142].

Having sustained the burden of proof that the defendant has committed a willful violation as defined by Section 15(b), the Commission must demonstrate that the imposition of a sanction is in the "public interest" [143] and that a particular sanction is appropriate [144]. One commentator has elucidated the "public interest" requirement by referring to constitutional principles, statutory purposes, and the Commission's practical experience in defining the "public interest" [145]. On the constitutional level, equal protection and due process in administrative proceedings embody the "public interest". The "public interest" is also served where a particular sanction furthers the purpose of the Securities Exchange Act of 1934 – "to insure the maintenance of fair and honest markets". Finally, the Commission's choice of sanctions has been shaped by numerous identifiable factors:

the nature of the violation; the respondent's prior record and reputation; the amount of money involved and loss, if any, to investors; the number of investors involved; the geographic scope of the violation; the respondent's age, experience, and current status in the business; and the respondent's attitude toward the offense including his willingness to reform and, if loss has been suffered, to make restitution [146] [footnotes omitted].

A person aggrieved by the final order of the Commission may obtain review of the order in the United States courts of appeals [147]. In *Steadman* [148], the Court of Appeals for the Fifth Circuit announced a standard of review which was not specifically considered in the Supreme Court's affirmance. The court of appeals applied a "compelling reasons" test [149]. It concluded that there is a direct relationship between the severity of the sanction imposed by the Commission and the Commission's burden of justification for imposing that sanction: "the greater the sanction the Commission decides to impose, the greater is its burden of justification" [150]. In other words, the Commission must state "compelling reasons" why a more lenient sanction would not satisfy the public interest. Rather than develop a standard of review per se, other courts have simply chastised the SEC for failing to set forth with the requisite degree of particularity the reasons for imposing severe sanctions [151].

Once it is determined that the SEC has not met its burden of justification or has failed to give adequate reasons for imposing particular sanctions, appellate courts usually vacate the order and remand to the Commission [152]. One court has taken the liberty of changing an SEC imposed sanction without remanding the case to the Commission [153].

3.3.2. Firm liability for violations by employees and agents

3.3.2.1. Controlling person liability. Section 20(a) of the Securities Exchange Act [154] provides a mechanism for imposing secondary liability on firms [155]. Under this section, a "control" person is subject to the same liability as the primary violator [156]. Section 20(a) states:

Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

The securities acts provide no statutory definition of "control", but rule 12b-2(f), promulgated by the SEC under the Securities Exchange Act, states: "The term 'control'... means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise" [157]. This definition has been applied under Section 20(a) [158].

Whether control exists depends upon the facts of each case [159]. Professor Bromberg lists the following factors as relevant:

(a) proportion of voting rights (through stock ownership, trust, proxy or otherwise) relative to remaining voting rights and relative to percentages required (by statute, charter, by-law, agreement or otherwise) for pertinent acts; (b) director, officer or other positions of power within the company; (c) business or financial leverage outside the company, e.g., by the customer-or-supplier relationship or by loan agreement; (d) personality factors, and other relationships by family or through business; (e) history of past cooperation or opposition; (f) with respect to the litigated transaction, who originated the idea, who negotiated it, who reviewed it, who questioned or objected to it, who approved it, and related circumstances [160].

The Commission's definition of control and such factors as the above indicate that the imposition of liability under Section 20(a) requires "only some indirect means of discipline or influence short of actual direction" [161]. In other words, potential control as well as actual control is sufficient for vicarious liability under Section 20(a) [162].

Secondary liability based on potential control is commonly referred to as "control by status," *i.e.* the status of the defendant with respect to the primary wrongdoer. When the position of the defendant is such that he could have influenced the primary wrongdoer, he will be deemed a control person. Thus, in *Kaufman v. Merrill Lynch, Pierce, Fenner & Smith* [163], a brokerage firm was held liable as a controlling person even though it was not directly involved in the fraudulent transactions of its employee. The involvement of the firm merely extended to placing the investment adviser employee on an "approved list", processing her transactions, and offering substantial advice on transactions. This broad construction of the control status of brokerage firms is justified by the remedial purpose of Section 20(a) [164].

Other courts have held that liability under Section 20(a) requires more than a showing of the potential to exercise actual control. Affirmative participation in the transaction in question is required [165]. For example, in *Gordon v. Burr* [166], the Court of Appeals for the Second Circuit concluded that a brokerage firm was not a "controlling" person where: the plaintiff was not a regular customer of the firm; the firm did not manage the questioned transaction involving purchaser plaintiff's acquisition of stock; and brokers at a meeting of prospective purchasers of stock were present in their private capacities [167].

Section 20(a) does afford a defense to the firm. Even where control is established, liability will not be imposed if the "controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action" [168]. There is no agreement on the meaning of this exculpatory language. A court's idiosyncratic interpretation of "control" determines the elements of a defense to "control" person liability. Jurisdictions requiring actual control are inclined to find good faith where there is no culpability on the part of the firm [169]. Culpability for purposes of Section

20(a) cases includes the subjective element of knowledge about the alleged wrongdoing [170]. On the other hand, the “control by status” interpretation of Section 20(a) has required a more objective proof of good faith: the controlling firm must defend by showing that it met a prescribed duty of supervision [171].

3.3.2.2. Exclusivity of controlling person liability. The availability of a good faith defense to Section 20 liability is moot where the brokerage firm is also subject to secondary liability under the common law doctrine of respondeat superior. Common law agency theory provides for strict liability within the scope of the employment relationship [172]. The United States courts of appeals are currently split on whether enactment of Section 20 of the Securities Exchange Act, as well as Section 15 of the Securities Act, supplanted common law agency principles, thereby affording the exclusive means by which secondary liability could be imposed on firms for employees’ primary violations of the securities laws [173].

Only one court of appeals decision directly considers the exclusivity question in SEC administrative proceedings [174]. The following discussion therefore reviews decisions in private damage actions and SEC civil injunction actions. The majority of the circuits now support the position that Section 20 does not provide an exclusive remedy [175]. The brokerage firm is subject to liability under both the statutory controlling person provision and the common law agency theory of respondeat superior. The circuits that take this view of concurrent remedies reason that Section 20(a) was not intended to narrow the remedies against brokerage firms for primary violations of employees [176]. Rather, Section 20(a) and respondeat superior should be applied in tandem to prevent brokerage firms from avoiding secondary liability by simply demonstrating good faith [177]. The policy rationale for denying the good faith defense to firms through application of respondeat superior is that “investors rely upon the reputation and prestige of the brokerage firm rather than the individual employees with whom they deal” [178].

A minority of courts take the position that Section 20(a) furnishes an exclusive mechanism for imposing vicarious liability on brokerage firms for the primary violations of employees [179]. Though the Court of Appeals for the Ninth Circuit strictly adheres to the exclusivity doctrine, it has never stated the reasons for its position [180]. The Court of Appeals for the Third Circuit, though not absolutist, has provided the most illuminating exposition of the exclusivity doctrine. In *Rochez Brothers, Inc. v. Rhoades* [181], the president of a brokerage firm defrauded the vice-president of that firm. The vice-president sued both the president and the firm for violation of rule 10b-5. In refusing to hold the firm liable for the independent acts of its president, the court reasoned that liability could be imposed only upon a showing of culpable participation under Section 20(a). In enacting Section 20(a), Congress had rejected the adoption of an “insurer’s liability” standard. Application of

respondent superior would in effect superimpose “insurer’s liability” on Section 20(a) by nullifying the good faith defense. The Third Circuit did leave room, however, for the application of respondent superior in cases involving the relationship between broker–dealer and customer [182].

3.3.2.3. Statutory actions against the firm for primary violations by employees. Broker–dealer disciplinary actions for violations by employees may proceed under several statutory provisions. One frequently applied provision is Section 15(b) (4) (E) of the Securities Exchange Act [183], providing in part that the SEC shall sanction a brokerage firm for failing to supervise reasonably against securities law violations by employees [184]. A firm is deemed to have satisfied the duty of reasonable supervision where:

(i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and

(ii) [the firm] has reasonably discharged the duties and obligations incumbent upon [it] by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with [185].

A firm can also be held liable under Section 15(b) (4) (D) of the Securities Exchange Act [186], which may be described as a statutory embodiment of the doctrine of respondent superior. Section 15(b) (4) (D) authorizes the Commission to sanction any registered broker or dealer for violations of the securities laws by the broker or dealer or by “any person associated with such broker or dealer”. As noted previously, the universe of associated persons includes partners, directors, officers, branch managers, controlling persons, and employees [187].

3.3.3. Self-regulatory organization proceedings

One sanction available in an SEC administrative disciplinary proceeding against broker–dealers is the suspension or revocation of the firm’s membership in a self-regulatory organization [188]. The Commission may also discipline persons associated with a member firm by suspending or barring such persons from association with members of the organization [189]. Additionally, the self-regulatory organizations themselves are required by statute to discipline members for securities law violations or infractions of their own rules or regulations [190].

Congress has allocated an important role to industry self-regulation. Self-regulation has been thought to have many significant benefits, including “the expertise and intimate familiarity with complex securities operations which members of the industry can bring to bear on regulatory problems, and the informality and flexibility of self-regulatory procedures” [191]. Accordingly, Congress authorized the formation of self-regulated national securities associ-

ations under Section 15A of the Securities Exchange Act [192] and entrusted national securities exchanges with self-regulatory powers in Section 6 of the Act [193].

The National Association of Securities Dealers, Inc. (NASD), the only national securities association registered with the SEC under Section 15A, is composed of firms trading in the over-the-counter market, including members of the national securities exchanges. Section 15A(b) (6) [194] requires that the NASD adopt rules for regulating the conduct of member firms and associated persons in accordance with “just and equitable principles of trade” [195]. This phrase has come to include the provisions of the Securities Exchange Act, rules and regulations promulgated thereunder [196], and the internal rules of the association [197].

The NASD is also obliged to enforce compliance through the imposition of disciplinary sanctions on its members and associated persons [198]. The penalties for violations of the NASD Rules of Fair Practice include censure, fine, suspension of membership or registration of a person associated with a member, and expulsion of a member or revocation of the registration of an associated person [199].

The NASD administrative disciplinary proceedings are subject to SEC oversight [200]. The written conclusions of the NASD Board of Governors must be filed with the SEC, which may review the matter on its own motion or on the motion of an aggrieved party [201]. Section 19(e) [202] authorizes the Commission to affirm or modify a NASD sanction, or to remand to the NASD for further consideration [203]. As a last resort, an aggrieved party has recourse to the appropriate United States court of appeals [204].

The congressionally mandated scheme of self-regulation with SEC oversight of national securities exchanges is virtually identical to that provided for the national securities associations. The exchanges are under the same obligations to establish rules in furtherance of “just and equitable principles of trade” [205] and to enforce compliance with such rules [206]. Similarly, a disciplinary sanction imposed through an exchange administrative proceeding is subject to review by the SEC [207] and appellate courts [208].

3.4. SEC disciplinary proceedings against attorneys and accountants

3.4.1. Operation and administration of rule 2(e)

Rule 2(e) of the SEC Rules of Practice [209] authorizes the Commission to discipline attorneys, accountants, and others [210] by suspending or permanently revoking the privilege of practicing before it (described hereinafter as “disbarment”). “Practicing before the Commission” has been broadly construed [211], thereby allowing the Commission relatively far-reaching disciplinary powers. In the wake of geometric increases in the number of disciplinary proceedings instituted pursuant to rule 2(e) over the past decade [212],

rule 2(e) has become the most controversial mechanism for imposing liability on securities professionals [213]. The controversy is attributable not only to the increased frequency of rule 2(e) proceedings (often directed at major firms as well as individual practitioners) but also to the expanding scope of conduct subject to SEC discipline [214]. The technical operation of rule 2(e) and the controversy surrounding the Commission's administration of the rule are considered below.

Rule 2(e) is applied in three different situations. First, 2(e) (1) [215] provides for suspension or disbarment following an administrative proceeding before the Commission, initiated at the request of the general counsel. Second, under paragraph (2) of rule 2(e) [216] a professional is automatically suspended when: a state authority has suspended or revoked the practitioner's license, or the respondent has been "convicted of a felony or misdemeanor involving moral turpitude". Third, an accountant or attorney who has been permanently enjoined from violating the securities laws or who has been found to have violated the securities laws may be temporarily suspended from practicing before the Commission without a hearing [217].

Rule 2(e) (1), authorizing administrative disbarment proceedings by the Commission, is the most controversial feature of the rule. It establishes three independent bases for the imposition of sanctions in such a proceeding: (i) lack of qualifications to represent others; (ii) unethical or improper professional conduct; or (iii) willful violations or willful aiding and abetting violations of the securities laws [218].

Lack of qualifications seldom has been used as a basis for a 2(e) proceeding [219]. The Commission has increasingly imposed sanctions for violations of professional standards of conduct, though the Commission rarely brings a disciplinary proceeding against an attorney solely on this basis [220]. As a general matter, rule 2(e) (1) proceedings against attorneys involve charges of primary violations or of aiding and abetting violations of the securities laws [221].

In the much debated opinion of *In re Carter & Johnson* [222], the Securities and Exchange Commission defined "unethical or improper professional conduct" by attorneys for rule 2(e) (1) (ii). An attorney violates the norms of ethical and professional conduct in the following circumstances:

When a lawyer with significant responsibilities in the effectuation of a company's compliance with the disclosure requirements of the federal securities laws becomes aware that his client is engaged in a substantial and continuing failure to satisfy those disclosure requirements, his continued participation violates professional standards unless he takes prompt steps to end the client's non-compliance [223].

The affirmative action required of the attorney may include resignation or "a direct approach to the board of directors". Departing from the standard enunciated by the administrative law judge, the Commission declined to

require the attorney to disclose his clients' violations to interested third parties, such as company shareholders, to the public or to the SEC. The Commission did note that disclosure might be required by other standards of professional conduct, such as the American Bar Association Disciplinary Rule 7-102(B) [224]. DR 7-102(B) requires that the attorney who learns that

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 a privileged communication [225].

The recent debate over attorneys' responsibilities to prevent violations by clients was precipitated by *SEC v. National Student Marketing* [226], an injunction action under rule 10b-5 [227]. In its provocative complaint [228], the SEC, alleged that the National Student Marketing Corporation (NSMC) and the Interstate National Corporation (INC) issued a misleading joint proxy statement to solicit their shareholders' approval of the merger of INC into NSMC. Although NSMC's interim income statement contained in the proxy showed a profit, a draft "comfort letter" prepared by NSMC auditors and delivered at the closing revealed that NSMC had in fact suffered a loss for the interim period. The SEC claimed that, before closing, the counsel for INC and NSMC should have insisted that the interim financial statement be revised and that INC's shareholders be resolicited. In the absence of the client's acquiescence to these demands, counsel should have resigned and notified the Commission about the misleading nature of the nine months' financial statement. The district court did not reach the Commission's theory, finding it "unnecessary to determine the precise extent of [the lawyers'] obligations here since... they took no steps whatsoever to delay the closing pending disclosure to and resolicitation of the Interstate shareholders" [229].

The *Carter & Johnson* decision suggests that the SEC has abandoned its position that attorneys must "blow the whistle" on their clients, imposing instead a duty to seek higher authority within the corporate structure. The movement from *National Student Marketing* to *Carter & Johnson* reflects a moderation of the "access theory" discussed in section 2 *supra*. As already indicated, this theory posits that insofar as attorneys supply the "passkey" to the capital markets through their role in providing services and advice [230], they are obliged to ensure that the markets remain orderly and fair. Under the access theory, the role of the securities lawyer as an independent "ombudsman" in the securities markets supplants that of advocate. The attorney is not simply a spokesman for the client but owes certain responsibilities to the public. Likening the position of the attorney to that of the independent auditor, former Commissioner Sommer has remarked that these responsibilities require "the healthy skepticism toward the representations of management which a good auditor must adopt" [231]. Theoretically, where management is defraud-

ing the investing public and fails to respond to counsel's advice, the securities attorney as an independent "ombudsman" must "blow the whistle" or, under the less extreme version of the access theory, seek higher authority within the corporate structure.

Subsequent to *Carter & Johnson*, the SEC solicited public comment on the standard of ethical conduct the Commission had enunciated in that case. The American Bar Association (ABA) responded by filing a statement which did not comment on the Commission's proposed standard itself but challenged the very authority of the Commission to promulgate such a standard [232]. In fact, the ABA House of Delegates has recently recommended federal legislation that would bar federal agencies from exercising disciplinary authority over lawyers practicing before them [233].

The bar is not totally averse to a standard of conduct that would include the duties to "seek higher authority" and "blow the whistle", as long as federal agencies are not the enforcers. The "proposed final draft" of the Model Rules of Professional Conduct that would set standards for attorneys representing corporate clients includes the highly controversial rule 1.13 [234]. If a lawyer knows that a corporate officer or employee is engaged in conduct that is a violation of a legal obligation to the corporation or that is a violation of law which might be imputed to the corporation and result in "material injury" to it, he is required under proposed rule 1.13(b) to "proceed as reasonably necessary in the best interest of the organization" [235]. The measures taken to satisfy the standard may include asking reconsideration of the matter, advising that a separate legal opinion on the matter be sought, and referring the matter to the highest authority in the organization. If the highest authority in the organization fails to take corrective action, the attorney may disclose the situation to the shareholders or others who can act to protect the organization where: "(1) the highest authority in the organization has acted to further the personal or financial interests of members of that authority which are in conflict with the interests of the organization; and (2) revealing the information is necessary in the best interest of the organization" [236].

In addition to lack of qualifications to represent others and unethical or improper professional conduct, a third basis for instituting an original disciplinary proceeding against an attorney or accountant is an allegation that the professional "willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws, or the rules and regulations thereunder" [237]. This provision was added by amendment to the rule in 1970 [238] and in part explains the increase in the number of proceedings against attorneys. As stated in the above discussion, "unethical or improper conduct" rarely is alleged in 2(e) proceedings involving attorneys absent charges of securities laws violations.

This amendment in essence authorizes the Commission to use rule 2(e) proceedings as an alternative to an injunction action or referral to the Justice

Department for a criminal prosecution. Their use for that purpose is a matter of controversy. The Commission has maintained that rule 2(e) is not an alternative enforcement remedy [239]. Rather, “it is addressed to a different problem – professional misconduct – and its sanction is limited to that necessary to protect the investing public and the Commission from the future impact on its processes of professional misconduct” [240]. Others maintain that this purported purpose is not the SEC’s real purpose [241]. The most recent general counsel to the SEC, Edward F. Greene, seems to agree with this view: “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 [sic] repetition of such conduct, not bring a 2(e) proceeding” [242]. Given that 2(e) (1) actions against attorneys are rarely brought for lack of requisite qualifications and 2(e) (1) actions based on allegations of “improper or unethical conduct” are usually tied to allegations of securities laws violations, one could predict that few if any disciplinary actions against attorneys would be brought under Mr. Greene’s interpretation of the rule.

Once a basis for the 2(e) proceeding is established, the Commission must show that the attorney’s or accountant’s misconduct is connected with the Commission’s processes. This requirement flows from the purported purpose of rule 2(e): to protect the integrity of the administrative process. This element of a 2(e) case has been referred to as the “nexus” requirement [243].

The “nexus” requirement has been broadly construed. The alleged connection with the Commission’s processes has become increasingly tenuous in 2(e) cases [244]. In recent years, 2(e) proceedings have been instituted in situations involving no direct relationship between the misconduct of the respondent and a Commission proceeding or filing [245].

The broad construction of the “nexus” requirement is in part attributable to the expansive definition of “practice before the Commission”. As mentioned above, the Commission’s disciplinary powers extend to denying the privilege of practicing before it. The definition of “practice before the Commission” sets the bounds of the Commission’s processes and in turn determines the scope of conduct subject to disciplinary sanctions. Thus, where practice before the Commission is defined to include “any participation, involving legal advice respecting the federal securities laws, in the preparation or dissemination of any offering memorandum... and... any participation in the preparation or dissemination of any oral or written opinion dealing with the federal securities laws” [246], the scope of misconduct brought within the disciplinary authority of the Commission is quite broad. The “nexus” between the administrative processes and the misconduct is therefore attenuated.

The scope of rule 2(e) disciplinary proceedings may be restricted over the course of the next few years. Mr. Greene has commented:

[A]bsent 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 [247].

3.4.2. Firm liability for rule 2(e) violations

Rule 2(e) has been used to reach the firm as well as the individual practitioner. Though disciplinary sanctions against law and accounting firms have been imposed with increasing frequency, the Commission has failed to articulate adequately the legal theories underlying such liability.

The doctrinal bases for the SEC disciplinary actions against the firm fall into two categories: vicarious liability and firm-wide fault [248]. *Touche Ross & Co. v. SEC* [249] raised a question about the authority of the Commission to sanction firms under 2(e) on the basis of vicarious liability, although the court did not explicitly address the issue. The Court of Appeals for the Second Circuit suggested that the Commission might want to consider whether Congress has in fact delegated authority to sanction the firm on a theory of respondeat superior and whether appropriate standards for such a proceeding have been established through rulemaking. The Commission has yet to consider openly the applicability of the theory of respondeat superior in the 2(e) context.

The Commission more frequently has made firm-wide fault the basis for imposing liability on firms. The cases suggest three general theories of liability. First, the firm may be held liable if the public has relied on the firm's representations [250]. Thus, where an accounting firm issues a report in its own name, it will be held responsible for the contents. Second, involvement of top management or substantial numbers of the firm's members will implicate the firm. In *In re Keating, Muething & Klekamp* [251], the Commission imposed sanctions on a law firm where almost every member of the firm was aware of one or more of the material transactions deemed by the Commission to involve inadequate or misleading disclosure. Third, a firm may be held liable where its internal procedures were not adequate to prevent or detect misconduct. This is analogous to imposing liability on brokerage firms for the failure to supervise [252]. In *Keating*, the division of authority among partners impaired communication within the firm and partners with material information failed to inform properly the member of the firm responsible for the filings with the Commission. In the offer of settlement the firm agreed to "adopt, maintain and implement additional internal and supervisory procedures which are reasonably designed to ensure that respondent has adequate procedures with respect to representation in matters involving federal securities laws" [253].

3.4.3. *The future of rule 2(e) proceedings*

In addition to controversy surrounding the operation and administration of the rule, critics have contested the very authority of the Commission to promulgate a rule empowering it to discipline accountants and particularly attorneys. Only one court has considered the authority of the Commission to adopt and administer rule 2(e). In *Touche Ross & Co. v. SEC* [254], the Court of Appeals for the Second Circuit affirmed the Commission's authority to initiate 2(e) proceedings against accountants. The court concluded that the authority of the Commission could be implied from the Commission's general statutory power to adopt rules and regulations necessary for the implementation of the securities laws [255]. In dictum, the court suggested that the same reason for the authority of the Commission to discipline accountants – protecting the integrity of the administrative process – applies equally to 2(e) proceedings against attorneys. The court stated that limited resources require the Commission to “rely heavily on both the accounting and legal professions to perform their tasks diligently and responsibly. Breaches of professional responsibility jeopardize the achievement of the objectives of the securities laws and can inflict great damage on public investors” [256]. In *Carter & Johnson*, a 2(e) case involving attorneys, the SEC adopted the reasoning of the Second Circuit in holding that rule 2(e) is clearly within the Commission's authority.

The most outspoken critic of the Commission's exercise of disciplinary power over attorneys and accountants is former Commissioner Roberta Karmel [257]. In *Keating, Muething & Klekamp*, Commissioner Karmel dissented from the disciplinary action against a law firm. According to Karmel, while express statutory provisions legitimize disciplinary proceedings against accountants under the Commission's general rulemaking authority, no comparable statutory provisions govern attorneys. The securities laws empower the Commission to regulate the terms and form of financial statements [258] and to require that the statements be certified by an independent public accountant [259]. The administrative sanctioning of accountants is arguably a necessary and appropriate adjunct to an express Commission mandate and responsibility. In *In re Darrell L. Nielson* [260], Commissioner Karmel maintained that even the legitimacy of 2(e) proceedings against accountants is “not free from doubt”. Many commentators agree with the former Commissioner, adding that the procedural safeguards which attend judicial proceedings under the securities laws are lacking in 2(e) proceedings: due process questions arise about the legitimacy of rule 2(e) as a mechanism for imposing liabilities on securities professionals [261].

4. Conclusion

This review of the major types of liabilities indicates that the exposure of securities professionals to liability as non-principals in securities transactions is comprehensive. The evolution of this encompassing complex of liabilities is marked by the expansion of liability beyond the responsibilities expressly prescribed by Congress. In the case of lawyers, for example, no explicit standards of conduct are set forth in the securities acts. Yet, the vulnerability of lawyers to liability for the illegal securities transactions of principals has increased dramatically through secondary liability and rule 2(e) disciplinary proceedings.

There are indications that the scope of liabilities is now contracting. Supreme Court decisions since 1975, which have assumed a literalist approach toward the securities acts, may augur a trend towards limiting liability to the express prescriptions of the acts. In addition, the more pronounced conservatism of SEC personnel under the Reagan administration will likely lead to moderation in the use of rule 2(e) disciplinary proceedings. Nevertheless, the degree to which this confluence of judicial and administrative restraint will limit the liabilities of securities professionals is uncertain.

Notes

[1] 17 C.F.R. §201.2(e) (1981).

[2] See R. Karmel, *Regulation by Prosecution 175* (1982). *see also* Dolin, *SEC Rule 2(e) After Carter-Johnson: Toward a Reconciliation of Purpose and Scope*, 9 *Sec. Reg. L. J.* 331, 338 n. 22 (1982).

[3] The recommendation for the formation of such a committee is reported in *Sec. Reg. & L. Rep.* (BNA) No. 182, at A-2 (summarizing a letter to Robert W. Meserve, President of the ABA, from Daniel J. McCauley, Jr.).

[4] See List of Enforcement Related Accounting Series Releases, [Accounting Releases Binder] *Fed. Sec. L. Rep.* (CCH) at 63,351 (1982).

[5] Large accounting firms disciplined include: Arthur Andersen & Co.; S.D. Leidesdorf & Co.; Ernst & Ernst; Price, Waterhouse & Co.; Laventhol & Horwath; Peat, Marwick, Mitchell & Co.; and Touche, Ross & Co.

[6] The authors gratefully acknowledge the contribution of Robert C. Pozen, Esq., to the analysis of these legal theories.

[7] For discussions of the "access" theory, *see* R. Karmel, *supra* note 1, at 174, and Sommer, *The Emerging Responsibilities of the Securities Lawyer*, [1973-74 Transfer Binder] *Fed. Sec. L. Rep.* (CCH) ¶79,631 (Jan. 1974).

[8] 328 F. 2d 854 (2d Cir.), *cert. denied*, 377 U.S. 893 (1964).

[9] *Id.* at 863.

[10] *Great Sweet Grass Oils, Ltd.*, 37 SEC 683 (1957), *aff'd per curiam*, 256 F.2d 893 (D.C. Cir. 1958); *Kroy Oils, Ltd.*, 37 SEC 683 (1957), *petition for review withdrawn*, No. 13,930 (D.C. Cir. Dec. 10, 1958). The actions of the United States' lawyer are set forth in *Schwebel v. Orrick*, 153 F.Supp. 701 (D.D.C. 1957) (the district court dismissed the lawyer's complaint for injunction against the SEC commissioners), *aff'd*, 251 F.2d 919 (D.C. Cir.), *cert. denied*, 356 U.S. 927 (1958).

[11] See Lipman, *The SEC's Reluctant Police Force: A New Role for Lawyers*, 49 N.Y.U. L. Rev. 437 (1974).

[12] The leading article on aiding and abetting liability is Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution*, 120 U. Pa. L. Rev. 597 (1972). *See also* Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934* [sic], 69 Calif. L. Rev. 80 (1981).

[13] Secondary liability refers to the implied civil liability imposed on a collateral defendant when the primary wrongdoer has violated express statutory prohibitions. *See* Fischel, *supra* note 12, at 80 n. 4.

[14] *But see* Securities Exchange Act §15(b) (4) (E), 15 U.S.C. §78o(b) (4) (E) (1976), which authorizes the Commission to censure a broker or dealer, or any person associated with such broker or dealer, who "has willfully, aided, abetted, counseled, commanded, induced or procured the violation by any other person of any provision [of the securities laws]".

[15] Aiding and abetting theory is most frequently applied under Section 10(b) of the Securities Exchange Act, 15 U.S.C. §78(j) (1976), and implementing rule 10b-5, 17 C.F.R. §240.10b-5 (1982). Section 10(b) provides: "It shall be unlawful for any person, directly or indirectly... (b) to use or employ, in connection with the purchase or sale of any security... any manipulative or deceptive device or contrivance..." Under rule 10b-5, it is unlawful:

(a) [t]o employ any device, scheme, or artifice to defraud,

(b) [t]o make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) [t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

[16] 259 F.Supp. 673, 680 (N.D. Ind. 1966).

[17] See, e.g., *Rochez Brothers, Inc. v. Rhoades*, 527 F.2d 880, 886 (3d Cir. 1975); *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974), cert. demed, 420 U.S. 908 (1975); *Landy v. FDIC*, 486 F.2d 139, 162 (3rd Cir. 1973), cert. denied, 416 U.S. 960 (1974).

[18] Restatement of Torts §876 (1939). Restatement (Second) of Torts §§876, 877 (1977) uses this same language.

[19] See, e.g., *SEC v. Seaboard Corporation*, 677 F.2d 1301, 1311 (9th Cir. 1982); *IIT an Int'l Inv. Trust v. Cornfield*, 619 F.2d 909, 922 (2d Cir. 1980); *Investors Research Corp. v. SEC*, 628 F.2d 168, 178 (D.C. Cir.), cert. denied, 449 U.S. 919 (1980); *Rolf v. Blyth, Eastman Dillon & Co., Inc.*, 570 F.2d 38, 47-48 (2d Cir. 1978); *Woodward v. Metro Bank*, 522 F.2d 84, 94-95 (5th Cir. 1975); *SEC v. Coffey*, 493 F.2d at 1309. See also *In re Carter & Johnson*, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶82,847 at 84, 166 (SEC Feb. 28, 1981).

[20] Scierter is defined as the "mental state embracing intent to deceive, manipulate, or defraud". *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976).

[21] See, e.g., *Decker v. SEC*, 631 F.2d 1380, 1386-88 (10th Cir. 1980); *Investors Research Corp. v. SEC*, 628 F.2d 168, 176-79 (D.C. Cir.), cert. demed, 449 U.S. 919 (1980).

[22] *Aaron v. SEC*, 446 U.S. 680, 686 n.5 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976).

[23] See, e.g., *Investors Research Corp. v. SEC*, 628 F.2d at 176-79; *SEC v. Coffey*, 493 F.2d at 1316 n.30.

[24] See, e.g., *SEC v. Seaboard Corporation*, 677 F.2d at 1311; *Decker v. SEC*, 631 F.2d at 1388 n.16.

[25] *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d at 44. See also *Woodward v. Metro Bank*, 522 F.2d at 97.

[26] *Edwards & Hanley v. Wells Fargo Securities Clearance Corp.*, 602 F.2d 478, 485 (2nd Cir.), cert. demed, 444 U.S. 1045 (1978). See also *Decker v. Massey-Ferguson*, 681 F.2d 111, 120-21 (2d Cir. 1982).

[27] *Wessel v. Buhler*, 437 F.2d 279, 283 (9th Cir. 1971).

[28] 457 F.Supp. 682, 713 (D.C. Cir. 1978).

[29] See also *Strong v. France*, 474 F.2d 747, 752 (9th Cir. 1973); *Kerbs v. Fall River Industries*, 502 F.2d 731, 740 (10th Cir. 1974).

[30] *Rochez Brothers, Inc. v. Rhoades*, 527 F.2d at 889. See also *SEC v. Washington County Utility District*, 676 F.2d 218, 226 (6th Cir. 1982); *Gould v. American-Hawaiian Steamship Co.*, 535 F.2d 761, 780 (3d Cir. 1976).

[31] 522 F.2d at 97.

[32] [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶82,847 at 84,169 (SEC Feb. 28, 1981).

[33] In *Ernst & Ernst v. Hochfelder*, 425 U.S. at 192 n.7, the Court reserved the issue of whether aiding and abetting liability can be imposed under section 10(b) and rule 10b-5.

[34] See Fischel, *supra* note 12; Ruder, *Express and Implied Remedies and Secondary Liability Under the Securities Laws*, 12 Inst. on Sec. Reg. 339 (1981).

[35] Fischel, *supra* note 12.

[36] 442 U.S. 560 (1979).

[37] 444 U.S. 11 (1979).

[38] Fischel, *supra* note 12, at 93.

[39] See, e.g., Securities Act §15. 15 U.S.C. §77o (1976), & Securities Exchange Act §20(a), 15 U.S.C. §78t (1976) (the controlling persons provisions).

[40] 456 U.S. 353 (1982).

[41] 15 U.S.C. §§77a-77aa (1976).

- [42] 15 U.S.C. §77k (1976).
- [43] *Barnes v. Osofsky*, 373 F.2d 269 (2d Cir. 1967).
- [44] 15 U.S.C. §77k(a) (1976).
- [45] *Id.*
- [46] *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 208 (1976). *See also Strauss v. Holiday Inns, Inc.*, 460 F.Supp. 729, 732 (S.D.N.Y. 1978).
- [47] Materiality is an equally important concept under SEC rule 10b-5, 17 C.F.R. 240.10b-5 (1982), discussed *supra* note 15.
- [48] 17 C.F.R. 230.405 (1982).
- [49] 426 U.S. 438 (1976).
- [50] *See Ross v. Warner*, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶97,735 at 98,861 (S.D.N.Y. Dec. 11, 1980); *Greenapple v. Detroit Edison Co.*, 468 F.Supp. 702, 708-09 (S.D.N.Y. 1979), *aff'd*, 618 F.2d 198 (2d Cir. 1980) (“A fact is material if there is substantial likelihood that, under all the circumstances, a reasonable investor would consider it important in reaching an investment decision”).
- [51] 15 U.S.C. §77k(a) (1) (1976).
- [52] 15 U.S.C. §77f(a) (1976).
- [53] 15 U.S.C. §77k(a) (3) (1976).
- [54] 15 U.S.C. §77k(a) (4) (1976).
- [55] 15 U.S.C. §77k(a) (5) (1976).
- [56] 15 U.S.C. §77k(a) (4) (1976).
- [57] A lawyer is not liable as an “expert” where he has written the entire registration statement. *Escott v. BarChris Construction Corp.*, 283 F.Supp. 643, 683 (S.D.N.Y. 1968).
- [58] *See Sax, Lawyer Responsibility in Tax Shelter Opinions*, 34 Tax Lawyer 5, 17-19 (1980).
- [59] R. Jennings & H. Marsh, Jr., *Securities Regulation* 1181 (1982).
- [60] The extension of liability to all members of the syndicate was “one of the most novel aspects of the 1933 Act”. Dooley, *The Effects of Civil Liability on Investment Banking and the New Issues Market*, 58 Va. L. Rev. 776, 794 (1972).
- [61] *See infra* section 3.2.3.
- [62] 283 F.Supp. 643 (S.D.N.Y. 1968).
- [63] 15 U.S.C. §77k(a) (4) (1976).
- [64] 283 F.Supp. at 697-703.
- [65] 15 U.S.C. §77k(b) (3) (1976).
- [66] *Id.*
- [67] 15 U.S.C. §77k(c) (1976).
- [68] Generally accepted auditing standards are established for the profession by the American Institute of Certified Public Accountants.
- [69] 283 F.Supp. 643, 703 (S.D.N.Y. 1968). *See also SEC v. Arthur Young & Co.*, 590 F.2d 785, 788 (9th Cir. 1979).
- [70] *See SEC v. Seaboard Corp.*, 677 F.2d 1301, 1313 n.15 (1982). *See also* R. Jennings & H. Marsh, Jr., *supra* note 59, at 1162.
- [71] 425 F.2d 796 (2d Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970).
- [72] Generally accepted accounting principles are established by the Financial Accounting Standards Board.
- [73] 283 F.Supp. at 697.
- [74] *See Folk, Civil Liabilities Under the Federal Securities Acts: The BarChris Case*, 55 Va. L. Rev. 1, 53-55 (1969).
- [75] 283 F.Supp. 643, 697 (S.D.N.Y. 1968).
- [76] *Id.* at n.26.
- [77] *Folk, supra* note 74, at 56-58.
- [78] Securities Act Release No. 5275, at 11-12 (July 26, 1972), *reprinted in In re Gap Stores Sec.*

Litg., 70 F.R.D. 283, 301 (N.D. Cal. 1978). See also McAtee & Volk, *The Underwriter and Due Diligence*, 5 Inst. on Sec. Reg. 181, 196–201 (1974).

[79] The term “specialist director” is used by Folk, *supra* note 74, at 33:

It designates the individual who may bear a heavier burden under the various “reasonableness” tests because of his particular function in the corporation (other than as an officer), his professional knowledge or skill in an area relevant to his liability, or the fact that he participates in the registration process not only as a director but also in some additional capacity. The *BarChris* treatment of several such persons raises the fundamental issue of whether the standard of care varies if such factors are present.

[80] See *supra* text accompanying notes 35–40.

[81] See, e.g., *Hagert v. Gluckman, Lurie, Eiger & Co.*, 520 F.Supp. 1028, 1033-34 (D. Minn. 1981); *McFarland v. Memorex Corp.*, 493 F.Supp. 631, 642 (N.D. Cal. 1980); *In re Equity Funding Corp. of America Sec. Litig.*, 416 F.Supp. 161, 181 (C.D. Cal. 1976). But see *In re Caesars Palace Sec. Litig.*, 360 F.Supp. 366, 384 (S.D.N.Y. 1973).

[82] *McFarland v. Memorex Corp.*, 493 F.Supp. at 642.

[83] 15 U.S.C. §77b(11) (1976).

[84] 15 U.S.C. §77k(a) (5) (1976).

[85] L. Loss, 1 Securities Regulation 547 (1961).

[86] 15 U.S.C. §77b(11) (1976).

[87] 15 U.S.C. §771 (1) (1976).

[88] 15 U.S.C. §771(2) (1976). Section 12(2) provides that any person who

offers or sells a security...by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

[89] *Id.*

[90] 448 F.2d 680 (5th Cir. 1971).

[91] *Id.* at 693.

[92] *Id.* at 692.

[93] 487 F.2d 617 (5th Cir. 1973).

[94] *Id.* at 622.

[95] 621 F.2d 656 (5th Cir. 1980).

[96] *Id.* at 667.

[97] 624 F.2d 709 (5th Cir. 1980).

[98] *Id.* at 714.

[99] 650 F.2d 1349 (5th Cir. 1981).

[100] *Id.* at 1360.

[101] See, e.g., *In re Intel Sec. Litig.*, 89 F.R.D. 104 (N.D. Cal. 1981); *de Bruin v. Andromeda Broadcasting Systems*, 465 F.Supp. 1276 (D. Nev. 1979); *Brick v. Dominion Mortgage & Realty Trust*, 442 F.Supp. 283 (S.D.N.Y. 1977); *Stern v. American Bankshares Corp.*, 429 F.Supp. 818 (E.D. Wis. 1977); *Sandusky Land, Ltd. v. Uniplan Groups, Inc.*, 400 F. Supp. 440 (N.D. Ohio 1975); *In re Caesars Palace Sec. Litig.*, 360 F.Supp. 366 (S.D.N.Y. 1973).

[102] 15 U.S.C. §77o (1976). See *infra* section 3.3.2.1.

[103] *Huddleston v. Herman & MacLean*, 640 F.2d 543, 551 n.27 (5th Cir. 1981); *Croy v. Campbell*, 624 F.2d at 713 n.5.

[104] 360 F.Supp. at 380.

[105] See, e.g., *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979); *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979).

[106] 605 F.2d 110 (3d Cir. 1979).

[107] *Id.* at 113.

[108] A self-regulatory organization is defined as “any national securities exchange, registered securities association, or registered clearing agency”. Securities Exchange Act Section 3(a) (26), 15 U.S.C. §78c(26) (1976).

[109] See Securities Exchange Act §21, 15 U.S.C. §78u (1976); Securities Act §§19(b), 20(a), 15 U.S.C. §§77s(b), 77t(a) (1976).

[110] A “broker” is defined as a “person engaged in the business of effecting transactions in securities for the account of others”. Securities Exchange Act §3(a) (4), 15 U.S.C. §78c(a) (4) (1976). A “dealer” is a “person engaged in the business of buying and selling securities for his own account”. Securities Exchange Act §3(a) (5), 15 U.S.C. §78c(a) (5) (1976).

[111] An “investment adviser” is defined as “any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities”. Investment Advisers Act §202(a) (11), 15 U.S.C. §80b-2a(11) (1976).

[112] 15 U.S.C. §78o(b) (4) (1976).

[113] The term “person associated with a broker or dealer” is defined in Section 3(a) (18) of the Securities Exchange Act, 15 U.S.C. §78c(a) (18) (1976), as follows:

The term “person associated with a broker or dealer” or “associated person of a broker or dealer” means any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer....

[114] 15 U.S.C. §78o(b) (6) (1976).

[115] Investment Advisers Act Sections 203(e),(f), 15 U.S.C. §§80b-3(e),(f) (1976).

[116] 15 U.S.C. §78o(b) (4) (A) (1976).

[117] 15 U.S.C. §78o(b) (4) (D) (1976).

[118] 15 U.S.C. §78o(b) (4) (E) (1976).

[119] See, e.g., *In re Cea*, 44 S.E.C. 8, 25 (1969); *In re White*, 3 S.E.C. 466, 539–540 (1938).

[120] *Addington v. Texas*, 441 U.S. 418, 423 (1979). See also *Steadman v. SEC*, 603 F.2d 1126, 1139 (5th Cir. 1979), *aff’d*, 450 U.S. 91 (1981).

[121] 562 F.2d 820 (D.C. Cir. 1977).

[122] 604 F.2d 676 (D.C. Cir. 1979).

[123] *Id.* at 681.

[124] 628 F.2d 168 (D.C. Cir.), *cert. denied*, 449 U.S. 919 (1980).

[125] *Id.* at 175 n.41.

[126] 15 U.S.C. §80a-17(e) (1) (1976). This section makes it unlawful for an affiliated person of a registered investment company,

acting as agent, to accept from any source any compensation (other than a regular salary or wages from such registered company) for the purchase or sale of any property to or for such registered company or any controlled company thereof, except in the course of such person’s business as an underwriter or broker.

- [127] See also *Decker v. SEC*, 631 F.2d 1380 (10th Cir. 1980).
- [128] 450 U.S. 91 (1981).
- [129] 5 U.S.C. §556 (1976).
- [130] See Securities Exchange Act §§15(b) (4) (A),(D),(E) & §15(b) (6), 15 U.S.C. §§78o(b) (4) (A),(D),(E) & §78o(b) (6) (1976). See also Investment Advisers Act §§203(e) (1),(4),(5) & §203(f), 15 U.S.C. §§80b-3(e) (1),(4),(5) & §80b-3(f) (1976).
- [131] 344 F.2d 5 (2d Cir. 1965).
- [132] *Id.* at 8. See also *Decker v. SEC*, 631 F.2d at 1386; *International Shareholders Services Corp. v. SEC*, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶80,493 at 86,285 (SEC April 29, 1976); *A.J. White & Co.*, 3 SEC Docket 550, 551 (SEC 1974), *aff'd* 556 F.2d 619 (1st Cir.), *cert. demed.*, 434 U.S. 969 (1977).
- [133] 425 U.S. 185 (1976).
- [134] See, e.g., Matthews, *Litigation and Settlement in SEC Administrative Enforcement Proceedings*, 29 Cath. U. L. Rev. 215, 238-40 (1980). It will be recalled that *Hochfelder* held that scienter is an element of a Section 10b/rule 10b-5 cause of action.
- [135] Matthews, *supra* note 134, at 240.
- [136] *Whitney v. SEC*, 604 F.2d at 682 n.23. See also *Wasson v. SEC*, 558 F.2d 879, 887 (8th Cir. 1977).
- [137] 547 F.2d 171 (2d Cir. 1976), *cert. denied*, 434 U.S. 1009 (1978).
- [138] *Id.* at 180 n.6, 181. See also *Edward J. Mawood & Co. v. SEC*, 591 F.2d 588, 596 (10th Cir. 1979) (following the lead of the Commission, the court assumed that the *Hochfelder* standard applied to a determination of willfulness in an administrative proceeding for a 10-b violation of the Securities Exchange Act).
- [139] 603 F.2d 1126 (5th Cir. 1979), *aff'd*, 450 U.S. 91 (1981).
- [140] 15 U.S.C. §77q(a) (1) (1976).
- [141] 15 U.S.C. §80b-6(1) (1976).
- [142] See *Steadman v. SEC*, 603 F.2d at 1143.
- [143] See Securities Exchange Act §§15(b) (4), (6), 15 U.S.C. §§78o(b) (4), (6) (1976); Investment Advisers Act §203(e), (f), 15 U.S.C. §§80b-3(e), (f) (1976).
- [144] Matthews, *supra* note 134, at 241-44; Thomforde, *Patterns of Disparity in SEC Administrative Sanctioning Practice*, 42 Tenn. L. Rev. 465, 470-474 (1975).
- [145] Thomforde, *supra* note 144.
- [146] *Id.* at 473-74.
- [147] Securities Exchange Act §25(a), 15 U.S.C. §78y(a) (1976).
- [148] 603 F.2d 1126 (5th Cir. 1979), *aff'd*, 450 U.S. 91 (1981).
- [149] *Id.* at 1139-40.
- [150] *Id.* at 1139.
- [151] See, e.g., *Nassar & Co., Inc. v. SEC*, 566 F.2d 790, 794 (D.C. Cir. 1977).
- [152] See, e.g., *Steadman v. SEC*, 603 F.2d 1126 (5th Cir. 1979), *aff'd*, 450 U.S. 91 (1981).
- [153] *Arthur Lipper Corp. v. SEC*, 547 F.2d 171 (2d Cir. 1976).
- [154] 15 U.S.C. §78t(a) (1976).
- [155] The pertinent literature includes: Note, "Controlling Persons" Liability of Broker-Dealers for Their Employees' Federal Securities Violations, 1974 Duke L.J. 824 (1976); Note, *Burden of Control: Derivative Liability Under Section 20(a) of the Securities Exchange Act of 1934*, 48 N.Y.U. L. Rev. 1019 (1973); Note, *Securities Regulation: "Control" Person Liability Under Section 20(a) of the Exchange Act*, 33 Okla. L. Rev. 665 (1980); Comment, *A Comparison of Control Person Liability and Respondeat Superior: Section 20(a) of the Securities and Exchange Act* [sic], 15 Cal. W. L. Rev. 152 (1979); Comment, *Secondary Liability of Controlling Persons Under the Securities Acts: Toward an Improved Analysis*, 126 U. Pa. L. Rev. 1345 (1978).
- [156] See also Section 15 the Securities Act, 15 U.S.C. §77o (1976), which provides for liability of persons who control a primary violator of Sections 11 or 12 of the Securities Act, 15 U.S.C. §§77k, l (1976).

[157] 17 C.F.R. 240.12b-2(f) (1982). See also Securities Act rule 405(f), 17 C.F.R. §230.405(f) (1982).

[158] See, e.g., *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1120 (5th Cir. 1980); *Rochez Brothers, Inc. v. Rhoades*, 527 F.2d 880, 890 (3d Cir. 1975); *Kaufman v. Merrill Lynch, Pierce, Fenner & Smith*, 464 F.Supp. 528, 538 (D. Md. 1978).

[159] It is apparent that this was intended by Congress. See H.R. Rep. No. 1383, 73d Cong. 2d Sess. 26 (1934).

[160] 2 A. Bromberg, *Securities Law* §4.7 (634) at 88.107-08 (1975).

[161] *Myzel v. Fields*, 386 F.2d 718, 738 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968).

[162] See, e.g., *Bird v. Ferry*, 497 F.2d 112, 117-118 (5th Cir. 1974); *Richardson v. MacArthur*, 451 F.2d 35, 41-42 (10th Cir. 1971); *Myzel v. Fields*, 386 F.2d at 738; *Savino v. E.F. Hutton & Co.*, 507 F.Supp. 1225 (S.D.N.Y. 1981); *Kaufman v. Merrill Lynch, Pierce, Fenner & Smith*, 464 F.Supp. at 538.

[163] 464 F.Supp. 528 (D. Md. 1978).

[164] See *Myzel v. Fields*, 386 F.2d at 738.

[165] See, e.g., *Christoffel v. E.F. Hutton & Co., Inc.*, 588 F.2d 665, 668-69 (9th Cir. 1978); *Rochez Bros., Inc. v. Rhoades*, 527 F.2d at 891; *Gordon v. Burr*, 506 F.2d 1080, 1086 (2d Cir. 1974).

[166] 506 F.2d 1080 (2d Cir. 1974).

[167] *Id.* at 1086.

[168] The defense provided to a control person by Section 15 of the Securities Act, 15 U.S.C. §77o (1976), is somewhat different. He must defend by showing that he "had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist".

[169] See, e.g., *Christoffel v. E.F. Hutton & Co.*, 588 F.2d at 668-669; *Rochez Brothers, Inc. v. Rhoades*, 527 F.2d at 890; *Gordon v. Burr*, 506 F.2d at 1086; *Lanza v. Drexel & Co.*, 479 F.2d 1277, 1299 (2d Cir. 1973).

[170] See, e.g., *Lanza v. Drexel & Co.*, 479 F.2d at 1300-1304.

[171] See, e.g., *Marbury Management, Inc. v. Kohn*, 629 F.2d 705, 716 (2d Cir.), cert. denied, 449 U.S. 1011 (1980); *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d at 1120; *SEC v. First Securities Co. of Chicago*, 463 F.2d 981, 987 (7th Cir.), cert. denied, 409 U.S. 1041 (1972).

[172] See, e.g., Restatement (Second) of Agency §§219, 257 (1958):

§219. When Master is Liable for Torts of His Servants:

- (1) A master is subject to liability for the torts of his servants committed while acting in the scope of their employment.
- (2) A master is not subject to liability for the torts of his servants acting outside the scope of their employment, unless:
 - (a) the master intended the conduct or the consequences, or
 - (b) the master was negligent or reckless, or
 - (c) the conduct violated a non-delegable duty of the master, or
 - (d) the servant purported to act or to speak on behalf of the principal and there was a reliance upon apparent authority, or he was aided in accomplishing the tort by the existence of the agency relation.

§257. Misrepresentations; in General

A principal is subject to liability for loss caused to another by the other's reliance upon a tortious representation of a servant or other agent, if the representation is:

- (a) authorized;

- (b) apparently authorized; or
- (c) within the power of the agent to make for the principal.

[173] For detailed discussions of the split, see Reininger, *Exclusive or Concurrent – The Role of Control and Respondeat Superior in the Imposition of Vicarious Civil Liability on Broker-Dealers*, 9 Sec. Reg. L. J. 226 (1981); Matthews, *Litigation and Settlement of SEC Administrative Enforcement Proceedings*, 29 Cath. U. L. Rev. 215 (1980); Note, *Rule 10b-5 and Vicarious Liability Based on Respondeat Superior*, 69 Calif. L. Rev. 1513 (1981). See also Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934* [sic], 69 Calif. L. Rev. 80 (1981).

[174] *Armstrong, Jones & Co. v. SEC*, 421 F.2d 359 (6th Cir.), cert. denied, 398 U.S. 958 (1970) (affirmed sanction of broker-dealer for violations of agents under doctrine of respondeat superior). See also *A.J. White & Co. v. SEC*, 556 F.2d 619, 624 (1st Cir.), cert. denied, 434 U.S. 969 (1977) (citing *Armstrong* for proposition that brokerage firm “can act only through its agents, and is accountable for the actions of its responsible officers”).

[175] See *Henricksen v. Henricksen*, 640 F.2d 880 (7th Cir.), cert. denied, 454 U.S. 1097 (1981); *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111 (5th Cir. 1980); *Marbury Management, Inc. v. Kohn*, 629 F.2d 705 (2d Cir.), cert. denied, 449 U.S. 1011 (1980); *Holloway v. Howerdd*, 536 F.2d 690 (6th Cir. 1976); *Carras v. Burns*, 516 F.2d 251 (6th Cir. 1975).

[176] *Marbury Management, Inc. v. Kohn*, 629 F.2d at 716.

[177] *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d at 1118-19.

[178] *Id.*

[179] See, e.g., *Christoffel v. E.F. Hutton & Co.*, 588 F.2d 665 (9th Cir. 1978); *Rochez Brothers, Inc. v. Rhoades*, 527 F.2d 880 (3d Cir. 1975); *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968).

[180] See *Christoffel v. E.F. Hutton & Co.*, 588 F.2d 665 (9th Cir. 1978); *Zweig v. Hearst*, 521 F.2d 1129 (9th Cir.), cert. denied, 423 U.S. 1025 (1975); *Kamen & Co. v. Paul H. Aschkar & Co.*, 382 F.2d 689 (9th Cir. 1967), cert. granted, 390 U.S. 942, cert. denied (by stipulation), 393 U.S. 801 (1968).

[181] 527 F.2d 880 (3d Cir. 1975).

[182] *Id.* at 886. See also *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 184 (3d Cir. 1981).

[183] 15 U.S.C. §78o(b) (4) (E) (1976).

[184] See, e.g., *SEC v. Geon Industries, Inc.*, 531 F.2d 39 (2d Cir. 1976); *In re Wulff Hansen & Co.*, Securities Exchange Act Release No. 19081 (Sept. 27, 1982); *In re First Interregional Equity Corp.*, Securities Exchange Act Release No. 19039 (Sept. 7, 1982); *In re Bache Halsey Stuart Shields, Inc.*, [Current Binder] Fed. Sec. L. Rep. (CCH) ¶83,249 (SEC Aug. 24, 1982); *In re J.B. Hanauer & Co.*, [1981-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶83,099 (SEC Feb. 11, 1982); *In re Frank J. Guiffrida United Monetary Services*, Securities Exchange Act Release No. 17335 (SEC Nov. 15, 1980); *In re Oppenheimer & Co., Inc.*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶82,125 (SEC July 5, 1979).

[185] 15 U.S.C. §78o(t) (4) (E) (1976).

[186] 15 U.S.C. §78o(b) (4) (D) (1976).

[187] Securities Exchange Act §3(a) (18), 15 U.S.C. §78c(a) (18) (1976).

[188] Securities Exchange Act §19(h) (2), 15 U.S.C. §78s(h) (2) (1976).

[189] Securities Exchange Act §19(h) (3), 15 U.S.C. §78s(h) (3) (1976).

[190] See Securities Exchange Act §§15A(b) (2), (7) & §19(h) (1), 15 U.S.C. §§78o-3(b) (2), (7) & §78s(h) (1) (1976).

[191] Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, *Securities Industry Study*, S. Doc. No. 93-13, 93d Cong., 1st Sess. 149 (1973), reprinted in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. NASD*, 616 F.2d 1363, 1366 (5th Cir. 1980).

[192] 15 U.S.C. §78o-3 (1976).

[193] 15 U.S.C. §78f (1976).

[194] 15 U.S.C. §78o-3(b) (6) (1976).

[195] *Id.* See also NASD Rules of Fair Practice, Art. III, §1, reprinted in NASD Manual (CCH) ¶ 2151 (1981) (“A member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade”).

[196] See, e.g., Securities Exchange Act §19(h) (1) (B), 15 U.S.C. §78s(h) (1) (B) (1976), which would seem to require NASD to enforce compliance with the Securities Exchange Act and related rules and regulations.

[197] See NASD Rules of Fair Practice, reprinted in NASD Manual (CCH) (1981).

[198] See Securities Exchange Act §§15A(b) (2),(7) & §19(h) (1), 15 U.S.C. §§78o-3(b) (2),(7) & §78s(h) (1) (1976).

[199] NASD Rules of Fair Practice, reprinted in NASD Manual (CCH) ¶2301 (1981).

[200] Securities Exchange Act §§19(d),(e), 15 U.S.C. §§78s(d), (e) (1976).

[201] Securities Exchange Act §§19(d) (1), (2), 15 U.S.C. §§78s(d) (1), (2) (1976).

[202] See Securities Exchange Act §§19(e) (1), (2), 15 U.S.C. §§78s(e) (1), (2) (1976).

[203] See, e.g., *In re Wall Street West, Inc.*, [1981-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶83,069 (SEC Dec. 9, 1981) (affirmed); *In re Stix & Co.*, [1976-77 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶80,722 (SEC Sept. 2, 1976) (modified); *In re Samuel A. Sardinia*, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,501 (SEC April 27, 1976) (modified).

[204] Securities Exchange Act §25, 15 U.S.C. §78y (1976). See, e.g., *Sorrell v. SEC*, 679 F.2d 1323 (9th Cir. 1982); *Sirianni v. SEC*, 67 F.2d 1284 (9th Cir. 1982); *Seaton v. SEC*, 670 F.2d 1309 (D.C. Cir. 1982).

[205] Securities Exchange Act §6(b) (5), 15 U.S.C. §78f(b) (5) (1976).

[206] Securities Exchange Act §§6(b) (1), (6) & §19(h) (1), 15 U.S.C. §§78f(b) (1), (6) & §78s(h) (1) (1976).

[207] Securities Exchange Act §§19(d),(e), 15 U.S.C. §§78s(d), (e) (1976).

[208] Securities Exchange Act §25, 15 U.S.C. §78(y) (1976).

[209] 17 C.F.R. §201.2(e) (1981).

[210] Paragraph (1) of the rule pertaining to original administrative proceedings actually authorizes the Commission to discipline “any person” who violates the enumerated standards. The rule has in practice only been applied to accountants and attorneys.

[211] “Practicing before the Commission” is defined in 17 C.F.R. §201.2(g) (1981), as including but not limited to “(1) transacting any business with the Commission; and (2) the preparation of any statement, opinion or other paper by any attorney, accountant, engineer or other expert, filed with the Commission”. The Commission has liberally applied this definition. See, e.g., *In re Petrallia, Turk, and DiConsiglio*, Securities Act Release No. 5963 (Aug. 25, 1978) (definition expanded to include “[3] any participation, involving legal advice respecting the federal securities laws, in the preparation or dissemination of any offering memorandum...and [4] any participation in the preparation or dissemination of any oral or written opinion dealing with the federal securities laws”).

[212] See Marsh, *Rule 2(e) Proceedings*, 35 Bus. Law. 987, 988 (1980).

[213] See, e.g., Daley & Karmel, *Attorneys’ Responsibilities: Adversaries at the Bar of the SEC*, 24 Emory L. J. 747 (1975); Dolin, *SEC Rule 2(e) After Carter-Johnson: Toward a Reconciliation of Purpose and Scope*, 9 Sec. Reg. L. Rev. 331 (1982); Downing & Miller, *The Distortion and Misuse of Rule 2(e)*, 54 Notre Dame Law. 774 (1979); Gross, *Attorneys and Their Corporate Clients: SEC Rule 2(e) and the Georgetown ‘Whistle Blowing’ Proposal*, 3 Corp. L. Rev. 197 (1980); Fiftis, *Choice of Federal or State Law for Attorneys’ Professional Responsibility in Securities Matters*, 56 N.Y.U. L. Rev. 1236 (1981); Karmel, *A Delicate Assignment: The Regulation of Accounting by the SEC*, 56 N.Y.U. L. Rev. 959 (1981); Marsh, *supra* note 212; Note, *SEC Disciplinary Proceedings Against Attorneys Under Rule 2(e)*, 79 Mich. L. Rev. 1270 (1981). See generally *The Evolving Problems for and Responsibilities of Attorneys Under the Federal Securities Laws*, 36 Bus. Law. 1777 (1981).

[214] See Dolin, *supra* note 213, at 338; Marsh, *supra* note 212, at 990-91.

- [215] 17 C.F.R. §201.2(e) (1) (1981).
- [216] 17 C.F.R. §201.2(e) (2) (1981).
- [217] 17 C.F.R. §201.2(e) (3) (1981).
- [218] See generally Marsh, *supra* note 212, at 995–98.
- [219] Ferrara, *Administrative Disciplinary Proceedings Under Rule 2(e)*, 36 Bus. Law. 1807, 1809 (1981).
- [220] On the other hand, 2(e) (1) proceedings against accountants are frequently based solely on violations of professional conduct standards. See, e.g., *In re Lester Witte & Co.*, [Accounting Releases Binder] Fed. Sec. L. Rep. (CCH) ¶72,307 (SEC Jan. 7, 1981).
- [221] See Greene, *Lawyer Disciplinary Proceedings before the Securities and Exchange Commission*, 14 Sec. Reg. & L. Rep. (BNA) 168, 170 (Jan 20, 1982).
- [222] [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶82,847 (SEC Feb. 28, 1981).
- [223] *Id.* at 84,172.
- [224] Model Code of Professional Responsibility Canon 2, DR 7-102(B) (1979).
- [225] *Id.*
- [226] 457 F.Supp. 682 (D.D.C. 1978).
- [227] 17 C.F.R. §240.10b-5 (1982).
- [228] *SEC v. National Student Marketing Corp.*, [1971–72 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶93,360 (D.D.C. filed Feb. 3, 1972).
- [229] 457 F.Supp. at 713.
- [230] Sommer, *The Emerging Responsibilities of the Securities Lawyer*, [1973-74 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶79,631 at 83,689 (Jan. 1974).
- [231] *Id.* at 83,690.
- [232] See *SEC Standard of Conduct for Lawyers*, reprinted in 37 Bus. Law. 915 (1982).
- [233] See Sec. Reg. & L. Rep. (BNA) Vol. 14, No. 33 at 1477 (1982).
- [234] Model Rules of Professional Conduct Rule 1.13 (Proposed Final Draft, 1981).
- [235] *Id.*
- [236] *Id.*
- [237] 17 C.F.R. §201.2(e) (1) (iii) (1981).
- [238] Securities Act Release No. 5088, Fed. Sec. L. Rep. (CCH) ¶77,913 (Sept. 24, 1970).
- [239] See, e.g., Ferrara, *supra* note 219, at 1807.
- [240] *In re Carter & Johnson*, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶82,847 at 84,149-50 (SEC Feb. 28, 1981).
- [241] See, e.g., Dolin, *supra* note 213; Downing & Miller, *supra* note 213.
- [242] See Greene, *supra* note 221, at 168.
- [243] See, e.g., *In re Darrell L. Nielson*, [Accounting Releases Binder] Sec. Reg. L. Rep. (CCH) ¶72,297 (SEC Jan. 10, 1980) (Karmel, dissenting); Ferrara, *supra* note 219, at 1810–11; Greene, *supra* note 221, at 169–70.
- [244] See Marsh, *supra* note 212, at 990–93.
- [245] *Id.*
- [246] *In re Petralia, Turk, and DiConsiglio*, Securities Act Release No. 5963 (Aug. 25, 1978).
- [247] Greene, *supra* note 221, at 169.
- [248] See Ferrara, *supra* note 219, at 1812.
- [249] 609 F.2d 570, 582 n.21 (2d Cir. 1979).
- [250] See, e.g., *In re Ernst & Ernst*, [Accounting Releases Binder] Fed. Sec. L. Rep. (CCH) ¶72,270 (SEC May 31, 1978).
- [251] [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶82,124 (SEC July 2, 1979).
- [252] See Securities Exchange Act §15(b) (4) (E), 15 U.S.C. §78o(b) (4) (E) (1976).
- [253] *In re Keating, Muething & Klekamp*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶82,124 at 81,989 (SEC July 2, 1979).
- [254] 609 F.2d 570 (2d Cir. 1979).

[255] See Securities Act §19(a), 15 U.S.C. §77s(a) (1976); Securities Exchange Act Section 23(a), 15 U.S.C. §78w(a) (1976).

[256] *Touche Ross & Co. v. SEC*, 609 F.2d at 581.

[257] See *In re Darrell L. Nielson*, [Accounting Releases Binder] Sec. Reg. L. Rep. (CCH) ¶72,297 (SEC Jan 10, 1980) (Karmel, dissenting); *In re Richard D. Hodgin*, 18 SEC Docket 458 (SEC Sept. 27, 1979) (Karmel, dissenting); *In re Keating, Muething & Klekamp*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶82,124 (SEC July 2, 1979) (Karmel, dissenting); R. Karmel, *Regulation by Prosecution* (1982); Karmel, *A Delicate Assignment: The Regulation of Accountants by the SEC*, 56 N.Y.U. L. Rev. 959 (1981); Daley & Karmel, *Attorneys' Responsibilities: Adversaries at the Bar of the SEC*, 24 Emory L.J. 747 (1975).

[258] Securities Act §19(a), 15 U.S.C. §77s(a) (1976); Securities Exchange Act 13(b) (1), 15 U.S.C. §78m(b) (1) (Supp. IV 1980).

[259] Securities Act Schedule A, Items 25-27, 15 U.S.C. §77aa Schedule A, Items 25-27 (1976); Securities Exchange Act §§12(b) (1) (J), (K), & §13(a), 15 U.S.C. §§78l(b) (1) (J), (K), & §78m(a) (1976).

[260] [Accounting Releases Binder] Sec. Reg. L. Rep. (CCH) ¶72,297 (SEC Jan. 10, 1980).

[261] See, e.g., Best, *In Opposition to Rule 2(e) Proceedings*, 36 Bus. Law. 1815 (1981); Dolin, *supra* note 213; Dowing & Miller, *supra* note 213.

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