ARTICLE

COMPETING DUTIES? SECURITIES LAWYERS' LIABILITY AFTER CENTRAL BANK

Ann Maxey*

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INTRODUCTION

THE role of lawyers is defined by an indefeasible tension attributable to the competing demands of their legalistic functions and the society that law governs. Lawyers are licensed by society to perform

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tasks that may include challenging the system that empowers them. In serving their unique function, lawyers owe a primary obligation to their clients, but they also assume responsibilities to the society that is the source of their authority. Lawyers are required to sort out, as best they can, what to do when circumstances produce tension and conflict between those different responsibilities. Fortunately, those conflicts often do not arise when lawyers represent their clients in a controversy or transaction. Each lawyer can pursue his obligation of representing his client’s interests without assuming responsibility for the other side or looking out for the public’s welfare. The public’s welfare, presumably, is best served when lawyers collectively advance their clients’ interests.

This primary obligation to the client is supported by the legal rules. Traditionally, lawyers do not owe a legal duty to those with whom they are not in privity.\(^1\) The rules of professional conduct forbid a lawyer to assume responsibility for third parties or the public welfare at the expense of his client.\(^2\) The standard rationale is that any duty lawyers owe to a third party or the public could conflict with the duty owed to their clients. The duty to the client is thought to represent the higher good because it fosters the client’s confidence in the lawyer, thus allowing the lawyer to counsel the client to comply with the law. Moreover, the lawyer must be allowed to vigorously defend his client without fear that the government will sanction the lawyer for failing to assume a duty to the public. The government’s own lawyers represent the public on the other side of that controversy. This adversary model reduces, but does not necessarily eliminate, the tension that can arise between the lawyer’s duty to client and the lawyer’s responsibilities to society.

Securities lawyers are especially aware of this tension because they represent clients outside the adversary model as well as within it. Securities lawyers, like other lawyers, represent clients in transactions where the other side is represented by lawyers. They also assist clients in interpreting and complying with regulatory requirements of the Securities and Exchange Commission (“SEC” or “Commission”) and state securities agencies. Securities lawyers may be required to

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1. During the 1960s, tortfeasors began facing liability from parties with whom they had not contracted. See William L. Prosser, The Fall of the Citadel (Strict Liability to the Consumer), 50 Minn. L. Rev. 791, 791-94 (1966). Lawyers, however, generally survived the decline of the privity requirement. In limited circumstances, the lawyer may be liable to third persons who are the identified intended beneficiary of the legal services. See, e.g., Greycas, Inc. v. Proud, 826 F.2d 1560, 1565 (7th Cir. 1987) (applying Illinois law to hold lawyer liable for negligent misrepresentation to third parties concerning title of property); see also Ackerman v. Schwartz, 947 F.2d 841, 846 (7th Cir. 1991) (limiting lawyer’s liability to third parties for misrepresentations in reports to persons whom the lawyer knew might rely).

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...defend their clients against enforcement actions initiated by those regulatory agencies.

Securities lawyers frequently advise clients in selling securities to investors who lack legal representation. In doing so, lawyers generally have been able to rely on the traditional rules of primary duty to the client without assuming duties to investors. These rules do not, however, negate potential liability to investors who are protected by the fiduciary notions of the federal securities laws. Until recently, if a securities lawyer knowingly assisted a client in violating securities laws, the investors could also recover against the lawyer for aiding and abetting the client's violation. Liability for aiding and abetting was imposed on lawyers without the need for courts to articulate what independent duties, if any, lawyers owed to the protected third parties. In protecting investors, courts avoided creating rules that would compete with and erode the lawyer's strict duty of loyalty to the client.

The Supreme Court eliminated aiding and abetting actions in a 1994 decision, Central Bank v. First Interstate Bank. That decision swept away thirty years of federal common law by limiting the reach of private remedies against lawyers and others who provide services in connection with the offering of securities. The Court ruled that the general antifraud provision of the 1934 Securities Exchange Act, Section 10(b), did not include a private right of action against those who "aid and abet" the "manipulative or deceptive" conduct of a primary violator of Section 10(b).

Investors who suffer a loss because they relied on an issuer's misleading disclosures can sue the issuer as a primary violator of SEC Rule 10b-5. Before Central Bank, investors could also recover from the issuer's lawyer and others who had aided and abetted the primary violation by establishing that the aider and abettor had knowledge of the violation and had knowingly provided substantial assistance to the

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   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange... (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.
5. Central Bank, 114 S. Ct. at 1455.
6. See 17 C.F.R. § 240.10b-5 (1995). The reach of Rule 10b-5 has much broader application than just those transactions involving an issuer's sale of securities. See generally Louis Loss & Joel Seligman, 7-8 Securities Regulation 3485-3631 (3d ed. 1991). This Article, however, uses the paradigmatic transaction of an issuer selling its securities because the securities lawyer usually plays an important role in managing the project, assisting in drafting disclosure documents, and counseling the client.
primary violator. Investors can now seek remedies only from those found to have committed a "primary" violation of the rule.

The Central Bank decision did not resolve whether securities lawyers will now be held liable under theories of primary liability. Aiding and abetting theory in the implied private actions of Rule 10b-5 played a significant role in holding lawyers legally accountable in securities transactions. The federal securities laws do not specifically refer to lawyers in providing investors with express remedies for misconduct as they do for other securities professionals, such as accountants and underwriters. The implied action therefore provided the most important remedy for investors to hold a lawyer liable for damages when the lawyer acting qua lawyer participated in a fraudulent securities transaction.

The SEC, relying on aiding and abetting actions, has been responsible for bringing some of the most significant actions against lawyers. Central Bank's rationale left in doubt whether the SEC would be able to continue to bring aiding and abetting actions. Eighteen months after the Central Bank decision, Congress enacted the Private Securi-

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8. The deterrence effect of liability is not an effective incentive to promote securities lawyers' careful conduct as are their own economic interests. Securities lawyers are repeat players in the securities markets. They must not only protect against reputational loss in representing their clients before regulatory agencies but also must foster confidence and respect among the participants in the securities industry with whom they deal.

While the deterrent effect of the risk of liability is not capable of measure, evidence suggests that the risk is substantial enough to act as an entry barrier to practicing securities law. Legal malpractice insurance premiums in securities law practice are significantly higher than for other kinds of practice. Insurance is often unattainable for lawyers deemed under-qualified. Without the possibility of Rule 10b-5 law suits, insurance rates should eventually drop and more nonqualified lawyers would take up the practice of securities law.

Positive economic interests and deterrence provided by liability rules should promote careful lawyer behavior. Unfortunately, there seems never to be a shortage of plausible actions for securities lawyers' misconduct.

9. See Securities Act of 1933 § 11, 15 U.S.C. § 77k (1994) ("1933 Act"). A lawyer, however, can be held liable for his legal opinion under § 11 if he could not prove the due diligence defenses provided in § 11. In practice, legal opinions required by the securities laws in the public sale of securities are limited and the risk is not great.

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Ties Litigation Reform Act of 1995, which restored to the SEC the ability to enjoin lawyers (and others) who knowingly aid and abet a primary violation. The 1995 Reform Act did not restore private actions for aiding and abetting.

Prior to Central Bank, lawyers were held liable under aiding and abetting theory without the plaintiff establishing that the investor relied on the lawyer’s conduct. In a case in which the investor was deceived by misrepresentations, the investor needed only to show that he relied on the misrepresentations made by the issuer to establish a primary violation. The investor also had to prove that each of the defendants acted with scienter. As to whether the lawyer aided and abetted that primary violation, the court’s inquiry focused primarily on the lawyer’s state of the mind. Courts inquired as to whether the lawyer knowingly assisted in the misrepresentations. Establishing that the lawyer provided substantial assistance was not usually a problem because in most instances he was engaged to provide, and did provide, substantial assistance. When the investor was deceived primarily through the failure to disclose information, the investor would have to show that the issuer owed the investor a duty to disclose the omitted information. Once the breach of duty was shown, the collateral participants, including the lawyer, could be held liable for aiding and abetting that breach of duty.

The key point is that the aiding and abetting action bypassed inquiry into whether the lawyer owed a duty to the investor. Liability based on aiding and abetting permitted courts to avoid determining what duties lawyers owed to third parties in securities transactions. The securities industry matured and the role of securities lawyers evolved for six decades without development of rules or standards governing the securities lawyers’ responsibilities to investors.

Indeed, the aiding and abetting concept served as an implicit compromise between the organized bar and the courts in the regulation of lawyers’ professional conduct. In that compromise, the bar retained its prerogative to define professional responsibility, including the lawyers’ responsibility to third parties. The courts retained their power to hold lawyers liable for misconduct that harmed investors without having to define lawyers’ duties of professional responsibility.

Central Bank has altered that compromise. Private actions against lawyers under Rule 10b-5 must now establish a basis for primary liability. This structure presumes that the investor is entitled to rely on

13. Id.
14. Scienter, as it applies to a cause of action under § 10(b) and Rule 10b-5, refers to a “mental state embracing intent to deceive, manipulate, or defraud.” Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 n.12 (1976); see infra part I.A.2.
the lawyer's conduct because the lawyer either sufficiently participated in the drafting of the misrepresentations, or the lawyer owed a duty to the investor to disclose the material omissions.

This Article examines theories courts can use to hold lawyers liable as primary violators. Part I explores the development of lawyer liability based on aiding and abetting. Part II considers the issues left unresolved by the Central Bank decision and explores the theories under which the lawyer acting qua lawyer may be held liable for misrepresentations and omissions. Finally, part III focuses on the effect of the 1995 Reform Act on SEC enforcement actions against lawyers.

Despite newly imposed impediments to suing securities lawyers, this Article argues that the Central Bank decision should not lull lawyers into complacency or a false sense of security. Lawyers will be held responsible for their clients' misrepresentations. Moreover, if lawyers are unwilling or unable to address their responsibilities to investors, the courts will, by default, develop the disclosure duties lawyers owe to the investing public.

I. LAWYERS' LIABILITY BEFORE CENTRAL BANK

A. Overview of Aiding and Abetting

The private cause of action under Rule 10b-5 has developed like all common law—in fits and starts, uneven and messy, taking time to coalesce into a workable, never neat, theory. To establish a primary

15. The SEC promulgated Rule 10b-5 in 1942 pursuant to Congress's 1934 grant of statutory authority under § 10(b) to prescribe rules to prohibit any person to use or employ any manipulative or deceptive device in connection with the purchase or sale of any security. 15 U.S.C. § 78j (1994); see supra note 4. Rule 10b-5 is the chief enforcement mechanism for § 10(b) of the Securities Exchange Act of 1934. 15 U.S.C. §§ 78a-78kk (1994) [hereinafter “Exchange Act”]. The substance of Rule 10b-5 was taken from § 17(a) of the 1933 Act, substituting the words “in connection with the purchase or sale of any security” for the words “in the sale of any securities.” The drafters of Rule 10b-5 intended this substitution to define the scope of the rule as a supplement to the SEC’s enforcement capacity under § 17(a) by extending protection to sellers as well as to purchasers. Milton Freeman, Remarks, Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 921-23 (1967).

Four years after the SEC implemented Rule 10b-5, a federal court, relying on tort principles, implied a private remedy for those investors injured by violators of the rule. Congress did not provide investors with an express remedy against those who violated the “catchall” securities fraud provisions of § 10(b) and Rule 10b-5. Chiarella v. United States, 445 U.S. 222, 234-35 (1980) (describing Section 10(b) as a “catch all” securities fraud provision). The cause of action itself and its scope were court created. The first case to imply a private remedy for a violation of Rule 10b-5 was Kardon v. National Gypsum Co., 73 F. Supp. 798 (E.D. Pa. 1947). For 50 years, federal courts have permitted private actions against those persons who deceived investors in connection with the purchase or sale of a security.

Regardless of what Congress may have originally intended by § 10(b), the courts, over 30 years of litigation, expanded the SEC rule to apply to conduct deemed to be unfair or illegal in financial transactions. The courts, with the SEC's encouragement, generally proved sympathetic to plaintiffs' securities fraud claims. See Steve Thel, The Original Conception of Section 10(b) of the Securities Exchange Act, 42 Stan. L. Rev.
violation of Rule 10b-5, a plaintiff must prove the defendant, acting with scienter, made a misrepresentation of material fact on which the

385 (1990) (arguing that Congress intended Section 10(b) to confer expansive SEC regulatory powers instead of the restrictive view adopted by recent cases). Flagrant fraud occurs with sufficient regularity to keep courts sensitive to the need to redress the wrongs and to adapt the rule to punish wrongdoers. See Donald C. Langevoort, Rule 10(b)-5 as an Adaptive Organism, 61 Fordham L. Rev. S7 (1993).

Beginning in 1975, the Supreme Court, in a series of cases, began to trim the reach of the private remedy. In Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), the Supreme Court, expressing for the first time the majority of the Court's growing concern with the need to limit "vexatious litigation," held that standing in private actions was limited to purchasers or sellers of securities. Id. at 733. That case was followed the next year by Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), where the Court found that an accounting firm could not be held liable in an aiding and abetting action for merely negligent conduct, and that a plaintiff must plead and prove that a defendant acted with scienter. Id. at 213-15. In 1977, Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977), established that defendants' unfair conduct alone would not state a claim; rather, the unfairness must be accompanied by deceitful conduct. Id. at 474.

As the Supreme Court restricted Rule 10b-5's reach, especially with the requirement that plaintiffs plead and prove scienter, plaintiffs turned, with success, to § 12 of the 1933 Act. Section 12 provides an express private remedy against "sellers" of unregistered securities and does not require proof of scienter. 15 U.S.C. § 771 (1994). The lower courts were receptive to a broad definition of "seller" that included those who participated in the sale, including lawyers.

The Supreme Court, in its 1988 decision in Pinter v. Dahl, 486 U.S. 622 (1988), restricted the definition of "seller" to a person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner. Id. at 641-55. This definition has made it difficult to hold lawyers liable as "sellers" of securities as long as the lawyer stays within his counseling role and does not have direct contact with the buyers of the securities.

The Court also cut off claims against collateral participants in RICO cases. In Reves v. Ernst & Young, 113 S. Ct. 1163 (1993), the Court interpreted the statutory text to hold that "[Section] 1962(c) cannot be interpreted to reach complete 'outsiders' because liability depends on showing that the defendants [in this case, independent accountants] conducted or participated in the conduct of the 'enterprise's affairs,' not just their own affairs." Id. at 1173. The 1995 Reform Act, however, eliminated RICO civil actions where the defendants' predicate offense was conduct "that would have been actionable as fraud in the purchase or sale of securities." 1995 Reform Act, Pub. L. No. 104-67, § 107, 1996 U.S.C.C.A.N. (109 Stat.) 737, 758 (codified at 18 U.S.C. § 1964(c)(1995)). Thus, the RICO laws do not apply to defendants who are not criminally convicted of securities fraud.

In 1995, the Court further restricted the reach of the securities laws in holding that § 12(2) of the 1933 Act (imposing liability on sellers who make oral or written misrepresentations unless the sellers can prove they were not negligent) applied only to public offerings. Gustafson v. Alloyd Co., 115 S. Ct. 1061, 1071 (1995). Therefore, investors in private offerings and secondary market transactions no longer have this express remedy available.

Even though the Supreme Court has, since 1975, generally sought to restrict the reach of the federal securities remedies, the lower courts have continued to be receptive to new arguments offered by plaintiffs to hold collateral participants liable in fraudulent securities transactions.

16. Rule 10b-5 provides:

   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

   (a) To employ any device, scheme, or artifice to defraud,
plaintiff relied, and the misrepresentation caused the plaintiff’s harm. A defendant who fails to disclose material facts can also be held liable if the plaintiff can establish that the defendant owed the plaintiff a duty to speak. Added to the concepts of scienter, materiality, reliance, and causation, are the requirements that the misrepresentation or omission be made “in connection with the purchase or sale of any security.” The plaintiff must have either purchased or sold the security to have standing to bring the action. Privity is not required.

Before Central Bank, liability was also imposed on collateral participants who aided or abetted a primary violation. Ignoring the interjurisdictional and intertemporal variations, the plaintiff could generally recover from a collateral participant if he could prove: (1) the existence of a primary violation; (2) the collateral participant’s knowledge or recklessness as to the primary violation; and (3) the substantial assistance provided by the participant to the primary violator.

The concept of aiding and abetting a securities violation was derived from civil common law and criminal law doctrine. Brennan v. Midwestern United Life Insurance Co., the first private remedies

(b) To make any untrue statement of a 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) To 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.


17. The Fifth Circuit distinguishes between transaction causation and loss causation. The plaintiff must prove “transaction causation,” i.e., the plaintiff would not have purchased the security or would not have purchased the security at the same price if he had known the truth of the matters that were misrepresented. Huddleston v. Herman & MacLean, 640 F.2d 534, 549 n.24 (5th Cir. 1981), aff’d in part and rev’d in part, 459 U.S. 375, 391 (1983). The plaintiff must also prove “loss causation,” i.e., the matters misrepresented caused the security to lose its value. Id. at 549. If the security lost value, for instance, through a general decline in the stock market, rather than from the market’s repricing of the security due to the revelation of the misrepresentation, “loss causation” would not be established. Id. The Supreme Court has not used those terms. In holding that reliance is an element of a Rule 10b-5 cause of action, the Court stated: “[R]eliance provides the requisite causal connection between a defendant’s misrepresentation and a plaintiff’s injury.” Basic, Inc. v. Levinson, 485 U.S. 224, 243 (1988). However, some courts make a distinction between “transaction causation” and “loss causation.” The 1995 Reform Act now requires a plaintiff in a private action to prove loss causation. 1995 Reform Act, Pub. Law No. 104-67, § 105, 109 Stat. 737, 757 (codified at 15 U.S.C. § 771(3)(b)).


case to recognize aiding and abetting, adopted the term from two earlier SEC injunction actions. In giving content to aiding and abetting theory in a private civil action, Brennan relied on Section 876 of the Restatement of Torts, which provides that a person is responsible for harm resulting to a third party if the person, knowing of the wrong, gives substantial assistance to the wrongdoer. Section 876 does not mention the words "aiding and abetting" or any concept of primary and secondary liability. At common law, the joint tortfeasors—the wrongdoer who has direct contact with the plaintiff and those persons who assist the wrongdoer in accomplishing the wrong—are equally liable.

Brennan gave rise to joint tort liability for participation in fraudulent schemes even though the participants were not acting in con-
The actions of each actor in these multiple party transactions may be different but all actors who were liable for the tort were "primary" in the sense that they were considered to be engaged in conduct to bring about the same results and they were liable in the same degree. Liability for aiding and abetting premised on tort law concepts did not require two separate causes of action under Rule 10b-5. The bifurcation of joint tortfeasors into primary and secondary actors and the development of primary and secondary liability in Rule 10b-5 actions arose only after Professor David Ruder, in 1972, published an influential law review article.

1. Primary and Secondary Liability

In his article on multiple defendants in securities fraud cases, Professor Ruder argued a fundamental distinction between "primary" and "secondary" levels of misconduct:

In most multiple defendant securities law suits some of the defendants will be primarily engaged in the wrongdoing, while others will be engaged only in a secondary fashion. This distinction between primary and secondary wrongdoers provides a method for determining liability and for allocating rights among wrongdoers. For purposes of this Article, persons owing direct duties to the public will be classified as primary wrongdoers. Those whose liabilities arise only because another has violated the law will be called secondary wrongdoers. In most cases those who are only secondarily liable will be less culpable than those who are primarily liable.

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26. Brennan v. Midwestern United Life Ins. Co., 286 F. Supp. 702, 708, 725-27 (N.D. Ind. 1968) (finding that defendants were liable because even if the losses would have occurred without their conduct, they still aided and abetted the conduct), aff'd, 417 F.2d 147 (7th Cir. 1969), cert. denied, 397 U.S. 998 (1970).

27. There was no concept that one actor was the "primary" tortfeasor, connoting a higher degree of fault, and that another actor was "secondarily" liable, connoting a lesser degree of fault. The common law theories of so called "secondary" liability—the agency theory of respondeat superior; the criminal law theories of conspiracy and aiding and abetting, or their civil law equivalents—do not distinguish relative degrees of culpability.

The common law theories of multiple defendants' liability in the actions of conspiring with, or aiding and abetting the wrongdoer who has contact with the plaintiff, are concerned with establishing the parameters of proximate or legal cause. Once that outside parameter is established, all those falling inside it are bound together in the same degree of fault. The actors are bound together because they in some way throw in their lot with each other to make the wrongdoing succeed. Because there is more than one actor, the conduct is more likely to succeed, thus creating the potential for more certain and greater harm.

28. See supra notes 15-17 and accompanying text.

29. David S. 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). Professor Ruder marshaled 34 cases on either conspiracy or aiding and abetting he had found from 1944 through 1971. Id. at 625, nn.123-24. A review of those cases demonstrates that none of those decisions refers to or uses a concept of "primary" and "secondary" liability among the tortfeasors.

30. Id. at 600.
Professor Ruder stated that the "primary" wrongdoer "violates the law" because he owes a duty to the public, while the "secondary" wrongdoer's conduct does not in itself violate the securities law. When applied to the "secondary liability" of aiding and abetting, Professor Ruder's classification scheme requires two additional assumptions: (1) the aider and abettor's own culpable conduct in assisting in the fraud is not, without something more, deceptive conduct that violates the law, and/or (2) the aider and abettor does not owe either a derived duty or an independent duty to investors to refuse to aid and abet another's breach of duty. These distinctions between primary violators and aiders and abettors are difficult to justify under common law ideas of holding joint tortfeasors liable as a group, especially when each member of the group is acting with scienter. The 1995 Reform Act resurrected SEC aiding and abetting actions, and abolished this arbitrary distinction between primary and secondary liability. It provides that the aider and abettor is deemed to be in violation of the securities laws to the same extent as the principal.

The differing degrees of culpability between primary and secondary wrongdoing encouraged the courts to describe two causes of actions: one for the primary wrongdoer who was deemed more culpable, and another for the supposedly less culpable, aider and abettor. The Courts were not required to be careful in distinguishing the conduct that constituted each cause of action because liability for the actions was joint and several. Eventually, the Supreme Court in Central Bank would conveniently dispose of aiding and abetting conduct by assuming (as had other courts) that aiding and abetting was a separate

31. See id. at 645-46.
32. An aider and abettor could be held to owe a derived duty analogous to a primary tippee in an insider trading violation. The tipper of inside information in breach of his fiduciary duty discloses to the primary tippee, who knows of the breach and who does not herself trade, but tips the information to a trader. The primary tippee in this situation is liable because she has assumed a duty derived from the original insider.
33. See Ruder, supra note 29, at 645-46.
35. Id. Federal criminal law does not attempt to justify the distinction between primary and secondary actors. It treats both the primary actor and the aider and abettor as principals. The federal criminal statute dealing with aiding and abetting, 18 U.S.C. § 2(b) (1994), applies to all federal criminal statutes. Aiding and abetting under that statute is not an independent crime; the statute simply abolishes the distinction between common law ideas of principal and accessory. United States v. Kegler, 724 F.2d 190, 200-01 (D.C. Cir. 1984). The elements of the substantive crimes provide the definition of the conduct that is prohibited. U.S. v. Campbell, 426 F.2d 547, 553 (2d Cir. 1970).
36. See, e.g., Moore v. Fenex, Inc. 809 F.2d 297, 304-05 (6th Cir.), cert. denied, 483 U.S. 1006 (1987). In Herman & MacLean v. Huddleston, 459 U.S. 375 (1983), the Supreme Court noted, without comment, that the trial court had found dual liability. Id. at 379 n.5.
cause of action and that the conduct was not deceptive conduct within the meaning of the statutory language of Section 10(b).37

2. Scienter

Although courts have blurred the distinctions between the primary and secondary actors’ conduct, they have consistently focused on the actors’ mental states with which they acted. In the expansive era of 10b-5 litigation,38 the courts split on whether negligence or some degree of scienter was the appropriate standard for a private action under Rule 10b-5.39 The Supreme Court’s first examination of aiding and abetting under Rule 10b-5 was in a case involving accountants who negligently failed to detect their client’s fraud.40 While expressly reserving the issue of whether aiding and abetting was actionable under Section 10(b), the Court held that scienter—“a mental state embracing intent to deceive, manipulate, or defraud”41—was a required element for all private actions.42 The Court did not reach the issue of whether reckless behavior was sufficient to meet the scienter standard.43 The majority of the circuits since Ernst & Ernst have adopted a recklessness standard for primary violations.44 The most often quoted definition of recklessness is one adopted by the Seventh Circuit:

[R]eckless conduct may be defined as a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.45

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37. Central Bank v. First Interstate Bank, 114 S. Ct. 1439, 1448 (1994) (“We cannot amend the statute to create liability for [aiding and abetting] acts that are not themselves manipulative or deceptive within the meaning of the statute.”).
41. Id. at 193-94 n.12.
42. Id. at 212-14.
43. Id. at 191-92 n.7.
44. See First Interstate Bank v. Pring, 969 F.2d 891, 901 (10th Cir. 1992), rev’d sub nom. on other grounds, Central Bank v. First Interstate Bank, 114 S. Ct. 1439 (1994); see also Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1568-69 n.6 (citing cases from the First, Second, Third, Fifth, Sixth, Seventh, Eighth, Tenth, Eleventh, and D.C. Circuits, and citing to opinions of district courts in the Fourth Circuit); 8 Loss & Seligman, supra note 6, at 3665-66 (marshaling cases from all the circuits).
Courts did not uniformly adopt a recklessness standard for aiding and abetting liability. Some courts applied a recklessness standard to all 10b-5 claims without distinguishing between primary and aiding and abetting liability. Other courts explicitly applied a recklessness standard to aiding and abetting claims. Some courts, however, in deciding nondisclosure cases, distinguished between aidsers and abettors who owed a duty to plaintiffs and those who did not. A recklessness standard applied to aidsers and abettors who remained silent when they owed a duty to speak to the plaintiff. In the absence of a duty to disclose, those courts held that the aider and abettor would be held liable only if he intended to assist the primary violation.

In First Interstate Bank of Denver, N.A. v. Pring ("Central Bank"), the Tenth Circuit had ruled that the defendant bank could be held liable for reckless conduct even though the court concluded that the bank did not owe a disclosure duty to the bondholders. The issue appealed to the Supreme Court in Central Bank was whether proof of reckless behavior was sufficient to trigger aiding and abetting liability when the aider and abettor did not owe any duty to the plaintiff. The Court itself decided to address the issue of whether Section 10(b) authorized an action for aiding and abetting.

The recklessness standard for primary violators continues to be valid. The 1995 Reform Act does not alter the degree of scienter necessary to prove a primary violation in a private action. The Reform Act's approach is to allocate damages based upon which defendants are found to have knowingly violated the securities laws.

46. See generally Note, Liability for Aiding and Abetting Violations of Rule 10(b)-5: The Recklessness Standard in Civil Damage Actions, 62 Tex. L. Rev. 1087, 1103-04 (1984) (stating that in aiding and abetting liability, some courts have adopted the general recklessness standard while other courts use the recklessness standard only if the aider and abettor owes a fiduciary duty to the plaintiff). Some courts held that absent a duty to disclose, there is no aiding and abetting liability for silence or inaction. Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 495-96 (7th Cir. 1986).

47. C.E. Carlson, Inc. v. SEC, 859 F.2d 1429, 1435 (10th Cir. 1988).


51. First Interstate Bank, 969 F.2d at 902-03.

52. Central Bank, 114 S. Ct. at 1444.

53. In holding that aiding and abetting did not exist, the Court did not address the "recklessness" issue. Subsequently, circuit courts have affirmed recklessness as behavior that meets the scienter requirement. See In re Software Toolworks, Inc., 50 F.3d 615, 626 (9th Cir. 1995) (quoting the formulation that has been adopted by the Ninth Circuit); Shields v. Citytrust Bankcorp., Inc., 25 F.3d 1124, 1128-29 (2d Cir. 1994).


55. Id.; see infra note 196 and accompanying text.
knowingly violate the laws are to be held jointly and severally liable, while all other defendants found liable must pay only their proportionate share of damages. The statute's definition of "knowingly" specifically excludes reckless conduct.

The 1995 Reform Act cuts both ways for the lawyer acting qua lawyer in a fraudulent securities transaction. Courts may find it easier to hold that plaintiffs have stated a claim against a lawyer for reckless conduct, especially when they are aware that the lawyer's liability exposure for the reckless conduct is limited to his proportionate share of the responsibility. On the other hand, the statute imposes strict pleading requirements that the complaint "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind," which should help lawyers from being named in suits without adequate grounds.

B. Lawyer Liability for Aiding and Abetting

1. Private Actions

Lawyers who actively participate in fraud or act as principals of an issuer engaged in misconduct will be held liable for securities laws violations. This Article is concerned, however, with issues arising when lawyers act qua lawyer in connection with securities transactions. The distinctions between the lawyer with actual knowledge participating in fraud and the lawyer acting qua lawyer in counseling his client with


57. For purpose of the proportionate liability provision only, "knowingly" is defined as "actual knowledge" that the representation is false, or omits to state a fact necessary in order to make the statement made not misleading [or] with actual knowledge that, as a result of the omission, one of the material representations . . . is false." Id. § 201, at 761 (codified at 15 U.S.C. § 78u-4(g)(10)(A)(i)(I)) (emphasis added).

The 1995 Reform Act does not define knowingly for purposes of the SEC's authority to bring civil aiding and abetting actions against "any person that knowingly provides substantial assistance" to one who violates the securities laws. Id. § 104, at 757 (codified at 15 U.S.C. § 78(t)(2)(f)). The term knowingly could include reckless conduct, see 10 Loss & Seligman, supra note 6, at 4690-93, but the issue is ripe for litigation.


59. See, e.g., Wilson v. Great Am. Indus., 855 F.2d 987, 995 (2d Cir. 1988) (lawyer who was also director, secretary, and shareholder liable to shareholders for misrepresentations); United States v. Benjamin, 328 F.2d 854, 863-64 (2d Cir. 1964) (holding liable a lawyer who knowingly prepared fraudulent documents and procured the services of others to assist in selling unregistered securities to public); United States v. Crosby, 294 F.2d 928, 937-38 (2d Cir. 1961) (holding lawyer who personally sold shares of unregistered stock and issued opinion letters that allowed millions of shares to be sold to the public primarily liable); Pucci v. Santi, 711 F. Supp. 916, 925-26 (N.D. Ill. 1989) (holding that lawyer was the primary participant when he also acted as officer, director, shareholder, and general partner of limited partnership); Felts v. National Account Sys. Ass'n, 469 F. Supp. 54, 68 (N.D. Miss. 1978) (holding lawyer who was also president of issuer liable as principal).
respect to the securities laws is crucial for an understanding of these issues. The factual distinctions important for these purposes are the kind of conduct at issue and the mental state in which the lawyer acts.

Rule 10b-5 prohibits the making of material misrepresentations or omissions. This broad rule prohibits conduct ranging from failing to disclose that the issuer's president intends to use the investor's money for his peccadillos (fraud) to a company denying rumors that merger talks are underway in order to protect the shareholders from having the deal fall through (a material misrepresentation). The lawyer acting qua lawyer who learns of the president's fraudulent scheme has no hesitation in withdrawing. If he fails to withdraw, he will be given little sympathy. Because he knows of the fraud, he will have demonstrated the requisite scienter and he will no longer be acting qua lawyer. As a lawyer he must withdraw, but whether he can disclose the client's secret to prevent the harm will depend upon the jurisdiction in which he is licensed to practice law. Does he have a duty of inquiry to discover the scheme? Does he have a duty to disclose the scheme to the investors? If so, how does he fulfill that duty? In deciding ex ante what action to take, he will also be aware that his former client may be able to sue him for breaching his professional responsibility in failing to keep the confidence.

In the merger example, does the lawyer who is representing the company in the merger negotiations withdraw as soon as she hears the company's spokesperson on CNN denying the merger talks? She will most likely know that the denial constitutes a material misrepresentation. What if the client had discussed the issue with the lawyer and she had advised that the denial would be a securities law violation? Does her continued representation make her a knowing participant in a securities law violation? What if the lawyer had advised the client that the denial would not constitute a violation? Would the lawyer have acted negligently in giving the wrong advice or was the mistake so obvious that she must have been reckless in giving that advice? Does the lawyer have a duty to appear on CNN to correct the material misrepresentation to prevent harm to those shareholders who will sell their shares at a loss before the merger? Does she have a duty to the remaining shareholders not to reveal the merger talks which revelation may kill the transaction? As reality would have it, most situations will not be as clear as the hypotheticals. They will include hazy facts and uncertain law that frequently will call for the lawyer to exercise judgment that may later prove to be wrong. Sometimes, his professional action or inaction may be egregious enough to be deemed reckless.

61. Model Rules, supra note 2, Rule 1.6(a).
Even though violations of Rule 10b-5 are frequently referred to as fraud, the term "fraud" used in this context is overbroad. This does not mean that injured investors should not recover for securities violations or that violations should not be deterred through civil actions. The nature of the violation, however, has important implications for the kind of lawyer decision-making and conduct that should be encouraged or deterred.

Several different factual scenarios predominate in securities lawyers liability cases. One genre of cases concerns lawyer liability in issuing legal opinions, e.g., the difficult legal opinion cases occur when a lawyer issues an erroneous legal opinion based on misrepresentations of material facts supplied by a client. Lawyers' tax opinions used in selling tax shelters or tax exempt bonds are the subjects of most of these cases. Before Central Bank, lawyers' liability for materially misleading opinion letters was sometimes dealt with as aiding and abetting and sometimes as a primary violation.\footnote{62}

Liability issues also arise in the setting of lawyers assisting their clients in drafting disclosure documents that are later shown to contain materially misleading statements. Some courts have held that the lawyer's liability in this situation is limited to aiding and abetting the client's misrepresentations.\footnote{63} Other courts, including two pre-Central Bank cases, have held that lawyers committed primary violations in drafting issuers' documents.\footnote{64}

\footnote{62. See Kline v. First Western Gov't Sec., Inc., 24 F.3d 480 (3d Cir. 1994) (imposing, in a post-Central Bank case, primary liability on lawyer); see also Ackerman v. Schwartz, 947 F.2d 841, 845-49 (7th Cir. 1991) (holding that misleading opinion letter was basis for lawyer liability without distinguishing primary or aiding and abetting liability); Gilmore v. Berg, 761 F. Supp. 358, 373 (D.N.J. 1991) (denying summary judgment to lawyer in an action for aiding and abetting issuing of tax opinion without experience or expertise and without investigation); Stevens v. Equidyne Extractive Indus. 1980, 694 F. Supp. 1057, 1064 (S.D.N.Y. 1988) (stating aiding and abetting claim against lawyer for tax opinion letter).


\footnote{64. In Molecular Technology Corp. v. Valentine, 925 F.2d 910 (6th Cir. 1991), a 1983 merger with a defunct public shell corporation was followed by the merged company making a private placement of convertible debentures. Within a year, the company was bankrupt. The lawyer who represented the parties in the merger transaction reviewed and made changes in the offering document prepared by a second lawyer (who was not a party to the suit). \textit{Id.} at 913. The Sixth Circuit held, without explanation, that the lawyer who made the changes in the offering document had a "direct" duty to investors to make full and accurate disclosure about matters within his knowledge gained in the merger transaction. \textit{Id.} at 917-18. The lawyer was also liable under Michigan law for negligent misrepresentation (which required the defendant to act with scienter) to foreseeable users of the information. \textit{Id.} at 915-16.

In Breard v. Sachnoff & Weaver, Ltd., 941 F.2d 142 (2d Cir. 1991), Berg, one of the principals of the issuer, had absconded with the investors money. \textit{Id.} at 143. The court ruled that plaintiffs stated a valid claim against the lawyer for preparing the limited partnership real estate private placement memorandum that did not disclose that Berg had been convicted of fraud in connection with a prior limited partnership offer-
The factual setting in which the lawyer is farthest removed from contact with third parties is when the lawyer is counseling and advising his client with respect to a securities transaction. During the course of representation, the lawyer becomes aware that his client is misrepresenting or withholding material information or is engaged in other behavior that violates the securities laws. The issue in this setting is whether the lawyer has a duty to disclose the violation. The *National Student Marketing* case of the early 1970s, discussed below, presented an opportunity to explore this issue, although the court largely bypassed it.

These factual settings present the conundrum of the securities lawyer—a duty of loyalty to represent his client and to keep his client's confidences, and a competing duty, if any, to prevent harm to innocent third parties. Under the current Model Rules of Professional Conduct ("Model Rules"), the lawyer's only choice upon discovering client fraud is to withdraw from the representation. He must, however, continue to hold his wrongdoing client's confidences inviolate.

Courts have not articulated a duty for a lawyer to disclose to investors in situations in which the lawyer counsels the client but does not participate in the drafting of misrepresentations. Courts, in imposing liability on lawyers for conduct that is essentially a failure to disclose, relied on an aiding and abetting theory. They thus avoided the necessity to define what duties of disclosure, if any, lawyers owed to investors.

When finding that a lawyer did not commit a violation, or aid and abet a violation, courts have tended to rely on the rule that lawyers do

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66. Model Rules, *supra* note 2, Rule 1.16(b). This was not always the lawyer's only choice. *See infra* part II.D.2.c.

67. *See* Model Rules, *supra* note 2, Rule 1.6(b). Rule 1.6(b) provides:

A lawyer may reveal such [confidential] information to the extent the lawyer reasonably believes necessary:

(1) to prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm; or

(2) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client.
not owe duties to third parties. In recent years, several courts have been especially outspoken in holding that lawyers do not assume duties to nonclients.\textsuperscript{68} In each of those cases, however, the facts were atypical of the usual model in which the securities lawyer plays a primary role in the issuance of securities to investors. When those courts concluded that the lawyers were not liable to investors, they invoked the general rule that a lawyer does not owe duties to nonclients. This invocation of the general rule was a conclusion the courts reached after satisfying themselves that: (1) there was not sufficient evidence of scienter; (2) the lawyer's participation in the transaction was not significant; (3) the lawyer's role in the transaction was limited to not disclosing his client's confidences when the lawyer was not assisting in drafting disclosure documents; or (4) some combination of the first three.\textsuperscript{69} The duties securities lawyers owe to investors were, and still are, confused: They owe duties except when they do not.

2. National Student Marketing

The SEC has attempted, with limited success, to impose general duties of disclosure on securities lawyers. In 1972, the Commission sought injunctive sanctions in \textit{SEC v. National Student Marketing Corp.}\textsuperscript{70} against numerous defendants, including lawyers of two prominent law firms, as a result of their representation of their respective clients in a merger of National Student Marketing Corporation ("NSMC") and Interstate National Corporation ("INC"). At the clos-

\textsuperscript{68} See, e.g., \textit{Fortson v. Winstead, McGuire, Sechrest \& Minick}, 961 F.2d 469, 473-75 (4th Cir. 1992) (lawyer providing tax opinion had no duty to ensure accuracy of other information provided to investors); \textit{Camp v. Dema}, 948 F.2d 455, 461-62 (8th Cir. 1991) (lawyer for buyer of corporation's stock was not liable to seller for failure to disclose interest of subsequent buyer of stock); \textit{Schatz v. Rosenberg}, 943 F.2d 485, 490-94 (4th Cir. 1991) (lawyer who had reason to know of client's true financial condition was not liable to seller of stock for providing seller with client's materially false financial statements in connection with client buying all the stock of corporation); \textit{Abell v. Potomac Ins. Co.}, 858 F.2d 1104, 1126-28 (5th Cir. 1988) (reversing verdict against underwriters' attorneys for failing to correct material misrepresentations in issuer's disclosure statements); \textit{Barker v. Henderson, Franklin, Starnes \& Holt}, 797 F.2d 490, 497 (7th Cir. 1986) (lawyer had no duty to investors to correct representations made after lawyer's firm had ceased representing client).

\textsuperscript{69} See \textit{Fortson}, 961 F.2d at 473-75 (combination); \textit{Camp}, 948 F.2d at 461-62 (insignificant participation); \textit{Schatz}, 943 F.2d at 490-94 (misrepresentations made by clients); \textit{Barker}, 797 F.2d at 496-97 (scienter).

ing of the merger, the NSMC accountant’s comfort letter revealed the need to materially restate revenues. This in turn made the proxy statement’s financial information materially misleading. That information had been used to solicit INC shareholders’ votes to approve the merger. INC lawyers did not take sufficient action to persuade their client to delay the merger until the shareholders could be resolicited using the accurate information. The SEC argued that the lawyers had a duty to disclose to the SEC, or the shareholders, their client’s refusal to resolicit the shareholders. In rejecting the SEC’s views, the court held that the lawyers aided and abetted the violation by failing “to take steps to ensure that the information would be disclosed to the shareholders.” The court thus sidestepped the issue of whether the lawyer had a duty to disclose the fraud to someone other than the lawyer’s own client. The court found that when a lawyer’s client commits a violation under these circumstances, the lawyer has a duty to both recognize that violation, and to take sufficient steps to attempt to persuade the client to disclose the matter or information to the shareholders. The lawyer’s breach of that duty was held to have aided and abetted the client’s violation.

71 National Student Marketing, 457 F. Supp. at 700-01.
72 Id. at 713. The court found that because the lawyers had taken no steps to delay the closing, “it [was] unnecessary to determine the precise extent of their obligations.”
73 Id. The court also stated that the lawyer had “fiduciary responsibilities to client shareholders.” Id. at 714. The opinion, however, does not imply that the lawyer himself must disclose to the shareholders.
74 Id. at 715. The court rejected an opportunity to begin determining the extent of lawyers’ duties of disclosure in this situation. In describing the lawyer’s duty, the court stated:

The major problem arising with regard to the Commission’s contention that the attorneys failed to interfere in the closing of the merger is whether inaction or silence constitutes substantial assistance [for aiding and abetting liability]. While there is no definitive answer to this question, courts have been willing to consider inaction as a form of substantial assistance when the accused aider and abettor had a duty to disclose. Although the duty to disclose in those cases is somewhat distinguishable, in that they contemplate disclosure to an opposing party and not to one’s client, they are sufficiently analogous to provide support for a duty here. Upon receipt of the unsigned comfort letter, it became clear that the merger had been approved by the Interstate shareholders on the basis of materially misleading information. In view of the obvious materiality of the information, especially to attorneys learned in securities law, the attorneys’ responsibilities to their corporate client required them to take steps to ensure that the information would be disclosed to the shareholders. However, it is unnecessary to determine the precise extent of their obligations here, since it is undisputed that they took no steps whatsoever to delay the closing pending disclosure to and resolicitation of the Interstate shareholders.... Their silence was not only a breach of this duty to speak, but in addition lent the appearance of legitimacy to the closing.

Id. at 713 (citations omitted).
National Student Marketing is remarkable more for the extraordinary attention it received from the legal community than for the narrow ruling that concluded the proceedings in 1978. The case was deemed to have represented "a substantial departure from traditional standards of care and priorities of duties for securities lawyers." The legal community was concerned not only that the courts might agree with the SEC that lawyers should be required to "blow the whistle" on their clients, but that the SEC was attempting to regulate the professional responsibility of lawyers.

In addition to bringing the National Student Marketing case, the SEC, in the early 1980s, used its administrative proceedings to bring aiding and abetting actions against lawyers in an attempt to discipline lawyers and to define professional responsibility standards. The most prominent of these actions, In re Carter, is discussed in part III of this Article.

II. PRIMARY LIABILITY AFTER CENTRAL BANK

A. The Central Bank Decision

Beginning in the 1970s, the Supreme Court applied a different methodology in defining Section 10(b) actions by examining the language of the text. In cases where the text could not resolve the issue, the Court then attempted to infer what Congress would have done by looking at the entire statutory scheme. Professor Daniel Fischel, following the Court's methodology in 10b-5 cases, concluded that Section 10(b) should not be interpreted to include aiding and abetting actions. Although all eleven circuits had recognized aiding and abetting actions, several courts had issued opinions questioning Rule


76. See, e.g., Special Issue, 30 Bus. Law. 1-227 (1975) (examining the responsibilities and liabilities of lawyers and accountants). The voluminous commentary written about the case at the time did not mention the contemporaneous events of Watergate in which lawyers' professional responsibility played a prominent role. The environment created by Watergate may have added impetus to the SEC's active pursuit of the case although the case was originally filed in 1972, before the facts in Watergate became known.


79. See supra note 15.


81. Justice Stevens pointed out in his dissent in Central Bank that all 11 Courts of Appeals had recognized a private cause of action for aiding and abetting. Central Bank, 114 S. Ct. at 1456 & n.1 (Stevens, J., dissenting).
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10b-5 as the basis for aiding and abetting actions.82 The stage was set for the Supreme Court’s opinion in Central Bank.83

The issue the defendant bank trustee appealed in Central Bank was whether recklessness or intent was the correct scienter standard when the bank did not owe a duty to the plaintiff.84 The parties and the lower courts had all assumed the existence of an aiding and abetting cause of action.85 The Supreme Court asked the parties to brief the issue of whether the cause of action existed.86 The Court’s majority opinion framed the issue as “whether private civil liability under section 10(b) extends as well to those who do not engage in the manipulative or deceptive practice but who aid and abet the violation.”87

The opinion focused on the scope of conduct prohibited by the language of Section 10(b). Following the strict textual construction approach used in earlier decisions,88 the Court examined the statute’s language to determine that its text did not mention aiding and abet-

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82. Akin v. Q-L Invs., 959 F.2d 521, 525 (5th Cir. 1992) (acknowledging that the Supreme Court’s methodology of statutory construction presented a “powerful argument” against aider and abettor liability); Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 495 (7th Cir. 1986) (requiring an aider and abettor defendant to commit a “manipulative or deceptive” act to be held liable); SEC v. Seaboard Corp., 677 F.2d 1301, 1311 n.12 (9th Cir. 1982) (stating that the Supreme Court’s strict statutory construction approach rejects an expansive reading of the Securities Acts that includes aiding and abetting and other “add-on” theories).


85. See id. at 1443-44.


87. Central Bank, 114 S. Ct. at 1443.

The Court concluded that aiding and abetting a Section 10(b) violation is not actionable. Congress had not used the words "aid" or "abet" in the statute and liability for conduct could not extend beyond the scope of conduct prohibited by the statute. The Court reaffirmed prior cases that limited Section 10(b) to deceptive or manipulative acts. This proscription, the Court reasoned, "does not include giving aid to a person who commits a manipulative or deceptive act." The Court confirmed its reasoning by explaining that one element necessary for a violation—reliance—was absent in the aiding and abetting context. If the court were to hold otherwise, a defendant who aided and abetted a primary violator of the statute could be held liable without the plaintiff having to show he relied on the aider and abettor's statements or actions. The Court noted this "would disregard the careful limits on 10b-5 recovery mandated by earlier cases."

90. Id. at 1448.
91. Id. The Court, noting that the statute itself resolved the issue, was willing to engage in an examination of how the issue would have been addressed if the text had failed to settle it. The Court "attempt[ed] to infer 'how the 1934 Congress would have addressed the issue had the 10b-5 action been included as an express provision in the 1934 Act.'" Id. (citation omitted). The Court addressed the SEC's contention that Congress generally legislated with an understanding of basic principles of tort law and that aiding and abetting liability was "well established in both civil and criminal actions by 1934 [and] Congress intended to include aiding and abetting liability in the 1934 Act." Id. at 1450 (citations omitted). The Court, as it had in recent decisions, relied on the language of the express private remedies of the Securities Acts as a model, reasoning that the 73rd Congress would likely have designed the right of action in a manner similar to the other rights of action in the Securities Acts. Id. at 1451-52; see Musick, Peeler, & Garrett v. Employers Ins., 113 S. Ct. 2085, 2089-92 (1993). Musick recognized a right to contribution under § 10(b), stating that the express rights of contribution contained in Sections 9 and 18 of the Acts were important features of the federal securities laws and that consistency requires the adoption of a contribution rule for the right of action existing under Rule 10b-5. Id. at 2090-91.

The Central Bank Court reviewed the express private causes of action under Sections 11 and 12 of the 1933 Act and Sections 9 and 18 of the 1934 Act to establish that none of them expressly imposed liability on those who may aid or abet the prohibited conduct contained in those sections. Central Bank, 114 S. Ct. at 1449. Section 11 of the 1933 Act prohibits false statements or omissions of material fact in registration statements and identifies different categories of defendants subject to liability for a violation, omitting aiding and abettors. 15 U.S.C. § 77k(a) (1994). Section 12 of the 1933 Act forbids the sale of unregistered, nonexempt securities and the sale of securities by the use of a materially false misstatement or omission. Id. § 77(1). Section 12 limits liability to persons who "offers or sells" the security. Id. § 77. Section 9 of the Exchange Act prohibits one from taking part in manipulative acts. Id. § 78i. Section 18 prohibits one from making misleading statements in reports filed with the SEC. Id. § 78r. The Court reasoned that because Congress did not attach aiding and abetting liability to any express private action, Congress would not have intended to expand the defendant class by attaching aiding and abetting liability to an implied private action under Rule 10b-5. Central Bank, 114 S. Ct. at 1449.

92. Id.
93. Id. at 1449-50.
94. Id. at 1450.
The Court rejected all arguments advanced by the respondents and the SEC, including policy arguments.\textsuperscript{95} In discussing the policy considerations, the Court sided with the conservative reformers in the national debate over the scope of liability in securities fraud actions.\textsuperscript{96}

\textsuperscript{95} The plaintiff and the SEC argued, and the Court rejected, that: (1) Congress legislated with an understanding of the principles of tort law and thus intended to include aiding and abetting liability in the 1934 Act; (2) Congress's silence on aiding and abetting when it amended the securities laws on several occasions suggested that Congress acquiesced in the courts' interpretation of Section 10(b); (3) policy considerations supported the inclusion of aiding and abetting in a Section 10(b) action; and (4) the criminal statute specifically prohibiting aiding and abetting strongly suggested the existence of a civil remedy. \textit{Id.} at 1450-55.

\textsuperscript{96} Class action private securities litigation is a subject of intense national debate. The issues in the debate are analytically distinct. The first issue is whether there should be any private remedy for securities fraud. A consensus appears to favor a remedy. The second issue concerns the substantive rules of that remedy. This Article deals with those substantive rules. The third issue encompasses the procedural and substantive rules of the class action itself and the market for these actions exploited by lawyers. The second and third issues are too often enmeshed, consequently creating more heat and adding less light to the debate.

The Court was aware that its \textit{Central Bank} decision to eliminate aiding and abetting would lend support to those who seek to reform class action private securities litigation by revising procedures and limiting the scope of the remedies. The Court was sympathetic to the need to limit "vexatious litigation." The opinion referred explicitly to reformist arguments and their statistics in the securities litigation debate. \textit{Id.} at 1453-54.

Rule 10b-5 and private securities litigation also have academic detractors. See, e.g., Bromberg & Lowenenfels, \textit{supra} note 7, at 770-73 (calling generally for reform in securities litigation); Fischel, \textit{supra} note 80, at 122-24 (same); Grundfest, \textit{supra} note 38, at 1011 (advocating a redefinition of 10b-5 claims).

Professionals, particularly accountants, have attacked what they perceive as an explosion in meritless class action securities litigation. They have charged that each time the market price of a company's shares tumbled 10%, especially in unseasoned companies such as high tech issues, the strike suit lawyer pulled out his roster of professional plaintiff-shareholders, printed out a form complaint, and filed a class action against the issuer alleging that the issuer's disclosure documents contained misrepresentations of material fact or material omissions. In a matter of days, the first lawsuit filed in the courthouse was followed by a filing of a bevy of "me-too" actions. The class-action complaints frequently included allegations that collateral participants, usually underwriters and accountants, aided and abetted the issuer's alleged fraud. Reformers observe that the defendants, under threat of joint and several liability for huge damage amounts, settled with the strike suit lawyers who walked away from a meritless suit with a hefty fee. In the end, the shareholders, the strike suit lawyer's putative clients, paid the costs of this meritless litigation. The company's value (and the shareholder's pro rata share) declined because of the company's litigation costs and the higher expenses of paying professionals to assume the risks of this kind of litigation when marketing the company's securities. Reformers also argue that small companies are denied access to professional services and capital markets because of increased litigation risks and expenses.

The defenders of class action securities litigation and private securities fraud remedies urge reformers to proceed cautiously when criticizing perceived litigation abuses. They emphasize the desirability of private remedies to compensate injured investors, the necessity for private remedies to augment SEC enforcement of the securities laws, and the importance of private remedies to deter fraud and to discipline the securities markets. They argue that private securities litigation has increased only moderately compared with the increase in the number of securities transactions. Moreover, they
The Court concluded, however, with an admonition that secondary actors in the securities markets are not necessarily free from all liability:

Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may point out that the abuses in securities litigation procedures are endemic to all class actions and should be dealt with as appropriate revisions of class action procedure in general; the procedural flaws should not be used as a pretext for curtailing substantive remedies against wrongdoing that injures investors. See generally A Call for My Profession's Epiphany, 1994: Hearings on Federal Securities Fraud Litigation Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 2d Sess. (1994) (statement of Abraham J. Briloff, Professor, Baruch College) (arguing that Congress should not further limit causes of action for defrauded investors because SEC enforcement needs augmentation); What We Know and Don't Know: A Very Short Primer on Securities Class Actions: Hearings on Federal Securities Fraud Litigation Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 2d Sess. (1994) (testimony of John C. Coffee, Jr., Professor, Columbia Univ. L. Sch.) (arguing that the merits of such actions are frequently considered by class plaintiffs and attorneys and that legislative action should focus on further enhancing merit relevance); Testimony of Donald C. Langevoort: Hearings on Federal Securities Fraud Litigation Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 2d Sess. (1994) (testimony of Donald C. Langevoort, Professor, Vanderbilt Univ. Sch. of L.) (claiming that securities litigation for fraud should be based on the deterence that private causes of action provide); H.R. 417 - Securities Fraud Litigation Reform: Hearings on Federal Securities Fraud Litigation Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 2d Sess. (1994) (testimony of Jon Lukomnik, Deputy Comptroller, City of New York) (arguing that institutional investors are well situated to enhance enforcement of securities fraud violations); Prepared Statement of Arthur R. Miller: Hearings on Federal Securities Fraud Litigation Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 2d Sess. (1994) (testimony of Arthur R. Miller, Professor, Harvard Univ. L. Sch.) (asserting that securities fraud class actions are but one subset of complex litigation and that reform proposals should have general applicability); Statement of Ralph Nader: Hearings on Federal Securities Fraud Litigation Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 2d Sess. (1994) (testimony of Ralph Nader) (urging the formation of Financial Consumers Associations to augment government enforcement securities law); Testimony of Joel Seligman: Hearings on Federal Securities Fraud Litigation Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce, 103d Cong., 2d Sess. (1994) (testimony of Joel Seligman, Professor, Univ. of Michigan L. Sch.) (citing mistaken statistics on the increase of securities fraud litigation and arguing for a legislative overruling of Central Bank).

be liable as a primary violator under 10b-5, assuming all of the requirements for primary liability under Rule 10b-5 are met.\textsuperscript{97} Justice Stevens, writing for the four dissenting Justices, argued that the "settled construction of an important federal statute should not be disturbed unless and until Congress so decides."\textsuperscript{98} Justice Stevens argued that the Court's reasoning would eliminate all forms of secondary liability "not expressly spelled out in the securities statutes," including conspiracy and \textit{respondent superior} liability.\textsuperscript{99} Justice Stevens observed that the Court's literal reading of the statute would also preclude the SEC from bringing aiding and abetting actions.\textsuperscript{100} Congress, however, expressly provided in the 1995 Reform Act that the SEC can bring aiding and abetting actions.\textsuperscript{101}

\textbf{B. Unresolved Issues}

The \textit{Central Bank} decision cuts off claims against more remote collateral participants, such as banks, who cannot be linked to the misrepresentations or omissions of the issuer. Aiding and abetting actions were overbroad in this respect because even under an expansive interpretation, the securities laws do not contemplate that participants in transactions tangential to the sale of securities assume duties to the investing public.\textsuperscript{102} Investors, who ultimately bear the costs of

\begin{footnotesize}
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\item \textsuperscript{97} Central Bank v. First Interstate Bank, 114 S. Ct. 1439, 1455 (1994).
\item \textsuperscript{98} \textit{Id.} at 1458 (Stevens, J., dissenting) (citation omitted).
\item \textsuperscript{99} \textit{Id.} at 1460 & n.12 (Stevens, J., dissenting). Aiding and abetting and conspiracy are different concepts: Civil conspiracy requires proof of an agreement between the coconspirators, with one actor committing at least one of the acts in furtherance of the conspiracy. Aiding and abetting requires only knowing assistance. \textit{See} Ruder, \textsuperscript{ supra} note 29, at 627. The facts that support one concept can often support both. Conspiracy is a more demanding standard to prove because it requires proof of knowing conduct to show that the conspirators made an express or tacit agreement. \textit{See} Roberts v. Heim, 670 F. Supp. 1466, 1483-84 (N.D. Cal. 1987), \textit{aff'd in part, rev'd in part sub nom.} Roberts v. Peat, Marwick, Mitchell & Co., 857 F.2d 646 (9th Cir.), \textit{cert. denied}, 493 U.S. 1002 (1988). If facts prove that a lawyer conspired with the client, her conduct would remove the lawyer from having acted \textit{qua} lawyer. Aiding and abetting, on the other hand, can be consistent with reckless behavior so that it is the more important concept with respect to the lawyer acting \textit{qua} lawyer. \textit{See} James D. Cox, \textit{Just Desserts For Accountants and Attorneys after Bank of Denver 12-14} (1995) (unpublished manuscript, on file with The Fordham Law Review). Professor Cox argues that after \textit{Central Bank}, it is doubtful that primary participant liability will be established using a conspiracy approach because in applying the Court's strict textualism, the word "conspiracy" does not appear in the statutory text. \textit{See} \textit{id.} at 12. Professor Cox concludes that the conspiracy itself is not proscribed, but the acts of the conspirators are a violation and the agreement could be a basis to link the actors to the acts of at least one of the conspirators to establish their participation in a fraudulent scheme. \textit{Id.} at 15.
\item \textsuperscript{100} \textit{Central Bank}, 114 S. Ct. at 1460 (Stevens, J. dissenting).
\item \textsuperscript{101} \textit{See infra} part III.C.
\item \textsuperscript{102} The bank that was sued in \textit{Central Bank} was acting as a trustee pursuant to a contract and the Trust Indenture Act of 1939 that specifically excluded the bank from assuming any duties with respect to the bondholders before a default on the bonds. First Interstate Bank v. Pring, 969 F.2d 891, 900-01 (10th Cir. 1992), \textit{rev'd sub nom.} First Interstate Bank v. Fountaingate Investors Partnership L.P. 971 F.2d 900, 903 (8th Cir. 1992), \textit{rev'd sub nom.} First Interstate Bank v. Pring. 116 S. Ct. 2084 (1996).
\end{itemize}
\end{footnotesize}
all investor protection, should not be required to pay the substantial additional costs for the marginal benefits, if any, of scrutiny of transactions provided by these remote collateral participants.

Securities lawyers, however, should not be sanguine that this same reasoning will apply to them. Even though conservative winds are blowing through the country to reduce the amount of consumer litigation, part of their force is driven by a perception that it is the lawyers who create excess litigation. Lawyers are not likely to see many friendly faces in the courtroom. Moreover, lawyers tend to get sued when there are allegations of serious fraud so the 1995 Reform Act’s procedural and pleading restrictions imposed on private class actions are not as likely to affect the number of actions brought against them.

Lawyers are among the core participants who play an integral role in the securities issuance process. Relying on the logic of the common law of joint tortfeasors, and without using the words “aid or abet,” courts will continue to examine the conduct of those core participants to determine whether they will be held liable as primary violators.

The courts have seldom parsed the distinction between conduct that constitutes a primary violation and conduct that is aiding and abetting. Until Central Bank, the distinction was not only difficult, but from a practical view, unnecessary because both classes of actors were jointly and severally liable. Courts instead focused their attention on the aider’s and abettor’s state of mind and whether substantial assistance was given to the primary violator. The relevant issues were what the lawyer knew and when he knew it. If there was evidence that the lawyer learned of the fraud and had not thereafter acted in an appropriate manner, an inference could be drawn that the lawyer knowingly aided and abetted the wrongdoing.

After Central Bank, courts will be forced to distinguish the lawyer’s conduct between acts that constitute primary violations and those that do not rise to that level. Central Bank offers no assistance in making those distinctions other than to exclude conduct on which the plaintiff does not rely. Thus, it is not enough for a person who, throwing in his lot with other wrongdoers, engages behind the scene in acts that are then packaged by the seller and sold to deceived investors. Regard-

Central Bank v. First Interstate Bank, 114 S. Ct. 1439 (1994). Presumably, if the bank had assumed duties to the bondholders, the cost of those services and the risks assumed would have been included in the price that the trustee charged and would have been borne by the bondholders. First Interstate Bank, 969 F.2d at 900. The district court and the Tenth Circuit agreed that the bank did not owe a duty to the bondholders. Basically, defendants who provide routine financial services in connection with a securities transaction have been protected from suit in the absence of an establishment of duties to third parties. See, e.g., Schneberger v. Wheeler, 859 F.2d 1477, 1480-81 (11th Cir. 1988) (holding that bank was not liable for aiding and abetting when bank’s knowledge of company’s shaky financial situation did not impose duty of disclosure), cert. denied, 490 U.S. 1091 (1989).

103. See supra notes 15-19 and accompanying text.
In a misrepresentation case, if the plaintiff can show that the defendant, including a lawyer, made a material misrepresentation on which the plaintiff relied, the plaintiff can establish a primary violation provided all other elements of the action are proven.\textsuperscript{104} In a nondisclosure case, the plaintiff must prove that the defendant owed a preexisting duty to speak to the plaintiff, which the defendant breached by remaining silent.\textsuperscript{105} Two issues are raised. First, under what circumstances will the material misrepresentations made to the investors be deemed to have been made by the lawyer acting \textit{qua} lawyer so the investor can establish that he relied on the lawyer's conduct? Second, under what circumstances will a lawyer acting \textit{qua} lawyer owe a duty of disclosure to the investor, the breach of which will cause the investor's reliance to be presumed?

\section*{C. Misrepresentations}

Courts will hold lawyers liable for primary violations when they make material misrepresentations to investors.\textsuperscript{106} Courts can elect to

\textsuperscript{104} See infra part II.C.

\textsuperscript{105} See infra part II.D.

\textsuperscript{106} Professor Fischel concluded that under certain circumstances, collateral participants may be held liable as primary violators of the rule. Fischel, \textit{supra} note 80, at 102-03. He defined “core conduct” meant to be deterred by Section 10(b) as “the making of misrepresentations which distort the transmission of accurate information.” \textit{Id.} at 108. He argues that collateral participants can be held liable as primary violators for the “core conduct” provided the other elements of liability are satisfied, such as scienter and the “in connection with” requirement. \textit{Id.} He noted, for example, that accountants can be held liable for knowingly preparing and issuing false financial statements and lawyers can be liable for preparing false opinion letters. \textit{Id.} In other words, only when the collateral participant's material misrepresentations are intended to reach the investor, may the actor risk violating Section 10(b). \textit{See id.} Professor Fischel does not include within “core conduct” those fraudulent practices or schemes other than the transmission of misrepresentations, such as the scheme in Brennan v. Midwestern United Life Insurance Co., 286 F. Supp. 702 (N.D. Ind. 1968), aff'd 417 F.2d 147 (7th Cir. 1969), \textit{cert. denied}, 397 U.S. 989 (1970). His use of the word “distort” and the limits he would put on nondisclosure cases suggests that the prohibited conduct with which he is concerned is limited to misrepresentations and half-truths referred to in subsection (b) of Rule 10b-5. His concept fails to deal adequately with omissions.

Moreover, fraud comes in a variety of forms that all have one element in common. In order for the fraudulent activity to benefit the wrongdoer, the person who parts with his money must be deceived. There is nothing to suggest that Congress intended that “deceptive conduct” be as narrowly construed as represented by Professor Fischel's “core conduct.” Indeed Congress more likely intended the term to be broad enough to encompass all kinds of inventive deceptive practices which the SEC could prohibit through rule making. A broad definition of fraud is consistent with the rest of the securities statutory scheme.

The Supreme Court has held that the scope of prohibited conduct under rule 10b-5 cannot be broader than the meaning given by Congress in Section 10(b). Central Bank v. First Interstate Bank, 114 S. Ct. 1439, 1446 (1994); \textit{see also} Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976) (stating that the SEC's interpretation “cannot
hold a participant liable only for misrepresentations that appear in a document signed by that participant. The speaker is easy to identify—the accountant is responsible only for the financial information he certifies; the lawyer, for his opinion letters on which an investor may reasonably rely; and the issuer, for all other disclosures, usually made through the prospectus or offering memorandum. This approach has the advantage of simplifying the application of the laws and reducing securities litigation. Lawyers acting qua lawyer could easily prevent being named as defendants by avoiding any contact with investors although some exposure would remain. Tax opinion letters would cause the greatest risk. Other legal opinion letters required to be filed with the SEC could become an issue, but that is not likely. The risk of representing an issuer would thus decline appreciably.

1. The Participation Issue

Courts could chart another course. Courts would deem the misrepresentations in every disclosure document to have been made by all defendants who participated in drafting the document, thus returning to the common law concept of joint tortfeasors being held primarily liable as a group. In securities transactions, the gathering and the transmission of information is a group project and the transmission of information is not a one shot transaction—information is continuously transmitted and transformed over a period of time with different actors joining and leaving the group during that time. Information that was accurate when first disclosed can become inaccurate and other information can be introduced into the continuum. The reality exceed the power granted the Commission by Congress under § 10(b)). Even so, nothing in Central Bank implies that the meaning of "deceptive conduct" is limited simply to distortions in the transmission of inaccurate information.

107. A Massachusetts district court adopted this approach. In In re Kendall Square Research Corp., 868 F. Supp. 26 (D. Mass. 1994), plaintiffs alleged that the issuer, Kendall Square, materially overstated revenues from the sale of high performance parallel computer systems. Id. at 26-27. Price Waterhouse, the issuer's independent auditor from 1989 until June 1994, had issued a 1992 unqualified audit opinion reported in the issuer's Form 10-K. Id. at 27. Price Waterhouse had reviewed and approved quarterly financial reports and the representations made in the prospectuses of the issuer's 1992 and 1993 stock offerings, including representations of revenues. Id. at 28. Price Waterhouse also had participated in structuring several of the sales transactions that were subsequently reversed. Id. Plaintiffs' claims as to Price Waterhouse's liability for the certified financial statements were not dismissed. Id. The court found, however, that Price Waterhouse's review and approval of the interim financial statements did not make those statements "attributable" to Price Waterhouse and "thus Price Waterhouse cannot be found liable for making a material misstatement." Id. The court, in dismissing the claims, stated that the conduct was aiding and abetting at most. Id. The court drew a line between conduct that was a primary violation and aiding and abetting conduct without articulating any criteria. Id. It was apparently willing to accept the formality of who signed the document. See id. The court may not have deemed this issue to have been of much importance because the auditor still faced liability for the audited financial statements.
is that decisions and events in securities transactions take place in complex environments. Courts are not likely to ignore that reality in assessing liability against those who participate in wrongdoing. To find primary violations, information will now be deemed to have been transmitted to the investor by some or all members of the core group who knowingly assisted in the preparation of the misrepresentations even though they are not identified in the document as having authored them.

Post-Central Bank decisions support this view. In In re ZZZZ Best Securities Litigation ("ZZZZ Best"),\(^{108}\) a California district court de-

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108. 864 F. Supp. 960 (C.D. Cal. 1994). ZZZZ Best Co., Inc. ("ZZZZ Best"), purportedly the nation's largest carpet cleaning company, offered its shares to the public beginning in December 1986. Id. at 963-64. The company collapsed into bankruptcy within a year. Id. at 963. ZZZZ Best's founder was ultimately convicted and imprisoned for fraud and embezzlement. Id. Plaintiffs brought a securities class action suit against multiple defendants, alleging that a fraudulent scheme was carried out through a series of false and misleading "public statements regarding ZZZZ Best, its finances, management, and future business prospects." Id. at 964.

Plaintiffs' claims against the accountants, Ernst & Young ("E & Y"), arose out of E & Y's issuance of a "review report ["the Review Report"] on first quarter interim financial information . . . included in Z Best's December 1986 offering prospectus." Id. at 964. ZZZZ Best's 1985 financial statements had been certified by another accounting firm. Id. E & Y was apparently retained sometime during 1986 and simply reviewed the first quarter unaudited financial statements prepared by ZZZZ Best's management. Id. E & Y's Review Report stated: "[W]e are not aware of any material modifications that should be made to the consolidated interim financial statements referred to above for them to be in conformity with generally accepted accounting principles." Id. E & Y admitted that Central Bank did not affect their liability for the Review Report, which was E & Y's representation. Id. at 965. Plaintiffs also claimed that E & Y was liable for 13 other false publicly released statements, including press releases, a supplement to the prospectus, a Form 10-Q quarterly report, and a Form 8-K report ("the Other Statements"). Id. at 964-65. Plaintiffs asserted that E & Y was intimately involved in the creation, review, or issuance of the Other Statements, although the statements did not include any public indication that E & Y had anything to do with them. Id. at 965.

E & Y moved for summary judgment on the Other Statements claims, arguing that even if E & Y had reviewed, edited, or approved the Other Statements, that conduct was a secondary act and therefore constituted an allegation of aiding and abetting that Central Bank had eliminated. Id. at 966. "E & Y contend[ed] that Central Bank 'eliminate[s] claims brought against all those alleged to have "participated" in the primary wrongdoer's statement but not to have made a statement to the public directly.'" Id. at 968. Plaintiffs argued that despite the fact that E & Y had not actually issued the statements, E & Y, knowing that the statements were based, in part, on its statements and also knowing that the false and misleading statements were being disseminated to the public, could be held to have participated in the making of the misrepresentations. Id. at 968-69. Plaintiffs further argued they had "submitted sufficient evidence to suggest that E & Y's participation ... was extensive enough to attribute th[e] mis-statements ... to E & Y." Id. at 970.

The court, conceding that "this case create[d] a close call and perhaps one of first impression," ruled for the plaintiffs. Id. at 970. The court stated that its reasoning was supported by SEC v. Seabord Corp., 677 F.2d 1301 (9th Cir. 1982), and In re Union Carbide Corp. Cons. Prod. Bus., 676 F. Supp. 458 (S.D.N.Y. 1987). ZZZZ Best, 864 F. Supp. at 970. In Seaboard, the accountants would be held liable as primary violators for misrepresentations of the company's certified financial condition. Seabord, 677
nied a defendant accounting firm's motion for summary judgment on the issue of whether the accountants were liable for the company's material misrepresentations in issuing press releases, a supplement to the prospectus, and reports filed with the SEC. In holding that the allegations stated a primary violation against the accountants, the court determined that the issuer's disclosure documents, which the accountants assisted in preparing, could also be representations of the accountants. Subsequent to the ZZZZ Best decision, the Ninth Circuit, in *In re Software Toolworks Inc. Securities Litigation,* reversed F.2d at 1312. The ZZZZ Best court admitted in a footnote that the accountants in Seaboard had certified the financial statements. ZZZZ Best, 864 F. Supp. at 970 n.12. Therefore, Seaboard does not offer support for the attribution of unidentified statements. ZZZZ Best, 864 F. Supp. at 970 (citing Union Carbide, 676 F. Supp. at 467-69). In Union Carbide, Morgan Stanley unsuccessfully argued that financial projections it prepared could not be attributed to the firm because it had not announced the results. Union Carbide, 676 F. Supp. at 467-69. The Union Carbide court held that because the accountants had prepared the projections and participated in the fraud, the projections could be attributed to the accountants and they could be held primarily liable. *Id.* The ZZZZ Best court found that even if the public could not reasonably attribute the additional misstatements to E & Y, "the securities market still relied on those public statements and anyone intricately involved in their creation and the resulting deception should be liable under Section 10(b)/Rule 10b-5." ZZZZ Best, 864 F. Supp. at 970. The court was also willing to find that liability under Rule 10b-5 was not restricted solely to misrepresentations or omissions, but could also be predicated on subsections (a) and (c) of Rule 10b-5, which prohibit the use of any scheme to defraud and engage in any course of business that operates as a fraud. *Id.* at 972. However, if the conduct is not "deceptive conduct" within the meaning of Section 10(b), the ZZZZ Best court's reliance on subsections (a) and (c) will not likely support alternate grounds for affirmance.

In addressing the reliance issue, the ZZZZ Best court stated that in a fraud-on-the-market case, reliance can be presumed because the market price reflects consideration of all public information, including the materially misleading statements. *Id.* at 973. Admitting that the market must rely on the statements or omissions of identified defendants, the court nevertheless concluded that if plaintiffs could prove that: E & Y's participation in the preparation or issuance of those additional statements was so extensive that the statements should reasonably be attributed to E & Y, the market need only rely on the statements or omissions, not E & Y's participation. Thus, the focus of the reliance issue is shifted from E & Y's alleged participation to the actual misleading statements or omissions themselves.

*Id.* at 973.

109. *Id.* at 970.

110. *Id.*

111. 50 F.3d 615 (9th Cir. 1995), *amending in part,* 38 F.3d 1078 (9th Cir. 1994), *rev'd in part and aff'd in part,* 789 F. Supp. 1489 (N. D. Cal. 1992). The Ninth Circuit's first opinion reversed the trial court's grant of summary judgment in favor of the accountants. *Software Toolworks,* 38 F.3d at 1083. In that opinion, the court described the misleading letters sent to the SEC. *Id.* at 1090. The SEC, in a comment letter to a draft of the prospectus, told 'Toolworks it should disclose in the prospectus preliminary financial results for Toolworks' second quarter. *Id.* Toolworks wrote to the SEC that preliminary financial data was not available, while acknowledging to the professionals that some data was actually available. *Id.* Another letter to the SEC was alleged to be stated that the letter "was prepared after extensive review and discussions with . . . Deloitte' [the accountants] and actually referred the SEC to two Deloitte partners for further information." *Id.* at 1090 n.3 (omission in original). The
in part summary judgment in favor of accountants and underwriters, holding that the defendants could be liable as primary violators for participating in drafting the materially misleading letters that the issuer wrote to the SEC, and for the failure of the prospectus to disclose poor financial performance in the company's second quarter.112

In addition, the district court in Employers Insurance v. Musick, Peeler, & Garrett,113 considering the case on remand from the Supreme Court,114 held that a claim was stated against the lawyers for primary liability.115 The complaint alleged that the lawyers drafted the entire prospectus, which contained material misrepresentations, and that they were responsible for omissions arising out of the overall representations made in the disclosure document.116

letter to the SEC was misleading because a "model" sales agreement attached to the letter materially differed from the sales agreement in actual use. Id. at 1091.

The court stated that Deloitte should have been aware that the model agreement was false and misleading and inclusion of it in the letter could raise a "reasonable inference" of Deloitte's knowledge or reckless disregard of the falsehoods. Id. The court affirmed summary judgment in favor of Deloitte for their preparation of the audited financial statements appearing in the prospectus on the ground that the plaintiffs' showing of mere misapplication of some accounting principles was not sufficient to establish scienter. Id. at 1089-91.

In its second opinion, the Ninth Circuit held that the letters could also be attributed to the underwriters as well as the accountants. Software Toolworks, 50 F.3d at 625. The court stated: The plaintiffs presented evidence . . . that the letter was a joint effort of all professionals working on the offering, including the Underwriters. In fact [Toolworks' lawyer] specifically testified that, "[w]hen the letter finally went to the SEC, all parties had been involved in the process of creating it. There had been conference calls discussing it and comments and changes made by a lot of different members of the working group."

Id. (alteration in original).

Because the lawyers in the case settled, the extent of liability, if any, for their role in drafting the letters to the SEC is not known. The logic that held the working group responsible for the letter should apply to the lawyers as well. Securities lawyers for issuers usually assume a leadership role in the communications between their clients and the SEC during a public securities offering.

112. Id. at 629.


114. Employers Ins. of Wausau v. Musick, Peeler, & Garrett, 113 S. Ct. 2085 (1993), aff'g on other grounds, 954 F.2d 575 (9th Cir. 1992). The Supreme Court had granted certiorari for the narrow purpose of resolving a circuit split on whether a cause of action for contribution is permitted under section 10(b). In holding that contribution was permitted, the Court distinguished between theories of liability (e.g., aiding and abetting) and theories of recovery, such as contribution. Id. at 2088.


116. Id. at 388-89. The defendant lawyers argued that the claim was based solely on the lawyer's failure to disclose and that, therefore, the defendants would be liable only if they had a duty to disclose. Id. at 388. The court distinguished a failure to disclose case as one in which the defendant remained completely silent. Id. at 389. The court was willing to attribute to the lawyers the misrepresentations and the omissions that made the representations misleading who had assisted in the drafting of the prospectus. Id.
These cases demonstrate that courts will hold that misleading disclosures are disclosures made by all those who participate in their preparation; thus, the plaintiff may establish reliance with respect to each defendant. The circumstances in which courts are willing to attribute authorship to the group are exactly the same kind of circumstances in which pre-Central Bank courts found that the issuer was the primary violator and that the other participants aided and abetted the issuer.

To the extent that the participation test is unclear and offers little predictive value, Central Bank has not changed the playing field for lawyers, accountants, and other core players who participate in the disclosure process. The participation test has the disadvantage of an ad hoc determination as to the amount of participation necessary, which can produce unfair results in some instances. Among all of the issuers' disclosure documents, it may be difficult to ascertain which documents were prepared only by the issuer, which by one member of the securities professionals, and which by several members of the group. The courts, as they did with aiding and abetting, will sort it out based on the inferences of who acted with scienter. As with common law torts, the courts will be less concerned with the conduct of each member of the group as the evidence increases of his intent to participate in a fraudulent scheme.

The courts' exercise of discretion as to how much participation is enough to sort out the respective responsibilities of the group opens the door for the same mistakes made with a loose application of an aiding and abetting standard. For instance, in the ZZZZ Best case, the court was willing to let stand plaintiffs bare allegations that the accountants were liable for the issuer's thirteen false, publicly released documents. The accountants admitted they were responsible for drafting their own report, but it would have been unusual for accountants to have participated in drafting all the documents for which they were accused. The willingness to impose liability on deep pocket defendants, without examining closely the basis of that liability, may be too tempting, especially when dealing with egregious facts such as those in the ZZZZ Best case.

From an operational perspective, courts will be tempted to use an indiscriminate participation test in deciding pretrial motions because of the limited time they have to deal with highly complex factual alle-

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117. Aiding and abetting actions also lack a firm underpinning. Justice Kennedy, in Central Bank, worried that aiding and abetting rules were "unclear," which "leads to the undesirable result of decisions made on an ad hoc basis, offering little predictive value" to those who provide services to participants in the securities business." Central Bank v. First Interstate Bank, 114 S. Ct. 1439, 1454 (1994) (quoting Pinter v. Dahl, 486 U.S. 622, 652 (1988)). Justice Kennedy's complaint may be more accurately charged against § 10 and Rule 10b-5 itself.

LIABILITY AFTER CENTRAL BANK

gations and the deference they are required to give in favor of stating a claim. The 1995 Reform Act, however, attempts to remove much of the court's discretion with respect to private securities class actions and reverses the usual presumption in favor of stating a claim under notice pleading. The Act's pleading procedures resemble in complexity the procedures required for derivative claims under Delaware state law. Similar to decisions made in derivative actions, courts will exercise their discretion in favor of stating claims when egregious fact patterns are presented that do not pass the judge's sensitive nose. If the claims survive a motion to dismiss or a summary judgment motion, lawyers usually try to negotiate settlements because of the damage to reputation associated with the notoriety of the trial and perhaps the fear of unsympathetic juries. They will now be able to negotiate within the framework of proportionate liability rules of the 1995 Reform Act. The difficulty with the settlement process is that it does not allow for a determination of whether the lawyer acted knowingly, negligently, or something in between.

Once the participation test is accepted, the implication for lawyer liability is more troublesome than for accountants. The accountant's liability for group-prepared misleading financial statements or other documents that deal with accounting issues can be explained in most cases by the accountant's duty to correct misleading certified financial statements that are directly attributable to them.

Lawyers, on the other hand, routinely assist clients in disclosing a wide variety of business information that is not susceptible to audit, and in matters about which lawyers have no special expertise. The disclosure process is continuous from the initial public offering, through quarterly and annual reports to the SEC, proxy solicitations, and press releases. If the issuer's information were routinely attributed to the lawyer because of the lawyer's active participation in its preparation, the lawyer would become a guarantor of the issuer's disclosure. If, for instance, the lawyer and the client drafted a press release to address rumors surrounding merger talks, and the client then told his lawyer that he was going to use the press release, but would deny that the merger talks were underway, against the lawyer's advice, has the lawyer participated sufficiently in the misrepresentation to be liable for it? Would it make a difference if the lawyer only advised the client without participating in the writing? Should it?

119. See infra part III.C.
121. This procedure may not make the investors whole, especially when the issuer is insolvent, but it will act as a deterrent against wrongful conduct.
122. Fortson v. Winstead, McGuire, Sechrest & Minick, 961 F.2d 469, 475 (4th Cir. 1992); see also Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 496-97 (7th Cir. 1986) (stating that plaintiffs must prove not only that the defendant must have had knowledge of the facts, but also that the lawyer "has thrown in his lot with the primary violators," or else the scienter doctrine would be superfluous).
Lawyers could distance themselves from the disclosure drafting process because of the added risk of liability. Lawyers may choose not to represent those clients who present unacceptable risks because of their lack of financial ability to pay investors' claims. This action would presumably impair the quality of disclosure, especially for new companies, to the detriment of the investors. The word "presumably" is used because one presumes that the securities lawyer adds value to the quality of disclosure through the independent advice given to clients. This may only be a partial explanation for the lawyer's involvement, however, especially when routine disclosure advice for companies is now frequently performed by in house counsel.

Clients are willing to pay independent lawyers' premium legal fees—in comparison to fees for most other legal services—in the securities issuance process. The premiums paid cannot be explained entirely as payment for disclosure advice that may be routinely supplied by in house counsel or for the risk that counsel assumes. In the context of a public offering, fees paid to independent securities lawyers may represent, in effect, a purchase of the imprimatur of the securities lawyers whose opinions provide comfort to the underwriter and who lend their reputations in dealing with the SEC and the market. If this is a substantial part of the value securities lawyers add to the transaction, the reality should have implications in designing normative lawyer liability and accountability rules in securities transactions. For instance, in a rule-making process, securities lawyers who participate in public offerings may be deemed to have signaled to the public that they are competent, have performed due diligence, and are not aware of any facts that would cause them to believe that the prospectus is materially misleading. The rule would need to be predicated on standards that the lawyer should meet. A violation of those standards should not necessarily expose the lawyer to a private action if the rules could be enforced in more effective ways. The same standard need not apply to giving ongoing securities law advice to clients. Rule making, as opposed to case law development of duties, would have the advantage of considering the role of the securities lawyer and designing those rules that would provide guidance to the lawyer, his client, and the public.

2. A Duty of Inquiry

In the context of legal opinions, the lawyer's sufficient participation in the drafting is not the issue because there is no doubt that the lawyer is responsible for the document he signs. The legal opinion cases that present difficult issues usually occur in settings in which the lawyer issues an erroneous legal opinion based on misleading facts supplied by a deceitful issuer. The investor relies on the opinion even though the opinion was not addressed to the investor. Two issues predominate: (1) under what circumstances are investors entitled to
rely on the lawyer's legal opinion when it is not addressed to them; and (2) whether the lawyer has a duty of inquiry to verify the facts on which his opinion is based.\textsuperscript{123} For example, in a post-\textit{Central Bank} case, \textit{Kline v. First Western Government Securities, Inc.},\textsuperscript{124} customers of First Western who had invested in straddle transactions sued the law firm that had issued to its client, First Western, three tax opinion letters over a three-year period addressing tax issues with respect to straddle transactions.\textsuperscript{125} The letters specifically stated that the law firm had relied on the client to provide accurate facts on which the opinions were based and that the opinions were intended for the client's use and should not be relied on by any other person.\textsuperscript{126} The law firm had not attempted to verify the facts, but it had expressly limited the right to rely on the opinions to its client.\textsuperscript{127} Nevertheless, the investors claimed they had relied on the tax opinions in attempting to deduct losses, which the IRS disallowed.\textsuperscript{128}

In holding that the law firm was not entitled to summary judgment, the Third Circuit addressed the circumstances in which the lawyers had continued to issue opinion letters to their client. The law firm had represented a previous partnership, on which First Western was modeled, in connection with IRS civil and criminal investigations.\textsuperscript{129} During that representation, the law firm began representing one of the partnership's principals in the formation of First Western and may have helped design the straddle transactions.\textsuperscript{130} Despite the law firm's stated limitations on reliance, the law firm was aware of at least ten instances where potential investors contacted the firm with respect to its three opinions given over the three-year period.\textsuperscript{131} The court concluded that the law firm had been "put on notice that its efforts to

\textsuperscript{123} See \textit{e.g.}, \textit{Ackerman v. Schwartz}, 947 F.2d 841, 848 (7th Cir. 1991) (holding that a lawyer acts recklessly when he relies on questionable assertions provided by a client in drafting an opinion letter); \textit{Felts v. National Account Sys. Ass'n}, 469 F. Supp. 54, 67 (N.D. Miss. 1978) (stating that the duty of a lawyer for an issuer of securities encompasses "the obligation to exercise due diligence, including a reasonable inquiry, in connection with responsibilities [the lawyer] has voluntarily undertaken"). The lawyer "must make a reasonable, independent investigation to detect and correct false or misleading materials." \textit{Id.}

\textsuperscript{124} 24 F.3d 480 (3d Cir. 1994).

\textsuperscript{125} \textit{Id.} at 481-82. Straddle transactions involve contracts to buy and sell the specified security in the future, so-called "forward contracts." The investor bets which way the market is going to go and gains or loses on the difference or "spread" between the buy contract and the sell contract. \textit{Id.} at 482. In \textit{Kline}, the contracts were to buy and sell money market instruments at a designated interest rate on a fixed future date. \textit{Id.} The investor bet on whether interest rates would rise or fall and biased the contracts on the basis of those predictions. \textit{Id.}

\textsuperscript{126} \textit{Id.} at 483.

\textsuperscript{127} \textit{Id.}

\textsuperscript{128} \textit{Id.} at 484.

\textsuperscript{129} \textit{Id.} at 482.

\textsuperscript{130} \textit{Id.}

\textsuperscript{131} \textit{Id.} at 483-84.
dissuade reliance were not always successful." 132 The court held that the law firm could be held liable as a primary violator "for both mis-representations and omissions where the result of either is to render an opinion letter materially inaccurate or incomplete." 133 The recklessness requirement could be met if the plaintiffs established that the lawyer issued the opinions "without reasonable genuine belief [of the facts supplied by the client] or if [the opinions] ha[d] no basis." 134 The court found that the lawyer had a limited duty to investigate the facts on which the opinion was based. Moreover, the lawyer could not rely on its written assertions that no one other than the client could rely on its opinions when the lawyer had knowledge that the client was circulating the opinions to potential customers.

The dissenting opinion raised a valid point in arguing that the investors' reliance on the opinion letters was unreasonable as a matter of law. 135 The dissent maintained that the straddle transaction investors, who were sophisticated, were not reasonable in relying on opinions that specifically stated that they could not rely. 136 Moreover, the investors had both the resources and the responsibility to protect themselves through their own inquiries. The dissent concluded that the investors had accepted the risks that these cutting edge transactions would not pass IRS scrutiny. 137

The Kline majority, however, was not willing to allow the lawyers off so easily by simply including strong "others cannot rely" language when the lawyers knew their client was using the opinions to sell the investments. 138 At a minimum, Kline can be viewed as imposing a duty to act when the lawyer is put on notice about his client's use of an opinion beyond its stated scope. The lawyer's actions must follow the limiting words of his opinions. When those actions are inconsistent with the limitations, the lawyer cannot rely on the limiting language of his own opinions as a defense.

The facts of the Kline case do not seem remarkable if we assume that the lawyer acted with scienter instead of negligence. The case does raise questions about the extent of a lawyer's duty of inquiry. Lawyers need guidance in this area so that professional standards can be established and maintained. Currently, except for the lore of the corporate securities bar, general standards or generally accepted guidelines do not exist.

A duty of inquiry imposes on the lawyer the need to conduct some investigation into what the client is actually doing and not simply to

132. Id. at 484.
133. Id. at 486.
134. Id.
135. Id. at 492-500 (Greenberg, J., dissenting).
136. Id. at 497-98 (Greenberg, J., dissenting).
137. Id. at 496-97 (Greenberg, J., dissenting).
138. See id. at 488-90.
rely on the client's representations. The difficulty is determining how and to what extent this legal audit is to be accomplished and at what cost to the transaction. Moreover, lawyers are frequently asked to opine about transactions that the client plans to accomplish in the future. The lawyer has no way to substantiate or investigate circumstances that have yet to occur, although lawyers may wish they had this gift.

The acute difficulty is distinguishing when the lawyer acted with recklessness or out of carelessness in undertaking the inquiry. Moreover, there is no standard to guide the lawyer on how to conduct an inquiry. Therefore, it becomes difficult to determine if the lawyer was so far below the mark as to be reckless in his conduct. The lawyer will always appear more culpable after the fact. Even if liability is not imposed for carelessness, a duty of inquiry nonetheless imposes liability for conduct less than fraud. When he is put on notice, the lawyer is called upon to use judgment and to question. This duty of inquiry begins to resemble the duty of care that arises when a board of directors is put on notice to inquire about possible problems within the company. The duty of inquiry also has elements of a "know your client" rule. If the lawyer is aware that the client has a history that increases risk to the transaction, that knowledge can be used against the lawyer if the transaction turns sour.

D. Omissions

Omissions present more difficult issues, not the least of which is distinguishing between what constitutes a material misrepresentation or half-truth and what is essentially a failure to disclose material facts. Assuming that a court is dealing with what is essentially a nondisclosure case, the court will impose liability for failing to disclose only if it first finds a duty to disclose.

Lawyers will be significantly affected if courts are willing to impose a general duty to disclose material information to third parties. First, imposing a duty to disclose may, depending upon the jurisdiction in which the lawyer practices, create a conflict between that duty and the lawyer's duty of professional responsibility to keep his clients' confidences. The confidentiality rule found in professional responsibility codes, however, could be modified by case law so that the duty to disclose under some circumstances trumps the duty of confidentiality. The lawyer would still face potential liability to his client if a court subsequently found that the lawyer did not have the privilege to disclose under the circumstances. If a duty to disclose is placed on the lawyer, he must have freedom from client liability to avoid a Hobson's choice.

139. See Model Rules, supra note 2, Rule 1.6.
1. A Duty to Disclose?

The Supreme Court in *Central Bank*, citing its decision in *Chiarella v. United States*, affirmed that omissions or nondisclosures could constitute a primary violation under Section 10(b) if the person failing to disclose owed a duty to investors to disclose the material information. The problem is that a duty-to-disclose analysis in an insider trading case, such as *Chiarella*, is irrelevant to the analysis of whether a participant in a securities offering has a duty to disclose. *Chiarella* held that trading on material inside information is not a violation of Section 10(b) unless the trader has an independent duty to disclose. Inside traders can disclose the material inside information or, alternatively, they can refrain from trading. *Chiarella*, which states a duty in the alternative (disclose or not trade), offers no guidance in a situation that does not involve a choice between these alternative actions. *Chiarella* and its progeny can be relied upon only for two general propositions: (1) there is no duty to disclose absent a specific relationship between two parties; and (2) fiduciaries owe duties to their beneficiaries. The essential questions—to whom the duty is owed and for what—are not answered.

One possibility is that the *Central Bank* decision will eliminate lawyers' liability for nondisclosure claims. Some courts have articulated a restrictive rule governing the duty of lawyers to disclose. Because lawyers can no longer be held liable in private actions for aiding and abetting their clients' wrongdoing, if the courts decide that lawyers have no duty to disclose, lawyers would avoid liability under Rule 10b-5 except in those instances when the lawyer has either written his document or participated sufficiently in the drafting of other documents to be held responsible.

It is too early to tell whether courts will reconsider the duty issue. A conclusion that courts will not impose duties to disclose on lawyers is not consistent with courts’ demonstrated willingness to hold law-

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143. As Justice Frankfurter put it: "[T]o say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary?" SEC v. Chenery Corp., 318 U.S. 80, 85-86 (1943).
145. See Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 496 (7th Cir. 1986) ("When the nature of the offense is a failure to 'blow the whistle,' the defendant must have a duty to blow the whistle. And this duty does not come from Section 10(b) or Rule 10b-5; if it did the inquiry would be circular. The duty must come from a fiduciary relation outside securities law." (citing *Dirks*, 463 U.S. at 653-64; *Chiarella v. United States*, 445 U.S. 222, 227-35 (1980))).
yers' conduct liable. The policy reasons for holding lawyers liable are still present. Securities transactions occur in group settings with the required participation of securities professionals. When the securities professionals actively participate in fraudulent transactions, those professionals, including lawyers, should not be allowed to escape liability. Claims against lawyers deter lawyer and client wrongdoing, and encourage lawyers to be vigilant and to practice law with competence. The suits also compensate deceived investors. Even though the securities laws do not contemplate that lawyers, like auditors, act as watchdogs of their clients, lawyers should not be insulated from liability if they participate in their clients' wrongdoing even when that wrongdoing consists of deceit by the client in failing to disclose information to the investor when the client has a duty to disclose.

In deciding nondisclosure cases before *Central Bank*, courts did not need to articulate whether lawyers owed an independent duty of disclosure to investors. If lawyers participated in the wrongdoing and remained silent, then courts, such as in *National Student Marketing*, could proceed on the basis that the lawyer's conduct under the circumstances aided and abetted the primary violator's duty. Even though the SEC can continue to bring actions against lawyers for aiding and abetting, the courts will now be required to articulate independent duties of disclosure if the same conduct is to be held actionable in private actions.

2. The Search for Duty

The finding of a duty in a nondisclosure case represents a court's sense that the defendant's conduct should be considered the legal or proximate cause of the plaintiff's injury. In a misrepresentation case, proof of the plaintiff's reliance on the defendant's misrepresentations is one of the elements needed to prove that the defendant "caused" the plaintiff's injury. The defendant's misrepresentations or half-truths to the plaintiff on which the plaintiff relied are the nexus between the defendant and the plaintiff to help establish causation. In a nondisclosure case, actual reliance is not present. Plaintiffs cannot rely or consider the undisclosed information in making investment decisions when they are not aware of that information. If the undisclosed information is the kind of information the court determines to have been material to the investment decision, the court presumes the plaintiff would have relied on the information in making the investment decision. This legal presumption replaces the requirement that the plaintiff must prove actual reliance.

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147. See Gabaldon, *supra* note 118, at 1032-50 (discussing theories and roles of causation).
148. See *Kline v. First Western Gov't Sec., Inc.*, 24 F.3d 480, 487 (3d Cir. 1994).
The defendant's failure to perform his duty to disclose is the "cause" of the plaintiff's injury. Duty is the nexus between the defendant and the plaintiff that permits a legal conclusion that the defendant can be held responsible for the plaintiff's injury. The breach of duty is the legal or proximate cause of plaintiff's injury. As in all legal or proximate causation issues, whether to impose a duty on the defendant to disclose is a conclusion. To say a defendant owes a duty is a conclusion, not an analysis of to whom the duty is owed and for what. That analysis, explicit or implicit, is made by the court in reaching its conclusion of whether the duty is owed.

Courts can search several sources of law to establish a preexisting duty: federal common law, state common law, state statutory law, rules of professional conduct, and SEC disciplinary proceedings in which the Commission sets standards of practice.150

a. Federal Common Law

Federal courts have not traditionally examined state law in the jurisdiction where defendants committed securities laws violations to ascertain if that jurisdiction would have imposed a duty of disclosure. The Supreme Court in Chiarella followed prevailing common law doctrine that fiduciaries, or other persons who have a "relationship of trust and confidence" with investors, owe a duty to the investors.151

150. See Schatz v. Rosenberg, 943 F.2d 485 (4th Cir. 1991). The Schatz court examined federal law, Maryland common law, and the Maryland Rules of Professional Conduct and determined that there was no duty for the lawyer to disclose to the investor. Id. at 490-93. The opinion was disappointing because it offered no analysis of the particular situation in which a law firm was accused of participating in misrepresentations by delivering its client's fraudulent financial statement to the plaintiff's lawyer. The plaintiff alleged that because the law firm represented the defendant in other matters, the firm must have been aware that his financial statement was fraudulent. Id. at 489. This may have been a case in which the securities laws did not apply. The court did not address the issue of whether the note was a security. The transaction was commercial and there is a good argument that the note was not a security. The note was issued in connection with the sale of the plaintiff's company to the defendant, who delivered the note as a cash substitute for the sales price of the business. The note was guaranteed by the defendant and may have been collateralized by the assets, although this is not clear in the opinion. The plaintiff was neither an investor, nor a co-partner. See Futura Dev. Corp. v. Centex Corp., 761 F.2d 33, 41 (1st Cir.), cert. denied, 474 U.S. 850 (1985); Emisco Indus. v. Pro's Inc., 543 F.2d 38, 40 (7th Cir. 1976); C.N.S. Enters. v. G&G Enters., 508 F.2d 1354, 1362 (7th Cir.), cert. denied, 423 U.S. 825 (1975). This was not the kind of transaction in which the public reasonably expects they are dealing with a security. See Reves v. Ernst & Young, 494 U.S. 56, 67-70, reh'g denied, 494 U.S. 1092 (1990). If the note was not a security, the plaintiff could have only recovered against the lawyers if they could have proven that the lawyers participated in the transaction with an intent to deceive. Schatz, 943 F.2d at 496. The standards for the lawyer's liability to a third party are dramatically different in this transaction depending on whether the note is a security. The circumstances do not justify this kind of distinction.

151. Chiarella v. United States, 445 U.S. 222, 228-33 (1980). The Chiarella Court refused to adopt an information parity rule that requires that all persons who had "regular access" to nonpublic information must disclose or not trade. The Court ex-
Dirks v. SEC\(^{152}\) also relied on federal common law in establishing when an insider breaches a duty in an insider trading case.\(^{153}\) If courts continue to follow the kind of analysis applied in Chiarella and Dirks, they will initiate a federal common law inquiry into the definition of duty in 10b-5 actions.\(^{154}\) Because the insider trading cases are not relevant to lawyers' duties in omission cases, the courts will be hard pressed to find federal common law precedent to define lawyers' duty to disclose to someone other than their clients in a securities violation context. Federal common law as to lawyers' duties would have to be created on a case-by-case basis, just as the law is being developed on insider trading. Plaintiffs now have an incentive to push for that development.

b. **State Law**

Fiduciary duties of lawyers, like fiduciary duties in general, have always been a special province of state law. The courts may look to state law as the source to define lawyers' duties. State law would include case law, state statutes, and state rules of professional conduct.

Moreover, the Supreme Court has signaled a retreat from creating federal common law to fill in the interstices of federal statutory schemes.\(^{155}\) State courts, following the Supreme Court's lead, could use state law to define the content of disclosure duty in primary viola-
tions. For example, the Ohio Supreme Court recently held that a lawyer owed a duty of disclosure directly to the limited partners because the lawyer was retained by the general partner who owed a fiduciary duty to the limited partners. The court applied a rule, historically restricted to trust situations, that a lawyer "retained by a fiduciary owes a similar duty to those with whom the client has a fiduciary relationship." The lawyer was alleged to have breached his duty to the limited partners by failing to disclose material information in an offering circular. In the next 10b-5 action against an Ohio lawyer, plaintiffs will rely on this case to establish in a federal district court that the lawyer had a preexisting duty to investors.

In Twiss v. Kury, investors sued a brokerage firm for aiding and abetting a Rule 10b-5 violation for failing to report to the Florida Securities Commission, as required by state statute, the firm's reasons for deciding to fire a securities sales representative. He had been fired for defrauding investors. Subsequently, the sales representative had moved to another firm where he defrauded the complaining investors. The court held that although the investors could not bring an aiding and abetting claim because of the Central Bank ruling, the investors did have a state securities claim against the brokerage firm for failing to comply with its statutory duty of disclosure. The Florida statute created a disclosure duty. Statutes like that one could be used as

taken, and asserted that its original opinion stood because it had applied state law. FDIC v. O'Melveny & Myers, 61 F.3d 17, 19-20 (9th Cir. 1995).

Even though the O'Melveny case was dealing with a state law malpractice claim, the Supreme Court's opinion instructs courts on when to apply state law even in extensive federal statutory schemes such as FIRREA. Writing for a unanimous court, Justice Scalia, citing Erie, opened the opinion with the statement: "There is no federal general common law." Id. at 2053. In determining when to apply federal or state law in a federal statutory scheme, the opinion began with the presumption that "matters left unaddressed in such a scheme are presumably left subject to the disposition provided by state law." Id. at 2054. The judicial creation of a federal rule is "limited to situations where there is a 'significant conflict between some federal policy or interest and the use of state law.' " Id. at 2055. The Court reasoned that the need for "uniformity" in the rules was not a sufficient federal policy interest in itself because if that were the only justification necessary "we would be awash in 'federal common-law' rules." Id.

This emphasis on the return to Erie may portend that the Court is not willing to make more federal common law in creating lawyers' duties under Rule 10b-5. This conclusion would be inconsistent with the 50 years of federal common law created in Section 10b-5 cases—the implied private remedy is an entire creature of federal common law.

156. See Arpadi v. First MSP Corp., 628 N.E.2d 1335, 1339 (Ohio 1994). But see Moore v. Fenex, Inc., 809 F.2d 297, 301 (6th Cir.) (stating that under Ohio law, lawyer had no fiduciary relationship with investors unless both parties understood that a special trust or confidence relationship had been established), cert. denied, 483 U.S. 1006 (1987).

157. Arpadi, 628 N.E.2d at 1339.

158. 25 F.3d 1551 (11th Cir. 1994).

159. Id. at 1557-58 (remanding investors' claims for further proceedings in light of Florida law).

grounds for establishing a preexisting duty to disclose in Rule 10b-5 actions.

If a breach of state law duty to disclose gives rise to a duty to disclose under Rule 10b-5, each state will develop a different variation on a lawyer's duty to disclose leading to the result that different lawyers in the same transaction will have different duties depending on the state or states in which they practice. The same difficulties result if lawyers' duty to disclose were based on the various professional responsibility codes adopted by the states. For example, investors will argue that a New York securities lawyer who advises an Ohio corporation owes a duty of disclosure to investors under Ohio law. The lawyer may have no duty under New York case law and moreover may be forbidden under New York's code of professional responsibility to disclose the client's confidences.

c. Rules of Professional Conduct

Rules of professional conduct also could serve as a basis for defining lawyers' duties to investors. The preamble to the American Bar Association's ("ABA") Model Rules specifically states that the Rules "are not designed to be a basis for civil liability." 161 Most state codes incorporate similar language, but that has not stopped courts from looking at the ethical rules to define standards of conduct in malpractice cases. Lawyers have argued that standards for civil liability cannot be derived from professional conduct standards defined by state codes. The Fourth Circuit, for instance, rejected an argument that an ethical duty of disclosure under the Maryland Rules of Professional Conduct created a corresponding legal duty under the federal securities laws. 162 The professional conduct rules could, however, serve as a basis for establishing, under some circumstances, a special relationship similar to a fiduciary relationship, which could form a basis for creating a duty lawyers owe to investors. 163

Under all professional responsibility rules and common law, lawyers' professional responsibilities to clients do not permit them to assist their clients in conducting fraudulent activities. 164 Lawyers are required to withdraw from the representation if their services would

161. Model Rules, supra note 2, Scope.
163. See Barker v. Henderson, Franklin, Starnes & Holt, 797 F.2d 490, 495-96 (7th Cir. 1986). In holding that the lawyers were not liable for securities laws violations, Judge Easterbrook discussed the debate surrounding ethical duties to disclose, but argued that an award of damages under the securities laws "is not the way to blaze the trail toward improved ethical standards in the legal and accounting professions. Liability depends on an existing duty to disclose. The securities law therefore must lag behind changes in ethical and fiduciary standards." Id. at 497. This argument supports the view that ethical standards can form the basis for creating duties to investors.
164. Model Rules, supra note 2, Rule 1.16(b).
be used to perpetuate a fraud. In obvious cases of common law fraud, this rule is easy to apply provided that the lawyer is not duped by his client. The issue may not be as simple, however, when the withdrawal rule is applied to violations of securities law or other regulatory schemes. A person commits a violation of securities laws in making misrepresentations (or omissions) of material facts. This kind of prohibited activity encompasses a wide range of conduct that includes fraud and conduct far less culpable than the accepted idea of common law fraud.

The requirement of withdrawal is at once too broad and too narrow. It is too broad if any violation of law triggers withdrawal. That interpretation does not take into account that corporations are increasingly subject to regulatory regimes that routinely authorize criminal sanctions for violations. In practice, criminal sanctions are enforced only against blatant misconduct. The withdrawal rule is too narrow if it permits a lawyer to continue to represent an unsavory client in business transactions where the client hovers on the line between legal and illegal activity. The withdrawal rule, like all rules in professional responsibility codes, states a broad principle and draws a line at the minimum possible standard; it is not where lawyers should aim their conduct.

Investors could argue that the failure of the lawyer to withdraw when required constituted an implied representation that the lawyer was not aware of any material omissions and that the duty of withdrawal created a duty in favor of the deceived investors. This rule would create its own set of issues. Consider first that omissions and misrepresentations of material facts that occur because the client or the lawyer was negligent are not violations of Rule 10b-5. The defendants must have acted with scienter. Ex post, especially when information has transformed from an unlikely event to an accomplished fact, the failure to disclose may appear to have been reckless or intentional conduct. Moreover, disclosures under the securities laws often require difficult judgment calls in which both lawyers and their clients should have room to guess wrongly. It is easy to conclude that the issuer should err on the side of disclosure but that conclusion does not take into account that some disclosures to competitors or others can harm the issuer’s prospects, which will be detrimental to the issuer’s investors.

A disclosure duty does not necessarily serve the interests of the public. The integrity of the securities issuance process may be undermined by lawyers who abandon their clients at the first hint of trouble. Lawyers who desert too quickly their misguided but honest clients may harm the public’s interests. Most clients want to comply with

165. Id. Rule 1.16(b)(2).
166. See supra part I.A.2.
167. See id.
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Disclosure laws, but want to do so in a way that does not harm perceived interests of the issuer—e.g., disclosure of information useful to competitors; premature release of information that will cause the stock price to rise or fall; and premature release of news that hurts employee morale. Many of these issues require difficult judgment calls in which the experienced lawyer's judgment is vital to determining when and how to disclose in a way that fairly balances the competing interests—assisting investors in making decisions to buy and sell the securities, and withholding information that protects the long-term investor. Clients also have a legitimate interest in obtaining a second opinion in difficult judgment situations. Lawyers should not be required to protect themselves from liability by abandoning too quickly a client that appears to be acting in good faith. At some point the lawyer may conclude that the client is not acting in good faith and then the lawyer should withdraw. This process and the standards that should inform securities lawyers in the process are not set forth in professional codes of responsibility.

The organized bar has framed the issue of securities lawyers' responsibilities to investors in simplistic terms. If the lawyer concludes that her client's continuing conduct requires her to withdraw, the issue in the rules becomes whether the lawyer has a duty to disclose the fraud (common law variety) if the harm can be prevented or whether the interest in keeping the client's secrets serves a higher purpose undermined by a duty to disclose to third parties. This issue has divided the bar within the ABA and the American Law Institute ("ALI"). States have treated the issue in a wide variety of ways in enacting their professional responsibility codes.168

The ABA's Model Code of Professional Responsibility ("Model Code"), adopted when National Student Marketing was filed in 1972, permitted but did not require, a lawyer, when in possession of "information clearly establishing" his client's fraud, to reveal the client's fraud to the affected person or tribunal.169 By 1974, that code provision had been amended to preclude disclosure of the client's fraud "when the information is protected as a privileged communication."170

168. See Harris Weinstein, Client Confidences and the Rules of Professional Responsibility: Too Little Consensus and Too Much Confusion, 35 S. Tex. L. Rev. 727, 733-37 (1994). The author notes that only seven jurisdictions have followed the ABA's Model Rule on confidentiality and that at least 10 different versions of the rule governing when a lawyer may, must, or may not disclose fraud or financial crime have been adopted in the 50 states. Id.; see Fred C. Zacharias, Federalizing Legal Ethics, 73 Tex. L. Rev. 335, 338-44 (1994) (providing an overview of the recent history of the regulation of lawyers).

169. Weinstein, supra note 168, at 731.

170. Model Code of Professional Responsibility, DR 7-102(B)(1) (1980); see also id. at EC 8-5 (stating that "[u]nless constrained by his obligation to preserve the confidences and secrets of his client," a lawyer must reveal the fraud). A committee of lawyers, under the auspices of the ABA, studied the issue of securities lawyers' professional responsibilities with respect to their clients and the public. They concluded
In protecting the attorney-client privilege and under circumstances that appeared self-serving, the ABA had taken quick action to make it more difficult to disclose client fraud.

In 1980, when the Kutak Commission undertook to rewrite the ABA rules on professional responsibility, a proposed new rule would have permitted disclosure of confidential information to prevent the client from committing a fraudulent act. The debate on the proposal within the bar was intense with the trial lawyers generally opposing any disclosure countered by many business lawyers supporting the proposed rule. The trial lawyers prevailed with a further tightening of disclosure rules when the current rules passed in 1983. The current rule permits disclosure only when necessary to prevent substantial bodily harm.

The debate over these same issues continues unabated within the American Law Institute ("ALI"). In attempting to write a Restatement of the Law Governing Lawyers, the ALI has stalemated with three different proposals ranging from permissible (but never re-

that the ABA Code of Professional Responsibility permitted, but did not require the lawyer, to reveal the fraud. Although lawyers may reveal the fraud under circumstances in which the lawyer has "information clearly establishing" the fraud, "it [did] not yet appear to have been held that a lawyer qua lawyer in a disclosure situation has a legal obligation to make public disclosure (although lawyers have been held liable as principals or as aiders and abettors for misstatements and omissions)." The Code of Professional Responsibility and the Responsibility of Lawyers Engaged in Securities Law Practice - A Report on the Committee on Counsel Responsibility and Liability, 30 Bus. Law. 1289, 1295 (1975).


A lawyer may reveal [confidential] information to the extent the lawyer believes necessary: . . .

(2) To prevent the client from committing a criminal or fraudulent act that the lawyer believes is likely to result in . . . substantial injury to the financial interests or property of another; [or]

(3) To rectify the consequences of a client's criminal or fraudulent act in the commission of which the lawyer's services had been used.

Id. at 807 n.242 (citing in full the text of the Kutak Commission's proposed rule 1.6); see generally Sixth Annual Baron de Hirsch Meyer Lecture Series, 35 U. Miami L. Rev. 639 (1981) (symposium and articles covering the 1981 proposed Model Code and demonstrating the controversy over the proposed code among members of the bar).

172. Model Rules, supra note 2, Rule 1.6(b). Rule 1.6(b) provides:

A lawyer may reveal such [confidential] information to the extent the lawyer reasonably believes necessary:

(1) to prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm; or

(2) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client.

Id.

173. Id.
required) disclosure to prevent a death, to disclosure necessary to prevent substantial financial loss.\textsuperscript{174}

Those who oppose permitting lawyers to disclose client confidential information are concerned that the rule would erode the attorney-client privilege and clients' willingness to confide in their lawyers. This erosion, they argue, of holding clients' confidences inviolate would seriously impair a client's right to a defense, especially a defense against a government entity that could sanction lawyers for not cooperating. Many transactional lawyers find it repugnant not to disclose when they learn that their services were used to commit fraud. If a lawyer learns that his services have been used to assist a completed fraud, the lawyer, under the Model Code, can do nothing to rectify the fraud even though he withdraws from the representation.

\textsuperscript{174} The American Law Institute appears to be at an impasse with three current proposals, which the members did not address in their May 1995 meeting. The three approaches are:

\textbf{§ 117A. Using or Disclosing Information to Prevent Death or Serious Bodily Injury}

Following an attempt by the lawyer, if feasible, to dissuade the client, a lawyer may use or disclose confidential client information if and to the extent the lawyer reasonably believes:

1. The client intends to commit a crime or fraud that threatens to cause death or serious bodily injury; and

2. The lawyer's use or disclosure is:
   (a) Reasonably appropriate to prevent the act; and
   (b) Necessary in view of the imminence of the death or injury.


\textbf{[Reporters' Proposal]}\textsuperscript{117B. Using or Disclosing Information to Prevent Substantial Financial Loss}

Following an attempt by the lawyer, if feasible, to dissuade the client, a lawyer may use or disclose confidential client information if and to the extent the lawyer reasonably believes:

1. The client intends to commit a crime or fraud that threatens to cause substantial financial loss; and

2. The lawyer's use or disclosure is:
   (a) Reasonably appropriate to prevent the act; and
   (b) Necessary in view of the imminence of the substantial financial loss.

\textit{Id.} (Reporters' Proposal) § 117B.

\textbf{[Alternative Proposal]} \textsuperscript{117B. Using or Disclosing Information to Prevent Substantial Financial Loss}

Following an attempt by the lawyer, if feasible, to dissuade the client, a lawyer may use or disclose confidential client information if and to the extent the lawyer reasonably believes:

1. The client intends to commit a crime or fraud that threatens to cause substantial financial loss;

2. The lawyer's services were employed in the client's course of conduct and the loss is likely to occur if the lawyer takes no action; and

3. The lawyer's use or disclosure is:
   (a) Reasonably appropriate to prevent the act; and
   (b) Necessary in view of the imminence of the substantial financial loss.

\textit{Id.} (Alternative Proposal) § 117B.
These opposing views are probably irreconcilable because the issue is framed in terms of irreconcilable rules and views of the issue are based on entirely different perspectives, each of which is legitimate—adversarial and transactional. This conflict as framed by the bar presents one of many conundrums that could be resolved by dividing the profession into solicitors and barristers. The legal profession in the United States is not likely to be ready for that solution. The twenty-year-old impasse also is evidence that the rules of professional conduct are not likely to be relevant in determining standards under which securities lawyers should practice. The rules are, after all, minimum standards based on broad principles that are the result of compromise between lawyers practicing in entirely different fields. That framework does not lend itself to the kind of thoughtful analysis to produce a consensus on the kind of standards under which securities lawyers should practice.

III. SEC Enforcement Actions

The SEC does not directly regulate the conduct of lawyers in the way it directly regulates brokers and dealers, even though the roles lawyers play in the regulatory system are essential. The Commission does, however, have available a number of potential remedies to punish and deter professional misconduct. These include: civil injunctive actions;\(^\text{175}\) Section 15(c)(4) administrative proceedings;\(^\text{176}\) Section 8(d) stop order proceedings;\(^\text{177}\) and Rule 2(e)(1) administrative proceedings.\(^\text{178}\) Since 1990, the SEC has also had the ability to enter cease and desist orders and to impose monetary penalties.\(^\text{179}\) The Commission

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175. The SEC can enjoin any person, under § 20(b) of the Securities Act of 1933 and § 21(d) of the Exchange Act of 1934, who is engaged or is about to engage in acts or practices amounting to a violation of any provision of the Acts. See 15 U.S.C. §§ 77t(b), 78(u)(d) (1994). Actions against lawyers and accountants are usually brought under § 10 and Rule 10b-5 of the 1934 Act and § 17 of the 1933 Act, respectively.

176. Administrative proceedings may be brought, after a hearing, whenever there is a need to correct a filing made. Id. § 77(o)(c)(4). Additionally, the SEC can institute a proceeding to require the making of an omitted filing. Id.

177. The SEC can suspend the effectiveness of a registration statement under § 8(d) of the 1933 Securities Act. Id. § 77h(d).

178. Rule 2(e)(1) provides:

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


179. See infra part III.B.
also can refer cases to the Justice Department for criminal prosecutions.

A. Rule 2(e)

Rule 2(e) of the Commission's Rules of Practice permits the Commission to deny a lawyer the right to practice before the Commission if the lawyer has been found "to have engaged in unethical or improper professional conduct," and has been the centerpiece of SEC enforcement actions against lawyers.\textsuperscript{180} Despite two recent prominent cases brought against lawyers pursuant to other SEC proceedings,\textsuperscript{181} Rule 2(e) has been the more important proceeding because it accommodates the establishment of standards of practice for securities lawyers. The SEC historically has sought to enjoin lawyers' misconduct on the grounds that the conduct aided and abetted the lawyers' clients' misconduct. During the 1980s, however, the SEC used Rule 2(e) in an attempt to discipline lawyers and to define practice standards in \textit{In re Carter}.\textsuperscript{182} The case sparked immediate intense controversy within the bar and the SEC. In \textit{Carter}, the SEC brought a Rule 2(e) proceeding against two lawyers alleging that they failed to take steps that, in the SEC's view, were required to assure that the lawyers' client adequately disclose its continuing financial problems.\textsuperscript{183}

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\textsuperscript{180} 17 C.F.R. § 201.2(e) (1995).
\textsuperscript{181} See \textit{In re George C. Kern, Jr. (Allied Stores Corporation)}, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,342 (Nov. 14, 1988). The SEC authorized a § 15(c)(4) proceeding against George Kern, Allied Stores' principal outside counsel and an Allied director. Naming a lawyer was an unprecedented step. The SEC staff alleged that Allied had failed to adequately disclose information about steps being taken to fend off a corporate takeover. \textit{Id.} at 89,582. The SEC also sought an order against Kern prohibiting any future violations of securities laws, not limited to dealings with Allied. The SEC went forward with this proceeding, despite the objections of Commissioner Fleischman, who asserted that proceedings against lawyers relating to their legal advice to clients should be handled through outside injunctive action, not in an SEC § 15(c)(4) proceeding. The Commission affirmed the discontinuance of the proceeding on the ground that orders of general future compliance under 15(c)(4) were not authorized under the 1984 Amendments thereto. \textit{Id.} at 89,593-95; see also \textit{In re Jeffrey L. Feldman, Findings and Cease and Desist Proceeding Order Pursuant to Section 8A of the Securities Act of 1993, Securities Act Release No. 33-7014, 1993 WL 370958} (Sept. 20, 1993). The SEC obtained a consent cease-and-desist order under § 8A of the Securities Act against a lawyer who rendered an opinion to a foreign bank that the sale of the bank's foreign exchange bearer certificates ("FEBC"s) in the U.S. did not require registration. \textit{Id.} at *2. The SEC charged that neither the lawyer nor any member of his firm had "any background in the practice of law relating to the offer and sale of securities." \textit{Id.} Furthermore, the SEC charged that Feldman failed to consult authority experienced in securities-related matters and had received notice from the Commission' staff that the FEBCs would have to be registered. \textit{Id.} at *4. The description of the lawyer's conduct reads like a malpractice claim.

\textsuperscript{183} The client, National Telephone Company, a telephone leasing company, had issued numerous press releases and SEC filings that were false and misleading, including releases that failed to disclose that the company had entered into an agreement.
The Administrative Law Judge ("ALJ") found that the lawyers had aided and abetted the company's primary 10b-5 violation and had engaged in unethical or improper professional conduct. The Commission, relying on the Model Rules, reversed the ALJ on the grounds that the lawyers did not have notice of a sufficiently clear rule formulated in the profession's ethical precepts. At the same time, however, the Commission wrote a lengthy opinion on what steps a lawyer must take when the client is not following his disclosure advice. Essentially, the lawyer is required to go up the chain to the board of directors or to the independent directors to urge compliance. In declining to impose sanctions on the lawyers, the Commission avoided judicial review of its authority to impose sanctions and to define lawyers' professional conduct.

The controversy between the bar and the SEC surrounding the ruling was diffused in 1982. The SEC's general counsel, Edward Greene, stated that as a general matter, the SEC would not initiate Rule 2(e) proceedings against a lawyer unless an Article III court had first made a determination that the lawyer had violated the securities laws, and there was a sufficient relational nexus between the practice of securities law and the violation. Since 1982, the Commission's policy with respect to disciplining lawyers has been to obtain first a ruling in district court that the lawyer aided and abetted a violation of the federal securities laws.

B. The Remedies Act of 1990

The Greene solution may soon be modified because of Congress' grant to the SEC of enhanced enforcement powers in The Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (the "Remedies Act"). The amendments to the Securities Act and the

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184. Id. at 84,158-60. The LMP required the company, once its funds were exhausted, to maintain existing leases until they expired and not to enter into new leases. The agreement was, in effect, a liquidation plan. The lawyers repeatedly advised the CEO that he make this disclosure and correct and revise proposed press statements. Id. at 84,161-62. The CEO, fearing that the revelations would demoralize the employees and make failure more probable, ignored the lawyers' advice. Id. at 84,159-60.

185. Id. at 84,165, 84,169.

186. Id. at 84,173.


Exchange Act permit the SEC to bring administrative proceedings to obtain cease-and-desist orders directed against any person who is "causing" a violation of the relevant statute.\textsuperscript{189} Causing a violation may prove to be a broad standard in sanctioning lawyers. Although questions remain as to what must be shown to impose liability, "causing" liability may be easier to establish than aiding and abetting liability. Liability may be predicated on negligence\textsuperscript{190} instead of proof of scienter; the nexus between the acts of the person who caused the violation and the person who committed the violation may not require the same degree of proof as substantial assistance. Furthermore, the SEC may have to meet a lower standard to obtain a cease and desist order than is needed to obtain an injunction. The SEC has incentives to use the administrative courts: These courts are efficient forums for a group of defendants; a high percentage of ALJ decisions favor the SEC; and the SEC's regulatory goals may be damaged if an important case is lost.\textsuperscript{191}
C. The 1995 Reform Act

Congress acted to strengthen the SEC's enforcement powers in 1990 and to limit private class actions in 1995. The Private Securities Litigation Reform Act of 1995 ("1995 Reform Act") contains several amendments scattered throughout various sections of the Securities Act and the Exchange Act. The amendments include procedural and substantive changes and penalties designed to thwart meritless securities litigation, safe-harbors for those who make forward-looking statements, elimination of securities violations as a predicate for civil liability under the RICO Act, proportionate liability for defendants who did not commit a violation with "actual knowledge," and requirements that auditors develop procedures to detect illegal activity and a duty to blow the whistle. The 1995 Reform Act also authorizes the Commission to bring actions against "any person that knowingly provides substantial assistance to another person in violation" of the securities laws, rules, or regulations.

The amendments to curb meritless suits and to provide safe harbors for forward-looking statements should not affect many suits against lawyers. Lawyers tend to be sued in securities cases that deal with egregious facts that should survive the stringent pleadings requirements of the Act. On the other hand, lawyers should benefit from proportionate liability unless they have participated in a violation with actual knowledge of the wrongdoing.

The SEC's ability to pursue aiding and abetting actions while private actions are seeking to define primary liability could cause confusion. The Commission will not have to prove that a lawyer has a duty to disclose under aiding and abetting theory and the private litigant will have to prove a duty in the omissions cases. Because SEC actions brought in court are usually influential in establishing precedent and in defining lawyer's responsibilities, courts in private actions may take their cues from those decisions not to impose disclosure duties on lawyers in omission cases. The SEC may assume a more aggressive enforcement policy if the 1995 Reform Act's limitations on private actions result in significant increases in violations. The Commission is at issue or when the case involves professional standards, the federal district court would be the preferred forum. *Id.* at 1317. If the nature of the lawyer's conduct does not raise these issues, they argue that then an administrative proceeding may be the appropriate forum. *Id.*

195. *Id.* § 108, at 758 (codified at 18 U.S.C. § 1964(c)).
198. *Id.* § 104, at 757 (codified at 15 U.S.C. § 78t(2)(f)); *see supra* note 57 for a discussion on the definition of "knowingly."
likely to bring more enforcement proceedings in administrative courts that may not be as protective of the lawyer's role as federal district courts have been. The effect of *Central Bank* and the 1995 Reform Act has been to put a larger responsibility on the SEC's shoulders to discipline those who participate in the securities industry. Whether the SEC will have the ability to assume this responsibility effectively is doubtful in the current environment of reducing government spending.

### CONCLUSION

The *Central Bank* decision produced changes in the liability landscape of Rule 10b-5. Some of those changes are for the better. Banks, acting as indenture trustees in the sales of bonds, such as the bank trustee in *Central Bank*, were never intended to bear the risks of investor protection. Investors, who ultimately bear the costs of all investor protection, should not be required to pay substantial additional costs for the marginal benefits, if any, of oversight provided by those kind of remote actors whose transactions are tangential to the issuance of the securities. The aiding and abetting action had strayed too far in the direction of imposing liability on these remote providers of services. The Court's decision has the positive effect of placing needed limitations on investors' ability to sue all possible defendants.

Those limitations, however, should have been left to Congress or to the SEC's rulemaking authority. For example, the 1995 Reform Act's proportionate liability provisions would have gone a long way in reducing unfairness in overbroad or loose interpretations of aiding and abetting rules. The Court's broad stroke in limiting the reach of Section 10(b) in private actions went too far. Aiding and abetting, contrary to the majority's opinion, is in itself deceitful conduct in the context of a transaction that can only be accomplished by the actions of a group. The courts will, however, continue to sanction group conduct that results in defrauding investors.

As discussed in part I of this Article, the lower courts have not needed a separate action to hold members of the core group liable as primary violators. The lower courts, relying on common law notions of culpability and liability of joint tortfeasors, will continue to hold the members of the core group, whose conduct is essential to the issuance process, liable as primary violators. This development could have serious repercussions for securities lawyers. In holding lawyers liable for misrepresentations, the courts may be more willing to find that the issuers' disclosure documents are also those of the lawyer, thus imposing even more responsibility on the lawyer. The participation test could lead to the unfair result of rendering the lawyer a guarantor of his client's disclosures.

Moreover, in holding lawyers liable as primary violators in nondisclosure cases, the courts will need to define lawyers' additional duties
owed to investors. Those newly articulated obligations to investors may force lawyers into the untenable position of having to choose between facing liability to third parties, and disclosing their clients' confidences with the risk the clients will sue the lawyers for breach of their professional responsibility. Even in situations when the certainty of the fraud can be recognized, the lawyer's resignation alone may not be sufficient to avoid liability if the lawyer owes investors a duty of disclosure. Overall, the lawyer's decision on how to deal with the client's misrepresentations will have to be made in the setting of conflicting and ambiguous information.

If lawyers' duties to third parties are developed on a case-by-case basis, the results are likely to be unfortunate. First, the rules are not likely to be developed in a factual setting in which the requisite mental state has been proven because few of these cases are tried. Courts' opinions in this area are usually written on pretrial motions. Second, opinions are likely to be written to address egregious allegations, which do not promote objectivity. In reviewing allegations of egregious conduct, courts are not likely to address the fundamental issue that a lawyer's role is to assist his client with disclosure without assuming the identical risks of disclosure belonging to the client. Third, lawyers will find themselves subject to different rules, and thus different standards, depending on where they practice or where the case is filed. Investors also will depend on this luck of the draw. Fourth, the SEC has added incentive and opportunity to encourage courts to adopt rules that benefit the agency's regulatory goals. These rules, however, create the risks that securities lawyers may be required to perform the same kind of watchdog functions assumed now by independent auditors. Moreover, the rules will not be subjected to deliberation and consensus building of which a legislative-type process is theoretically capable.

Lawyers should take the initiative to formulate thoughtful solutions in this new environment by adopting standards of conduct that meet reasonable expectations. In forming a group to undertake this task, lawyers should include lay persons for a much needed perspective on these issues.

The standards developed should promote the unique and useful functions lawyers can serve in our society. Both society and lawyers are disserved by rules that are perceived as predominately serving the lawyer's interest. If the rules are fair they will promote respect for the profession, which in turn will assist the lawyers to improve the quality of disclosure for capital formation. If the rules are perceived as unfair, lawyers will lose value. In other words, rules that take into account the public's reasonable expectations are not only good for society, but they are good for lawyers earning a living within the restraints of practicing a profession. Client confidentiality must yield to the extent necessary to assure that the lawyer's services are not used
for unlawful or unprincipled ends. To find a solution, lawyers and others must be willing to examine the entire rationale of client confidentiality and should not view the issue as a conflict between two mutually exclusive solutions. Lawyers’ various responsibilities will continue to compete with each other, but they need not conflict with each other.

The ABA’s current Model Rules do not provide securities lawyers with guidance in this area. The Model Rule on confidentiality is rigid and perceived as self-serving. The Model Rules state general principles of minimum conduct that do not adequately assist the securities lawyer in practicing law in today’s complex environment. Moreover, the ABA would provide a much needed service if it would produce guidelines for securities lawyers who are practicing in an uncertain and highly competitive environment.

The ALI’s experience with drafting the Restatement of the Law Governing Lawyers is merely a continuation of the twenty-year-old debate of the intense differences within the bar in which lawyers view the issues surrounding the lawyer’s duties to clients and their responsibilities to society and investors. The ALI is currently at an impasse. If the ABA and the ALI fail to address these issues, courts will fill the void.