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Disciplinary Proceedings by the S. E. C. Against Attorneys

*Paul J. Kemp**

I. Introduction

Authority of the Commission to Discipline Attorneys Who Appear Before It.

THE SECURITIES AND EXCHANGE COMMISSION, created by Section 4(a) of the Securities Exchange Act of 1934,[1] has from its earliest days proclaimed its right to determine who may appear before or transact business with it in a representative capacity[2] and in Rule 2(e) of its present Rules of Practice has reserved to itself the right, in its discretion, to "deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice of and opportunity for hearing in the matter (1) not to possess the requisite qualifications to represent others, or (2) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct." [3]

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[1] 15 U. S. C. § 78d(a).

[2] Rule II of the Commission's Rules of Practice, effective September 13, 1935, dealt with appearance and practice before the Commission; this rule had the same substantive provisions with respect to the qualification and disqualification of attorneys as at present (see *infra*, n. 3), but provided in addition for a formal admission to practice before the Commission and for a register of attorneys (1 S. E. C. Ann. Rep. 45-46 (1935); 17 C. F. R. § 201.2 (1939)).

The rule was amended in 1938 to eliminate formal admission to practice and the keeping of a register of attorneys (Securities Act Release No. 1761 (June 27, 1938); and see 4 S. E. C. Ann. Rep. 92 (1938)). The action of the Commission in amending its rules was in accord with the suggestion subsequently urged by interested members of the bar. See Survey of the Legal Profession, Standards of Admission for Practice Before Federal Administrative Agencies 22 (1953).

[3] 17 C. F. R. § 201.2(e) (1964). The power to adopt this rule is found in Section 23(a) of the Securities Exchange Act of 1934, 15 U. S. C. § 78w(a), which provides in pertinent part that the Commission may make such rules and regulations "as may be necessary for the execution of the functions

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The power of an administrative agency to set standards for determining who may appear and practice before it has long been recognized. *Goldsmith v. United States Board of Tax Appeals*[4] held that a federal administrative agency which has general authority to prescribe its rules of procedure may set standards for determining who may practice before it. The Court specifically rejected the argument that the absence in the Board's statute of an express provision requiring a list of enrolled attorneys to which a practitioner must be admitted was indicative of Congressional intent to deny the power to the Board. On the basis of *Goldsmith,* the Court of Appeals for the District of Columbia Circuit in *Herman v. Dulles*[5] sustained an order of the International Claims Commission disqualifying an attorney from practicing before that agency, noting that the agency's governing statute conferred express authority on it to "prescribe such rules and regulations as may be necessary to enable it to carry out its functions." [6] Pursuant to this authority the International Claims Commission adopted and published certain Rules of Practice and Procedure. One of these rules provides that an attorney's right to appear before the Commission may be revoked if the Commis-

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vested in [it] . . . by this title." Similar power to make rules and regulations is contained in the other statutes administered by the Commission. See Section 19(a) of the Securities Act of 1933, 15 U. S. C. § 77s(a); Section 20(a) of the Public Utility Holding Company Act of 1935, 15 U. S. C. § 79t-(a); Section 319(a) of the Trust Indenture Act of 1939, 15 U. S. C. § 77sss-(a); Section 38(a) of the Investment Company Act of 1940, 15 U. S. C. § 80a-37(a); and Section 211(a) of the Investment Advisers Act of 1940, 15 U. S. C. § 80b-11(a).

In addition to the Rules of Practice the Commission has also adopted a comprehensive Conduct Regulation regarding the conduct of present and former members and employees: 17 C. F. R. § 200.31 *et seq.* (1964). Although space limitations forbid a complete analysis of the Conduct Regulation, which is a codification of prior miscellaneous memoranda and which was adopted in 1953, it may be noted that Rule 6 thereof (17 C. F. R. § 200.36), which was designed to prevent the unfair use of information by former members and employees in their private practice of the law before the Commission, provides in brief that (1) no person shall appear in a representative capacity before the Commission in a particular matter if the person or one participating with him personally considered the matter or gained personal knowledge of the facts while he was an employee or a member of the Commission, and (2) for a period of two years after leaving Commission employment former members or employees must file a statement with the Commission with regard to each matter in which they expect to appear before the Commission, explaining the nature of the matter and why their appearance is deemed consistent with the rule.

[4] 270 U. S. 117 (1926).

[5] 205 F. 2d 715 (D. C. Cir. 1953).

[6] *Id.* at 716.

sion finds that the attorney "has failed to conform to recognized standards of professional conduct." [7] The Court of Appeals noted that this rule, which is indistinguishable from this Commission's rule quoted *supra,* "supports the [International Claims] Commission's action against the appellant." [8]

In May 1957 the Commission issued a notice and order for a private hearing[9] pursuant to Rule 2(e) of its Rules of Practice, 17 C. F. R. § 201.2, to one Morris Mac Schwebel, alleging that the said Schwebel was an attorney practicing before the Commission within the contemplation of Rule 2, that the Commission had reason to believe that he had engaged in unethical and improper professional conduct in certain particulars,[10] and setting a date for a private hearing on the charges to determine whether respondent Schwebel should be disqualified, temporarily or permanently, from practicing before the Commission. Thereupon respondent filed a motion with the Commission to dismiss the disqualification proceeding on the ground that the Commission lacked jurisdiction in the matter and in a supplemental motion to dismiss alleged that the Commission had failed to comply with the notice provisions of Section 9(b) of the Administrative Procedure Act.[11] The Commission denied respondent's motions and extended his time to answer the charges. Instead of answering the charges respondent filed a complaint in the United States District Court for the District of Columbia seeking to enjoin the Commission from maintaining its disqualification proceeding against him.

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[7] *Ibid.*

[8] *Ibid.*

[9] It is the Commission's usual practice to order that disciplinary proceedings pursuant to Rule 2(e) be held privately, which means that only persons directly connected with the case are made aware of it.

Generally, of course, hearings before the Commission or a hearing officer are held publicly (Rules of Practice, Rule 11(b), 17 C. F. R. § 201.11-(b)), and notice of such public hearing is given general circulation through press releases and, where ordered, by publication in the Federal Register (Rules of Practice, Rule 6(c), 17 C. F. R. § 201.6(c)).

[10] The substance of the Commission's findings is outlined in detail hereinafter at Section II e.

[11] 5 U. S. C. 1008(b), Section 9(b) provides in pertinent part:

"Except in cases of willfulness or those in which public health, interest, or safety requires otherwise, no withdrawal, suspension, revocation, or annulment of any license shall be lawful unless, prior to the institution of agency proceedings therefor, facts or conduct which may warrant such action shall have been called to the attention of the licensee by the agency in writing and the licensee shall have been accorded opportunity to demonstrate or achieve compliance with all lawful requirements. . . ."

On motion of the Commission, the district court dismissed the complaint and accordingly denied the motion for a preliminary injunction.[12]

The Commission's contentions in the district court were three pronged: (1) that the court lacked jurisdiction to entertain the complaint in view of plaintiff's failure to exhaust his administrative remedies, (2) that plaintiff had alleged no legally cognizable injury, and (3) assuming the court has jurisdiction to decide the legal question presented, the Commission's action was completely within its jurisdiction and proper in all respects.

The district court decided that it had jurisdiction, notwithstanding the doctrine of exhaustion of administrative remedies, to determine the question of the Commission's authority to maintain disciplinary proceedings against the plaintiff "because of the peculiar delicacy of an attorney's good reputation, his chief asset in his profession, and the fact that some members of the public may assume guilt from disbarment proceedings despite final exoneration." [13] Having thus found jurisdiction the court held, *inter alia,* that the Commission has, under its general rule making power, authority to establish qualifications for attorneys practicing before it and to take disciplinary action against attorneys found guilty of unethical or improper professional conduct, citing the *Goldsmith* and *Herman* cases.[14]

In affirming dismissal of the complaint on the ground that plaintiff had failed to exhaust his administrative remedy, the Court of Appeals, in a short *per curiam* opinion, held that the district court had erred in reaching the question whether the Commission had authority to disbar attorneys.[15] Thus the ruling of the district court on the question of the Commission's authority, while undoubtedly sound in its reliance on the *Goldsmith* and *Herman* cases, was properly disclaimed by the Court of Appeals.[16] A square ruling on the issue will have to await a proper case.

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[12] Schwebel v. Orrick, 153 F. Supp. 701 (D. C. Cir. 1957).

[13] *Id.* at 705.

[14] *Supra,* n. 4 and 5. *Id.* at 704.

[15] 251 F. 2d 919 (D. C. Cir. 1958), *cert. denied* 356 U. S. 927 (1958).

[16] In December 1958 the Commission amended its notice of hearing in the disqualification proceeding, adding two allegations of improper professional conduct by respondent. Thereupon respondent filed a second complaint in the United States District Court for the District of Columbia, seeking to

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II. Factual Analysis of Disciplinary Proceedings Brought by the Commission Involving Attorneys.[17]

a. *In the Matter of Albert J. Fleischmann,* 37 S. E. C. 832 (1950).

By its order adopted June 5, 1950 and in conformity with its Findings and Opinion issued concurrently therewith, the Commission denied to respondent Fleischmann the privilege of appearing or practicing before it without obtaining its prior approval, with the proviso that no application for approval would be entertained for a period of one year from the date of the order.

The Commission's Findings and Opinion reveals the following facts. Respondent, acting as attorney on behalf of a Protective Committee ("the committee") of preferred stockholders of Standard Power and Light Corporation ("Standard") formed to participate in proceedings involving that company under a provision of the Public Utility Holding Company Act of 1935 ("the Act"), filed with the Commission on March 18, 1949 a declaration pursuant to a rule promulgated by the Commission under the Act. The declaration, which stated that respondent was the committee's counsel and secretary and was signed by respondent, recited that the Committee was formed at the request of one Engel, stated to be the holder of 100 shares of preferred stock of Standard which he had purchased on March 2, 1948, and by two others.

The Commission began an investigation on April 1, 1949 and subsequently ordered a public hearing to determine, *inter alia,* whether the declaration contained any untrue statements of material fact or omissions of material facts required to be stated therein or necessary to make the statements therein not misleading. Prior to the date of the hearing, however, the committee and respondent filed a petition with the Commission stating that the declaration was withdrawn and the committee dissolved.

(Continued from preceding page)

enjoin the holding of the administrative proceeding on the ground of lack of jurisdiction. The district court by order of August 28, 1959 denied respondent's motions and dismissed the complaint. *Schwebel v. Gadsby* (D. D. C. Civil Action No. 2398-59). Respondent's petition to the Court of Appeals for a preliminary injunction pending appeal was denied by order of August 31, 1959 and the appeal was dismissed by order of December 4, 1959. *Schwebel v. Gadsby* (D. C. Cir., No. 15,338).

[17] The cases described herein include all of the disciplinary proceedings against attorneys brought by the Commission which have been made public.

Subsequently the Commission ordered a hearing pursuant to Rule 2(e), alleging that, contrary to the representations which respondent caused to be made in the declaration, (1) respondent, and not Engel, was responsible for the formation of the committee, (2) respondent, and not Engel, had purchased Standard's preferred stock and was both record and beneficial owner of it at the time the declaration was filed, (3) respondent took steps on or about March 17, 1949 to have the stock transferred to Engel on Standard's books and prior to the transfer caused Engel to give him an assignment of the stock in blank, (4) respondent described the addresses of the committee members and himself in such a way as to conceal the fact that he and the committee members maintained law offices at the same address and to create the misleading impression that his address and that of the committee members was different.

Respondent filed an answer to the Commission's charges and appeared and gave testimony at private hearings before a hearing examiner, who in due course filed his recommended decision. Exceptions to the decision were filed by respondent, and the Commission, on the basis of an independent examination of the record, found that respondent had engaged in unethical and improper professional conduct in connection with the filing of the declaration and accordingly entered its order denying to respondent the privilege to practice before it. The Commission found that respondent had prepared the declaration which contained untrue statements of material facts as alleged or failed to disclose such facts. The Commission also stated that circumstances "strongly suggest" that the transfer and sale of stock to Engel was a fictitious transaction. Finally, the Commission found that respondent attempted, through misrepresentation of his own and the committee's address, to conceal from stockholders who were to be solicited in connection with the formation of the committee, the lack of independence of the committee from its attorney.[18]

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[18] Respondent was subsequently readmitted to practice before the Commission by order of June 12, 1952. The application for readmission represented, *inter alia*, that applicant's professional conduct in the future would in all matters be such that its propriety would not be open to question. The order of readmission appropriately provided that respondent was readmitted to practice before the Commission "except that he may not appear on behalf of committees or groups of security holders."

b. *In the Matter of William A. Dougherty,* 38 S. E. C. 82 (1957).

By its order adopted October 18, 1957 and in conformity with its Findings and Opinion issued the same day the Commission denied to respondent Dougherty the privilege of practicing before it until he obtained the Commission's approval.

The Commission was conducting an investigation of Union Electric Company ("Union Electric"), a registered public utility holding company, to determine whether Union Electric and certain other persons directly or indirectly made political contributions in violation of Section 12 (h) of the Public Utility Holding Company Act of 1935 ("the Act").[19] The investigation developed the facts that respondent, in addition to holding other legal and executive positions, was general counsel and a director of Mississippi River Fuel Corporation ("Mississippi Fuel"), a natural gas pipeline company which sold gas at wholesale to Union Electric, that respondent had drawn a check on the account of his law firm for $5,000 to his own order, that he had indorsed the check, and that the check was deposited in a private bank account of Orville E. Hodge, then Auditor of Public Accounts of the State of Illinois.[20]

Respondent's initial testimony with regard to the check was that it had been drawn in response to a request by a "friend" for a loan, that the loan had been repaid, that the friend, whom he refused to identify, had never been a public official and was not connected with the state government and that he did not know how the check had reached Hodge's account. In addition, respondent stated that he had at no time done anything looking

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[19] Section 12(h) of the Act provides:

"It shall be unlawful for any registered holding company, or any subsidiary company thereof, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, directly or indirectly—

"(1) to make any contribution whatsoever in connection with the candidacy, nomination, election or appointment of any person for or to any office or position in the Government of the United States, a State, or any political subdivision of a State, or any agency, authority, or instrumentality of any one or more of the foregoing; or

"(2) to make any contribution to or in support of any political party or any committee or agency thereof.

"The term 'contribution' as used in this subsection includes any gift, subscription, loan, advance, or deposit of money or anything of value, and includes any contract, agreement, or promise, whether or not legally enforceable, to make a contribution."

[20] Prior to the commencement of the Commission's investigation Hodge had been convicted of embezzling state funds and removed from office.

toward influencing the passage or defeat of any pending legislation in Illinois.

Respondent was subsequently recalled for further testimony but refused to identify his friend, claiming his privilege against self-incrimination. He was then directed to testify pursuant to Section 18(e) of the Act.[21] Respondent thereupon testified that his friend was Hodge; that the loan was a personal one and had never been repaid; that in making this loan he took into consideration the fact that Hodge, because of his official position, could be influential in preventing a certain company from building a pipeline in Illinois which would compete with Mississippi Fuel, and in preventing passage of any legislation in Illinois which would subject Mississippi Fuel to the jurisdiction of the Illinois Commerce Commission. Respondent also testified that Hodge knew he was counsel for Mississippi Fuel and that Hodge, in requesting the loan, said to let him know if he could be of any assistance on legislation.

Typical of respondent's explanation of some of his earlier testimony was that when he said he had received repayment of the full amount of the loan, he meant in experience, not in cash.

The Commission found that respondent in giving his testimony, which contained false and misleading statements, had engaged in improper professional conduct within the meaning of Rule 2(e) of the Rules of Practice. Respondent was accordingly disqualified from practice.[22]

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[21] Section 18(e) of the Act provides:

"No person shall be excused from attending and testifying or from producing books, papers, correspondence, memoranda, contracts, agreements, or other records and documents before the Commission, or in obedience to the subpena of the Commission or any member thereof or any officer designated by it, or in any cause or proceeding instituted by the Commission, on the ground that the testimony or evidence, documentary or otherwise, required of him may tend to incriminate him or subject him to a penalty or forfeiture; but no individual shall be prosecuted or subject to any penalty or forfeiture for or on account of any transaction, matter or thing concerning which he is compelled to testify or produce evidence, documentary or otherwise, after having claimed his privilege against self-incrimination, except that such individual so testifying shall not be exempt from prosecution and punishment for perjury committed in so testifying."

The Commission held that the immunity from penalties or forfeitures granted by Section 18(e) does not extend to disbarment proceedings under its Rules of Practice, citing *In re Rouss*, 221 N. Y. 81, 116 N. E. 782 (1917), cert. denied 246 U. S. 661 (1918) and 8 Wigmore, Evidence § 2257 (3d ed., 1940).

[22] Upon application respondent was readmitted to practice on April 2, 1958, S. E. C. Holding Company Act Release No. 13716; respondent was, however, disbarred from practice in New York State on January 6, 1959, *In the Matter of William A. Dougherty*, 180 N. Y. S. 2d 971 (App. Div. 1959).

c. *In the Matter of James T. DeWitt,* 38 S. E. C. 879 (1959).

Cushman Food Company, Inc. ("Cushman") retained respondent DeWitt to represent it in connection with a proposed public offering of 100,000 shares of its common stock at $3.00 per share.[23] Respondent was also given authority by Cushman to execute and file with the Commission whatever papers were necessary for the offering. Pursuant to this authority respondent filed a notification under Rule 255(a) of Regulation A; he then advised Cushman to sell the shares covered by the notification, despite the fact that Regulation A requires a ten-day waiting period from the date of filing to the date of the initial offering of securities. Cushman, acting on respondent's advice, sold more than 4,000 shares.

The notification also contained financial statements which were false at the time they were filed, and respondent admitted he knew they were false. In addition, respondent requested and received $100 from Cushman which he represented to Cushman was to be "passed along" to Commission employees. Respondent admitted, however, that no money, gifts or inducements of any kind were given to Commission employees.

At a hearing ordered by the Commission to determine whether respondent had engaged in unethical or improper professional conduct respondent filed a "consent to order of disqualification." The Commission in its memorandum opinion and order stated that respondent's conduct represented "an unconscionable repudiation of the high standards required of a member of the legal profession," [24] and permanently denied him the privilege of appearing or practicing before it.

d. *In the Matter of Sol M. Alpher,* 39 S. E. C. 346 (1959).

The Commission instituted a proceeding to determine whether respondent Alpher had engaged in unethical and improper

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[23] Section 3(b) of the Securities Act of 1933, 15 U. S. C. § 77c(b), permits the Commission to exempt from the provisions of the Act offerings not exceeding $300,000 subject to such terms and conditions as the Commission may impose. Under this authority the Commission has promulgated Regulation A, which consists of Rules 251 through 263, 17 C. F. R. §§ 230.251-263 (1964). Upon full compliance with these rules, which provide, among other things, for the filing of a notification at least ten days prior to the offering of securities (Rule 255) and the filing and use of an offering circular (Rule 256), there is afforded an exemption "from the principal registration requirements of the Federal securities legislation." *R. A. Holman & Co. v. Securities and Exchange Commission,* 299 F. 2d 127, 128 (D. C. Cir.), *cert. denied,* 370 U. S. 911 (1962).

[24] 38 S. E. C. at 880.

professional conduct in that, as alleged, (1) he had prepared a registration statement under the Securities Act of 1933 certified by an accountant who was not independent of the registrant, knowing that the accountant was required by law to be independent but was not in fact so, and (2) he attempted to conceal from the Commission the lack of independence by withholding from the registration statement information which would have disclosed that the accountant was a partner of the person controlling the registrant, and caused the accountant to use his home address rather than his business address on the certificate.

Respondent's answer was a denial of the allegations, an averment of reliance upon others believed to be more familiar with accounting requirements and a statement that any errors or omissions were honest ones on his part. Respondent also requested the Commission to dismiss the proceeding, stating that he would not appear or practice before it in the future without its approval and consented to issuance of an opinion. Respondent also consented to incorporation of the record of a prior proceeding against the individual accountants and the firm[25] as a part of the record in this proceeding.

The Commission was of the opinion that the record in the prior proceedings against the accountants substantiated the allegations in the instant proceeding, but also recognized that respondent was not a party in those proceedings and that in view of respondent's agreement not to practice no hearing was being held at which respondent could offer further defense to the allegations. Under all the circumstances the Commission, holding it was not inconsistent with the public interest to do so, discontinued the proceeding, subject to respondent's agreement not to appear or practice before the Commission in the future without obtaining its approval.

e. *In the Matter of Morris Mac Schwebel,* 40 S. E. C. 347 (1960), *modified* 40 S. E. C. 459 (1961).

The Commission's order instituting the above proceeding was at first challenged in the courts, as noted *supra* in the Intro-

[25] The Commission had previously instituted Rule 2(e) proceedings against the accountants involved in connection with the registration statement and respondent had testified as a witness in that proceeding. The Commission subsequently found that the accountants had engaged in improper and unethical professional conduct and imposed sanctions. S. E. C. Accounting Series Release No. 82, *In the Matter of Bollt and Shapiro,* 38 S. E. C. 815 (1959).

duction, but after failing in that endeavor respondent filed an answer, hearings were held, and respondent consented *inter alia* to (1) withdrawal of his contest of the allegations without admitting their truth, (2) findings by the Commission for purposes of the proceeding that all the charges but one were established, and (3) entry of an order permanently disqualifying him from practice before the Commission.

The Commission found substantially as follows: Respondent, acting as counsel for Great Sweet Grass Oils, Limited ("Great Sweet Grass"), a Canadian company, and Kroy Oils Limited ("Kroy"), a Canadian company and affiliate of Great Sweet Grass, filed periodical reports with the Commission on behalf of these companies pursuant to Section 13 of the Securities Exchange Act of 1934.[26] One such report of Great Sweet Grass was deficient, however, and respondent was requested by the Commission to rectify the matter by filing specified supporting data. Respondent, however, failed to transmit these instructions accurately to his client. In addition respondent failed to inform the Commission that a letter report by a petroleum engineer, which had been attached as an exhibit to the report to the Commission, was unauthorizedly filed, and was inaccurate and out of date.

Respondent also filed with the Commission a report by Kroy. Whereupon the respondent was informed that the Commission considered the report to be misleading and requested by letter that certain specified information be supplied by Kroy. No answer was ever received to this letter, nor was any attempt made to secure the information requested.

In another instance respondent furnished his legal opinion to the American Stock Exchange, in connection with his application for listing, that 500,000 shares of Great Sweet Grass stock sold to another Canadian company were not required to be registered under the Securities Act of 1933 on the ground that such shares were not to be sold in the United States. Respondent also filed a periodic report with the Commission describing the above transaction and claiming exemption from the Act. The Commis-

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[26] Section 13(a) provides that "every issuer of a security registered on a national securities exchange shall file the information, documents, and reports below specified with the exchange (and shall file with the Commission such duplicate originals thereof as the Commission may require), in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security. . . ."

sion held that the opinion was given and the report filed without adequate inquiry as to the facts, and later, when respondent knew or should have known that the stock had been resold in the United States, he failed to inquire whether his legal opinion and report to the Commission required revision.

In another transaction, the Commission found that respondent arranged for his client, a broker-dealer, to purchase from three Canadian companies more than 500,000 shares of Great Sweet Grass stock for sale in the over-the-counter market in the United States, but did not sufficiently inquire as to the source of the shares so as to be able to determine whether the shares should be registered or not.[27] Respondent also accepted a finder's fee of $5,000 from one of the sellers.

In another instance respondent filed a report with the Commission that 500,000 shares of Great Sweet Grass stock were exchanged for the assets of a Canadian corporation, and 1,750,000 such shares were exchanged for the assets of an Oklahoma corporation. In connection with the listing of these blocks of stock on the American Stock Exchange respondent furnished an opinion to the Exchange that registration was not required and claimed in the report filed with the Commission that the shares were exempt under Rule 133 of the Securities Act of 1933.[28]

Subsequent to this time approximately 2,190,000 of these shares were sold to public investors in the United States without registration through three broker-dealer firms. One of these firms, Murray Securities Corporation ("Murray"), a client of respondent, acquired two 100,000 blocks of Great Sweet Grass stock from "minority" shareholders and requested respondent's opinion as to the propriety of selling these shares without registration. Respondent contacted the Canadian attorney for Great Sweet Grass, who was in control and a principal stockholder, and was told that some of the Canadian and American stockholders were selling their shares. Without further investigation respondent advised Murray that his stock could be sold. Accordingly, the Commission found that respondent, on the basis of his

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[27] If the three Canadian companies were in fact underwriters or "statutory underwriters" for Great Sweet Grass, there would be no exemption from the registration provisions of the Act. See Sections 4(1) and 2(11) of the Securities Act of 1933.

[28] Rule 133, 17 C. F. R. § 230.133, provides that no "sale" of securities requiring registration is involved in certain situations in which assets of one corporation are exchanged for securities of another.

knowledge or what he should have known had he made sufficient inquiry, had failed to revise his opinion to the Exchange and his claim of exemption in the report to the Commission[29] and had failed to make sufficient inquiry to warrant rendering an opinion to his client Murray.

Respondent engaged in two other securities transactions in which through the issuance of erroneous legal opinions to his clients securities were sold in violation of the Securities Act.

(1) *The Basic Atomics Transaction*

Respondent, as general counsel of a Delaware company called Basic Atomics which was in need of financing, suggested that the company sell its shares in Europe to avoid the expense of registration. The shares to be sold in Europe were supposedly to be purchased for investment and not for redistribution in the United States. Pursuant to this plan 750,000 shares of Basic Atomics were sold to Huttenwerk Trust ("Huttenwerk") through a Swiss bank which represented that Huttenwerk was its client, and these shares, according to a letter to respondent dated September 9, 1955, were said to have been sold to bona fide European investors at $2 per share. Immediately thereafter, however, on September 12, which was a Monday, two broker-dealer firms in New York received orders from the Swiss bank to sell 250,000 shares of this stock, and by December 1955 540,000 of the 750,000 shares of Basic Atomics had been resold to the public in this country[30] at approximately twice the price.

The Commission found that the plan to resell this stock began concurrently with, if not before, the arrangements for sale to Huttenwerk,[31] and although respondent may not have known all

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[29] Upon conclusion of proceedings instituted by the Commission the registrations of the securities of Great Sweet Grass and Kroy were withdrawn from the American Stock Exchange. Great Sweet Grass Oils Limited, 37 S. E. C. 683, *aff'd* 256 F. 2d 893 (D. C. Cir., 1958). The Commission found in that proceeding that the exchange of 500,000 and 1,750,000 shares of Great Sweet Grass were not exempt from registration under Rule 133, as respondent had stated to the Exchange and reported to the Commission. Rather, there had not been any bona fide reliance on the Rule but only deliberate efforts to evade the Securities Act by creating corporate entities and effecting transactions meeting the requirements of the Rule in appearance only. 37 S. E. C. at 686-91.

[30] All in all about 610,000 shares were distributed in the United States.

[31] It seems evident that the person or persons who acquired these shares did so with the intention to, and did redistribute them in the United States. Such persons were thus statutory underwriters within the meaning of Sec-

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the facts surrounding the scheme, his knowledge was sufficient to cast serious doubt on the validity of his continuing opinions to the officers and the president of Basic Atomics and others that resales in this country were within the law.

(2) *Soil Builders Transactions*

Respondent, as general counsel of Soil Builders, engaged in transactions very similar to that of Basic Atomics, even including some of the same participants. The plan ostensibly was to sell Soil Builders stock in Europe to persons who would take for investment and not resale in the United States. In fact, however, most of these unregistered shares were subsequently resold in the United States at a substantial profit, and respondent's continuing legal opinions to the president of Soil Builders and others of the legality of these sales helped to make such sales possible.

On the basis of the above facts the Commission found that respondent's conduct evidenced a "gross indifference to the observance of legal requirements which an attorney in particular should strive to foster, and violated the standards of professional ethics." [40 S. E. C. at 371]. Respondent was accordingly permanently disqualified from practicing or appearing before the Commission.[32]

f. *In the Matter of Arnold D. Naidich,* S. E. C. Securities Act Release No. 4372 (June 8, 1961).

On the basis of a stipulation the Commission entered an order in the above case permanently denying the respondent the privilege of appearing or practicing before it. The stipulation recited (1) that respondent had been convicted in the United States

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tion 2(11) of the Securities Act of 1933, which defines underwriter to include any person who purchases from an issuer with a view to the distribution of any security or who participates in any such undertaking. There was therefore no exemption available and the shares were sold in violation of Section 5 of the Securities Act of 1933.

[32] The supplemental modifying opinion and order of the Commission did not disturb the Commission's prior findings and opinion. It merely clarified a procedural point raised by respondent (40 S. E. C. 459).

Respondent was later indicted in the Southern District of New York, pleaded guilty on May 1, 1964 to three counts of aiding and abetting the sale of unregistered stock, and on June 6, 1964 was sentenced to a year and a day in prison and fines totaling $15,000. S. E. C. Litigation Release No. 2959 (June 9, 1964). Previously respondent had filed motions to dismiss the indictments, which motions were denied by the court in the following opinions: *United States v. Greenberg,* 200 F. Supp. 382 (S. D. N. Y., 1961) and *United States v. Greenberg,* 204 F. Supp. 400 (S. D. N. Y., 1962).

District Court for the District of New Hampshire of a violation of the registration provisions of the Securities Act of 1933 (Section 5) after having entered a plea of *nolo contendere*,[33] (2) that respondent had written a letter to the Commission indicating he would no longer appear or practice before it, and (3) that respondent waived the institution of formal proceedings by the Commission under Rule 2(e) and consented to the issuance of an order of permanent disqualification.

g. *In the Matter of Nathan Wechsler*, S. E. C. Securities Exchange Act Release No. 6932, S. E. C. Accounting Series Release No. 94, C. C. H. Fed. Sec. L. Rep. ¶ 72,115 (Nov. 5, 1962).

The Commission's notice and order for private hearing under Rule 2(e) in the above case made certain charges of improper and unethical professional conduct against respondent Wechsler, an attorney and certified public accountant. It was alleged that respondent had acted as counsel for Lost Canyon Uranium and Oil Co. ("Lost Canyon"), an issuer of securities under a Regulation A offering, by preparing the offering circular and causing himself to be listed in the broker-dealer registration statement of Coombs & Company ("Coombs") as the person to be notified of any proceedings before the Commission regarding such registration.

During this period Coombs, which was dominated and controlled by respondent, became the sole underwriter for Lost Canyon's stock, sold approximately $99,000 worth of it and converted approximately $55,000 of this amount to private purposes. The proceeds of the sale were not remitted to the issuer and thus Lost Canyon stock was not delivered to the purchasers. In addition, although respondent knew Coombs was insolvent during this time he nevertheless caused it to continue effecting transactions in Lost Canyon stock. Respondent also caused Coombs to buy from him certain privately held stock at prices not reasonably related to the market, and failed to take effective steps to advise the public and the Commission of Coombs' fraud.

Respondent's answer denied the charges and also denied that he practiced before the Commission. Respondent also moved for

[33] Section 5 of the Act makes it unlawful *inter alia* to offer or sell securities in interstate commerce when no registration statement is either on file or in effect with the Commission.

a discontinuance of the proceedings on the grounds (a) that his health was seriously impaired and that a continuation of proceedings constituted a significant risk of serious aggravation of his condition, and (b) that he had agreed not to practice before the Commission in any way in the future.

The Commission accepted the respondent's representations and entered an order that it was not inconsistent with the public interest that no further proceedings be held.

h. *In the Matter of Erwin Pincus and Pace Reich,* S. E. C. Securities Act Release No. 4619 (June 27, 1963).

The Commission's order for a private hearing in the above case alleged that respondents prepared and submitted for filing with the Commission registration statements, prospectuses and related correspondence on behalf of three corporations pursuant to the registration requirements of the Securities Act of 1933 and notifications, offering circulars and related correspondence on behalf of eight corporations pursuant to Regulation A. These statutory filings were alleged to contain misrepresentations and omissions of material facts and deceptive and misleading statements with respect to the promotion, financing and management of certain of these companies, the role and interest of respondents and certain of their associates in the promotion and management, and the availability of the claimed exemption under Regulation A with respect to certain of the companies.

The above general statement of the nature of the Commission's allegations was particularized in succeeding paragraphs of the order for hearing. Respondents were charged with making misrepresentations, omissions of material fact and misleading statements in their statutory filings on behalf of the above companies as to, *inter alia,* (1) the existence, identity and stock interests of persons providing financing; (2) the existence, identity and stock interests of certain officers, controlling persons and promoters; (3) respondent Pincus' participation as a promoter of certain corporations and the services he performed; (4) fees payable to respondents' law firm; (5) the identity of a finder; (6) the financial condition of the companies; (7) the state of development of a company's products; (8) the plan of distribution of the offering and (9) the identity of counsel for the underwriter.

Although the pleadings do not present as full a picture of respondents' activities as they might have it is fairly evident that the Commission was charging respondents, *inter alia,* with misrepresentations, misleading statements and the failure to disclose their intricate personal involvement in the promotion and management of the companies for whom they acted as counsel. And with respect to respondent Pincus it appears that he may have been engaged in some form of solicitation of clients, contrary to the Canons of Professional Ethics, since he was instrumental in promoting certain of the companies and presumably in encouraging them to seek public financing for which he would, of course, make appropriate filings with the Commission in his capacity as counsel.

Whatever the true facts might be the Commission foreclosed public disclosure of them when it accepted respondents' resignations from appearance or practice before it[34] and entered an order that no further proceedings need be held.

i. *In the Matter of Leonard A. Nikoloric,* S. E. C. Securities Act Release No. 4642 (Sept. 19, 1963).

The Commission's order for a private hearing in the above case alleged that respondent prepared and filed with the Commission a notification under Regulation A on behalf of a corporation but failed to disclose therein that he was himself a promoter of the corporation. In addition, the notification stated that 285,545 shares of the company's stock had been sold privately, that they had been taken for investment only and not with a view to distribution to the public, and therefore they were exempt from registration under Sections 2(11) and 4(1) of the Securities Act of 1933. As a matter of fact, however, it was alleged, these unregistered shares had been sold publicly and were not taken for investment. Furthermore, some of the 14 persons named in the notification as having been the purchasers were actually nominees for other persons, and some of the nominees had already resold their shares even before the notification was filed. Finally, it was charged that respondent at the time he prepared and filed the notification knew that the sale of these shares con-

[34] Each respondent also agreed that if application should be made in the future to appear or practice before the Commission he would not, for purposes of considering the application, deny the charges in the Commission's order for hearing in this case.

stituted a public offering in violation of Section 5 of the Securities Act, and that he had himself solicited some of the sales made to members of the public.

The respondent, while not admitting or denying the allegations of the Commission's order, consented to the entry of an order disqualifying him from appearing or practicing before the Commission.[35]

III. Summary and Conclusions

The body of federal securities law is composed of six separate statutes,[36] the first of which, the Securities Act of 1933, has as its central doctrine the principle of disclosure.[37] The Act has been popularly referred to as the "truth in securities" law and requires full disclosure in the flotation of securities by means of transportation or communication in interstate commerce or by the mails, and also prohibits fraud in their sale. Briefly, the Act requires issuers of securities to register them with the Commission before they are distributed and to disclose in a prospectus, of prescribed content, information important to a prospective investor's assessment of the security offered and the investment risks involved. It also prohibits fraud and misrepresentation in the sale of securities on initial distribution or thereafter, but does not authorize the Commission to pass on the merits of securities or to determine which securities may be offered to the public.

It follows that when this Congressionally mandated disclosure is denied to public investors through untrue statements

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[35] Respondent's consent also provided that upon any application by him in the future for reinstatement all of the allegations in the notice for hearing would be deemed admitted for the purpose of the Commission's consideration of the application.

[36] The statutes are listed *supra,* n. 3.

The Commission also has the responsibility of advising courts in corporate reorganizations under Chapter X of the Bankruptcy Act, 11 U. S. C. § 608.

[37] The other federal securities laws administered by the Commission also rely heavily on disclosure to accomplish their objectives.

On August 20, 1964 President Johnson signed the Securities Acts Amendments of 1964. The Commission's general interpretive release on these new amendments, issued on September 15, 1964, described them as achieving two major objectives, the first of which is "to afford investors in publicly-held companies whose securities are traded over-the-counter the same fundamental disclosure protections as have been provided to investors in companies whose securities are listed on an exchange." S. E. C. Securities Act Release No. 4725, p. 1; S. E. C. Securities Exchange Act Release No. 7425, p. 1.

or omission of material facts, misleading statements or misrepresentations, the Congressional purpose is frustrated and the securities laws are rendered nugatory. Thus in the *DeWitt* disqualification proceeding *supra* respondent's action in the filing of deliberately false financial statements with the Commission was especially reprehensible, since it was a clear violation of both the letter and spirit of the securities laws in an area of prime interest to potential investors. It is, in fact, difficult to imagine a more vital area for accurate, truthful information. The *Alpher* disqualification proceeding, while not involving such a blatant disregard of the requirements of the Act, was nevertheless a serious infraction of an extremely important rule, that the certifying accountant must be in fact independent of the registrant. The underlying rationale of the rule is, again, complete and especially *objective* disclosure of the financial affairs of a company. In *A. Hollander & Son, Inc.*,[38] the Commission explained that "one of the purposes of requiring a certificate by an independent public accountant is to remove the possibility of impalpable and unprovable biases which an accountant may unconsciously acquire because of his intimate non-professional contacts with his client. The requirement . . . is not so much a guarantee against conscious falsification or intentional deception as it is a measure to insure complete objectivity." [39]

Failure to disclose was also the heart of the violations in the *Fleischmann* proceeding, where omissions of material facts and untrue and misleading statements were made by respondent in the declaration filed by him, the *Schwebel* proceeding, which involved the repeated filing with the Commission of false and misleading reports and the furnishing of incorrect legal opinions to his clients and others which the respondent knew or should have known required revision, the *Naidich* order, where there was a total failure to register the stock, the *Nikoloric* proceeding, where in a Regulation A filing there was an alleged attempt to conceal a prior violation of Section 5 of the Securities Act of 1933, the *Wechsler* proceeding, where respondent allegedly knew of the conversion of the proceeds of the sale of stock and the insolvency of the broker-dealer but failed to take effective action to advise the public and the Commission of the fraud, and the

[38] 8 S. E. C. 586 (1941).

[39] *Id.* at 613.

Pincus and Reich proceeding, which involved, among other things, the alleged filing of false and misleading reports. The *Dougherty* proceeding, while not concerned with a failure to disclose information in reports filed with the Commission, was nevertheless basically a disclosure proceeding, since respondent by his initially false testimony was impeding a lawfully instituted investigation by the Commission.

Every disqualification proceeding brought by the Commission thus far has involved to a greater or lesser degree a failure to disclose. This is, of course, no mere coincidence, since each of the attorneys was dealing with the federal securities laws, the guiding principle of which is disclosure. Poetic justice would require, presumably, that where attorneys violate the federal securities laws, or aid and abet such violation, their doings should be fully disclosed to all the world. Such a penalty suits the violation and serves as a warning to others of conduct to be avoided. In this connection it is noted that the last five disqualification proceedings instituted by the Commission ended in settlements. The consent in *Schwebel,* which permitted the Commission to make findings for purposes of the proceeding that all its charges but one were established, enabled the Commission to spell out in detail its findings of violations. This is highly desirable from an enforcement standpoint since it informs securities attorneys not only what the law is but what can be expected from the Commission in its judicial capacity.

The more recent disqualification proceedings generally terminate with a resignation from practice or a consent to disqualification without admitting or denying the Commission's allegations. Although this may not be the most desirable result, it can be made more palatable through a clearer delineation of the overall scheme charged in the order for hearing.[40] Thus, if the proceeding ends in a resignation from practice or a consent to disqualification, the order for hearing alone will tell a fairly complete story,[41] providing an explanation for the resignation, a justification for the disciplinary order consented to and form-

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[40] One or more introductory paragraphs in the order should set out, without going into the evidence, the violations in general terms, setting the stage, as it were, for the specific charges which follow.

[41] *The Pincus and Reich* order for hearing leaves much to be desired in this respect.

ing an intelligible starting point[42] in determining any future application for reinstatement.

It is perhaps a truism that an attorney's opinion represents his stock in trade, and the client who asks for and receives such an opinion properly expects to be able to rely on it. Where, in a public distribution of securities, an opinion is knowingly incorrect or given without sufficient inquiry as to the facts and reliance is thus misplaced, as *e.g.,* in the *Schwebel* proceeding, the consequences to the investing public may be disastrous. The Commission requires in registration statements an attorney's opinion of the legality of the offering, and when it appears that that opinion is knowingly incorrect or otherwise improper, the agency, as guardian of the public interest, must take appropriate action. It is fair to say that the Commission, in the carrying out of these responsibilities has, on the whole, effectively utilized its disqualification procedures.

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[42] In the case of permanent disqualification any action by the Commission on a petition for reinstatement would appear to be wholly discretionary. The Commission would not be confined to those matters appearing in its public files of the instant petitioner, but could look at any of its files which have any bearing on the matter.